THE EXCLUSIVE

Confidential*

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THE VALUENTUM TEAM

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Table of Contents

Closed Two Winning Short Ideas and Other Exclusive Portfolio Updates...….3

Valuentum's Economic Roundtable: Trade War, Factors and Beyond…….....4

Tracking Exclusive Idea Simulated Performance ……9-14

Income…….9
Capital Appreciation……11
Short Idea Considerations……....13

Income Generation: Bank of America Preferreds 15

Capital Appreciation: Avalara Inc (AVLR)…….....22

Short Idea Consideration: LendingTree Inc (TREE).....27

Inaugural Letter to Members, July 2016…….…….31

Closed Two Winning Short Ideas and Other Exclusive Portfolio Updates

By Callum Turcan

We closed short idea **Party City (PRTY)** on August 8. Email link: http://campaign.r20.constantcontact.com/render?preview=true&m=1110817109903&ca=82d4b529-db47-4cde-8c53-d92d25fd25b3&id=preview

Dear Exclusive members,

On August 23, we sent out an email closing two of our Exclusive Short Idea Considerations Dycom Industries Inc (DY) at $41.74/share versus a highlight price of $47.20/share back in March 2019 and Vera Bradley Inc (VRA) at $9.95/share versus a highlight price of $10.22/share back in December 2018. The link to the email is here: http://campaign.r20.constantcontact.com/render?m=1110817109903&ca=c2a50829-c068-4f65-bce1-36e47c984af7

We can't stress this enough; we love getting winning short ideas out in front of our subscribers especially during a bull market. The Valuentum Team continues to sift through thousands of equities outside of our conventional coverage universe to locate quality investment opportunities for Exclusive subscribers. In this edition of the Exclusive, we highlight why we see room for shares of loan matchmaking company LendingTree Inc (TREE) to fall further after its second quarter 2019 earnings report revealed weakness in its growth trajectory.

In other news, while May 2019 Short Idea Consideration Match Group Inc (MTCH) has gotten ahead of us, shares just recently came under fire after Facebook Inc (FB) launched its own online date matchmaking service 'Facebook Dating' in the US. We think this could be the start of something big as Match Group's valuation has already gotten way ahead of itself in our view. Having Facebook enter the scene could really stymie Match Group's growth trajectory given the immense amount of traffic Facebook generates every day in the US. Facebook's ability to target every kind of demographic group seeking date matchmaking services could be of real concern to Match Group and its subsidiaries including Tinder, Hinge, OkCupid, Match, and more. We will be monitoring the situation very closely going forward and expect that growing competitive pressures could create cracks in Match Group's growth story that catches the attention of investors.

We expect a combination of lower interest rates, Brexit, and the ongoing synchronized slowdown in economic activity to continue putting pressure on December 2016 Short Idea Consideration Royal Bank of Scotland Group (RBS). The bank recorded another £600 - £900 million-pound provision relating to Payment Protection Insurance ("PPI") that was erroneously sold to certain clients, which is in addition to the £5.3 billion pound provision already in place, and that charge will be reflected in its third quarter 2019 results. We caution that the charge may ultimately be higher or lower than estimated, but the trend is clear: Royal Bank of Scotland faces several significant headwinds going forward.

August 2019 Capital Appreciation Idea South32 (SOUHY) reported full-year FY2019 results on August 22 that initially saw shares shift lower before recovering in recent weeks. The miner ended June 30, 2019, with $1.4 billion in cash on hand versus a total debt load of $0.9 billion, good for a net cash position of $0.5 billion. Additionally, South32 generated $1.1 billion in free cash flows in FY2019. South32 is in the process of divesting its South African thermal coal operations which reportedly will fetch between $0.3 billion - $0.35 billion according to Bloomberg. However, negotiations are still ongoing.

We really like South32's free cash flows and net cash position, keeping exogenous threats in mind. The relative strength in SOUHY stock indicates investors saw the sell off in South32 as a buying opportunity and highlights the positive effect recent US-China trade war news is having on metals prices. Divesting its South African thermal coal

segment is the right call in our view as that would bolster its net cash position while removing what would likely become a stranded asset in the future from its corporate profile.

April 2019 Income Generation Idea Evergy Inc (EVRG) and May 2019 Income Generation Idea National Health Investors Inc (NHI) are both up nicely since we highlighted the names as investor interest in high-yielding companies continues to grow. **We think the high yield space (REITs, utilities, etc.) will perform very well going forward as monetary authorities in developed nations around the world use a combination of conventional and unconventional methods to drive down interest rates in a bid to prop up inflation.** That pushes investors seeking yield towards higher yielding industries. February 2019 Income Generation Idea Eastgroup Properties Inc (EGP) is another big winner and we see room for additional upside. We are happy to bring you this edition of the Exclusive and hope you have a great weekend!

Valuentum's Economic Roundtable: Trade War, Factors and Beyond

The markets rallied hard September 5 on relief that the US and China (FXI, MCHI) will go back to the negotiations table next month. This back-and-forth news cycle is enough to give any investor whiplash. Let's catch up with the Valuentum Team on the latest developments, not only with the trade war but also with respect to factor investing, possible bubbles and beyond. Let's kick things off with the following prompt from ForeignPolicy.com, released August 2:

> **Trump Hired Robert Lighthizer to Win a Trade War. He Lost.**
>
> Robert Lighthizer, the U.S. trade representative, agreed to serve in President Donald Trump's cabinet in order to test his theory: that if the United States freed itself from the shackles of international trade rules, it could use the power of its large market to force other countries to bend to its will. Trump, with his stated love for tariffs and his conviction that the United States had been losing on trade for decades, seemed the perfect leader under whom he could test that proposition.
>
> Now, with Trump having announced that new 10 percent tariffs will be imposed Sept. 1 on the remaining $300 billion in Chinese exports to the United States, that theory has been shredded. The administration has fired almost every salvo it has to force the Chinese into submission, and the two countries are further away from a trade deal than ever before.

Callum Turcan: Generally speaking, I agree with this take. After the US-China trade talks blew up in May 2019, and given that two trade "truces" reached between President Trump and President Xi during two different summits (in December 2018 and June 2019) quickly broke down, it became increasingly clear that a politically acceptable deal between both parties had become nearly impossible to reach. Neither side can give in now, but it's possible the US blunts the impact of tariffs by adjusting what is and isn't hit with tariffs (and when), particularly with respect to the US-China trade war. The odds of a trade deal being reached before the end of 2020 isn't impossible, but any concrete agreement remains pretty unlikely (let's say less than a 25% chance) at this moment.

Brian Nelson: As I mentioned in a prior Economic Roundtable, "I felt following the tone of Trump's tweets Friday, August 23, that (President Trump's) staff may have talked him down from something very, very aggressive in response to the retaliatory tariffs from China. The adjustment to 30% from 25% on $250 billion of Chinese goods on October 1, and to 15% from 10% on another $300 billion worth of Chinese imports on September 1, was very, very mild compared to what I was expecting, especially in the context of his tweets."

It turns out that President Trump's staff did talk him down as he wanted to double tariffs. Given the latest back-and-forth saga and the upcoming 2020 election cycle, I think Trump is going to do whatever he can to cut a deal soon. It may not be exactly what the US is looking for, but I think whatever the deal will be, he will "declare victory" as he builds talking points for the upcoming debates. I think he knows China can just wait him out, so I expect a much more amenable President Trump at the next round of talks.

On the other hand, the best move for China at this point may be for no-deal, no matter what, and hope that President Trump loses the 2020 bid. If China agrees to anything before 2020, it may boost President Trump's chances at reelection, and if President Trump is then reelected, it could mean another four years of trade wars, as President Trump may then go for the jugular and get all that he wants from the country. I think President Trump now wants a deal badly, and China is indifferent, knowing that the longer it waits, the better terms it might get.

All things considered, the White House may have fired its last shot when it modestly raised tariffs last month because doing anything more aggressive may ultimately come home to roost as it may drive the global economy into deflationary bust. It is possible President Trump's political advisors have painted him into a corner. We'll see what happens at the next meeting, but I don't think China is ready to put things behind it. I think China will wait until after the 2020 election to determine long-term trade policy.

In other news, I wanted to mention a great article from ThinkAdvisor, Rob Arnott: Factor Investing Is 'Overhyped.' I talk a lot about the same concerns in my book *Value Trap: Theory of Universal Valuation*. Rob says "the biggest risk is that many factors aren't real. They've worked historically, but that doesn't mean they'll work in the future." Rob also shares some of my other concerns, why there are so many factors and why they perform so poorly:

> The thing is that every single one (factor) … works in back tests. But all that tells us is that people publish only the ones that did work. It doesn't tell us that factors work… The factors themselves were identified as a consequence of aggressive data mining. If you mobilize the entire academic community to search for factors because that's the easiest way to get tenure and you discover a factor that hasn't been published before — great! You become the expert on that factor and get tenure! So there's a powerful incentive to look for relationships that may or may not have merit.

Callum: Rob's comments on target date funds and asset allocation are quite interesting, as he sees the equity side of portfolio allocation better reflected by a curve (starts low when "young" and grows to ~80% by the time the investor is in his/her 50s, before quickly dropping as the investors hits his/her 60s) than a slope (starts high when young and decreases from there). Arnott is optimistic on emerging markets and bonds in those nations, as he doesn't see those spaces as richly valued as US equity markets, but I think exogenous shocks (trade wars) will put a lot of pressure on emerging market (EEM) economies in the medium-term (including on equity values and credit metrics).

Brian: Bloomberg recently reported that "The Big Short's Michael Burry Sees a Bubble in Passive Investing." For those that may not know this name, Michael Burry was catapulted into fame in the movie "The Big Short" as the hedge fund manager that bet big against mortgage backed securities prior to the Financial Crisis.

Burry is now calling for a "bubble" in passive management, and I tend to agree. There are over 5,000 ETFs and by some estimates as many as 70 times as many stock indexers as there are stocks. Anybody that is not calling a bubble in passive may not be calling it straight, in my view. There are simply too many ETF and index providers out there that will continue to push unnecessary products to consumers.

It's also important to differentiate between something being popular and a bubble. That something is popular doesn't mean it's hazardous and can lead to bubbles. However, as indexing and passive proliferates, fewer and fewer investors are paying attention to the value of their stocks, and this sets the stage for bubbles and crashes.

In this case, yes, index popularity can lead to bad things. Even Jack Bogle says that it could lead to chaos. Incentives are in place for index funds to continue to be sold, and I think it just comes down to decades of ill-marketing and investors not getting fee transparency, after *all* fees. It's not a good situation for the investor.

Callum: What I think is interesting is that Burry is bullish on some domestic small cap stocks (IJR)--pushing Tailored Brands (TLRD) and GameStop (GME) to buy back stock, while Arnott was bearish on U.S. small caps according to his past commentary in another article. Both investment managers are optimistic on emerging markets, but appear to have widely divergent views as it relates to holdings within the Russell 2000 Index (IWM). Arnott sees US equities, especially smaller firms, as way overvalued (versus global markets).

Brian: I think the proliferation of quant is doing many investors a disservice. While there are certainly applications to tilt portfolios according to market caps and sectors and other areas, this shouldn't happen absent the valuation context. My biggest suggestion for money managers: Don't let arbitrarily-defined groups of ambiguously-valued companies coupled with faulty logic (in assuming *all* back tests have validity) impact your thinking about intrinsic values, the anchor for prices.

Matthew Warren: Regarding Tailored Brands, if management thinks they can turn around comps to positive numbers, they should be buying back shares like mad instead of paying out the huge dividend yield they are currently doing. If they are worried about turning around comps (as I am), they should be defending their balance sheet by rapidly storing cash or paying down debt. Either way, the dividend makes no sense to me.

Callum: There's clearly an investment/corporate culture difference between American equity markets (where activist investors are common and management teams are constantly prodded by outside forces to change directions) and East Asian equity markets (where internal decision-making processes are prioritized over outside influence). South Korea's (EWY) chaebols and Japan's (EWJ) family-run conglomerates don't necessarily have to answer to shareholders in most circumstances, but America also has its own giants with tiered shareholder structures (giving the founders or the family of the founders outsized influence via super voting shares), especially in the tech and oil & gas midstream space.

Burry mentions that Korean stocks are perennially undervalued because managers don't treat shareholders as owners, which more broadly means Korean-based firms at-large aren't (in Burry's view) maximizing their future free cash flows effectively (prioritizing projects with returns that handily exceed estimated WACC, and returning cash to shareholders when those projects aren't available). Activist investing in East Asian markets hasn't yielded the kinds of results it has elsewhere, and I question whether Burry's firm would be able to change that paradigm.

Additionally, I think South Korean equities have historically been pressured by geopolitical affairs (whether those concerns are related to North Korea's missile tests, the ongoing Korea-Japan trade war, trade tensions with China in the recent past, the long-time row between China and Japan over a few islands the East China Sea, or other factors) and that's not properly captured in the performance of the KOSPI index over the past decade (a lot has happened on the Korean Peninsula since 2010).

Brian: Great information Callum. In other news, CNBC reported that Ray Dalio is warning "of serious problems and a bond blow off as a repeat of the late 1930s looms." What are your thoughts Matt?

Matthew: Great article Brian. Stimulating. I am in complete agreement that more quantitative easing (QE) and more asset buying would be like pushing on a string. All it will create is more bubbles and distortions as opposed to much in the way of increased economic activity. Cost of capital is not the problem in the world. Deflationary impulses are. Dalio's right about picturing what deflation would look like in the next down cycle when we can barely find inflation in this upcycle.

If he is right about a bond blow off, there will be a lot of market participants caught offside as they stretch for yield anywhere and everywhere they can find it. If the real cost of debt re-rates higher while economic activity also contracts and deflation mounts, you are talking about a seriously ugly recipe. And yes, politics could worsen around the globe, as if there aren't enough political problems already. This has been talked about as a tail risk for a long time, but I think it is actually a higher probability than I am comfortable with.

Matthew: I used to debate about whether the TARP/Fed bailout back in the Great Financial Crisis (GFC) was actually going to work or just push the problem down the road. To me, while it had looked like quite a successful thread-of-the-needle in the past decade, I am concerned that it was merely kicking the can down the road. For the life of me, I cannot picture how Europe finds its footing given negative interest rate policy (NIRP) and the "zombie" banks. I think the people buying peripheral bonds are out of their collective minds and are going to get burned very badly.

Draghi said "whatever it takes," but what if that is just a can kick down the road? How can it not be? Can you picture the politics coming together to deal with the excess capacity of the European banking system given all the national champions involved and the knock-on effect it would have on any given country to cull some of their banks? I cannot. The weaker European banks are going to bust sooner or later. Global deflation would get us there sooner.

Callum: On this topic, Ray Dalio is also optimistic on gold (GLD). We've mentioned gold in the past as a safe haven, possibly through an ETF of miners or the commodity itself. To Matt, you brought up global deflation. How does that meld or not meld with Ray Dalio's bullish sentiments on gold? I'm assuming global deflation would see gold sell off, unless it's a case of manic behavior (those gold bugs out there) encouraging the hoarding of gold or something counterintuitive like that.

Matthew: In my view, he doesn't sufficiently explain why gold goes up under the scenario he is talking about, but then he said he is going to explain it further. He talks about money printing, quantitative easing, and monetization of debt. He also talks about in-country and between country conflict. All of these things are pro-gold, in my opinion. He then talks about the QE not working and rates backing up. To me, that leads to deflationary bust, which should be gold negative. The only way gold should be positive in a deflationary bust is in the extreme--complete lack of trust in fiat money.

If he is making that argument, I sure as hell hope he is wrong.

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Valuentum's Economic Roundtable: Trade War, Factors and Beyond:

https://www.valuentum.com/articles/Valuentums_Economic_Roundtable_Trade_War_Factors_and_Beyond

Valuentum has now highlighted over 100 ideas in the Exclusive publication with fantastic success rates! If you would like for us to comment on previously-highlighted ideas, please just email us at info@valuentum.com, and we will include our updated thoughts in the subsequent edition. Thank you!

Tracking Exclusive Idea Simulated Performance

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon
Income Ideas						
Jul, 16	Universal Corp (UVV)	57.74	2.12	3.04	6.0%	Closed - 2/12/2017
Aug, 16	B&G Foods (BGS)	51.54	1.68	1.90	10.6%	Closed - 7/17/2017
Sep, 16	Maxim Integrated (MXIM)	41.12	1.32	1.92	3.5%	Closed - 2/12/2017
Oct, 16	Douglas Dynamics (PLOW)	31.94	0.94	1.09	2.6%	Closed - 2/12/2017
Nov, 16	Ennis Inc. (EBF)	14.60	0.70	0.90	4.5%	Closed -- 11/12/2016
Dec, 16	Watsco, Inc. (WSO)	150.57	4.20	6.40	4.0%	Closed - 2/12/2017
Jan, 17	Star Gas Partners (SGU)	11.21	0.41	0.5	5.3%	0-5 yrs
Feb, 17	Moelis & Co (MC)	35.00	1.28	2.00	6.0%	Closed - 6/22/2017
Mar, 17	Park National (PRK)	108.59	3.76	4.04	4.5%	0-20 yrs
Apr, 17	American Software (AMSWA)	10.44	0.44	0.44	3.0%	Closed - 6/22,23/2017
May, 17	NW Natural (NWN)	59.20	1.88	1.90	2.7%	Closed - 10/25/2018
Jun, 17	Japan Tobacco (JAPAY)	19.03	0.60	0.68	6.2%	0-20 yrs
Jul, 17	Vectren Corp (VVC)	58.21	1.68	Acquired	Acquired	Closed 8/30/2017
Aug, 17	National Retail Properties (NNN)	40.50	1.90	2.06	3.7%	Closed - 10/25/2018
Sep, 17	STORE Capital (STOR)	25.72	1.16	1.32	3.5%	Closed - 10/25/2018
Oct, 17	Fortis (FTS)	36.14	1.27	1.35	3.2%	Closed - 4/18/2019
Nov, 17	Black Hills (BKH)	61.23	1.78	2.02	2.6%	Closed - 10/25/2018

Many members have said that they prefer to focus on the long-term income-oriented dynamics of the income ideas, and we think this makes sense. The formatting of the table reflects a greater focus on the trajectory of the dividend as well as the current forward expected annualized dividend yield. We hope that you find this layout more helpful as you sort through the prior income ideas.

INCOME IDEAS

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon
Income Ideas						
Dec, 17	Four Corners Propety Trust (FCPT)	26.03	0.97	1.15	4.0%	Closed - 10/25/2018
Jan, 18	TransCanada Corp (TRP)	49.47	1.98	2.28	4.5%	0-20 yrs
Feb, 18	Siemens (SIEGY)	71.13	2.18	2.17	4.3%	0-20 yrs
Mar, 18	Philips 66 Partners (PSXP)	49.63	2.71	3.42	6.3%	Closed - 10/25/2018
Apr, 18	PS Business Parks (PSB)	113.68	3.40	4.20	2.4%	Closed - 10/25/2018
May, 18	Hubbell (HUBB)	103.97	3.08	3.36	2.6%	Closed - 2/11/2019
Jun, 18	Park Hotels & Resorts (PK)	32.43	1.72	1.80	7.6%	Closed - 5/3/2019
Jul, 18	Healthcare Trust of America (HTA)	27.36	1.22	1.26	4.4%	Closed - 2/11/2019
Aug, 18	QTS Realty Trust (QTS)	44.01	1.64	1.76	3.7%	Closed - 4/18/2019
Sep, 18	Atmos Energy (ATO)	93.62	1.94	2.10	1.9%	Closed - 10/25/2018
Oct, 18	Veolia Environment (VEOEY)	19.70	0.99	1.03	4.2%	Closed 4/18/2019
Nov, 18	Roche Holding (RHHBY)	29.82	1.08	1.07	3.1%	Closed - 2/11/2019
Dec, 18	OGE Energy (OGE)	40.46	1.46	1.46	3.4%	Closed - 2/11/2019
Jan, 19	BAE Systems (BAESY)	24.32	0.92	1.33	5.1%	Closed - 2/11/2019
Feb, 19	EastGroup Properties (EGP)	107.58	2.88	3.00	2.4%	0-20 yrs
Mar, 19	Canadian Natural Resources (CNQ)	26.76	1.01	1.14	4.7%	0-20 yrs
Apr, 19	Evergy (EVRG)	57.32	1.90	1.90	2.9%	0-20 yrs
May, 19	National Health (NHI)	76.43	4.20	4.20	5.1%	0-20 yrs
Jun-19	Corporate Office Properties Trust (OFC)	28.94	1.10	1.10	3.8%	0-20 yrs
Jul-19	Nuveen Real Estate Income Fund (JRS)	10.63	0.76	0.76	7.1%	0-20 yrs
Aug-19	South32 Limited (SOUHY)	10.01	0.28	0.28	3.0%	0-20 yrs

The information provided in the tables is offered for the convenience of the reader, for illustrative purposes only, and no actual trading is taking place. Actual results may differ from the simulated information being presented. Valuentum is a publisher of financial information, not a money manager, broker, or financial advisor.

CAPITAL APPRECIATION IDEAS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Capital Appreciation Ideas						
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	Closed -- 11/12/2016
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	Closed - 2/12/2017
Sep, 16	Grupo Aeroportuario (ASR)	157.87	181.61	-	15.0%	Closed - 4/5/2017
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	417.40SEK	17.7	38.2%	Closed - 6/1/2018
Nov, 16	Symrise AG (SYIEY)	16.25	16.34	-	0.6%	Closed - 4/5/2017
Dec, 16	Tootsie Roll (TR)	37.80	38.96	0.90	5.4%	Closed 4/18/2019
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	Closed - 2/12/2017
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	Closed - 2/12/2017
Mar, 17	Tesaro (TSRO)	180.84	122.62	-	-32.2%	Closed - 7/17/2017
Apr, 17	Yum China (YUMC)	31.15	37.67	-	20.9%	Closed - 5/23/2017
May, 17	Galapagos (GLPG)	87.67	76.13	-	-13.2%	Closed - 7/17/2017
Jun, 17	Huntington Ingalls (HII)	193.79	206.39	-	6.5%	Closed 8/18/2017
Jul, 17	Orbital ATK (OA)	102.33	104.65	-	2.3%	Closed 8/18/2017
Aug, 17	Wingstop (WING)	32.28	66.17	3.61	116.2%	Closed - 10/25/2018
Sep, 17	Qualys (QLYS)	51.10	75.44	-	47.6%	Closed - 10/25/2018
Oct, 17	Guidewire Software (GWRE)	78.24	87.50	-	11.8%	Closed - 10/25/2018
Nov, 17	Ferrari N.V. (RACE)	117.43	123.26	0.71	5.6%	Closed - 2/11/2019
Dec, 17	Square (SQ)	38.22	72.61	-	90.0%	Closed - 10/25/2018

Many capital appreciation ideas are based on a long-term thesis. However, rapid price-to-fair value convergence may mean we close the ideas relatively quickly, or sooner than expected. Our decision to close an idea may or may not be relevant to you given varying goals and risk tolerances.

CAPITAL APPRECIATION IDEAS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Capital Appreciation Ideas						
Jan, 18	Planet Fitness (PLNT)	33.70	46.41	-	37.7%	Closed - 10/25/2018
Feb, 18	Insulet Corp (PODD)	75.84	82.69	-	9.0%	Closed - 10/25/2018
Mar, 18	Preferred Bank (PFBC)	64.01	50.00	1.62	-	0-20 yrs
Apr, 18	Esperion Therapeutics (ESPR)	66.43	40.94	-	-38.4%	Closed - 4/18/2019
May, 18	Heidrick & Struggles (HSII)	37.65	40.77	0.41	9.4%	Closed - 3/9/2019
Jun, 18	Green Dot Corp (GDOT)	72.86	28.04	-	-	0-20 yrs
Jul, 18	Wix.com (WIX)	105.30	111.93	-	6.3%	Closed - 2/11/2019
Aug, 18	Tactile Systems Technology (TCMD)	50.84	63.52	-	24.9%	Closed - 10/25/2018
Sep, 18	Invitae (NVTA)	13.95	20.84	-	49.4%	Closed - 3/9/2019
Oct, 18	Cigna (CI)	215.72	149.00	0.04	-30.9%	Closed 4/18/2019
Nov, 18	Yeti Holdings (YETI)	16.50	17.99	-	9.0%	Closed - 2/11/2019
Dec, 18	Spotify (SPOT)	135.31	139.65	-	3.2%	Closed - 4/18/2019
Jan, 19	Suncor Energy (SU)	29.32	32.05	-	9.3%	Closed - 2/11/2019
Feb, 19	Delek Holdings (DK)	32.12	37.31	0.27	17.0%	Closed - 4/18/2019
Mar, 19	Physicians Realty Trust (DOC)	17.82	17.25	0.46	-	0-20 yrs
Apr, 19	Everbridge (EVBG)	72.75	98.43	-	35.3%	Closed 7/24/2019
May, 19	Teladoc Health (TDOC)	60.93	68.09	-	11.8%	Closed 7/24/2019
Jun-19	Alteryx (AYX)	95.15	119.29	-	25.4%	Closed 7/24/2019
Jul-19	CrowdStrike (CRWD)	67.21	86.42	-	28.6%	Closed 7/24/2019
Aug-19	Inovalon Holdings (INOV)	17.12	15.74			0-20 yrs

Success rate: The percentage of ideas highlighted in the Exclusive that have moved in the direction of our thesis (i.e. up for capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.

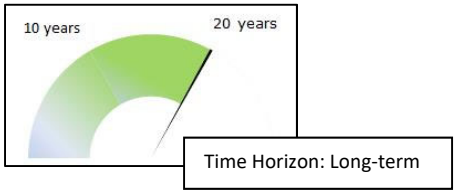
SHORT IDEA CONSIDERATIONS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Short Idea Considerations						
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	Closed -- 12/2/2016
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	Closed -- 12/2/2016
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	Closed -- 11/4/2016
Oct, 16	GoPro (GPRO)	16.68	11.16	NA	33.1%	Closed -- 11/4/2016
Nov, 16	Seritage Growth Properties (SRG)	44.31	42.13	0.25	4.4%	Closed -- 1/6/2017
Dec, 16	Royal Bank of Scotland (RBS)	4.91	4.65	0.39	-	0-5 yrs
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	Closed - 2/12/2017
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	Closed - 2/12/2017
Mar, 17	Fitbit (FIT)	6.07	5.71	-	5.9%	Closed - 4/5/2017
Apr, 17	Santander Consumer (SC)	12.51	11.65	-	6.9%	Closed - 5/23/2017
May, 17	Snap, Inc (SNAP)	23.19	17.19	-	25.9%	Closed - 5/10/2017
Jun, 17	Mallinckrodt (MNK)	42.65	36.41	-	14.6%	Closed - 8/18/2017
Jul, 17	Deutsche Lufthansa AG (DLAKY)	23.38	21.42	0.94	4.4%	Closed - 10/25/2018
Aug, 17	Del Frisco's (DFRG)	14.35	11.93	-	16.9%	Closed - 10/16/17
Sep, 17	Fiesta Restaurant Group (FRGI)	15.90	14.36	-	9.7%	Closed - 2/11/2019
Oct, 17	Ingles Markets (IMKTA)	26.50	24.20	-	8.7%	Closed - 10/16/17
Nov, 17	Fogo de Chao (FOGO)	10.85	15.62	-	-44.0%	Closed - 3/3/2018

The tables above are provided for the sole purpose of transparency, to allow readers to measure Exclusive ideas in a way they feel is most appropriate. Ideas within the Exclusive are not constructed as a portfolio, nor should they be viewed as a portfolio, and performance information is hypothetical and "trading" is simulated. "Hypothetical annualized returns," now labeled "Capital Efficiency," cannot be achieved and are provided for the sole purpose of rightsizing each idea to a common measurement period (one year), to compare ideas 'closed' within one year to ones 'open' longer than one year, taking into account capital efficiency. A reader, for example, may view a 20% hypothetical return over a period of five weeks as much better than a 20% hypothetical return over a period of five years. Whereas both represent 20% hypothetical returns, hypothetical annualized performance is much different under each case. Readers may have different views and time horizons. To retain independence, neither Valuentum nor Brian Nelson own any shares, nor do they plan to own any shares, of any companies highlighted in the Exclusive. Importantly, shorting stocks involves a number of abnormal risks, including theoretically the infinite loss of capital, and is not for everyone. Valuentum is a financial publisher not a financial advisor. Please contact your personal financial advisor to determine if any idea in the Exclusive may be appropriate for you.

SHORT IDEA CONSIDERATIONS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Short Idea Considerations						
Dec, 17	TrueCar (TRUE)	12.07	10.97	-	9.1%	Closed - 12/28/17
Jan, 18	Shake Shack (SHAK)	44.17	103.12	-	-	0-2 yrs
Feb, 18	iShares Core US Aggregate Bond ETF (AGG)	107.20	104.63	1.93	0.6%	Closed - 10/25/2018
Mar, 18	iShares iBoxx $ High Yield Corporate Bond ETF (HYG)	85.75	86.68	4.936	-6.8%	Closed - 4/18/2019
Apr, 18	Houghton Mifflin Harcourt (HMHC)	7.25	6.70	-	7.6%	Closed - 6/1/18
May, 18	Noodles & Company (NDLS)	7.25	7.04	-	2.9%	Closed - 2/11/2019
Jun, 18	iShares International High Yield Bond ETF (HYXU)	52.40	50.94	-	2.8%	Closed - 10/25/2018
Jul, 18	Installed Building Products (IBP)	56.15	40.10	-	28.6%	Closed - 9/28/2018
Aug, 18	Veritiv Corp (VRTV)	38.80	36.35	-	6.3%	Closed - 9/28/2018
Sep, 18	Box (BOX)	24.55	24.30	-	1.0%	Closed - 9/28/2018
Oct, 18	Modine Manufacturing (MOD)	14.73	12.00	-	18.5%	Closed - 10/25/2018
Nov, 18	Beazer Homes USA (BZH)	9.01	12.52	-		0-2 yrs
Dec, 18	Vera Bradley (VRA)	10.22	9.95	-	2.6%	Closed - 8/23/2019
Jan, 19	RH (RH)	117.84	106.99	-	9.2%	Closed - 4/4/2019
Feb, 19	QuinStreet (QNST)	14.77	12.79	-	13.4%	Closed - 3/9/2019
Mar, 19	Dycom Industries (DY)	47.20	41.74	-	11.6%	Closed - 8/23/2019
Apr, 19	Diplomat Pharmacy (DPLO)	5.69	5.29		7.0%	Closed - 5/16/2019
May, 19	Match Group (MTCH)	61.91	81.47			0-2 yrs
Jun-19	Tailored Brands (TLRD)	5.56	4.94	0.18	11.2%	Closed - 7/24/2019
Jul-19	Realogy Holdings (RLGY)	6.55	5.60		14.5%	Closed - 7/24/2019
Aug-19	Party City Holdco (PRTY)	6.04	4.50		25.5%	Closed - 8/8/2019



BANK OF AMERICA

Bank of America Preferred Shares

"However, [what] we saw in our client base during the second quarter 2019 [was] solid consumer activity pointing to a continued growing economy in the United States this year albeit at a slower pace. In that environment our company reported the best earnings quarter in the company's history. That was made possible through the hard work of my 209,000 team-mates who are driving responsible growth. We reported $7.3 billion in after tax net income and $0.74 per share. Both these items increased on a linked quarter and a year-over-year basis." – Brian Moynihan, CEO of Bank of America, during the company's second quarter 2019 conference call

Thesis

We believe that Bank of America's (BAC) preferred shares are a great option for those investors looking for a solid yield play. **There are several ways to frame such a pitch, but we think the best way is to make a pitch regarding the company overall, before getting into the preferred share itself. So, let's do just that. The CUSIP is 60505229 and the coupon stands at 6%.**

In our view, Bank of America has reached the point where it can legitimately claim that the firm is fast on the heels of JP Morgan (JPM) as the top-quality universal bank in the world. In the wake of an ongoing effort to improve its efficiency ratio over the past several years, Bank of America is posting return on tangible equity of 16.2% in the recent quarter, approaching JP Morgan's 20% level in the same quarter. Both banks have very similar profiles in terms of services offered and geographies in which they operate. Both are global universal banks offering everything under the sun when it comes to banking services. After substantial improvement over the past few years, Bank of America's efficiency ratio was now 57% in the recent quarter, as compared to JP Morgan's 55% level.

Corporate Profile

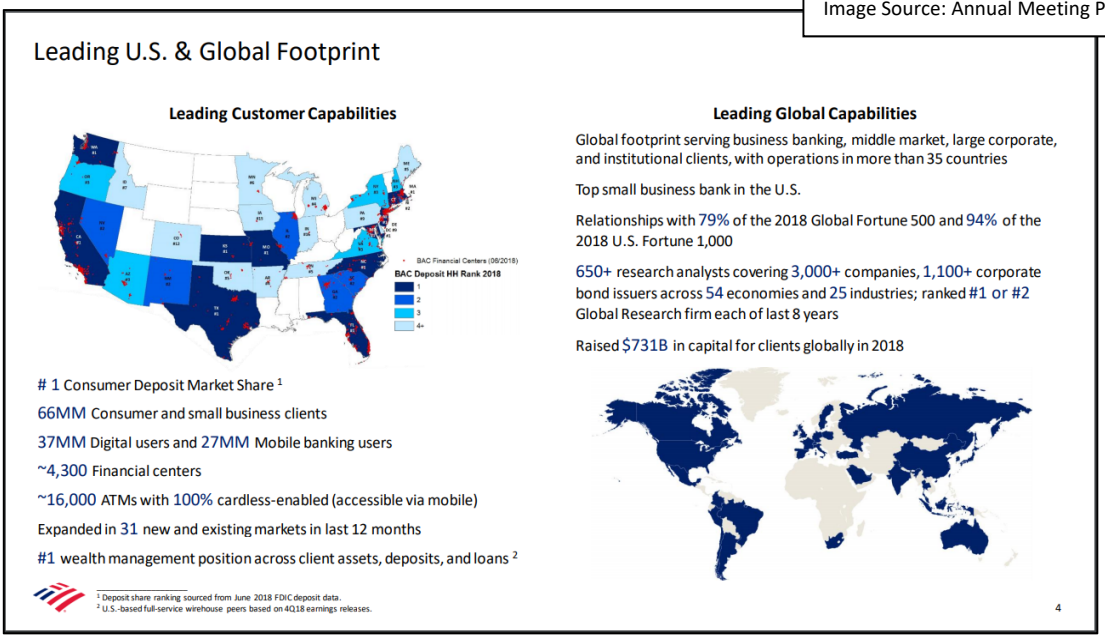
Bank of America Corporation (BAC) is a bank holding company with $2.4 trillion in assets and 209,000 employees worldwide as of the end of June 2019. The company operates in several dozen countries around the world and its retail banking footprint covers 86% of the US population. At the end of June 2019, Bank of America's domestic banking unit serviced 66 million retail and small business customers. That segment is supported by the bank's network of 16,600 ATMs, 4,300 retail financial centers, and online banking offerings.

Key Statistics	
Bank of America (BAC)	
Total Assets LFQ	$2.4T
Net Income TTM	$27.7B
Revenue TTM	$91.6B
Diluted EPS TTM	$2.81
Total Equity LFQ	$271.4B
Total Debt LFQ	$265.3B
Total Cash LFQ	$171.4B

This efficiency gap shows exactly where Bank of America has some remaining room to improve its earnings and resulting return on capital levels. Given current management's impressive track record, we think they are up for the job. **If achieved, this would further bolster Bank of America's earnings power for shareholders and increase the size of the earnings cushion for bond and preferred holders.**

Let's take a closer look at the bank. As you can see in the below slide, Bank of America's footprint skews heavily to the fastest growing regions of the US, with number 1 deposit positions in states like Washington, California, Texas, Florida, North Carolina, and several coastal New England states. In fact, Bank of America has number 1 consumer deposit market share in the country and is the top small business bank. Importantly, these are businesses where economies of scale matter. Large branch and ATM footprints, national advertising, slick mobile apps are all much more attainable and affordable when you spread the cost of these investments over more consumers and small businesses.

Image Source: Annual Meeting Presentation – 04/24/19



Bank of America has also entered a new era in the past 4 years as they have emerged from the aftermath of the Great Financial Crisis (GFC) as a much leaner and more profitable bank. This compares to the immediate aftermath when they were being sued left, right, and center for their own wrongs, but especially those of acquired Countrywide Financial and Merrill Lynch. **With large settlements apparently in the rear view mirror, the bank has been able to focus on the present and future, using digital technology to improve customer facing interfaces like branches, ATMs, and apps, as well as to streamline and automate various routine function in the back and middle offices.** This drive has both helped cement new and existing customer relationships, while also improving profitability and return on capital metrics.

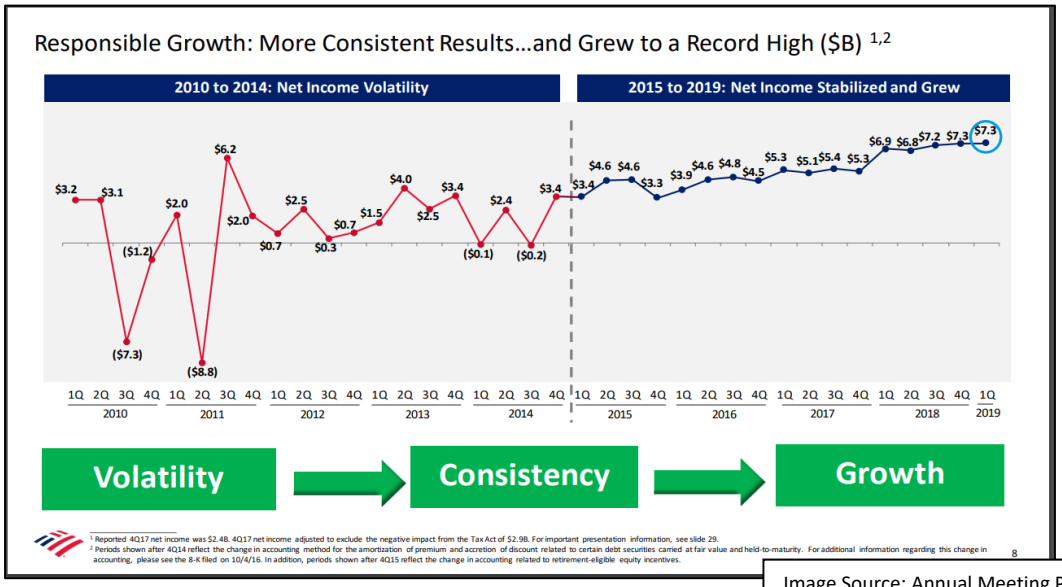
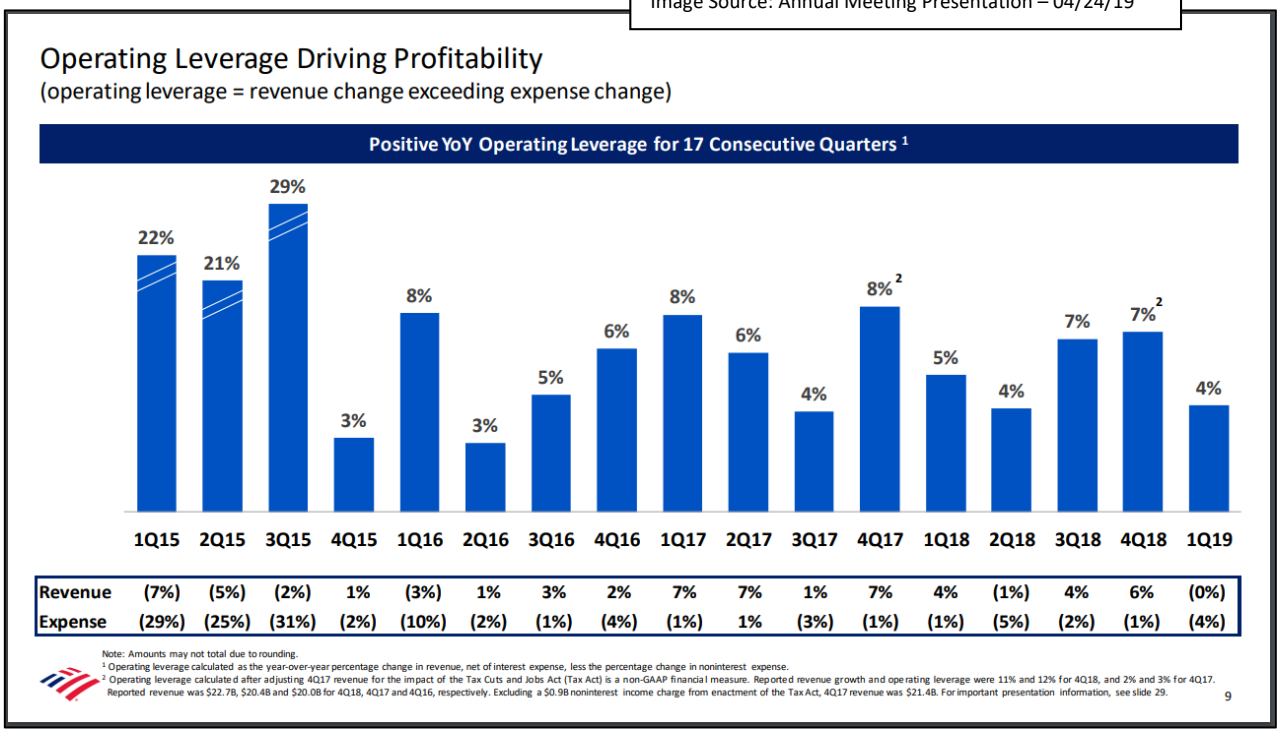


Image Source: Annual Meeting Presentation – 04/24/19

The below graphic is a beautiful picture for stock, bond, and preferred holders alike. **For 17 consecutive quarters, Bank of America has displayed positive operating leverage, including six quarters of negative revenue growth, a real herculean feat for any bank.** Importantly, this wasn't achieved just by cutting fat and cutting heads, but also by reinvesting in the digital future of the bank, which will make it more competitive in the decades to come.

Image Source: Annual Meeting Presentation – 04/24/19



Below, you can see the progress of expense reductions in real dollars and cents, showing that this improvement in efficiency ratio isn't simply the result of higher revenues in a ten-year bull market.

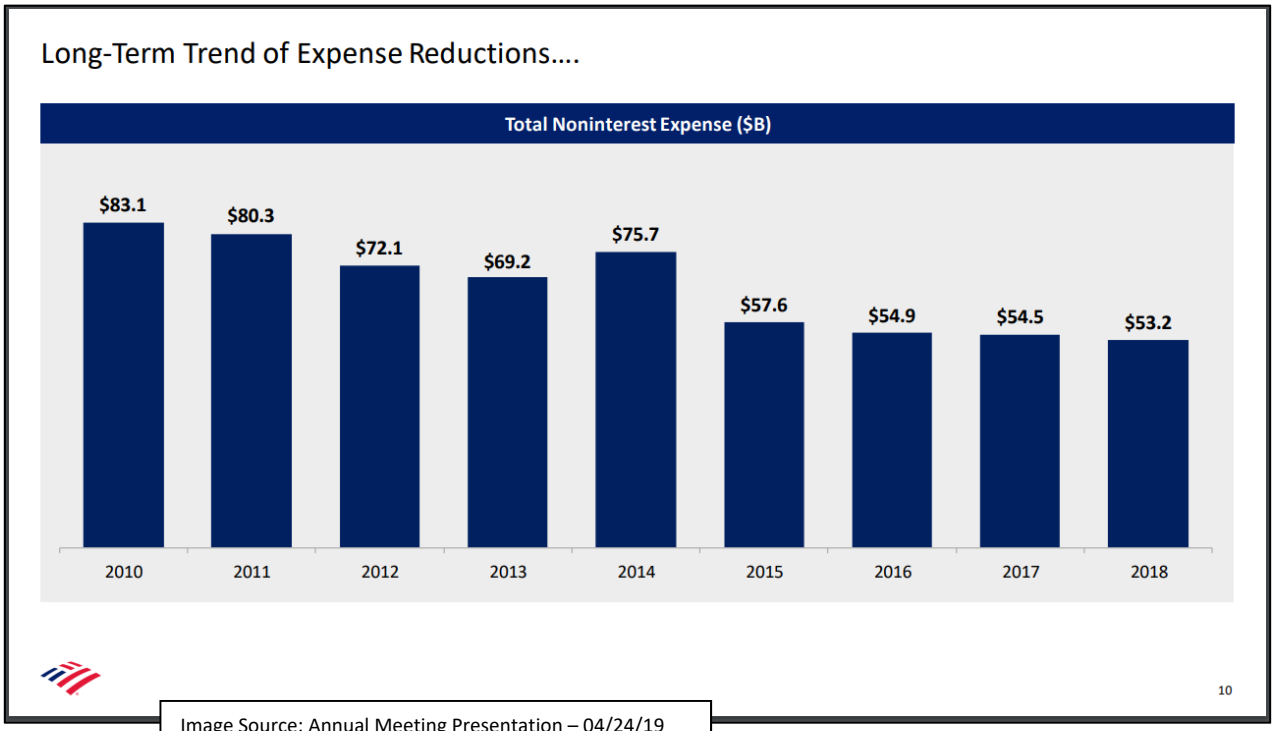


Image Source: Annual Meeting Presentation – 04/24/19

The next slide highlights that while inefficient spending has been removed on an ongoing basis, the bank has been reinvesting in the future of the business. Bank of America is adding branches in newly targeted geographies, adding ATMs, and continually improving the IT infrastructure and front end of the business. With modern day clients, being on the cutting edge of digital technologies is a must, and Bank of America is delivering on this front with the likes of Erica, it's app-based digital assistant.

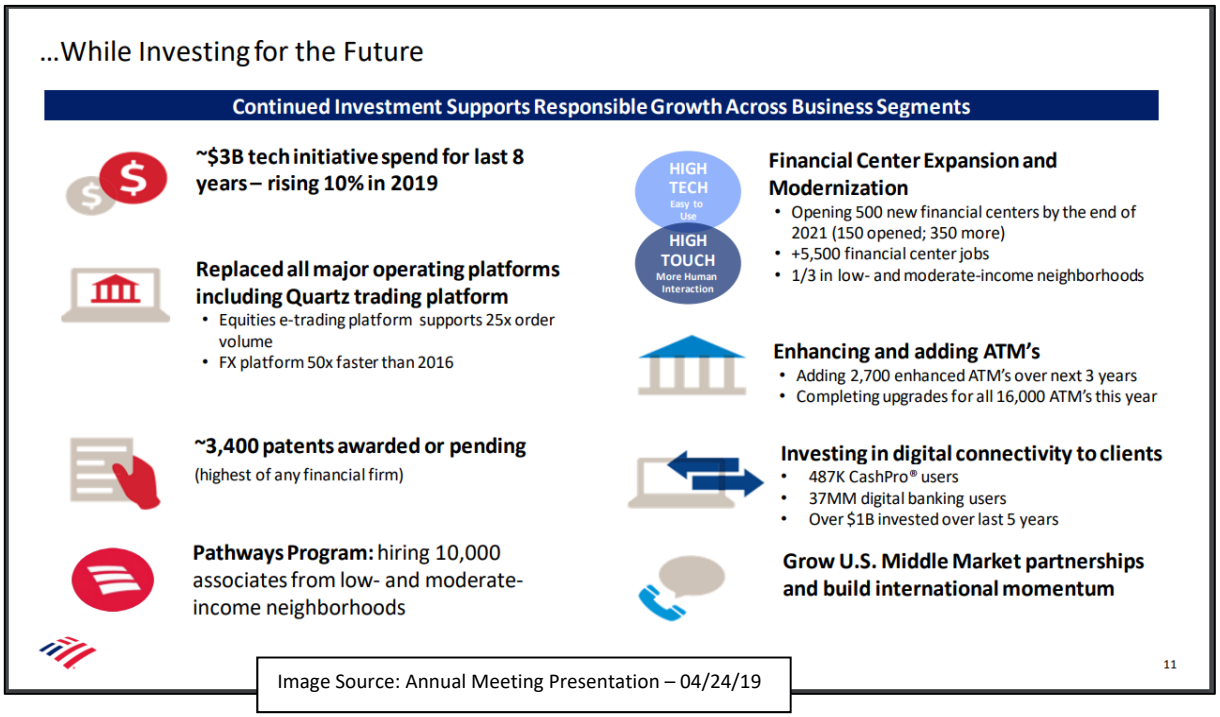


Image Source: Annual Meeting Presentation – 04/24/19

The result of all this investment in digital transformation is that the customers are taking up use of these capabilities at a rapid clip. Payments, deposits, and interactions in general are moving away from the branch and towards the various digital channels. This frees up the branch to focus on selling as opposed to such a heavy focus on routine transactions. Consumers and businesses still care about having a branch nearby, and Bank of America ticks that box as well as any nationwide bank.

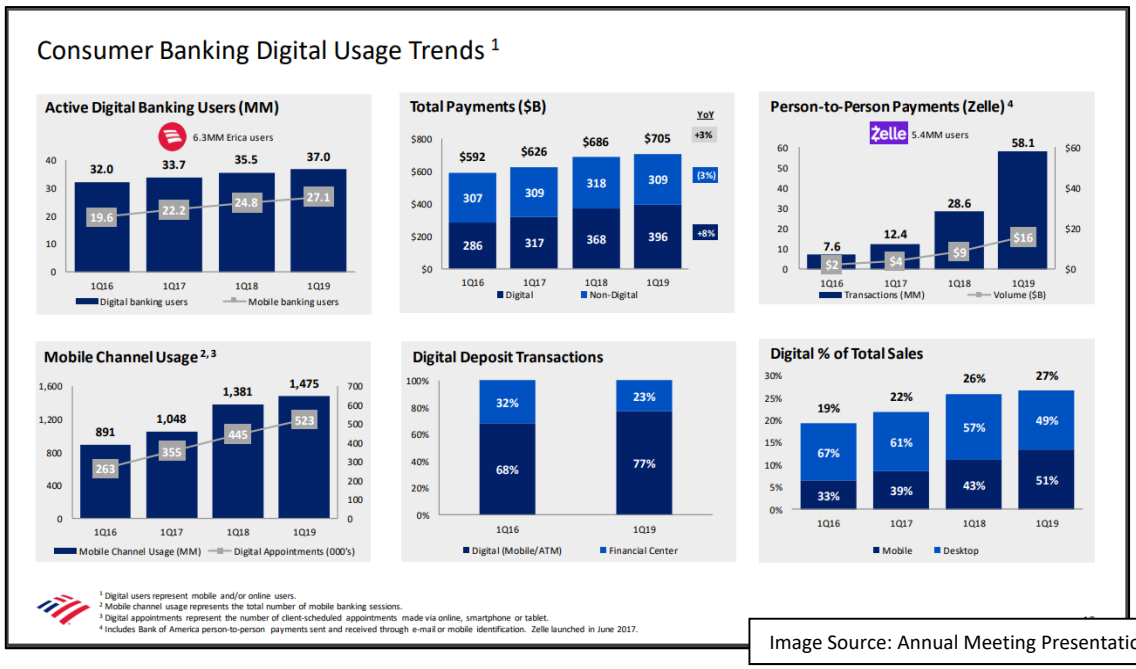


Image Source: Annual Meeting Presentation – 04/24/19

The below slide shows just how successful Bank of America has been at gathering deposits (especially from wealthy consumers,) and then finding credit worthy borrowers to turn around and lend most of these deposits back out. It is a tricky dance that Bank of America has executed successfully to date.

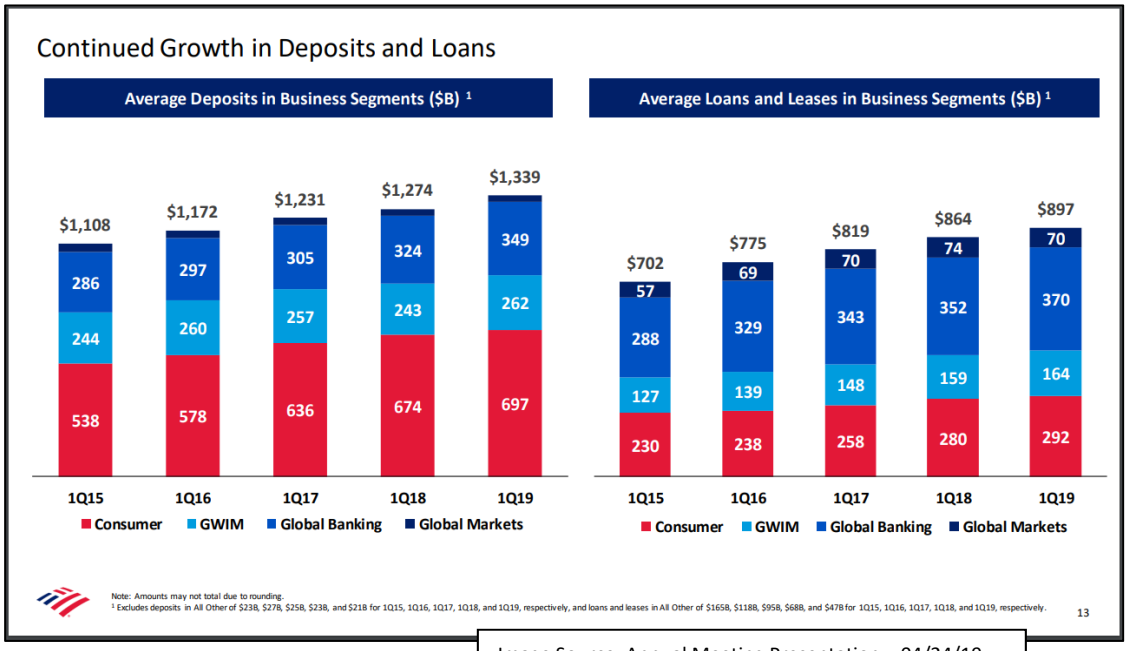
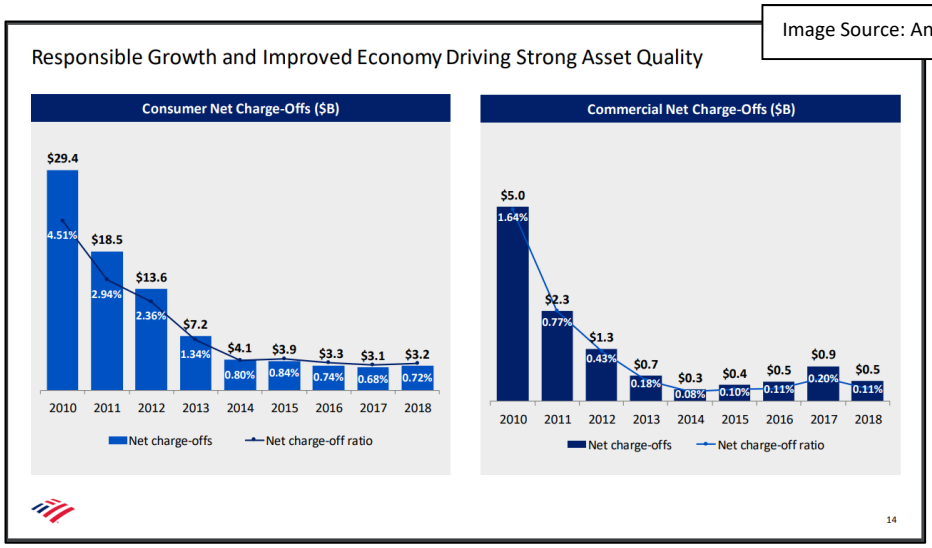


Image Source: Annual Meeting Presentation – 04/24/19

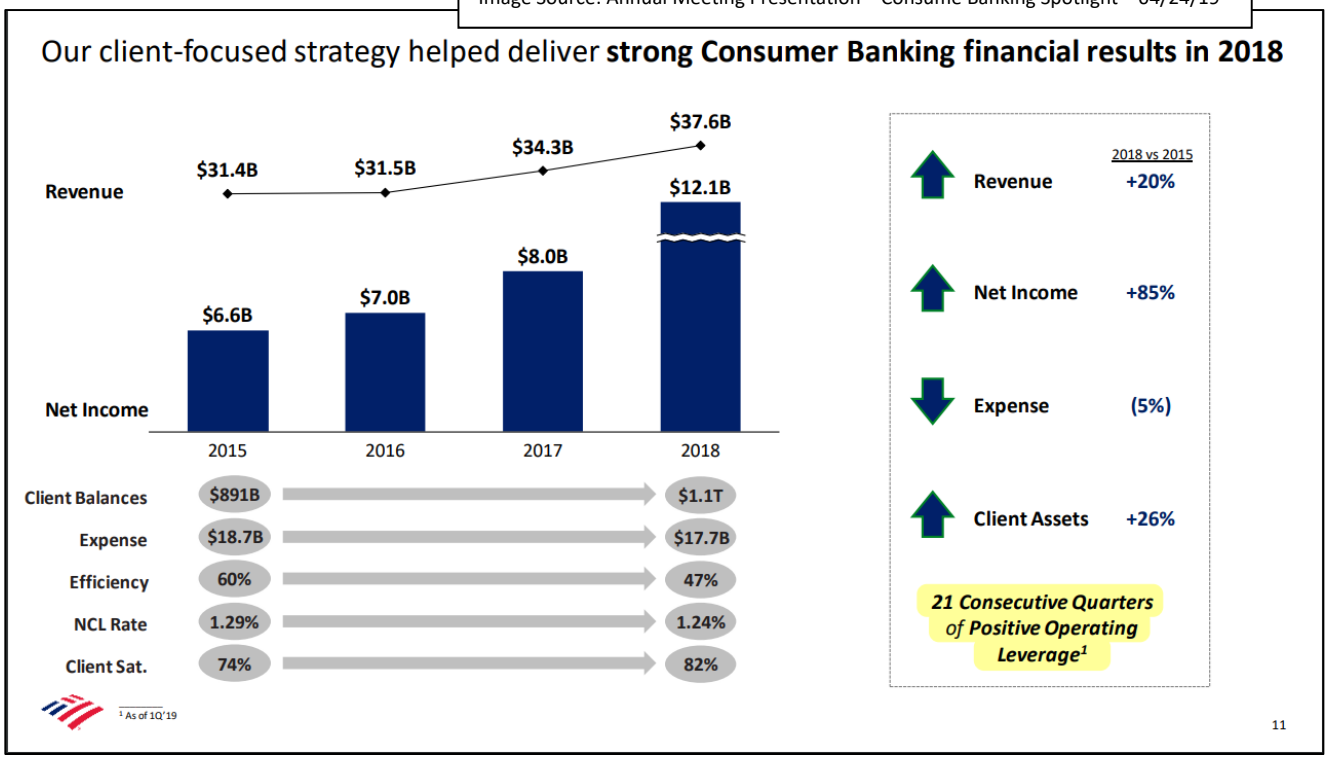
The below graphic highlights the ugly credit experience in the aftermath of the GFC, but it also shows how benign the credit market cycle has been in the rest of the decade since. These losses can be expected to tick higher in a recession, but Bank of America's balance sheet simply does not contain the kind of risky assets that it did in the run up to the GFC. There are no material (risky) amounts large collateralized debt obligations (CDO) or risky residential mortgage-backed security (RMBS) exposures like there were back then. There are not a lot of sloppy mortgages and home equity loans like there were then. While there will surely end up being higher-than-current loss content in the loan book in the next recession, and perhaps it will be concentrated in different areas like credit cards and leveraged loans, but we would expect for the credit cost line to be digestible in all but the most extreme global economy situations that you can imagine.

Image Source: Annual Meeting Presentation – 04/24/19



We include the below graphic to drive home the point that Bank of America's strength is its Consumer Banking unit. They simply own one of the top two or three most attractive, nationwide consumer franchises in the country alongside JP Morgan and Wells Fargo (WFC). When BB&T (BBT) merges with SunTrust (STI) later this year, they will remain a distant competitor in terms of sheer size of the consumer unit as compared to Bank of America. As mentioned previously, consumer banking is a business where scale matters, both in terms of defensibility, profitability, and return on capital. Bank of America has the wherewithal to stay out front in the digital transformation that is taking place in global banking and business in general.

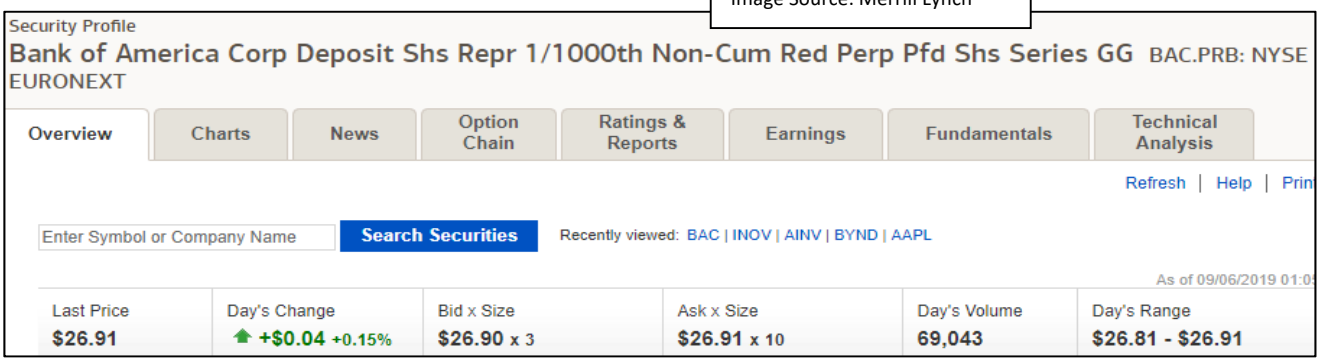
Image Source: Annual Meeting Presentation – Consume Banking Spotlight – 04/24/19



Bank of America Preferred Play:

Bank of America has several preferred share issuances outstanding, so we picked one of the larger and more liquid ones below, with ISIN US0605052291. Importantly, it appears to trade with at least some amount of liquidity, having traded nearly $2 million worth as of midday the day of this writing. See below for some of the relevant details.

Image Source: Merrill Lynch



On its recent $26.91 trading price, it yields approximately 5.6%, which is nothing to sneeze at in today's low and even negative rate (approximately $16 trillion in global bonds currently trade with a negative yield) environment.

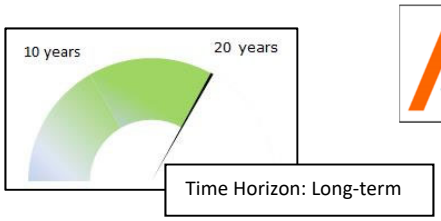
That's the reward, so what about the risk? To me, this is why Bank of America preferreds are so interesting as a way to pick up yield in a portfolio. Bank of America has a rock-solid balance sheet with a Common Equity Tier 1 ratio of 11.7%. The bank's allowance for loan and leases losses of $9.5 B or 1% of total loans and leases compares to recent charge off rates running from 0.38% to 0.43% over the past five quarters. This means they are well positioned for losses to double from current levels, without appearing under reserved.

Aside from all its inherent protections, there remains two wild cards in favor of any stakeholder in Bank of America. The first is that it is truly too big to fail. The government would be incentivized to keep Bank of America afloat even in the direst economic circumstances as it fits the definition of a national champion that keeps the financial circulatory system flowing throughout the country.

The second and we think more important wild card is that Berkshire Hathaway owns a significant equity stake in Bank of America. And Berkshire has the dry powder to invest more equity (and/or preferred equity) in the bank if times were dire enough to require such action.

We should emphasize that we don't think that additional capital would be required at Bank of America unless we entered another extremely serious global financial crisis, and even then, the bank might sail through without the need for additional capital. **Bank of America preferred shares look to us like a solid way to add income to a portfolio.**

Disclosure: *Matthew Warren does not own shares in any of the securities mentioned above.*



Avalara (AVLR)

"Q2 was another strong quarter for Avalara. We reported total revenue of $91 million representing an increase of 43% over the prior year. Our accelerating growth rate was driven by solid sales execution in every segment from small business to mid-market, to enterprise and increased revenue from a variety of initiatives. I said if before, and I will say it again. We have a vision to part of every transaction in the world, as our value proposition gains more traction, I'm increasingly confident in our ability to build a great company with durable growth characteristics." – CEO Scott McFarlane, 2Q conference call, August 7, 2019

Thesis

The capital appreciation idea for this month's Exclusive has had a fantastic 2019 thus far, and we expect that its future may be even brighter. Although the company has speculative tendencies at this point in its corporate lifecycle, we think it has a strong and stable end market. They say there are only two certainties in life, death and taxes, and Avalara (AVLR) focuses on the latter.

Corporate Profile

Avalara provides tax compliance software in the cloud on a real-time basis to more than 9,000 customers. It went public in June 2018, and it had nearly 1,600 full-time employees, as of December 31, 2018, with the majority of them based in the US. Avalara was incorporated under the name Advantage Solutions in 1999 and changed its name in 2005. Its principle offices are in Seattle, WA.

Key Statistics	
Last Close	$81.10
52-Week Range	$28.09 - $94.31
Market Cap	$6.2B
Revenue TTM	$323M
Dividend Yield TTM	N.A.
Total Asssets LFQ	$692M
Total Debt LFQ	$0.0M
Total Cash LFQ	$442M

The company provides a suite of cloud-based solutions that are created to "improve accuracy and efficiency by automating the processes of determining taxability, identifying applicable tax rates, determining and collecting taxes, preparing and filing returns, remitting taxes, maintaining tax records, managing compliance documents" and so on. Avalara's motto is "Tax compliance done right," and its vision is "to be part of every transaction in the world."

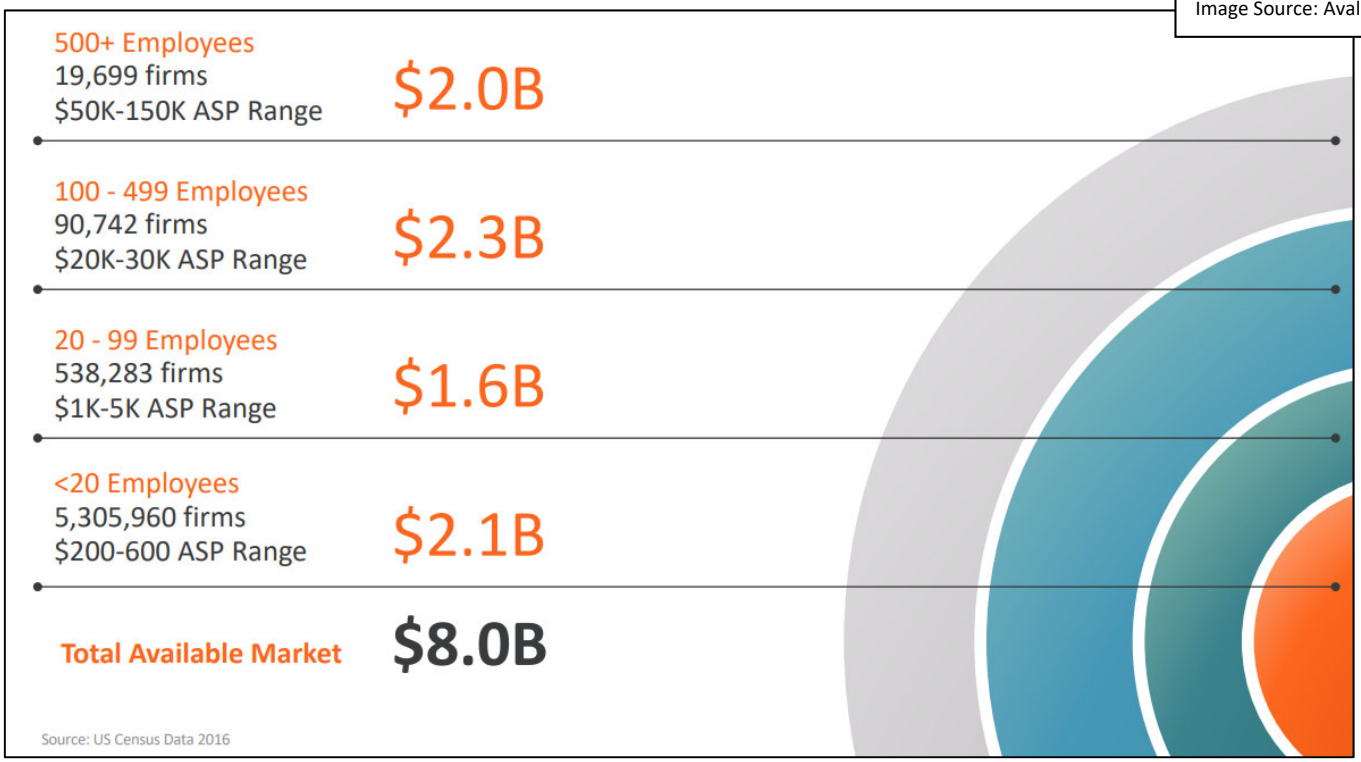
Avalara solves a big problem. Many businesses handle tax compliance processes manually, using spreadsheet software and internal staff, but such manual processes aren't robust and can result in incorrect collections and financial penalties. The Avalara Compliance Cloud combines a deep database of tax content with technology to reduce miscalculations and compliance costs.

The firm notes that "businesses that use (its) solutions can allocate fewer personnel to manage transaction tax compliance and focus their efforts on core business operations." **Its biggest competitive advantage is that its platform is integrated seamlessly into a business' applications, and when transactions are carried out, the Avalara Compliance Cloud delivers tax compliance in real time, requiring little customer oversight.** Businesses don't have to spend as many valuable resources at quarter or years' end trying to true up the books.

Businesses seem to love Avalara. Its net revenue retention rate has averaged 107% during the four quarters ending December 31, 2018, and the mark was equally as strong during 2017. As of the end of last year, Avalara had more than 9,000+ core customers, many of them Fortune 100 companies, even as its target market is mid-size companies with fewer than 500 employees. These mid-size companies account for about 85% of Avalara's total revenue, which is primarily subscription based. Most of its customers are in the US, but it does support tax compliance in Europe, South America and Asia, with an eye on expanding more internationally. No single customer accounts for more than 10% of sales.

During the company's second-quarter results, released August 7, the firm posted a solid top-line growth rate of 43%. Management continues to remain confident in its belief that its "broad tax content, robust platform, partner channel, and pre-built integrations position Avalara as a clear choice to lead this automation cycle." We share the optimism. **Avalara continues to capitalize on a large market opportunity, low penetration rate, and the inevitability of automation (its revenue was $272 million in 2018 versus an $8 billion long-term opportunity).**

Image Source: Avalara



Though its opportunity is large, the industry that provides support for transaction tax compliance is highly competitive and fragmented. Competition generally distills into three buckets: 1) internal, do-it-yourself approaches, 2) outsourced transaction tax compliance services offered by consulting firms, 3) and tax-specific vendors namely CCH Inc. ONESOURCE, and Sovos. We think the Avalara Compliance Cloud's integrated, real-time platform is a key competitive advantage, however, even as we admit other firms do have better brand recognition and some businesses in its target market may have different needs.

That said, Avalara has put up significant operating losses since inception, somewhat odd given that the firm is roughly 20 years' old. During 2018, 2017, and 2016, the company incurred $75.6 million, $64.1 million and $57.9 million in operating losses, respectively (it is targeting an operating loss in the range of $15-$20 million for full-year 2019). Free cash flow has improved during the past few years, however, but it, too, has also been negative, coming in at -$18.5 million, -$17.5 million, and -$28.4 million during the past three years. At the

moment, management is ramping up sales and marketing (S&M) expenses (which largely explains the poor financial performance), but we'd like to see free cash flow go positive in the coming years for us to stick with this idea over the long run (free cash flow was a positive $7.2 million during the second quarter of 2019).

Image Source: Avalara

	For the Year Ended December 31,			
	2018	2017	2016	2015
	(in thousands, except per share data)			
Revenue:				
Subscription and returns	$ 254,056	$ 199,942	$ 154,967	$ 112,804
Professional services	18,042	13,217	12,459	10,354
Total revenue	272,098	213,159	167,426	123,158
Cost of revenue:				
Subscription and returns	66,556	48,849	41,307	34,856
Professional services	12,093	9,128	7,206	5,889
Total cost of revenue (1)	78,649	57,977	48,513	40,745
Gross profit	193,449	155,182	118,913	82,413
Operating expenses:				
Research and development (1)	51,909	41,264	32,848	29,787
Sales and marketing (1)	168,817	133,794	103,483	98,686
General and administrative (1)	39,603	34,286	36,875	33,683
Restructuring charges	—	752	—	—
Goodwill impairment	9,174	8,418	—	—
Total operating expenses	269,503	218,514	173,206	162,156
Operating loss	(76,054)	(63,332)	(54,293)	(79,743)
Total other (income) expense, net	472	2,013	2,955	1,614
Loss before income taxes	(76,526)	(65,345)	(57,248)	(81,357)
Provision for (benefit from) income taxes	(976)	(1,219)	640	(3,593)
Net loss	$ (75,550)	$ (64,126)	$ (57,888)	$ (77,764)
Net loss attributable to common shareholders - basic and diluted (2)	$ (75,550)	$ (64,126)	$ (57,888)	$ (77,764)
Net loss per share attributable to common shareholders - basic and diluted (2)	$ (1.95)	$ (11.39)	$ (10.15)	$ (16.96)
Weighted average shares of common stock outstanding - basic and diluted (2)	38,692	5,632	5,706	4,586
Non-GAAP Financial Data				
Non-GAAP operating loss (3)	$ (44,971)	$ (37,425)	$ (41,107)	$ (68,660)
Free cash flow (4)	(18,545)	(17,496)	(28,356)	(54,920)

(1) The stock-based compensation expense included above was as follows:

Peculiarly, we were also somewhat surprised to find that Avalara has identified a significant deficiency in its own internal controls over financial reporting. Though the deficiency has yet to be remediated and while we don't think this is a big deal, for a tax compliance company, however, we wonder how something like this can happen and its implications on customer perception during the sales process. Of course, the company's solutions could encounter bugs or encounter cyber-security issues, but we don't view this risk as any greater than that of the average company. Given the rapid pace of sales growth, neither of these risks appear to be hurting the firm. Management also included the following in its 10-K, and we think investors should be aware of it, even as we are optimistic about Avalara's future:

> Because the market for (Avalara's) solutions is not fully developed and is rapidly evolving, it is difficult for us to predict our results of operations. We expect our operating expenses to continue to increase in future periods as we hire additional sales and other personnel, improve the Avalara Compliance Cloud, invest in sales and marketing initiatives, expand our international reach, and potentially acquire complementary technology and businesses. If our revenue does not increase to offset increases in our operating expenses, we may never achieve or maintain profitability.

As it relates to the balance sheet, Avalara doesn't have any real debt, and it held $441.6 million in cash on the books at the end of the second quarter of 2019, so this is a good thing. It does have an undrawn revolver, so we'd view its financial health as good, and the market continues to be receptive of new share issuances (it launched a public offering of 3 million shares of its stock in June of this year). We think cloud-based companies have been in vogue of late, too, and we'd point to Avalara as a take-out candidate (there's been lots of M&A in software and the cloud, and we expect this to continue).

Let's talk downside risks first.

When it comes to the valuation equation, normalizing S&M expenses is the biggest question mark. Right now, the company is growing at a tremendous pace on the top line, and it is using S&M to propel that growth rate. When it comes to a downside-case valuation, let's back out S&M expenses and, as a result, assume no further growth in the business. Under this scenario, we're looking at about ~$180-$200 million in normalized free cash flow (using free cash flow burn and S&M spending in 2018 as a proxy). In light of the balance sheet health, let's assume an 8% cost of capital to arrive at ~$3 billion in market cap (~$40 per share), inclusive of the hefty cash balance on the books – so there are meaningful downside risks under a no-growth scenario.

Image Source: Avalara

Long Term Model (Non-GAAP)

% of Revenue	2016	2017	2018		LT Target Model
Gross Margin	73%	75%	73%	>	80 – 82%
Sales and Marketing	59%	60%	59%	>	33 – 35%
Research and Development	19%	18%	18%	>	14 – 16%
General and Administrative	20%	14%	12%	>	8 – 10%
Operating Margin	(25)%	(18)%	(17)%	>	20 – 25%

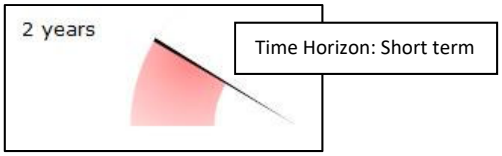
A no-growth scenario is about as worst-case a scenario as we can think of. On the other hand, to justify its existing valuation, we'd probably have to see annual top-line growth rates remain in the 30%-40% range for the next 3-5 years (the company's current run rate) or so with management better managing its cost profile, something that we view as achievable. We don't think the market price today is giving the company full credit for its long-term targets, which brings us to the next scenario.

As for upside from today's levels, if Avalara can maintain a 20%-40% top-line growth rate for the next decade or so and begin to scale back S&M expenses considerably over time (as in the image above), the stock could represent a bargain at today's levels, especially as cash builds on the balance sheet. We expect there may even be more leverage in its S&M line (it is forecasting it to fall to ~33%-35% of revenue from 59% in 2018). Long-term operating margins in the 20%-25% range compared to operating losses today implies considerable earnings expansion!

All told, Avalara has a unique niche in cloud-based automation tax compliance, material competitive advantages that are driving share capture, a large total addressable market relative to its annual revenue run rate, high customer retention, and significant long-term operating leverage, per sales and marketing scale. We'd view a fair value range for Avalara at $40-$100 per share. That said, in light of the risks and the size of our fair value estimate valuation range, we wouldn't hesitate to close the idea should it breach the triple-digit mark, the high end of the valuation range.

Image Source: Avalara

Name of Beneficial Owner	Total Shares Beneficially Owned Shares	%
Named Executive Officers and Directors:		
Scott McFarlane (1)	2,220,074	3.1%
William Ingram (2)	477,362	*
Alesia Pinney (3)	43,175	*
Marion Foote	530,812	*
Edward Gilhuly (4)	10,266,865	14.7%
Benjamin Goux (5)	55,759	*
Tami Reller	65,533	*
Justin Sadrian (6)	40,000	*
Rajeev Singh	20,000	*
Chelsea Stoner	47,824	*
Gary Waterman	1,436,344	2.1%
Kathleen Zwickert	—	—
All executive officers and directors as a group (13 persons) (7)	15,203,748	21.1%
5% Shareholders:		
Entities associated with Battery Ventures IX, L.P. (8)	5,115,095	7.3%
Entities associated with Sageview Capital Master, L.P. (4)	10,266,865	14.7%
Entities associated with Warburg Pincus & Co. (9)	9,259,989	13.2%



LendingTree Inc (TREE)

"The capacity constraint really only applies to our mortgage business but it is a constraint to grow in the current environment. For context, our volume of mortgage inquiries in Q2 was up more than 40% over just the first quarter. But our average revenue per lead declined 16% because existing lender capacity simply couldn't support the surge in volume. So one option for us would have been to simply pull back on marketing to preserve margin and you have seen us do that before." – Doug Lebda, CEO of LendingTree, during the company's second quarter 2019 conference call

Thesis

The September 2019 Exclusive Short Idea is loan matchmaking company LendingTree Inc (TREE). **While this isn't a "bad" company per se, we think the epic rally in LendingTree's share price is now way overdone.** As of this writing, LendingTree's market capitalization stands at ~$4 billion after shares of TREE increased 10-fold since 2014. The firm does not pay out a common dividend. Back in June 2014, the company rebranded its marketplace platform from Tree.com to My LendingTree, which heralded in a period of impressive growth. That being said when using the company's free cash flows in 2018 as a baseline, one would need to assume LendingTree would grow by 7-8% into perpetuity in order to justify its current valuation. **Furthermore, its net debt load stood at over $0.3 billion as of the end of June 2019.**

One of the reasons behind the rally in TREE is due to LendingTree's net operating cash flows roughly doubling from $64 million in 2016 to $124 million in 2018. **However, that growth needs to be put into perspective as part of that trajectory is built upon LendingTree leaning on non-cash compensation expenses to reduce its reported cash costs.**

Corporate Profile

LendingTree Inc (TREE) is a loan matchmaking company that operates branded online marketplaces which connect consumers with third-party financial institutions. Through its marketplaces, consumers can compare different offers for mortgages, student loans, insurance products and more from over 550 of LendingTree's Network Partners. LendingTree aims to provide consumers with multiple options, and the company receives match fees from its Network Partners along with other forms of revenue. LendingTree was founded in 1996 and launched nationwide in 1998.

Key Statistics	
Last Close	$309.02
52-Week Range	$183.25 - $434.94
Market Cap	$4.1B
Revenue TTM	$941M
Dividend Yield TTM	N.A.
Total Asssets LFQ	$981M
Total Debt LFQ	$378M
Total Cash LFQ	$51M

From 2016 to 2018, the company's annual non-cash compensation expense grew from $10 million to $44 million (for reference, G&A expenses grew from $37 million to $101 million over this period), leading to material shareholder dilution. **The firm's diluted outstanding share count grew by over 10% from 2016 to 2018, even though LendingTree spent $114 million buying back stock in 2017 and 2018 combined (on top of $49 million in stock repurchases in 2016).** While LendingTree is very free cash flow positive considering its capital expenditures averaged $18 million from 2016 to 2018, coming in at $15 million last year, we caution that its cash flow profile appears stronger at first glance than it really is.

Image Source: LendingTree – 2018 Annual Report

NOTE 10—SHAREHOLDERS' EQUITY

Basic and diluted net income per share was determined based on the following share data *(in thousands)*:

	Year Ended December 31,		
	2018	2017	2016
Weighted average basic common shares	12,504	11,945	11,812
Effect of stock options	1,043	1,626	886
Effect of dilutive share awards	153	111	75
Effect of Convertible Senior Notes and warrants	397	—	—
Weighted average diluted common shares	14,097	13,682	12,773

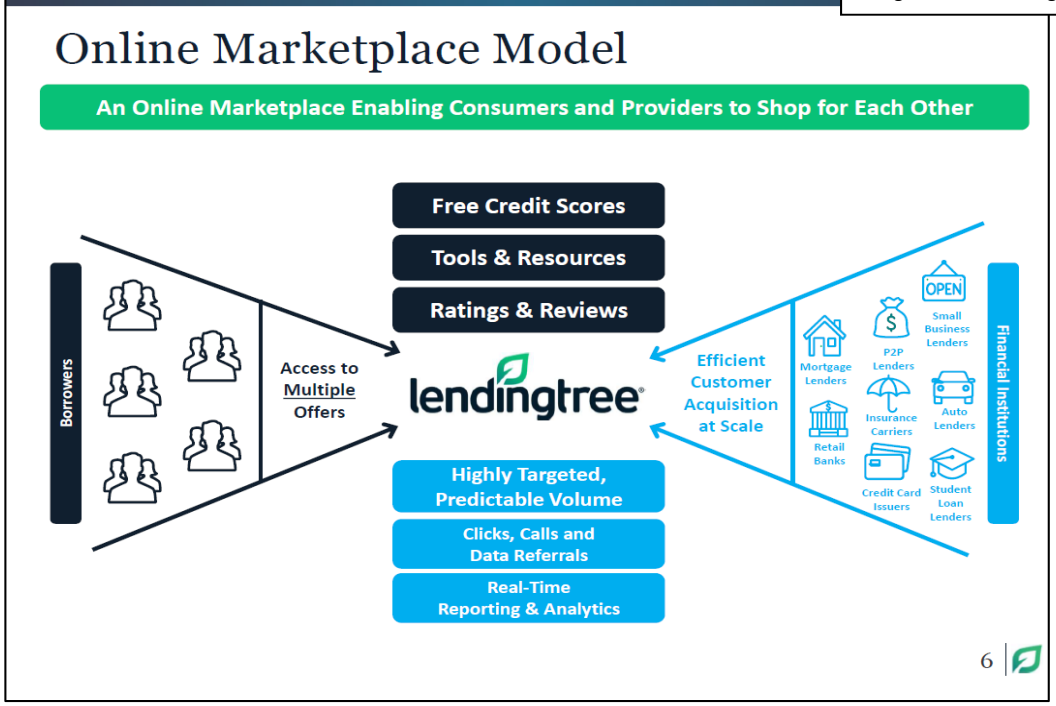
Non-cash compensation related to equity awards is included in the following line items in the accompanying consolidated statements of operations and comprehensive income *(in thousands)*:

	Year Ended December 31,		
	2018	2017	2016
Cost of revenue	$ 378	$ 175	$ 129
Selling and marketing expense	3,568	3,973	2,722
General and administrative expense	34,325	16,874	4,699
Product development	6,094	2,339	2,097
Total non-cash compensation	**$ 44,365**	**$ 23,361**	**$ 9,647**

Image Source: LendingTree – 2018 Annual Report

What's also important is keeping in mind LendingTree's ever growing need to advertise. The company's selling and marketing expenses roughly doubled from 2016 to 2018, hitting $0.5 billion last year, which played a key role in more than doubling its total GAAP operating expenses during this period (which totaled $0.7 billion in 2018). **Operating expense growth outpaced LendingTree's GAAP revenue growth during this period (revenue almost doubled, hitting ~$0.75 billion in 2018), leading to the firm's GAAP operating margin contracting by over 620 basis points to 7.35% in 2018.** Here we would like to highlight that while LendingTree's revenue almost doubled from 2016 to 2018, its GAAP operating income moved up by just 8%. That isn't the type of growth that merits LendingTree's high valuation, in our view.

Image Source: LendingTree – IR Presentation



LendingTree has been on quite the acquisitive streak acquiring numerous companies including QuoteWizard, SnapCap, CompareCards, and others from 2016 to 2018. These acquisitions further obfuscate the true nature of LendingTree's strong top-line growth. QuoteWizard, an online insurance comparison marketplace, was acquired late last year for ~$0.3 billion in cash and we caution that roughly three-fifths of that asset is represented by goodwill on LendingTree's balance sheet (as of the end of 2018). In the middle of last year, LendingTree acquired Student Loan Hero (a financial website for student loan borrowers) and Ovation Credit Services (a credit service for consumers) for roughly $0.1 billion in cash combined. Just like with QuoteWizard, most of the value of those acquisitions are reflected as goodwill on LendingTree's balance sheet as of the end of 2018. **As these are tech-related investments it makes sense that most of the value of the acquired assets are reflected as goodwill, however, we caution that if these acquisitions don't pan out as planned, then LendingTree will have little to show for it.**

While bulking up its branded marketplace offerings and expanding its partnerships with financial institutions provides for a stronger qualitative moat, we don't see its business model as particularly hard to replicate. LendingTree is a middleman, connecting potential borrowers with potential creditors and collecting fees for doing so. The firm also occasionally earns other types of revenue, such as closed sale fees (specifically for business outside of the mortgage and insurance space) and by collecting front-end fees by connecting consumers to its Network Partners (financial institutions that work with LendingTree) via website clicks.

This is the type of business that could easily be replicated by any of the tech giants including Amazon Inc (AMZN) and Facebook Inc (FB). Keep in mind those tech giants could charge far lower matching fees than LendingTree while also spending relatively less on marketing considering those companies can leverage existing web traffic (Amazon could add a loan matchmaking section to its e-commerce website or Facebook could tie in such a service in conjunction with its Libra offering) to drum up interest. These are illustrative examples to highlight a bigger point, LendingTree has no real qualitative moat. Management touts LendingTree's existing relationships with financial institutions as a moat, but those are relationships that could easily be replaced. Both Amazon (through its credit card partnership with JP Morgan (JPM)) and Facebook (through its nascent Libra program) already have their own partnerships with financial institutions and carry a lot more clout that LendingTree.

We would like to stress that LendingTree isn't in bad financial standing, its net debt load is very manageable and its free cash flows are strong. Setting dilution, margin contraction, and acquisitive history issues aside of a moment, LendingTree isn't in dire straits by any means. **Our concern regarding the lofty valuation of the company's equity given that LendingTree's business model appears easy to replicate, we are late in the business cycle, and the firm's aggressive selling and marketing spend is consuming most of its incremental revenue growth.** Rising non-cash compensation expenses are to be expected for a growing company, but the dilution is so aggressive that LendingTree's share repurchases have only partially mitigated some of the damage from stock-based compensation. Keeping in mind LendingTree does not pay out a dividend at this time.

During the second quarter of this year, LendingTree decreased full-year EBITDA guidance for 2019 due to margin pressure, weaker than expected mortgage product performance, and a slowdown at its personal loan products business. Conversely, the company increased its full-year revenue outlook for 2019 as LendingTree steals market share in lower margin parts of the loan and financial product matchmaking space.

NOTE 3—REVENUE

Revenue is as follows *(in thousands)*:

	Year Ended December 31,		
	2018	2017	2016
Revenue:			
Mortgage products	$ 242,175	$ 275,910	$ 219,991
Non-mortgage products			
Credit cards	165,776	147,028	39,434
Personal loans	134,199	88,244	66,457
Other	222,715	106,554	58,520
Total non-mortgage products	522,690	341,826	164,411
Total revenue	**$ 764,865**	**$ 617,736**	**$ 384,402**

Image Source: LendingTree – 2018 Annual Report

LendingTree now receives the majority of its revenue from non-mortgage products. **Please keep in mind that a large chunk of the revenue growth LendingTree has generated over the past few fiscal years has come from the company expanding into lower margin businesses through the aforementioned acquisitions.** Growth at its higher margin mortgage products business has been modest and uneven over the past few fiscal years as you can see in the graphic at the top of this page.

When management raised top-line growth for 2019 but lowered LendingTree's expected EBITDA generation, investors began to realize that the firm's growth trajectory isn't nearly as lucrative as once thought. Lower interest rates will help drum up business at LendingTree's mortgage products business, assuming the Federal Reserves cuts rates further during the upcoming FOMC meeting on September 17 – 18, but that can only do so much. Mortgage rates are already quite low. Weakness at its personal loans segment indicates its push outside of the mortgage space is running into problems.

At the start of 2019, LendingTree acquired Value Holding Inc for ~$0.1 billion in cash (the majority of which is reflected as goodwill on the balance sheet as of the end of June 2019). Value Holding is the parent company of Value Penguin, a personal finance website. LendingTree's acquisitive streak shows no signs of ending. By building up a suite of personal finance websites, branded online comparison marketplaces, consumer credit services, and related online offerings LendingTree is attempting to build up a moat around its business. We aren't convinced.

Considering LendingTree's market capitalization stands at ~$4 billion as of this writing, we think there's a lot of room for shares of TREE to move lower. **LendingTree's weak second quarter 2019 earnings report will likely be one of many and that should continue prompting investors to ratchet down their lofty growth expectations given the building pressures on the firm's margins and the lack of a long-term moat to keep giants like Amazon or Facebook away.** Aggressive dilution will further compound LendingTree's valuation problem.

Disclosure: *Callum Turcan does not own any of the securities mentioned in the article above.*

Inaugural Letter to Members

July 1, 2016

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your

personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

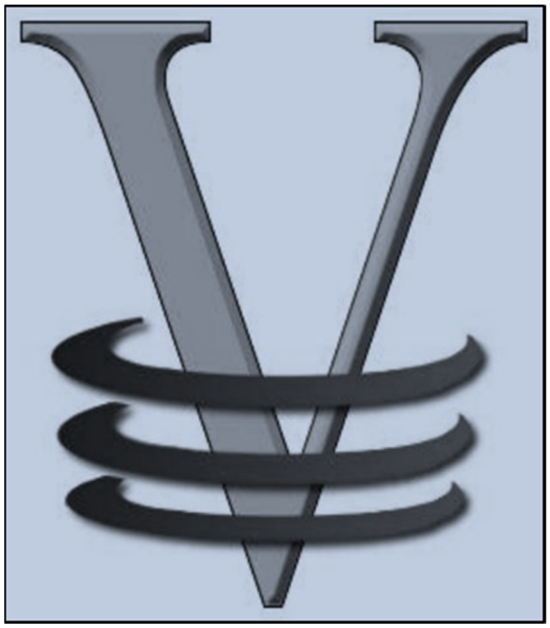
Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

Brian Nelson, CFA
President, Investment Research & Analysis
Valuentum Securities, Inc.
brian@valuentum.com



P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

The Nelson Exclusive: Volume 4, Issue 9

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(1) From the SEC's website: A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

Short selling is not for all types of investors, and readers should consult their personal financial advisor that understands their individual goals and risk tolerances before considering any investment or any strategy. Potential losses for an investor engaging in a short selling strategy are theoretically infinite.

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