

BROXTON

CAPITAL ADVISORS

December 2017 Trading Procedure Update

SUMMARY



As of December 1, 2017

Enhanced investment process
with the goal of increasing return.

Modified existing model and process

SUMMARY

Results:

Trade selection using the modifications returning over 25% annualized as of December 1, 2017

Note: Not altering the deep fundamental analysis with value as the central investment catalyst.

Increasing agility
Aligning investment timing with market sentiment

CURRENT PROCESS

- Use 4-5 independent mathematical appraisal methodologies combined with cash flow analysis to arrive at current and future valuations for securities.
- Most attractive securities trading at 3-5 X gross income.
- Ignore market sentiment and focus solely on financial results of the company to gauge performance and target outsized gains.
- Focus solely on the 12 month + time horizon of individual companies, ignore opportunities at the industry level and short-term opportunities.
- If successful, security behaves as predicted because other participants make decisions based on financial results.

CURRENT MARKET CONSIDERATIONS

- Some securities experience dramatic improvement in fundamentals but do not increase in price.
- Securities price action driven increasingly by sentiment or popular perception. Need to accommodate and consider different groups (machines or people) that affect securities pricing before purchasing.
- Short-term opportunities are available that can create capital gain.
- Social media can propagate and solidify perceptions, that may be incorrect, but remain firmly in place.
- Other participants are not making decisions based solely on financial results.
- Gains are being captured at the industry level using industry centric ETFs

MODIFICATIONS

- Place the highest priority on aligning value purchases or sales with market sentiment or changes in market sentiment.
- Create a broader basket of possible selections, including industry centric ETFs in order to increase opportunities.
- Reduce position size as a percentage of volume in order to create agility.
- Allow for shorter-term trading strategies.
- **Not Modifying:** Value strategy; Still Use 4-5 independent mathematical appraisal methodologies combined with cash flow analysis to identify value.

EXAMPLE

In June of 2017, investors believe that the Kroger grocery chain is under siege from Amazon.com and the shares trade down 35%. Amazon is not a problem, but this perception helps drive the shares lower. In October, the company releases a 94 page presentation explaining how it will enhance its' electronic media strategies helping to change perception. This provides an entry point for the purchase of shares. After posting results that advance year-over-year, the shares begin to advance.



EXAMPLES IN THE CURRENT BASKET

Gamestop (GME) Gamestop operates over 7,000 video game stores world-wide. The shares became heavily shorted on the perception that games would become downloaded instead of purchased. GME is switching its strategy to incorporate collectibles, Apple products and cell phone stores which is progressing nicely. The shares are heavily shorted and trade at a price to earnings ratio of less than 6 and have an 8% dividend. After reporting an advance in store sales, for the third quarter the shares have begun to lift off demonstrating a turn in sentiment. Using the new strategy we believe the shares would be timely at slightly lower prices but we are also willing to enter a position if the shares show increased positive sentiment from investors.

Energy Transfer Partners (ETP) ETP operates numerous gas and oil pipelines. The company committed to a number of large number of projects previous to

the oil downturn in 2014. In order to fund the projects, pay dividends and accomplish other goals, the company has engaged in numerous financings including share sales. In addition, there have been concerns raised that the new tax bill will affect the company which is a master limited partnership. Investors would also prefer a lower dividend to financial instability. Although the gross income is increasing and the company is rated investment grade, the shares have dropped 40% from the 2017 high, raising the dividend yield to 13%. As the cash flow is increasing and the majority of the projects will be completed by July of 2018 we are evaluating the shares for evidence of a perception change.

Qudian (QD) The fast growing Chinese lender's shares immediately spiked to \$35 after its' November IPO. The shares sank back to \$12 on news

that micro loans would be limited to an annualized rate of 24% including fees. Although lower than the 36% top that the company was able to charge, the adjustment would have the effect of reducing 2017 earnings from the \$1.10 area to about 58 cents. We have been watching the company due to the 200% growth in year-over-year revenues and do not think that the interest rate reduction will affect growth in consumer loans. Based on the new rates QD is trading at 10-12 X 2018 earnings and investor sentiment may improve since the news is out. The shares will most likely bottom out in this area in the next few weeks.

CONCLUSION



The Enhanced investment process is resulting in early improvements

We will continue to base new investments on this criteria and improve the investment process