January 2018

As we embark on a new year, we continue our daily routine of searching for value while attempting to avoid unnecessary risks. Our strategy is grounded in the view that recent trends, even those that deviate sharply from history, weigh heavily on how securities are priced. Excitement over expensive stocks with strong recent price momentum creates opportunities to invest in ignored or out-of-favor stocks at discounts to intrinsic value. Long-term prospects for these companies are often favorable, particularly for those with entrenched competitive positions and good balance sheets. By investing with a long time horizon in stocks that exhibit these attributes, we should be the beneficiaries of mean regression, which Nobel Laureate Daniel Kahneman described as "a statistical fact as common as the air we breathe." The concept allows us to profit on the future without undertaking the notoriously inaccurate science of economic prediction.

We remain disciplined in our investment process and stock selection criteria, particularly given potential market risks, including a prolonged period of low interest rates and subdued volatility. We invested in four new securities in the second half of 2017, described in more detail below. By our assessment, the earning power of each company is not accurately reflected in recent earnings due to factors that are likely to fade in time. Negative sentiment magnifies this issue, leading to compelling investment opportunities, in our opinion.

New Investments

Schlumberger

Schlumberger (SLB) is the world's largest oilfield services company. With operations in over 85 countries, about 80% of revenues are generated outside the United States. Schlumberger protects its market position by investing more in research and engineering than any of its competitors. The company maintains the industry's largest patent portfolio.

Profits are depressed due to the industry's underinvestment in oil and gas exploration. Global oil discoveries fell to 2.4 billion barrels in 2016, 73% below the average of 9 billion barrels per year over the last 15 years. There's basically no investment occurring offshore, where one-third of global supply is produced. The lack of investment in such a critical component of supply cannot be overcome by US shale, which currently accounts for just 6% of global production. We believe Schlumberger's "backlog" of future revenue rises as the industry prolongs its neglect of long-cycle projects such as deepwater exploration.

Despite difficult industry conditions, Schlumberger has continued to generate positive free cash flow. In fact, the company has generated positive free cash flow every year since at least 1971, a span that included six oil price corrections of at least 50%. Consistent cash flow has allowed the company to pay a dividend without interruption or reduction over those 46 years. Management recently stated that it expects to grow the dividend 15% annually for the next few years to make up for three years of no increase. It has grown the dividend at an average of 11% annually for the past decade. Growth of even half that over the next decade, assuming the dividend yield remains at the 3.1% reflected at our purchase price, would give shareholders a high-single-digit annual return. If dividend growth is in line with the last ten years, and if the yield reverts to the long-term average of 1.7%, shareholders would realize an annual return of over 20%. That's a very attractive range of outcomes for an industry leader.

Expedia

Expedia (EXPE) is the world's largest online travel agency (OTA) by bookings, and second largest by revenue to Priceline (PCLN). Expedia was spun out of Barry Diller's IAC/InterActiveCorp (IAC) in 2005. Diller remains Chairman and controls 54% of the voting shares. In addition to its namesake property, Expedia's major assets include direct booking sites Orbitz, Travelocity, Hotwire, and Hotels.com, and metasearch company trivago, which aggregates deals across various booking sites. The company also owns HomeAway, which includes VRBO and is the world's second largest vacation rental marketplace behind Airbnb.

Online bookings are capturing an ever-increasing share of the travel market. Online penetration is still below 50% globally, and Expedia's 13% global online share leaves plenty of opportunity for continued growth. According to travel industry research firm Phocuswright, OTAs have grown US hotel bookings at more than twice the rate of hotel industry revenue growth since 2012. Expedia's scale allows for considerable resources to feed marketing programs, robust technological infrastructure, and global call centers, all of which drive high volumes and conversions, giving Expedia leverage in its negotiations for inventory with travel partners. It's hard to beat Expedia on price because its room inventory is far greater than that of any individual hotel company.

The shares corrected about 25% in the second half of 2017, largely due to management's guidance for 2017 EBITDA growth of 7-8%, compared to average annual growth of 14% since 2010. The reduced guidance is primarily due to the migration of technology infrastructure to the cloud, an effort that will shave 4-5% off EBITDA growth this year, but should improve latency issues, increase data capacity, and lower capex requirements going forward. The company has ramped internal investments in the past that have led to variability in year-to-year results. We view these investments as supportive of long-term growth. Priceline's recent decision to reallocate its marketing budget away from metasearch platforms such as trivago will reduce EBITDA growth by another 2% relative to previous expectations. Priceline has made similar moves in the past, but ultimately returned to these platforms to drive growth.

Investors' reduced expectations increased the attractiveness of the shares. Despite growing third quarter 2017 revenues at 15% – that's 3x the rate of revenue growth for the S&P 500 – Expedia's shares trade at a cheaper multiple of revenue than the S&P 500. Even on a cash flow basis, with an EV / 2018 EBITDA ratio of 10x, Expedia is cheaper than every sector of the S&P 500 except the growth-challenged telecom group. Expedia's HomeAway business, which accounts for 10%

of the company's total revenue, grew third quarter revenue by 45%. Its primary competitor, Airbnb, last raised capital in March 2017 at roughly 8x revenue. That valuation reflects an industry with a long runway for growth, and supports the idea that Expedia, with an entrenched OTA business growing revenue at a low-double-digit rate, and a well-established platform in the burgeoning vacation rental market, is undervalued at approximately 1.7x 2018 revenue.

AmerisourceBergen

AmerisourceBergen (ABC) is the second largest pharmaceutical wholesaler in the United States. We believe drug distribution is a recession-resistant, toll-booth business with growth tailwinds for the next two decades as baby boomers continue to reach retirement age. Per capita, the 65+ population consumes more than twice the prescriptions as the rest of the adult population. Three companies – AmerisourceBergen, McKesson (MCK), and Cardinal Health (CAH) – account for about 90% of the country's drug distribution. Each of these distributors has long-term supply partnerships with large retailers. AmerisourceBergen is aligned with Walgreens Boots Alliance (WBA), which owns 25% of ABC stock. By sourcing drugs through WBA's buying consortium, which includes ABC and Express Scripts (ESRX), the country's largest pharmacy benefits manager (PBM), AmerisourceBergen has a cost advantage over new entrants. Its buying power and sophisticated logistics lowers costs through the value chain and fortifies its share of the market.

The shares have been under pressure over the last two years due to investor concerns over generic drug price declines, the role of distributors in the opioid crisis, and speculation that Amazon may begin competing in the wholesale market. Following a period of significant drug price inflation, distributors have more recently been faced with price deflation. ABC has managed continued earnings growth during this period, albeit at a slower pace. Because of growing demand for pharmaceuticals, we believe recent headwinds are cyclical rather than secular. Regarding the second investor concern, opioids are a subset of pain medication, which totals only about 4% of the dollar volume of annual prescriptions. ABC reports daily to the US Drug Enforcement Agency the quantity and details of every opioid order it ships. Litigation costs will likely fall on the broader industry, but we believe any potential expense borne by AmerisourceBergen will be manageable given its strong financial position.

As for the Amazon risk, the low-hanging fruit is the cash market, which is only 5% of total prescriptions. For Amazon to compete on a larger scale, it may need to acquire a large PBM or retailer to obtain the third-party payer component. We will be closely watching Amazon, but we believe it will be difficult for a new entrant to penetrate a heavily regulated industry where the largest participants represent well over $1 trillion of revenues and are intertwined through partnerships and consortiums.

At our purchase price, ABC shares were nearly 30% off their highs, and traded as cheap on an earnings basis relative to the market as they had in the last 15 years. Despite generating positive free cash flow year after year, the shares traded for a free cash flow yield of 9%. AmerisourceBergen's insulated position in a growth market, strong cash flow and balance sheet characteristics, and attractive valuation combine for what we view as a sensible long-term investment.

Barclays

Barclays (BCS) is a London-based commercial and investment bank with a focus on Europe and the United States. Its 328-year old commercial franchise is strong; half of the UK adult population have at least one Barclays product, and Barclays also has the leading credit card in Germany. Its investment banking franchise is mostly the legacy business of Lehman Brothers, which it acquired for $250 million in 2008 out of bankruptcy, thus avoiding liability for its toxic assets. Through the first half of 2017, Barclays' investment bank ranked #6 globally in fees earned.

Barclays' regulatory capital is healthy. Its tier 1 capital ratio of 15.4% is double its level of 7.8% in 2007. Its common equity tier 1 ratio of 13.1% is comparable to many global banks, all of which are required to carry far more equity capital than in the past as a regulatory reaction to the 2008 financial crisis. It was announced in November that Barclays passed the Bank of England's toughest stress test to date, which concluded the bank would survive a severe economic recession with 9.5% UK unemployment, a 33% drop in UK house prices, and a 50% fall in US stock prices. The European Central Bank's 2016 stress test also found that Barclays would survive a crisis.

The shares trade for about 60% of book value and 70% of tangible book value, roughly half the multiples of comparable US banks. Sentiment is negative due to litigation over deceptively sold mortgage-backed securities (MBS) and payment protection insurance (PPI), and uncertainty around Brexit. Regarding the MBS litigation, Barclays refused in late 2016 a $5 billon (£3.8 billion) settlement offer from the US Department of Justice. Barclays is the only major bank that has not yet settled. It was a relatively small participant in the US mortgage mess, having originated $47 billion of MBS from 2005-2007, compared to $618 billion and $532 billion for JPMorgan and Bank of America Merrill Lynch, respectively. As for PPI, Barclays has already accrued £9 billion against this liability. It was the third largest writer behind Lloyds Banking Group and Royal Bank of Scotland. That claims peaked in 2011, and must be submitted by August 2019 per Britain's Financial Conduct Authority (FCA), tightens the range of possible outcomes.

The top end of our loss assumptions from the PPI and MBS liabilities would reduce Barclays' common equity tier 1 ratio by two percentage points over the next two years. These losses should be fully offset by the company's internally generated capital, after paying the dividend, assuming an average return on tangible equity of 9%. Resolution of these issues over the next couple of years should alleviate pressure on the shares. Further upside is possible if volatility, interest rates, and regulatory costs return closer to historical norms.

While the impact of Brexit will depend on several factors, including whether the UK maintains access to the EU's Single Market, Brexit will likely cause Barclays' expenses to rise temporarily as the company re-domiciles certain of its operations. Barclays' commercial bank pre-dates the UK's affiliation with the EU's predecessor organization by 284 years. We think it will adapt to its new environment.

We look forward to updating you on the portfolio mid-year. As always, please feel free to contact us with any questions.

Sweetbay Capital Management

Important Disclosures:

The views expressed are those of Sweetbay Capital Management, LLC as of January 2018, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security. While the information presented herein is believed to be reliable, no representation or warranty is made concerning its accuracy.

Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. The New Investments section describes the new securities in which we initiated discretionary positions during the referenced six-month period. Every security may not have been purchased for each client based on the timing of a particular account opening, or based on assessed needs of a particular account.

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended by the adviser) will be profitable or equal to past performance levels.