Hidden Value Stocks
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From ValueWalk

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Noland Langford of Left Brain Capital

Noland Langford is the portfolio manager of the Left Brain Capital Appreciation Fund (LBCA). LBCA has only been around for two-and-a-half years, but it has already made a name for itself.

It was featured as one of Prequin's 'Top Performing Hedge Funds' for 2017 and was shortlisted at the US Hedge Fund Performance Awards as the 'Best Newcomer' for the same year.

In its first year, LBCA produced a return of 134% for investors, and since inception, the fund has returned 290%, compared to the S&P 500's gain of 32% over the same period.

The Left Brain Capital Appreciation Fund is targeting an annual return of 17%. This seems like a very high target but you've already smashed your goal for the first two years. My first question has two parts. Firstly, why did you decide on this target in the first place and secondly, what made you think you could achieve it?

We knew that it was an ambitious target, but we had full confidence that we could achieve it because we were giving ourselves the flexibility to go where the returns were.

As we were formulating the strategy, we knew that we wanted to avoid being trapped in a style box. A lot of funds miss out on opportunities when they're labeled as value, growth, small-cap fund and all of the buying opportunities are in emerging markets or credit. We felt that if we focused on a targeted return instead of a style box, it would make us really look hard at the long-term upside potential of the securities we looked at.

The 17% number felt right from a marketing standpoint as well as an investment standpoint. If we could produce 17% returns, net of fees, we could return $5 million to investors for every $1 million they invested after 10 years. A 5x return over 10 years in a simple figure that sticks easily with any investor. But make no mistake, we knew that with the right strategy, this number was feasible.

A gain of 134% in your first year is nothing short of outstanding. Why do you believe Left Brain has been able to succeed where others have failed?

The fund launched at an opportune time. The start of 2016 was one of the worst starts to a market year on record. But with discord came buying opportunity. And that's where the flexibility in our fund's mandate was ideal.

With oil falling to under $30 a barrel and the systemic risk-off mentality, there was a lot of distress in the high-yield bond market. We knew that many of these companies were financially sound and that the price was well disconnected from the actual level of risk. In many cases, we bought bonds at 60-70 cents on the dollar for companies still making timely interest payments. This meant that we were locking in yield-to-maturities of 18%-20%. We knew this was a rare opportunity, so we went in as hard as we could. Our call was well rewarded by the end of 2016 when the market normalized and prices jumped back up closer to fair value.

What makes you think the firm can continue to compound at the targeted rate?

We've had some very exceptional months along the way. We tell our investors that no one can ever expect these things to happen all the time. That said, we feel very good about our ability to continue our outperformance in the future.

We've been managing investment accounts for a long time through our RIA arm, applying many of the same strategies. The result has been very strong. And our capabilities have only grown over time. When we first started, it was just me, our proprietary security evaluation platform (Jarvis), and a desk full of annual reports. Now, I have a deeper research team helping me find even more opportunities in a challenging market.

We've also grown confident through our performance in recent months. When the stock market plunged, we were able to remain pretty resilient. We don't necessarily focus on protecting downside risk, but our individual positions are strong enough to stand tall when the markets buckle typically. If we can continue this, there isn't any reason we can't move in an upward trajectory.

Finally, our strategies continue to evolve as we grow. Our smaller size enables us to target securities that large funds overlook because they wouldn't be able to take large enough positions. The ability to concentrate our capital in a few good ideas has added to our performance and our risk metrics in a significant way.

How do you go about selecting assets to buy? Can you give us some insight into your process?

At the end of every week, we rank about 900 securities that we track. We then upload that file to Jarvis. Jarvis narrows this down, based on proprietary factors. That usually gives us a list of up to a dozen ideas to evaluate.

When we like a company, we don't just automatically go for the stock. We look across the entire capital structure to see if there are more attractive entry points. These can include bonds, preferred stock, etc. Often, we find additional opportunities that present higher upside value.

A security needs to be attractive on multiple fronts before we decide to buy. It needs to be fundamentally attractive, have solid technicals and meet some quantitative measures that we think will allow it to outperform.

We run a focused, concentrated fund of 25-30 names in the equity book and fewer in the bond book. We want to fill our portfolio with only the most attractive securities.

A high allocation to bonds, more specifically Valeant bonds has certainly helped performance. Can you tell us about your fixed income strategy?

Most of the market spends their time on investment-grade bonds (BBB or above).

But there are many well-known, very strong companies that sit below that rating. We aren't necessarily a high-yield shop, but we're more than happy to go after quality companies that the rest of the markets mistakenly overlook.

There are very few mispriced investment- grade bonds, but you can find a lot of attractive opportunities in high-yield because the pool of potential buyers is smaller. Also, bonds are still traded manually. The pricing discrepancies are a lot more common, opening up a lot more opportunity.

Valeant was a bold call. We started building our position after the bulk of the bad news came out and the stock fell to $8. Why were we so confident about such a beaten name? Because we liked the new CEO, Joe Papa, and his message about making debt reduction the company's top priority.

Bonds were trading at 70-75 cents on the dollar. At that price, the yield-to-maturity was over 10%. We had done our research and knew that their Bausch & Lomb arm was a very stable franchise that also made up over 50% of Valeant's business. With this and the deleveraging, we assessed that the upside was 50% if we were right and that the downside was 10% if we were wrong.

A lot of potential for relatively low risk – hence why we put a lot into this position, which paid off.

As interest rates rise, high-yields and Treasuries will be negatively impacted. But, high-yield bonds tend to do well here for two reasons. First, the higher coupon helps insulate holders from rising rates. Second, interest rate rises are reflective of improving economic conditions. This means that companies are in a better position to pay down debt, raising the likelihood of credit rating upgrades.

High-yield bonds are much more sensitive to economic conditions than interest rate hikes. Thus, the high-yield markets are a fruitful place for investors to seek returns.

What's your largest equity position today and why do you like it so much?

Netflix (NFLX) is our largest equity position at the moment. It's been a favorite of the market for quite some time – we like it for a lot of different reasons. The potential for revenue growth is high: Netflix has 120 million subscribers, paying an average monthly rate of $10. The pricing power is under appreciated.

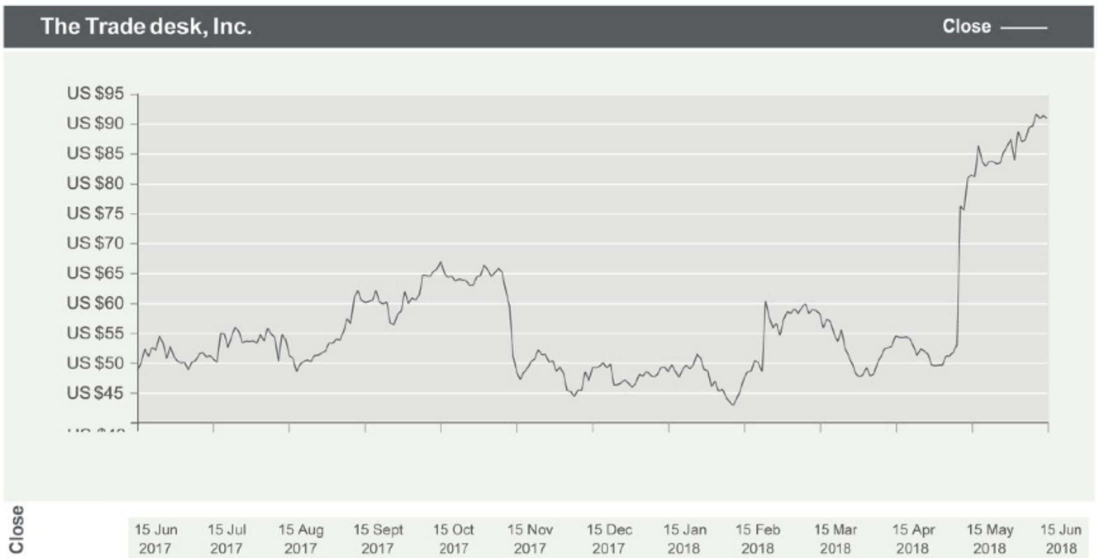
We think they could raise prices 10 times (i.e., 10 one-time increases of $1) before they see significant churn. For every $1 that Netflix increases its subscription price, that's $1.5 billion that's added to the bottom line annually (120 million x $1 x 12 months).

If you put a conservative 20 P/E ratio on those earnings, you get $30 billion in increased market value with every $1 increase.

Do you have another idea that most investors haven't heard of?

The Trade Desk (TTD) is a name that most investors haven't heard of. We highlighted the company at our October 2017 RIA client event. The shares are up 90% year-to-date. Most of the appreciation came after their 1st Quarter earnings release last month.

The Trade Desk operates a platform for programmatic advertising. Advertisers desire to place their product/service in front of potential customers. They also want to track who's watching, when they're watching and whose responding so that they can spend their ad dollars effectively. Advertisers also want to target, and segment who their message goes to. And, they want to do that across various mediums: TV, radio, the internet, etc. Trade Desk's platform allows them to do just that. And, they are not affiliated with any of the ad agencies so that advertisers can trust the platform because The Trade Desk is independent with no ad inventory to sell. And, they provide analytics for decision making.



Share Information June 15, 2018

Market Cap. $3.8bn	**P/E (f)** 42.1	**EV/EBITDA (f)** 42.8	**Dividend Yield (ttm)** N/A
Average Daily Volume 1,236,189	**P/B (ttm)** 14.4	**ROIC (ttm)** 25%	**Debt to Assets (ttm)** - 420%

What we really like is the Trade Desk is already profitable. Q1's revenue growth was 100%, and it produced EBITDA of $6.3 million and GAAP net income of $9.1 million. It's rare for a small high growth company to be showing positive net earnings in the hyper-growth stage. They are normally plowing all of their revenues back into their business to support their growth. And, with a market cap approaching $4 billion, uncontested leadership in the high growth programmatic industry with a total addressable market of $650 billion, we think the shares have a lot of headroom in the years ahead.