JDP

CAPITAL MANAGEMENT

2017 Annual Partnership Letter

2017 ANNUAL PARTNERSHIP LETTER

(edited for SEC compliance, 2024)

Dear Partner,

Two Thousand Seventeen was another transformational year of growth for our partnership. We strengthened the investment process, expanded our back-office infrastructure, and most importantly, earned an unleveraged return that exceeded the underlying business risk taken in our portfolio.

The Partnership gained 18.54% in 2017 net of all fees while the S&P returned 21.8% including dividends.

Our capital base grew by 70% from this time last year. Although this progress is exciting we are far from reaching the capacity of our strategy and could put much more capital to work without rocking the boat.

On that note I want to welcome our first European investors and mention the opportunity we have to strengthen our capital base in Europe. Sub-institutional sized funds with established track records like ours are less common in Europe due to regulatory barriers and high ongoing fixed costs.

JDP has structural advantages over the traditional financial institutions and large hedge funds where mega-asset sizes can restrict the investable universe. We are delighted to be able to offer an alternative for like-minded families as long as we are accepting new capital.

MONEY DOES NOT COMPOUND IN A STRAIGHT LINE

Our goal continues to be to generate compounded returns that beat what could be earned in passive index over a multi-decade period. To achieve this we use the public markets to gain access to superior businesses, management teams and inefficiencies that would not be available otherwise.

It is common for investments to initially lag the broader market in the early years of our ownership or show a paper loss. An infrequently traded portfolio almost guarantees we will trail the market in some years and widely outperform in others.

This contrarian approach, along with a carefully cultivated capital base, allows us to be picky and only consider businesses selling for meaningful discounts to intrinsic value that are in the process of being repositioned for transformative growth.

One example is our recently existed position in Bank of America “B” TARP warrants which we sold for a multi-bagger return after four years of ownership.

In 2013, Bank of America was still trading for a distressed valuation despite having moved far past the financial crisis-era. At times it felt like we could not have found a more hated and lonely idea. As call options on the underlying BAC stock, the A and B TARP warrants were not only

more mispriced than the stock but also uninventable for large funds or institutions with limitations on liquidity and volatility. I discussed our thesis in the 2014 annual letter and followed up in subsequent letters, so I won't rehash it again here.

Our profit on the BAC warrants came in the fourth year of our investment after *terribly lagging* the market for the first three years. At one point the Bs were down 90% and climbed back to help drive the bulk of our 2017 gains and making up for underperformance of other positions.

We still own the A warrants but sold the Bs because the combination had become an outsized percentage of the portfolio.

THE MARKET

Over our 7-year history we have experienced big shifts in what is required for a business to sustain a competitive advantage. Our thinking has evolved as well, but our core principles remain the same.

The pace at which technology is consolidating productivity is happening faster than at any time in history. The rising bifurcation between companies experiencing outsized growth at the expense of their old-economy peers is confusing to markets.

An earnings stream of an asset light business growing 30% annually is worth much more than a mature business growing at 3%. Investors are not used to seeing large-cap US tech companies growing 5- or 10-times GDP with stock prices that seem to always be playing catch up. Correctly underwriting a stocks' secular tailwind is becoming a more important factor in assessing margin of safety than traditional financial metrics.

EXAMPLE INVESTMENT—RIB SOFTWARE (FRA:RIB)

We see opportunity in discovering companies with a mature profile that are repositioning their business model to thrive in the future. This is often enabled by technological change, societal shifts, strategic partnerships or unusual capital allocation.

One example of this is RIB Software in Stuttgart, Germany. RIB is a software and consulting business in the European construction industry that we think is in the early innings of repositioning for growth. JDP built a position at an average cost of €16 per share.

RIB combines the stability of reoccurring software revenue with the opportunity to disrupt the European construction management industry which is ripe for change. With an EV of €500 million trading for 12x EBITDA and no debt, RIB's growth prospects do not seem to be priced in the stock. RIB is led by CEO Thomas Wolf who owns 18.5% of the company which represents the majority of his family's net worth.

RIB was founded in the 1960s as a consulting firm for the German construction industry. In the early 1970s RIB developed construction budget and tender process software. Until recently construction software was highly fragmented, under-developed, under-utilized and controlled by regional consulting companies or developed in-house by the largest firms. This explains why

RIB was able to maintain a dominant position within European construction IT services as a small company.

Today RIB finds itself at the center of a sector dash to modernize the $9 trillion construction industry[1]. IT spending only represents 1% of industry spend or $90 billion globally[2].

More recently RIB has formed partnerships with Microsoft, Flex Ltd., and Autodesk to integrate RIB features into their own construction process software. We believe one or more of these partnerships could be worth multiples of a standalone RIB someday.

As an example, the "MTWO" deal with Microsoft will combine RIB's iTWO 4.0 with Office 365 and SQL Database for an annual fee of $2,000 (SaaS) on the Azure platform. RIB management estimates the global market has 20 million potential users including architects, engineers, and sub-contractors. Management is targeting 100,000 RIB software users by 2020 and 10 million by 2022. Microsoft and RIB will each invest $100 million that will support a full-time development team. The venture will also receive a sizable percentage of Microsoft's annual marketing budget to fund the rollout.[3]

EXITING CARROLS RESTURANTS (NASDAQ: TAST)

TAST is the largest franchisee of Burger King restaurants in North America with 800 stores. What makes this franchisee unique is that it is 23% owned by Burger King's parent company Restaurant Brands International (NYSE: QSR).[4]

We invested in TAST in May 2014 after it had been re-capitalized by QSR in an effort to consolidate the fragmented US restaurant base and fund the remodeling of old stores. As part of the re-capitalization transaction, TAST received the right-of-first refusal from QSR to bid on *every* franchisee sale within 20 Eastern states and is preapproved to own 2,000 restaurants (150% more than today). This "golden child" advantage gives TAST the opportunity to grow much faster than underlying restaurant sales.

After initially moving quickly acquire other franchisees at low valuations, TAST management turned conservative leaving investors holding a low-growth business overly exposed to commodity costs, labor inflation and growing debt. We loved TAST's initial acquisition strategy because they were reportedly paying low-single digit multiples on owner free cash flow for mom-and-pop stores.

By becoming less aggressive in their roll-up strategy TAST has ceded transactions to private equity buyers and eroded future earning power. After doing some digging, we think management might be under pressure from other shareholders to pause M&A out of concern that TAST's balance sheet is becoming overleveraged. While we sympathize with being cautious, the long term risk of not reaching full scale potential as the Burger King brand is becoming more valuable might be greater than trying to please passive shareholders today.

[1] Company documents, sector research, JDP estimates
[2] Company documents, sector research, JDP estimates
[3] RIB management presentation
[4] Company documents, sector research, JDP estimates

SELECTED PORTFOLIO UPDATE

TerraForm Power (NASDAQ: TERP) 40% total return since initiation

The Partnership started buying TERP in April 2016 when its parent company SunEdison was in bankruptcy. Our average cost is around $10 per share and we have received $2.13 in dividends including a special dividend related to the Brookfield transaction. The current 6.8% dividend is nice, but our focus is the long-term compounder potential of the stock.

TerraForm is an exciting investment because it combines a balance sheet priced well below breakup value, a business model protected by enormous barriers to entry, and 100% upside potential based on our 2018 cash flow projections. Brookfield is positioning TERP to be an outsized beneficiary of long-term trends in the renewable power industry by leveraging its scale and an excellent record of capital allocation.

TERP is the largest pure-play publicly traded solar and wind (60%/40%) operator with 2,600 megawatts of utility scale power generation diversified among 500+ projects. All projects have investment-grade counterparties and a 15-year weighted average duration. The recently announced Saeta acquisition will add 1,000 megawatts in Spain with several large government power contracts with 20-year durations. For reference, Berkshire Hathaway Energy is the largest US player in regulated wind generation with 4,600 megawatts of renewable power *including* other renewables like natural gas.

In late October 2017, Brookfield Renewable Partners (NYSE: BEP) acquired 51% of TERP from SunEdison bondholders and Class A shareholders. "TERPfield" completed its first full reporting quarter in February 2018; the pace of progress has exceeded our expectations. Some of these developments include:

(1) New board and management team, no remaining reliance on SunEdison

(2) Refinanced 50% of its debt saving 30% in interest expense

(3) Set payout ratio of 80% - 85% of CAFD and 5% to 8% growth per year

(4) Announced merger with Saeta Yield, adding 24% to FCF per share and growing portfolio size by 40% (May 2018 close)

(5) Q1 2018 dividend of $0.19, $0.76 annual run rate, 6% increase over previous target

So, why does the market hate TERP?

"Let's just stop calling them YieldCos. We're trying to create a wind and solar powerhouse."
-Sachin Shaw, CEO Brookfield Renewable Partners (Jan 2018)

TERP is transforming from an abused YieldCo to a Brookfield platform incentivized by equity appreciation. Sell-side analysts dislike the stock because Brookfield's unorthodox *opportunistic-only* approach makes it difficult to predict acquisitions and strategic direction.

TERP was born from an industry model where a SponsorCo controls an independent YieldCo with the purpose of acquiring power projects developed by the Sponsor, after they are contracted by utilities. This relationship provides a predictable project pipeline for analysts that can be modeled and projected into the future. But the related-party nature of these transactions means that the YieldCo cannot be opportunistic and must accept whatever is in the SponsorCo's development pipeline (dropdowns). Projects must be sold fully valued at efficient multiples set by interest rates and competition from institutional investors.

Under Brookfield, TERP no longer has a project developer company as its controlling shareholder. Brookfield's approach to acquisitions is to focus on mispriced assets, generally entire companies (vs. individual projects) that can be acquired for material discounts to breakup value. This makes NewTERP less predictable for analysts to predict future growth.

As an example, TERP's recently announced acquisition of Saeta Yield in Spain was unexpected, but the price was about half of project breakup value. This discount was possible because TERP is buying the entire public company— well beyond the capability of a traditional YieldCo. We expect TERP to be able to repeat deals like this as the renewable power industry consolidates.

There are also macro concerns facing the industry including rising interest rates, new US tariffs on Chinese solar panels, and an expiring tax incentive for project construction that allowed for accelerated depreciation. However these headwinds will become tailwinds for the best capitalized players over time. The demand for renewables will continue growing, but with less competition. TERP is also positioned as a natural consolidator as utilities require larger and larger projects with guarantees to re-power old assets as PPA contracts rolls off.

The world is in the early stages of a multi-decade trend in a mandated conversion to wind and solar power. Rising utility demand will create a baseline for pricing. For example, New York State references a goal for three GWs of solar to be installed by 2023 (3X more than 2017). States like California and New York have stated goals of getting half their electricity from renewable resources by 2030 and others are following.

Today we think TERP is worth between $18 and $20 per share or ~100% upside including dividends. CAFD (cash available for distribution) should improve materially as future refinancing efforts get under way and Saeta is digested. Although EBITDA is our least favorite metric it acts as a lens to normalize earning power during this transitory time.

JDP model summary and estimates:

TERP 2018 VALUE, TAX-FREE CORP STRUCTURE					
	Full Year 2018E				
Equity Yield %	**8%**	**7%**	**6%**	**5%**	**4%**
Cash Available For Distribution (CAFD) Post Saeta Acquisition Close in May 2018	$190	$190	$190	$190	$190
Implied price per share	$12.8	$14.6	$17.1	$20.5	$25.6
Dividend per share/annualized	$0.76	$0.76	$0.76	$0.76	$0.76
Price + dividends	$13.6	$15.4	$17.9	$21.3	$26.4
Total gross return	26%	42%	65%	97%	144%

EV/EBITDA Multiple	**10x**	**11x**	**12x**	**13x**	**14x**
2018 EBITDA	$750M	$750M	$750M	$750M	$750M
Implied price per share	$12.50	$16.40	$20.40	$24.40	$28.30
Dividend per share/Year	$0.76	$0.76	$0.76	$0.76	$0.76
Price + dividends	$17.30	$21.30	$25.40	$29.40	$33.50
Total gross return	60%	97%	135%	172%	210%
Total Shares (millions)	185	185	185	185	185
Net Debt (billions)	$4.3	$4.3	$4.3	$4.3	$4.3
Dividend Payout Ratio	80%	80%	80%	80%	80%

New position: Teekay Offshore (NYSE: TOO) -2% return since initiation

The Partnership initiated an investment in Teekay Offshore (TOO) in August 2017 for $2.40 per share. TOO was recapitalized by Brookfield Business Partners (NYSE:BBU) in late September with an equity investment of $750 million at $2.50 per share. BBU is a subsidiary of Brookfield Asset Management (NYSE: BAM). Similar to TERP we were able to invest in TOO at a slightly better price than BBU and their institutional partners.

We see multi-bagger upside potential in TOO over time as BBU repositions its balance sheet and re-charters previously financially constrained vessels over the coming quarters.

TOO owns shuttle tankers and floating platforms called FPSOs that move oil between offshore rigs and the shore in the North Sea, Offshore Canada and Offshore Brazil. These mission-critical assets operate under multi-year fixed contacts with the largest E&P counterparties such as Shell, Petrobras and StatOil. TOO's business model is not levered to oil prices but instead to the life of an offshore well, generally 20+ years.

The company had become financially distressed in 2016 under an MLP-like structure that focused on maximizing dividend payouts and over-leveraging an otherwise very stable business. Our price, which is *pari passu* with BBU gives us a ~25% equity cash flow yield today, with growth that should occur once the balance sheet is further deleveraged.

We think TOO's current valuation is undervaluing BBU's controlling ownership and $6.5 billion in forward contracted revenue primarily financed by self-amortizing project debt. With an equity value of only $1 billion we do not need a macro view on oil and feel that our margin of safety is well covered. The previous shareholder base was MLP/dividend focused and has turned over since TOO temporarily stopped paying a dividend.

Last month Seth and I presented TOO at the MOI Global Best Ideas Conference 2018. The story is complex so we decided to focus on the company's asset quality, history of what caused the distress, and what Brookfield brings to the table as the new controlling shareholder.

Best Ideas 2018 Presentation: When 1 + 1 = TOO

NEWS & VIEWS

From time to time we are asked to present on general investing and finance topics to industry groups or students. Below are links to presentations we hosted last year. Seth and I also contributed a case study on TerraForm Power in a new book called *How to Profit from Special Situations in the Stock Market* by Maurice Schiller. Links to all presentations are in the News & Views section of our website.

"Survivors & Thrivers" CFA Society, Zurich

"No, You Can't Have Both". Podcast on the risk in dividend-first companies

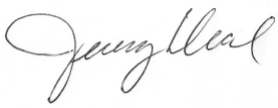
TerraForm Power case study, chapter contribution

CLOSING REMARKS

Our opportunity set as a small fund will always be good because of our flexibility to hunt the market for opportunities of all shapes and sizes. We are not looking for 100 ideas or a diversified portfolio, but one or two excellent ideas per year. It may seem improbable in the current market to find ideas that are both undervalued and high quality enough to potentially remain in our portfolio for many years. But given our size and strategy within a massive global market I cannot imagine any environment where we run out of things to do.

I have over 90% of my net worth in the fund and try to manage it as if it was all my own. We have an enormous opportunity ahead of us and I appreciate your partnership.

Sincerely,



Managing Partner