JDP
CAPITAL MANAGEMENT

Fund Update
1Q 2019

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Dear Partner,

The Partnership was up 13.6% in the first quarter and 21.25% through April (gross). The S&P 500 is up 18.25% as of April 30. Please see your individual statement for specific net returns and performance since joining the fund. We have made up a lot of ground since the 4Q 2018 sell-off. The majority of our holdings have reported 1Q earnings and the results have exceeded our expectations. This is exciting because our performance to date has been driven primarily by only two positions while the others are flat.

Even after the monster rally in stocks last quarter, the S&P's after-tax yield of about 5.8% is still much more attractive than the 2.5% you would get for lending your money to the US government for 10 years. Despite volatility in stock prices, business marches on, day after day.

What does mispriced risk mean to JDP?

Mispriced risk is when the potential upside (or downside) of an investment is much greater than the fundamental risk taken. In practice, the price we pay is the willingness to temporarily be down on paper (sometimes big time) during market selloffs. When this happens, our general reaction is to buy more of our favorite holdings. On that note I want to thank our LPs who added money in December when it felt like the world was falling apart—it paid off.

JDP aims to find one or two new investments per year. The short-term nature of markets means we can find great ideas no matter what state the broader markets are in. There is always something really, really interesting to do when you have ~6,500+ investable companies in the US and around 100,000 globally.

Even as a small fund trafficking in public companies we have access to the highest quality companies, management teams, and opportunistic situations that any private equity investor would kill for.

In economic cycles like today I cannot believe how superior one-off public valuations can be relative to what private equity or venture capital buyers pay for control of a lower quality equivalent. Of course, this point is irrelevant to volatility-sensitive managers or people without the temperament to view stocks as ownership of individual businesses.

As an example, if any *combination of two* of our core holdings appreciated to a valuation where we would be a seller, it would imply 80% upside for the entire fund (JDP does not use margin leverage). The odds of that happening in a short period is low, but that margin of safety is sure nice to have.

Common threads result tie together a seemingly strange mix of holdings

Over the past eight years JDP has focused on companies that fall into two buckets: Mispriced growth, and Mispriced balance sheets.

Mispriced growth is when the market is focused on the wrong metrics to assess a company's future earning power or has grossly underestimating the potential of a company's addressable market.

Mispriced balance sheet risk happens when stock investors miss the positive financial and sentiment impact of a refinancing, or capital infusion, that unlocks substantial value. We have invested here when a best-in-breed company has survived a distressed sector but still suffers from an unusually high interest rate or unfavorable terms which are mis-matched with improvements in business fundaments.

Regardless of the situation all of our holdings have some common threads: (1) we want to own the company for *at least* several years, (2) the consensus view is widely different from our own, (3) at the time of purchase we see at least a double in value over a 3 to 5-year time horizon.

JDP's resulting portfolio has always been a mix of very different businesses in unrelated sectors. Example holdings today include: Spotify (NASDAQ:SPOT), XPO Logistics (NASDAQ:XPO), Teekay Offshore (NYSE:TOO), EchoStar (NASDAQ:SATS) and Xero Ltd (ASX:XRO).

Although it is early in the year, here some thoughts and updates for three of our core holdings; all have been discussed in detail in past letters.

XPO Logistics – As discussed in the Annual Letter, JDP tripled down on XPO in December after the stock fell 65% on an error-prone and mis-informed short thesis and lowered guidance due to the loss of a low-margin Amazon contract. Controlling shareholder/ Chairman Brad Jacobs responded by using XPO's under-leveraged balance sheet to buy back about 30% of the company in two tranches early this year and table a prior acquisition strategy.

Management's updated bonus is now liked to $14 per share in free cash flow by 2022 and a stock price of $225. The implied multiple of 16x FCF translates to roughly 10x EV/EBITDA which is fair, if not below average based on peer comps and the contracted nature of XPO's earnings.

Teekay Offshore – Controversy and confusion is our primary source of opportunity as a fund and Teekay Offshore is not short of this. We remain confident in our position which is rooted in quantifiable company value that is now more disconnected with the stock price than any time.

Seth and I met have met with management twice this year and presented strategies for improved investor communication. In both meetings we returned with a high degree of confidence in the TOO team and a better understanding of the unique challenges they face in committing publicly to financial targets before achieving certain milestones. It was clear to us that management is very eager for the stock to trade for a rational multiple cash flow.

Consensus continues to ignore the numerous positive financing and business developments that have happened since Brookfield recapitalized the company in July 2017. The most recent example was earlier this year when Morgan Stanley erroneously predicted the company would face a $500 million funding gap for new shuttle tanker deliveries and an FPSO project.

Morgan Stanley's call was baffling because management had just announced that capex of the FPSO project in question would be funded by the customer upfront—and that the shuttle tanker delivery financing would be "in place" in 2Q19. Management executed just as they said; this month the company announced an 18-year $414 million credit facility with the Norwegian government-backed bank at an eye-popping low rate of Libor + 225 bps, secured more advantageous terms on a revolving credit facility and secured $100M in new financing on its FPSO fleet. So, a strong vote of confidence around Teekay's assets, customer quality, and Brookfield as a sponsor.

Additionally, the rumor-mill runs wild in the absence of a stated coherent strategy around Brookfield Business Partners (now 74% stake) commitment to not taking advantage of public minority shareholders.

Spotify – We continue to be impressed with SPOT's widening moat, long-term strategic thinking and unmatched focus on adding value to its customers lives. Our thesis on SPOT was discussed in the 2018 annual letter.

In summary our thesis is rooted in the future monetization of SPOTs non-US market share where its first-mover status still dominates in many of the 79 countries it now operates in. Last quarter SPOT launched in India and added 1 million users in the first week alone.

Our perception is that for the majority of non-North American high school kids with a mobile phone, Spotify is the primary app they have ever used to access music and podcasts. This is the most undervalued component to the long-term Spotify growth story.

The typical US-centric investor is accustomed to the story of expanding to "rest of the world" once the local market is penetrated. As a Swedish company SPOT did the opposite. Now in the final stretch of spreading their seed, SPOT appears to be in knife fight with Amazon and Apple in the US for subscribers.

Our counterview to the consensus is that outside the US, there is a low probability that Amazon's new free online music catalogue and Apple's steaming product (exclusively for Apple devices) is a material threat to Spotify's two-way marketplace. The US market is important, we get it. But the US market is also plenty big enough for Apple, Amazon and Spotify to co-exist and take share from radio.

SPOT's enterprise value today implies a rough value of $220 per premium subscriber (vs. $1,400 for Netflix). This is too cheap considering the lifetime value of customers that are in the very early stages of being monetized. Spotify is profitable, has plenty of cash, has huge insider ownership, and business decisions are being made for the very long term.

SPOT also owns 9% of Tencent Music through a partnership in the early days of playing out. This is a strategic advantage with significant hidden optionality given their combined leverage as the record label industry consolidates and Apple/Amazon spend more to compete in music streaming. SPOT's publicly listed stake in Tencent Music is worth about $2.3 billion today and probably much more over time.

Closing thoughts

We continue to be excited about our portfolio and the opportunities each company offers. All of our companies are run by first-class management teams at the top of their game. I also believe that our teams understand how their businesses fit into the broader economy, are sensitive to a slowing growth environment, and are being responsible in their capital allocation decisions.

Finally, I may sound like a broken record here, but having like-minded investors is our most important asset. Maintaining a capital base that supports our strategy in both the good and bad times is much more important than having a huge fund or being well known. I have 95% of my net worth invested alongside yours and am excited about what we are building together.

Please feel free to call or email me with any questions.

Sincerely,

Managing Partner

JDP Overview

JDP CAPITAL MANAGEMENT

- Founded October 2011
- Value strategy concentrated on highest conviction ideas
- Focused on companies undergoing a major transition
- Multi-year time horizon per idea with compounder potential
- Long only, no leverage

Team

JDP CAPITAL MANAGEMENT

Jeremy Deal, *Founder, Portfolio Manager*

Business Experience

- Private equity
- Co-founder Secure Wireless Inc., sold to Nortek (NASDAQ: NTK)
- Co-founder Energy Eye Inc., sold to Somfy SA (EPA:SO)
- Honeywell International (NYSE: HON), Home Controls Division

Seth Lowry, *Senior Analyst*

Business Experience

- Tech Coast Angels, Analyst
- Citigroup, Equity Research, Transportation
- Merrill Lynch, Investment Banking, Energy and Power
- Merrill Lynch, Global Securities Research

Mark Chapman, *Director, JDP Offshore Ltd.*

Business Experience

- Azur Consulting, Partner
- Director, Aquamarine Fund Zurich
- Deloitte & Touche, Managing Partner, BVI
- Deloitte & Touche, Senior Manager, Cayman Islands

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