January 1, 2018

# 2017 Annual Shareholder Letter

Wiedower Capital gained 22.7% (net of fees) in 2017. The Russell 2000 gained 14.6% (including dividends) in 2017.

Since the last update six months ago, we've added two new positions and sold one. Our portfolio companies continue to fall into two distinct buckets (and of the two new positions, one falls into each bucket). The first bucket, what I consider our core investments, are very high quality companies that I think can compound their value for the next 10+ years. Because of these long runways for growth, I view these holdings as almost permanent investments. Unless the facts change (and my thesis is proven wrong) or the founder dies or something like that, I plan to own these companies for many years (whether that's five years or ten years or forever, I don't know).

What I mean by "almost permanent investments" is that I don't consider selling them. An example of this is our recent acquisition of Parks! America (one of our new holdings that I'll describe below). We were 100% invested before we built our position in Parks! America and we're 100% invested now. When I was deciding what positions to trim (or sell completely) to make room for this new position, I didn't even consider selling shares of the core, long-term holdings. Again, unless something major changes, I don't consider these positions as being for sale.

While I would love to eventually have an entire portfolio of very high quality companies led by passionate founders with long runways for growth, unfortunately there aren't many of them out there. Until then, I'll continue to fill the rest of our portfolio with above average companies that are simply too cheap. This second bucket may consist of companies that are going through a business transition that isn't being appreciated by the market (Franklin Covey) or more often, they are just tiny companies that are overlooked (Calloway's Nursery and Parks! America).

**Issuer Direct (ISDR)**

Issuer Direct falls into our first bucket of core holdings. It contains several of my favorite investment traits: founder-led, profitable, growing, lots of cash, zero debt, a durable competitive position, and a long runway for growth. At a high level, Issuer Direct helps companies be public (though they do work with private companies as well) and they offer many products and services to do that: a stock transfer agent, they can manage earnings events, print and distribute annual reports and proxy materials, run a whistleblower hotline, maintain buy-side and sell-side datasets, and a variety of other things. But the product that is driving most of the company's current value is Accesswire.

Accesswire is a news distribution service. If you ever look at press releases from small and micro-cap public companies, you've almost certainly seen releases that were put out by Accesswire. As a news distributor, Accesswire is basically a middleman between a company that wants to put out a press release and the platforms that investors see that press release on. So a company gives its press release to Accesswire and they distribute it to Bloomberg, the Wall Street Journal, TD Ameritrade, Scottrade, and many other news outlets.

For many decades, the news distribution industry was dominated by a small handful of companies—PR Newswire, Business Wire, GlobeNewswire, and Marketwired (now integrated with GlobeNewswire). And in most respects, those big guys still dominate the industry. With that being said, Accesswire has been able to get a toehold in this industry by entering the low end of the market (focusing on micro-caps as opposed to larger caps) with a cost structure that is both simpler and significantly cheaper than all the big news distributors.

Right now, Accesswire has less distribution than the big guys (Brian Balbirnie, the CEO, estimates they have around 85% of all distribution). For tiny companies that can save 50% on each news release, whether they get 85% of distribution or 100% doesn't really matter. But as Accesswire continues to grow, getting those incremental distribution points will matter more. Eventually, I believe Accesswire will be able to get 100% distribution (or close to it) thanks to Regulation Fair Disclosure (commonly referred to as Reg FD).

Reg FD is the rule that requires public companies to make material disclosures to all investors at the same time. The reason this matters is that companies like E-Trade (a news distribution point that doesn't currently use Accesswire) have an obligation to provide their clients the fair disclosure that investors are getting on other platforms. Right now, Accesswire is a very small percentage of the distribution industry, so E-Trade can get away with ignoring them. But as Accesswire continues to grow, E-Trade's obligation to their clients for fair disclosure should overrule their current reluctance.

As those final distribution points add Accesswire, larger public companies that need their press releases to get 100% of distribution are more likely to switch to Accesswire. And the more public companies that use Accesswire, the more distribution points will be forced to add Accesswire. Over time, I think Accesswire will be able to move up-market to larger companies easier than the big news distributors will move down-market (in a meaningful way I mean, there are plenty of micro-caps that use the big news distributors) because of the pricing difference that Accesswire has.

Reg FD is also a big part of the barriers to entry to starting a news distributor. If I try and start a news distributor with only 10% of the overall distribution, no public company can use my service because they will almost certainly be violating Reg FD. It's a chicken and egg problem—a news distributor can't get clients without a significant portion of distribution, but the news distributor can't get that distribution without a large enough client base. This same dynamic existed before Reg FD by the way—now there's just a legal reason behind it.

One of the biggest benefits of Accesswire is its ability to bring many new customers into Issuer Direct. News distribution is an above average business, but it's not as sticky as some of Issuer Direct's other products. If I work for a company that puts out press releases, I'm probably going to stay with my news distributor as long as they don't screw anything up—especially if they're cheaper than all their competitors—but there's nothing that makes me stick to that distributor. It's quite easy for me to switch between the competition and try them all out. On the other hand, several of Issuer Direct's other products have structural attributes that make customers far stickier with high retention rates. So if Accesswire can bring a bunch of new customers in and Issuer Direct can cross-sell some percentage of those clients on their stickier products, that's going to create much more valuable long-term customer relationships.

I've done a lot of digging through EDGAR filings, Accesswire press releases, and stock transfer agent listings to try and see how many Accesswire customers use other Issuer Direct products and my best guess is between 10-25%. So if Accesswire continues to bring in a lot of new clients and Issuer Direct can cross-sell 10-25% of those new clients on their stickier products, that's a significant win for the company (and retaining the vast majority of the other 75-90% as just Accesswire clients isn't a bad result either). And once Issuer Direct gets a customer to use one of their stickier products, it becomes easier to upsell them on the other products they offer—and on and on. One of these stickier products is Blueprint.

Blueprint is a subscription software package that helps companies with their SEC filings. Companies use Blueprint to draft, edit and file their 10-K, 10-Q, proxy, etc. I believe this type of service is very sticky, and just as important, the switching costs will increase over time (similar to scale and network effects that also increase their advantages over time). The longer a company uses Blueprint to manage their SEC filings, the more ingrained into that company Blueprint becomes. The more employees in that company that are trained on Blueprint and use it, the more direct costs and lost productivity there are to switching to a competitor.

Another service that Issuer Direct offers that has even higher retention rates is their stock transfer agent. The stock transfer business is probably the stickiest part of Issuer Direct's business—their VP of Sales told me they've lost fewer than five of these clients in their entire history. This is because changing stock transfer agents is a major headache that requires board approval, so it's not worth the effort unless the agent really messes something up. This stickiness is why I was excited to see Issuer Direct's acquisition of another stock transfer agent, Interwest Transfer, in October. Interwest Transfer will more than double their stock agency business and thus, will give them a lot of new, very sticky customers that they can hopefully sell their other products to.

Last, but definitely not least, is Brian Balbirnie, who is the founder and CEO. Brian takes a reasonable salary, hasn't gifted himself options in many years, and is very passionate about what he does after starting the company in 2006. He seems to really understand the main drivers behind his company's success. When I asked him about key metrics for the business, he said he's narrowed down management incentives to one thing—client count. And his explanation for this was exactly what I've described above. Brian understands how sticky several of his products are, so as long as they can get customers in the door, they'll be able to upsell a certain percentage of them, and the business will take care of itself from there. One random thing I've picked up on from several conversations with Brian is that he probably talks about his competition nicer than any CEO I've ever spoken to. I've asked him about many of their competitors and his answers almost always start out with "Company x does so and so really well, they're probably better than us in that way, but this is how we differentiate ourselves." It's quite refreshing compared to many CEOs who jump at the opportunity to bash their competition. This is just one of many examples that lead me to believe Brian is intellectually honest, has high integrity, and is genuinely a good person who I can trust with our money.

As I've become more focused on founder-led companies over the past couple years, I've had several people inquire about the key man risk inherent in these companies. It's a legitimate concern—if a company is dependent on its founder's passion and vision for its future value, much of that value could disappear overnight if that founder dies, retires early, has a bad accident, etc. Key man risk is something that I think about, but all companies have risks and key man risk is one that I'm happy to have. The alternative to key man risk is key man opportunity—where the company becomes more valuable if the current CEO dies or leaves, and… well, that's not the type of situation I want to invest in.

Not that I'm opposed to investing in companies led by hired CEOs (we own several of them), but in general I think founder-led companies have intangibles that are almost impossible to replicate. I remember doing my first few discounted cash flows many years ago and I was surprised at how much of a company's value is determined by the very long-term. It's not uncommon that a company's terminal value is 70-80% of its value today. If how a company will perform in 10-20+ years is most of its worth today, then the most important factor when choosing companies to invest in is how durable their competitive position is over the very long-term. And if the long-term is what truly matters to a company's value, then the only way a CEO can be truly aligned with you and me is if they are motivated to grow the business in the right way over the very long-term.

Unfortunately, most hired CEOs own little stock (meaning they have little voting power) and could be fired at any moment, which encourages them to focus on making as much short-term money as possible (usually through annual bonuses). Founders almost always have a significant voting share so there's a much higher chance that they're around for the next 20 years (and just the fact that they're the founder gives them more staying power). A founder also has far more economic incentive to grow the business over the next several decades (thanks to their large ownership share) as opposed to focusing on short-term incentives. All of this adds up to founders, in general, being far more aligned with minority shareholders like us because they're more likely to care about the long-term health of the business.

**Parks! America (PRKA)**

Parks! America is the other company added to our portfolio over the past six months. Parks! America owns two drive-through safaris—one in Georgia and one in Missouri. What's a drive-through safari? Essentially, you rent a car from them and drive through a 200 acre park while zebras, giraffes and all kinds of exotic animals come right up to the car and eat food out of your hands. Right off the bat, I was attracted to this business for three reasons.

First, this is a very durable business model that is resistant to technological change. We'll see how good virtual reality is in ten years, but I highly doubt it will replace the experience of having a zebra eat out of the palm of your hand. I can't think of any reasons that humans will suddenly stop wanting to go experience wildlife in this unique fashion.

Second, their two parks benefit from local monopolies. While they do compete with regular zoos, theme parks, water parks, and other entertainment facilities to some extent, no one in their right mind would open another drive-through safari within a couple hundred miles of one of their parks. Customers drive from hundreds of miles away to visit these parks and it doesn't make sense to directly compete with a unique destination like that. The benefit of these local monopolies is pricing power. They've increased ticket prices the past several years without any effect on traffic.

Finally, I also believe this business should be relatively recession resistant. Tickets only cost $15-$25 so it's a fairly cheap way to spend a day, even if money is tight at home. Also, the Georgia park performed well through the financial collapse with revenue growth and operating margin expansion (the Missouri park was acquired in 2008 and struggled for a while, though their losses did shrink through the collapse).

The first two reasons are very similar to what I was attracted to at Calloway's Nursery (our second largest holding). Like Parks! America, Calloway's Nursery is very resistant to technological change (they own garden centers) and they benefit from local scale advantages (they are by far the largest nursery in Dallas). Both are run by shareholder friendly teams with large insider ownership and both are tiny companies (market caps: PRKA $18M and CLWY $61M) that seem to be ignored by the market.

The result of being ignored is undervaluation by even the simplest metrics. When we purchased Parks! America around $0.23, it was selling for ~14x on an enterprise value to owner earnings basis (before tax reform). In my opinion, that's too cheap for a company with a durable competitive position that is still growing, expanding margins, and should perform just fine through a recession. After doing several discounted cash flows, even before tax reform it was hard for me to get a fair value lower than $0.30. Especially after tax reform, the assumptions necessary to get a fair value equal to today's price are just unrealistic in my opinion. At the former corporate tax rate, my range for fair values was between $0.30 up to $0.48. Simply punching in a 21% tax rate increases this fair value range up to around $0.36-$0.54. With that being said, as a result of tax reform it's possible the company will increase wages or make more investments in their parks. Thus, once management discusses how tax reform will affect them, I expect my fair value range to be somewhere between those two ranges that I just listed. All that is a long-winded way of saying I think Parks! America is extremely undervalued and I'm surprised the stock hasn't moved up since tax reform passed (in fact, the stock hasn't moved much in ~5 months).

While Parks! America has organically grown double digits each of the past three years, I expect them to reach more mature, GDP-like growth sooner rather than later (though that could be two years away or ten). One of the negatives of their great local monopolies is that their growth options are very limited. When you can't open another park within a couple hundred miles of your current locations, there aren't many options to open or acquire other parks. Dale Van Voorhis, the CEO, would love to expand into more traditional amusement parks (which is actually his background), but there is nothing cheap right now. He's been searching for an acquisition for years and nothing has checked all his boxes.

Because of those things, my current plan is to own Parks! America until it reaches my estimate of fair value (low $0.30s+). When I buy into this second bucket of investments (above average companies that are too cheap, as opposed to very high quality companies with long runways for growth) I generally expect to own them for 1-3 years, but you never know how long the market will take to correct the pricing gap (or until my thesis is proven wrong of course). With that being said, if the company continues to perform well and they find other growth avenues, I may own it longer than I currently expect. A durable business with an incentivized, shareholder friendly leader isn't a bad place to park money.

**Other Portfolio Updates**

Franklin Covey (FC) remains our largest position at ~31% and I continue to believe the market is significantly underestimating the quality of their new business model. On the 2017 conference call (their fiscal year ends 8/31), management gave guidance for 2018 that lined up to what I was expecting (higher revenue than I thought, but lower bottom line because of investments). Given their guidance lined up with my own estimates and I think current fair value is in the high $20s to mid-$30s, I was surprised the stock didn't move up more after earnings. 2018 will be the first year the company is fully lapping the transition to the new business model, so hopefully after a few quarterly results this year the market will start to give the company more credit for their new and improved business.

On the valuation side, I struggle to see how the new business model isn't more efficient than their old one (customers who auto-renew to your software are better than customers you have to explicitly sell products to every year). From 2013-2015 (before this transition began), my estimates for their normalized earnings margins were 7-8%. Now there's a lot of noise in the current financials due to the transition, but let's ignore all that and just guess that their new normalized NOPAT margins with a more efficient business will be 9%—a little better than they achieved with their worse business model. Management's guidance for 2018 revenue is $227 million (including change in deferred revenue which is real cash in the door). $227 million x 9% = $20.4 million—what I would call owner earnings or NOPAT. I personally believe the company deserves a multiple in the 20s, but even a 20x multiple on those 2018 owner earnings would result in a stock price of $25.28 (~25% above today). If the new business model is more efficient than their old one, it's hard to justify today's price. Oh, and that entire calculation is before tax reform. Similar to Parks! America, it's still unknown how much of the tax cut will drop to the bottom line (increased wages and investments will probably take up a portion), but Franklin Covey is a full tax payer so they will benefit from tax reform more than most. After tax reform, it's hard for me to get a fair value lower than the high $20s.

Interactive Brokers (IBKR) and Where Food Comes From (WFCF) are two of our high quality compounders that both increased quite a bit in 2017 (each was up over 45%). Interactive Brokers has been mostly driven by increased interest income (as the Fed raises interest rates, Interactive Brokers makes more money on their credit balances) and the highest account growth they've seen in many years (driven by a healthy economy). Where Food Comes From's progress in 2017 was mostly driven by China opening its doors to US beef, in addition to their continued expansion into tangential markets (both organically and through acquisitions).

While I think both Interactive Brokers and Where Food Comes From are now in the ballpark of fairly valued, I have zero intentions of selling either. I use the phrase "in the ballpark of fairly valued" because I think most stocks have a relatively wide range of what their fair value could be. When I think about Interactive Brokers, I don't think "$56.39 is what my latest DCF spit out so that's its fair value." Instead, my thought process is more along the lines of "depending on what assumptions are made, I can imagine a reasonable person making an argument for fair value anywhere from $45 up to $65." Back to my point: I'd rather continue to hold a high quality, fairly valued company that I know well vs selling and having cash (that I don't have anything imminent to do with anyway). As long as the competitive dynamics and industry tailwinds don't significantly change, I will not be selling Interactive Brokers or Where Food Comes From, regardless of price. I hope to own each of these companies for a very long time.

**New York REIT (NYRT)**

New York REIT was my biggest mistake of 2017, both in terms of brain drain and our AUM. Overall it hurt our results by around 2.8%. As a reminder, New York REIT owns properties in New York City and announced their intent to liquidate in late 2016. Estimating their liquidation value to be 10-30% higher than the share price at the time, I started buying shares in December 2016 and added more in 2017. Looking back at my notes from around the time I initially invested, I don't necessarily disagree with my logic at the time. What I didn't put enough weight on was the chances of New York City cap rates increasing. Also, I think I put too much weight into the fact that the people liquidating New York REIT had successfully liquidated other REITs in the past, but I overlooked how different the cap rate environment was in those past years (decreasing) vs how it is now (increasing). I was aware of this when I invested, but it seems that I brushed it off too easily. Beyond that blatant error, I came to realize several other things while I owned New York REIT.

New York REIT has a lot in common with another investment I had previously made, Consolidated-Tomoka Land Company (CTO). We were lucky to make a little money in Consolidated-Tomoka, but I'm still not too happy about it. The value of both Consolidated-Tomoka and New York REIT were almost completely based on real estate and I never understood why the market would be mispricing either company. The market is pretty efficient so I think it's important before making an investment to at least have an idea as to what the market could be missing. Several of the companies we own (Calloway's Nursery, Parks! America) are just tiny companies that get overlooked by the market. Franklin Covey is going through a business transition that makes the current financials very difficult to parse through. Companies like Where Food Comes From and Interactive Brokers are more of a time arbitrage—the market is worried about the next three to twelve months while I'm looking at these companies on a 5-10+ year basis (worried about how the industries and their competitive positions may evolve as opposed to 2018 EPS). On the other hand, both Consolidated-Tomoka and New York REIT are large, liquid companies and their value is almost completely based on assets that the market should be good at valuing. I don't know if realizing this a year ago would have changed anything, but having no idea why a stock might be mispriced is a bad sign (and it's now a question on my pre-investment checklist).

The next realization I had while owning New York REIT was that I didn't look forward to the earnings releases and conference calls (and I recalled feeling the same way about Consolidated-Tomoka). With Where Food Comes From, I feel like I am constantly learning about an area of the world (food auditing) and I look forward to learning more. With Interactive Brokers and Issuer Direct, the conference calls almost always teach me something about Wall Street, investing, the brokerage business, how public companies operate, etc. But with New York REIT and Consolidated-Tomoka, all I ever learned was what buildings they bought or sold and I never found that very intellectually stimulating. Even though I thought both companies were undervalued when I bought them, it still felt like work keeping up with them. On the other hand, keeping up with passionate entrepreneurs who are growing unique business is far more exciting to me and doesn't feel like work. I don't know if I have much of a point here, but these two investments helped me realize that I get personal enjoyment out of being a partial owner of companies that are changing their industry, making the world a better place, and are led by passionate founders who I can learn from. Alternatively, I got very little enjoyment out of owning companies that just buy and sell assets.

Finally, even if I ended up being right about New York REIT, the best case scenario was a short-term gain that results in more cash in the portfolio. Shorter term, catalyst-driven ideas don't give me a great amount of leverage on my research time. If I'm right on a long-term, very high quality company, we're going to benefit from that for 5-10+ years. If I'm right on our second bucket of good companies that are too cheap, we're going to benefit from that for at least a couple years. My thesis on New York REIT was a relatively short-term catalyst which is great if I'm right, but then a year later we'd be sitting in cash and I would need to replace it with another position.

**Thoughts on Goal-Setting**

Thomas Peterffy's goal is to build Interactive Brokers into the biggest and most efficient broker in the world. John Saunder's goal is to teach Americans where their food comes from. Neither of these goals can be accomplished in one or even ten years. They are very long-term goals that help guide their day-to-day business decisions. My long-term (20+ year) goal is to outperform broad market stock indexes, net of any fees I charge. But shrinking that long-term goal down into an annual goal doesn't really work.

If my yearly goal is to outperform stock market indexes, that can encourage poor behavior. An example would be if I'm underperforming in October, I may be tempted to sell a high quality company (and very long-term investment) like Where Food Comes From and buy into a short-term situation that could double or go bust on its next earnings release. Likewise, if my one year goal is to raise a certain amount of money from outside investors, that would have me focused and spending time on the wrong things. More outside investors aren't going to get me any closer to my long-term goal of compounding capital at above average rates. What short-term actions will get me closer to my long-term goal is to learn—a lot.

To reach my long-term goal, I'm going to have to become a much better investor. And to become a better investor, I'm going to have to become much more knowledgeable—in many different areas. Learning about and researching many companies is obvious, but also developing a wide base of knowledge that allows me to see the world more clearly and from more angles than most people. I believe the best investors ultimately have a better understanding of the world than others. In a market that is mostly efficient, being able to see how the world is evolving slightly better than others is a big advantage. That's how I boiled a very long-term goal (build a respectable 20-year investing track record) into a relatively simple one-year goal for 2017 (read 24 books) that, if accomplished, guaranteed I left 2017 smarter than I entered it—and that I got a small step closer to my long-term goal.

Of the 31 books I ended up reading and finishing in 2017, two had a notable effect on my day-to-day work. The most influential was *Mistakes Were Made (but not by me)*. Ever since I read *Poor Charlie's Almanack* several years ago, psychology has been one of my favorite topics to read about. I think the reason the idea of cognitive biases stuck with me so much was that I recognized damn near every single one of them in myself. Thus, I realized how important it must be to be aware of my own biases. *Mistakes Were Made* was another leap forward in my attempt to understand my own brain. I love the book's idea that each of us is ruled by a totalitarian ego "that ruthlessly destroys information it doesn't want to hear and rewrites history" in our own favor. This totalitarian ego subconsciously justifies actions that we would demonize others for, fills in gaps in our memories (with a positive spin of course), and ignores evidence that contradicts our own personal story line. Now, when I'm studying past mistakes (like New York REIT), I'm constantly thinking about how my totalitarian ego is altering those memories, which results in a lot of hindsight bias.

*The CEO Pay Machine* was by far the best investing book I read in 2017. It really drilled into my head how bad the standard CEO pay package (salary, annual bonus, long-term options) is for shareholders. The vast majority of a company's value is dependent on what it will earn in 5, 10, or 20 years, yet CEOs are mostly incentivized (and pressured by Wall Street) to worry about the next few quarters. I came away from this book pissed off at how rigged the system of executive pay is, but I also came away even more determined to find those unique leaders who are focused on the long-term (usually founders).

The past couple years I've started to emphasize daily reading time and carving 1-2 hours out of my "traditional" work (reading annual reports and call transcripts, reading investment write-ups, researching companies, etc) to give myself more time to read—often books that don't have a direct correlation to investing. And while reading a wide variety of books in the short-term might not help my investing, I'm confident that as long as I'm expanding my knowledge of the world and getting smarter every day (ok, most days), I am becoming a better investor for the long-term. And the long-term is all that really matters.

Travis Wiedower
Managing Director

| Period | Wiedower Capital | Russell 2000 | S&P 500 |
|---|---|---|---|
| 2015* | -9.49% | -6.62% | -1.37% |
| 2016 | 17.48% | 21.28% | 11.95% |
| 2017 | 22.67% | 14.62% | 21.82% |
| Cumulative | 30.45% | 29.80% | 34.51% |
| Annualized | 9.77% | 9.58% | 10.95% |

* Started February 24, 2015. Wiedower Capital results are net of fees. Index results include dividends.