Hazelton Capital Partners

"Simplicity is The Ultimate Sophistication"

January 28, 2018

4rd Quarter 2017 Letter to Investors

Dear Partner,

Hazelton Capital Partners, LLC (the "Fund") gained 6.4% from October 1, 2017 through, December 31, 2017, gained 23.6% year-to-date and has returned 128% since its inception in August 2009. By comparison, the S&P 500 gained 6.6% in the same quarter, increased 21.8% year-to-date and has returned 206% since the Fund's inception.

The Year in Review – Position Updates

Hazelton Capital Partners ended the 4th quarter with a portfolio of 18 equity positions and a cash level equivalent to 27% of assets under management. The Fund's top five portfolio holdings, which are equal to slightly below 40% of the Fund's net assets, are: **Micron Technology (MU), Western Digital (WDC), USA Technologies (USAT), Ezcorp (EZPW), and Spirit Airlines (SAVE).** Similar to previous quarters in 2017, Hazelton Capital Partners continued to prune many of its top holdings, but unlike past quarters, the Fund was able to find two new investments to re-deploy some of its cash. One of those investments was in Hanesbrands which I presented at this year's MOI Best Ideas Conference.

Micron Technologies (MU) & Western Digital (WDC) ***Current Holdings***

Micron Technologies & Western Digital are the largest and second largest holdings in the portfolio, respectively. The Fund has not reduced its investment in either company, as I believe the overall memory and storage industry will continue to benefit from increased demand in DRAM, NAND, and HDD. Historically, the memory and storage industry has been very cyclical, driven by the demand for market share rather than return on invested capital. This behavior, along with quick technology innovations, led to a rapid decline in the average selling price (ASP) per unit. As I have stated before, cyclicality will continue to play a role in the memory and storage industry, but I expect the duration of the cycle will get longer and the peak to trough pricing will be less rapid and less dramatic. The market appears to be pricing in lower NAND and DRAM ASPs. My expectation is that declining ASPs will be met by an even greater reduction in unit costs, allowing memory and storage companies to improve their gross and operating margins.

During the 4th quarter, Western Digital settled its ongoing dispute with its JV partner, Toshiba. Like most corporate disagreements that become litigious, both sides mishandled the situation, became inflexible, claimed a "win-win" settlement, but in reality, lost as much as they gained from the exercise. The settlement does extend the JV agreement between Toshiba (TMC) and Western Digital through 2029, including existing and future fabrication plants. However, by agreeing to the settlement, Western Digital consented to the sale of Toshiba's portion of the JV to a consortium led by Bain Capital (which includes rivals SK Hynix, and Seagate Technologies), the primary reason behind Western Digital's litigation to block the sale. With months of uncertainty taking a toll on WDC's share price, the markets' reaction to the settlement has been muted. Western Digital's latest EPS guidance for fiscal 2018 is $13.75/share as it continues to see market demand for its enterprise HDD and SSD offerings. At its current share price, this equates to less than 6.5x earnings.

USA Technologies (USAT) ***Current Holding***

The largest contributors to the Hazelton Capital Partners' performance was USA Technologies (USAT). In the 3rd and 4th quarters, Hazelton Capital Partners trimmed some of its USAT position, believing that the share price had gotten a bit ahead of the company's fundamentals. We expect that USAT future valuation prospects will continue to flourish as the company continues to expand its vending machine point-of-sale platform both through organic and recent acquisition growth. In the meantime, the Fund is ready to repurchase shares if the opportunity presents itself.

Spirit Airlines (SAVE) ***Current Holding***

Spirit Airline was one of only a few investments that contributed negatively to the portfolio for the year. In mid-summer, shares of the discount carrier fell as United Airlines increased the number of "basic economy" seats on its regional flights from its hubs in New Jersey and Chicago. These "basic economy" fares compete directly with Spirit Airlines and the news drove down SAVE's share price by 38% in a matter of 2 months. It is important to understand that even though United, Delta, American, and Southwest all operate airlines, their business models are completely different than Spirits. Spirit Airlines makes its money by selling low fare seats while up charging for amenities, and then offsetting those revenues with even cheaper expenses. The other domestic carriers make their profits from baggage fees and selling airline miles to credit card companies; the flight is just a means to the end. Low oil prices gives the major airlines the flexibility to offer "basic economy" seats, but when oil prices rise, it will make competition with the low-cost carriers less attractive.

"Play your game. Play your game. Play Your Game." - Herb Brooks

With the winter Olympics less than two weeks away, the vivid memory of the 1980 US Mens Hockey Team's unimaginable defeat of the then Soviet Union is once again conjured up. On paper, there was no probable way that a team of US college athletes could defeat the Soviet National Hockey Team made up of full-time athletes (professionals). Instead of trying to match up to the Soviets, Herb Brooks (1980 US Olympic Mens Hockey Coach) decided his only competitive advantage would be to produce the best-conditioned athletes – out-skating their opponents. His strategy worked. Throughout the Olympics, the US Hockey Team outscored its opponents 27–6 in the second and third periods. In the pivotal game against the Soviet Union, the months of training paid off as Mike Eruzione's goal with 10 minutes left to play in the game gave the US a 4 to 3 lead and the eventual win. Not accustomed to taking the lead with so much time left on the clock, Brooks kept reminding his players to "Play your game."

It is said that "a rising tide lifts all boats," and given the recent strength of the US stock market, the passage of the US corporate tax cut appears to be that rising tide. A lower corporate tax rate is expected to add meaningfully to a company's bottom line while making the repatriation of the trillions of dollars held outside the US very affordable. In skilled hands, additional cash can be a significant competitive advantage for a corporation, creating value for both the company and its shareholders. But all too often, excess cash is given to an undisciplined and irresponsible management with the need to justify its existence. In the short-run, a company's value may appear to strengthen along with its earnings and the promise of accretive acquisitions, but eventually, the frivolous spending and incompetence will take its toll on the company's future value. Hazelton Capital Partners recognizes the impact the recent US corporate tax cut has had on the equity market but remains steadfast to its investment process. We temper the "fear of missing out" with the "fear of acting rashly." Revenue growth, operational efficiency, and a skilled management are the foundation on which sustainable and valuable companies are built. The Fund stands ready to invest its cash in companies that meet these criteria regardless of market conditions. Even with all the recent frenzy and hysteria, we intend to "Play our game."

Impatience and Short-Sightedness - Lesson Learned & Applied

I recently contributed an article to Kate Welling's thoughtful publication, Welling on Wall Street (WOWS), entitled "The 'Next Big Thing' - It Just Might Be Hidden in Plain Sight." In the article, I posed the following Question: What is going to be the most dramatic change in our society over the next 10 years and which company is going to benefit from this "next big thing?" Many investing strategies focus on the search for the "next big thing"- The company or asset that is not only going to disrupt an industry's status quo but leave an improved and streamlined business model in its wake. These are "story stocks," a company whose share price is based on the narrative of its expected future potential, rather than current earnings or assets. There are a number of very successful investors who use this strategy; I am not one of them.

Numerous variables and unknowns need to be considered for a company to not only be sustainable but profitable: Is the industry growing and are margins healthy? Are the barriers to entry significant enough to keep "outsiders" at bay? Will industry members act rationally? Just as important is the company's management team which plays a significant role in its success: Does management have a laser-like focus on execution? Is it able to pivot from setbacks and react to direct attacks on its business model? Of course, during this time, a healthy portion of luck also contributes to the company's fortunes. Maybe a better approach to investing in the "next big thing" is to invert the question: What is not going to change over the next 10 years and which company will benefit? Even though uncertainty has not been completely eliminated, this is a much easier question to answer.

In 2006, I invested in Sherwin Williams (SHW), a 150 year old paint and coating company. My investing thesis was very straightforward: As a global manufacturer and distributor of architecture paints and industrial coatings, Sherwin Williams, its brand and its industry would continue to grow steadily even through routine market cycles - Perhaps not the double-digit growth that many in the market had come to expect and covet, but steady and predictable growth nonetheless. Additionally, given Sherwin Williams assets, its well-known brand and market share, there was very little risk of a newcomer or technology disrupting this industry. By 2011, even as the market continued to recover, I decided to sell my SHW position. There was nothing inherently wrong with the company or the industry and my return was positive, slightly over 75%. The reason I eliminated the position was because I grew impatient and that impatience led me to question how this company was going to continue to grow in value when its revenue was only growing by 5-7% annualized. Looking back at that investment and my decision to sell it, I came to realize that I did not truly understand the company. **Let me be clear.** I was completely confident in my research, analysis, and valuation of the company and its financials. But what I did not take the time to contemplate was how Sherwin Williams' management would impact the value of the company over a 10 year period. I failed to appreciate that when a strong cash generating company encounters a management team focused on generating value for the company and its shareholders, this creates a powerful and disruptive force. This turned out to be a very costly lesson.

If I had held my Sherwin Williams position for a ten year period from the time I purchased it in 2006, the share price would have appreciated over 680%. That 680% return included: $2 billion in dividends paid to its shareholders, $5 billion spent on reducing its share count by 30%, an EPS that tripled, and a P/E multiple that doubled from 12x to over 25x. In fact, if I had continued to hold Sherwin Williams shares until the end of 2017 (an additional 16 months), the return would be closing in on a 1000% return, the elusive "10 bagger."

Sherwin Williams is an "anti-story" stock, operating in an unexciting, overlooked segment of our economy that attracts little to no attention. With the news media's insatiable appetite for reporting on the "next big thing," it is easy to see how investors can become preoccupied and overlook a high caliber company like Sherwin Williams. Some of the best long-term investments are often cloaked because they do not fit within a particular investing "style." They trade at too high a multiple or with too much debt to be considered a value stock, and their revenue growth rates have long since returned from the stratosphere to a more mundane but sustainable level. The lessons learned from my impatience and short-sightedness has helped shape future investments including Hanesbrands which I recently presented at the MOI Best

Ideas Conference. The presentation focuses on similarities between Hanebrands today and Sherwin Williams 10 to 12 years ago.

Although some treat investing as a competition, it is not an Olympic sport. An investor does not get extra points for his willingness to buy shares of a highly volatile "story stock." For those addicted to the adrenaline rush and the need to react to every news item and price change, the lure of "the next big thing" is just too great to ignore. But for the long-term investor, the "next big thing" might just be hidden in plain sight.

Administrative

My Pledge

From my years of experience in business and investing, I have come to learn that trust is earned, not bestowed. It takes years of hard work to earn someone's trust, but only a few seconds to destroy it. I do not take your trust in me lightly and pledge to continue to go beyond what is required to meet your expectations. The goal of Hazelton Capital Partners is to repay your trust with returns that will outperform the market.

Investing in Hazelton Capital Partners

Hazelton Capital Partners was created as an investment vehicle, allowing those interested in long-term exposure to the equity market to invest alongside me. With a substantial portion of my own capital in the fund, I manage Hazelton Capital Partners assets in the same manner in which I manage my own capital. The best source of introduction to potential investors in the Fund has come from those that have invested or followed Hazelton Capital Partners progress over the years. Introductions are both welcome and appreciated.

If you are interested in making or increasing your contribution to Hazelton Capital Partners or just learning more about The Fund, please feel free to contact me.

Please do not hesitate to call me at (312) 970-9202 or email me bpasikov@hazeltoncapital.com with any questions or concerns.

Warm Regards,

Barry Pasikov
Managing Member