CAPSTONE Portfolio Updates

June 19, 2020

Replacing Welltower with CyrusOne, Inc

With senior housing comprising one of the largest segments of Welltower's properties portfolio, the REIT company was negatively affected with occupancy rates falling due the impact of the coronavirus. With the virus affecting our senior demographic the hardest, it was reasonable to expect such a decline in occupancy rates. However, limited barriers to entry and heightened political risks regarding Medicare and Medicaid reimbursements could impact supply and demand dynamics in senior housing. Uncertainties about the duration and magnitude of the coronavirus is expected to continue to exert pressure on Welltower's properties. The company recently also cut its dividend by 30% to shore up additional cash should the uncertainty persist.

CyrusOne provides mission critical data center facilities that protect and ensure continued operation of IT infrastructure for its tenants. Secular drivers of growth from some of the biggest themes in technology such as big data, shift to the cloud, artificial intelligence, and Internet of Things could propel demand of data center facilities further. Although the industry remains competitive, CyrusOne benefits from its focus on hyperscale data centers which has seen more consolidation in recent years, making the company a viable buyout target or acquirer. Payout ratio in the 50% range is also reasonable given the growth potential embedded within the data center REIT.

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www.LibertyOneIM.com
847-680-9255

Replacing Preferred Apartment Communities with Americold Realty

Preferred Apartment Communities (APTS) owns and operate a diversified portfolio of multi-family, student housing, and office real estate properties mainly in the Southeast region. Despite favorable demographic tailwinds and high-quality assets that APTS owns, their sub-optimal capital structure contains significant leverage for common stock equity holders induced by the preference for preferred stock financing over debt despite market low interest rates. Additionally, the REIT company recently announced plans to internalize management for f their properties (insourcing instead of outsourcing property management) which will likely drag funds from operations due to higher overhead costs. This will add additional strains to its already stressed common stock dividend payout ratio. Investments in the other parts of APTS' capital structure may be more attractive than its common stock.

Americold Realty (COLD) holds leadership in a niche market- refrigerated warehouse segment and has shown strong growth and robust operational performance over the last few years. COLD's facilities are an integral component of the supply chain connecting food producers, processors, distributors, and retailers to consumers. Operating in the refrigerated and food market, the industry is anticipated to reach $320 billion by 2026, driven in large part by increasing global population, scarcity of food in some regions, strong demand from emerging economies, and specific demographic changes in the modern world. COLD continues to build and acquire strategic locations domestically and internationally to drive long-term cash flow growth and shareholder value. The company's capital structure is also more desirable than APTS with most of the financing driven through debt and common equity. 86% of its total outstanding debt is at a fixed rate with a weighted average interest rate of 3.89% for a remaining weighted average term of 6.5 years.

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Replacing The Children's Place with Canada Goose

Challenges continue to persist for The Children's Place (PLCE) who specializes in children apparel, footwear, and accessories primarily through traditional brick and mortar stores. Recently, online sales have picked up to offset major store closures nationwide, but many questions remain about the execution of its digital transformation strategy and future business prospects. Operating in a highly competitive environment, the lack of pricing power, cost advantages, and increasing competition from Walmart (WMT) and Target (TGT) have led to market share losses and weak return on capital for the children specialty retailer. Operating in a stagnant end market with low birth rates and existing customer base "aging out" of its market, several long-term headwinds pose a significant challenge for the company.

Canada Goose (GOOS) is a luxury apparel retailer specializing in winter outerwear that holds tremendous pricing power and some of the highest margins in the industry. Supported by its growing customer base and shifts towards direct-to-consumer distribution strategy, GOOS has captured six consecutive years of double-digit sales growth while accelerating fixed cost leverage with greater margin expansion. Additionally, the global winter wear market is currently valued at over $280 billion and is expected to grow 4.3% CAGR over the next five years driven by the rise in purchasing power of consumers along with increased demand for premium products across different end users and markets. With a sub $3 billion market value for GOOS, the growth potential in a large addressable market combined with management's strategy to diversify into other products to mitigate the seasonality of winter wear apparel makes GOOS a compelling replacement for PLCE.

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Replacing Royal Dutch Shell with SolarEdge Technologies

Impacted by similar sector-wide challenges as Exxon Mobil (XOM), Royal Dutch Shell (RDS.A) did what it had not done in over 75 years, which was to cut its dividend by 66% to help the company navigate an uncertain operating environment going forward. Although a dividend cut could afford RDS.A greater financial flexibility in the future, our long-term investment thesis in oil companies being able to generate a return above its cost of capital like it once did remains challenged.

SolarEdge Technologies (SEDG) designs and develops inverter systems for solar photovoltaic (PV) mainly found in solar panels as well as battery systems, panel optimizers, and power management systems. The company's solutions have quickly risen from 5% market share in 2013 to 60% of the US residential solar market. With a greater adoption and preference for alternative energy globally as cost of solar farms continue to decline, the growth potential and total addressable market for SEDG remains very enticing. Additionally, the company stands to benefit from a strong financial position with minimal debt and a net cash position of over $500M. As the inverter markets becomes saturated over time, SEDG's business could maintain its resiliency through its other offerings such as power management and battery systems which could eventually become much more important in the future.

In summary, Liberty One is taking a prudent but thoughtful approach in navigating our individual equity positions and will continue to remain fluid to adjust to new developments and environments. We remain largely favored towards high quality, fundamentally sound companies whose financial prowess and growth potential are going to help in uncertain business conditions.

If you have any questions about these or any changes in your Liberty One portfolio(s), potential tax implications, or would simply like to learn more, please contact your financial advisor.

Thank you for your continued trust and confidence!

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