SEVEN SUMMITS CAPITAL

1853 William Penn Way, Suite 9 · Lancaster, PA 17601 · 717 735 0013

NOVEMBER 2014 INVESTMENT COMMENTARY

A SIMPLE TRUTH: LONG-TERM INVESTMENT SUCCESS REQUIRES LOOKING PAST SHORT-TERM WORRIES

While planning this month's commentary, I was very tempted to rehash last month's stock market mini-correction and rapid recovery. However, due to today's 24/7 news cycle that seems to endlessly debate and speculate upon news events, I do not see any reason to continue to rehash these issues since they tend to fade from memory once the next faux crisis takes center stage. I am convinced that Seven Summits Capital's clients understand the difference between the short-term irrationality of markets and the optimism that is required for long-term wealth creation.

Thus, I have decided that over the next several months, I am going to accentuate the positive by focusing on secular themes that we view as attractive investment trends. To produce successful long-term investment results, it is often beneficial to identify companies that will gain from secular trends such as technological innovation and demographic shifts. Our willingness to put the necessary time into understanding these trends help us identify certain under-valued opportunities that may not always be obvious to the typical distracted investor. Unlike the typical top-down momentum oriented approach that is more commonly associated with thematic investing, Seven Summits Capital attempts to seek out temporarily out-of-favor investments that are uniquely positioned to capitalize on an identified long-term trend.

To successfully execute on this strategy, we indentify companies that are among the leaders in a rapidly developing industry or ones leading the transformation of an industry. We first must be convinced that the company's products or services will be adopted by end markets and result in a profitable enterprise. The more difficult task is to find companies that can do this more quickly or more successfully than market sentiment reflects. A couple examples where we have gotten the trend right, but the speed of adoption wrong has been with LED lighting and OLED displays through investments in companies such as Cree and Universal Display. On the other hand a very good example of this particular strategy working was our purchase of Facebook in March of 2013 when many analysts were skeptical of the company's future after a disastrous IPO the previous year. However, at that time, we became convinced that Facebook's increasing revenues and evolving mobile strategy set the company up for breakout profitability. Because we were able to objectively assess Facebook in the face of low market sentiment, we could anticipate, with better accuracy than the broad market, Facebook's success at growing its user base and monetizing its platform. This type of investing differs from traditional value investing because with new industries and revolutionary companies, there is very little precedent to draw upon in order to develop growth and valuation metrics.

When a promising growth company's profit initially breaks out, using traditional P/E ratio valuation techniques can be very misleading. A small profit generates a P/E ratio that inaccurately presents the stock as being outrageously expensive. Many times it takes the market quite some time to properly factor in realistic profit growth expectations. For example, we purchased Facebook when the stock was priced around $25.00 per share and, based upon trailing FY2012 earnings, the P/E ratio was greater than 1,500X, which made the stock look like it was 1000X more richly valued than the S&P 500. Today, the stock is priced around $75 per share and the P/E, as measured against FY2013 trailing earnings is 70X. At today's price, Facebook has seen its stock price triple over the last 18 months and its P/E ratio fall by 96%. For us, today's Facebook stock is much more challenging to commit new money to than when the P/E was over 1,600X. When traditional valuation metrics are largely meaningless, one has to understand the company's business model in order to invest against the prevailing market sentiment.

Once a transformational growth company like Facebook becomes consistently profitable and analyst profit expectations finally align with the reality of the company's growth trajectory, traditional valuation metrics can be used. See the illustration of Facebook's profit expectations, forecast growth rates and P/E ratio driven stock price forecasts below:

CONSENSUS EXPECTATIONS

	2014	2015	2016	2017	2018
EPS (estimate)	$1.31	$1.42*	$1.95*	$3.23*	$4.04**
Growth Rate	446%	8.3%	37.3%	65.64%	25.00%

STOCK PRICE FORECAST

	2014	2015	2016	2017	2018
Price @ 64 P/E	$83.00				
Price @ 54 P/E		$77.00			
Price @ 44 P/E			$85.00		
Price @ 34 P/E				$109.00	
Price @ 30 P/E					$121.00

Note: The current and forward year stock price forecasts are based upon P/E multiples that we believe will be commensurate with forward earnings growth expectations.

**EPS forecasts are from Zacks consensus estimates and are based upon fully diluted EPS, excluding non-recurring items.*

***2018 EPS estimates are an estimate from Seven Summits Capital.*

Once a high growth company achieves a market capitalization upwards of $200 million, as Facebook has, and future growth rates are forecasted to moderate, P/E ratios routinely normalize to 1.50 to 2.00 times long-term growth expectations.

The current P/E ratios of other mega-cap growth stocks in the technology/internet/social media space are as follows:

COMPANY	TICKER SYMBOL	1 YR FORWARD P/E
Google	GOOG	26
Apple	AAPL	13
Priceline	PCLN	23
Allibaba	BABA	53
Facebook	FB	53

From the above analysis, we believe that Facebook stock is unlikely to appreciate anywhere near the rate of growth achieved over the last 18 months. This leveling off of stock appreciation is the result of realistic future profit expectations being priced into the stock. We confidently hold Facebook stock at the current price and we are on the lookout for companies in other areas of the economy that might present a similar opportunity to that of Facebook in early 2013.

At Seven Summits Capital, we are studying the following transformational technologies/secular trends:

1. Solar Power
2. Lithium Batteries / Carbon Emission Reduction
3. 3D Printing
4. Life Longevity - Healthy Eating & Personalized Medicine
5. Internet Commerce Technology & Big Data

Currently, we have several companies included in our client portfolios that have exposure, directly or indirectly, to many of the aforementioned themes. Some companies are pure play opportunities such as Whitewave Foods, a plant based and organic food company. We first acquired Whitewave Foods stock in October 2013 at prices under $20 per share and at a forward P/E ratio of 26X. Today, Whitewave Food's stock is trading at around $37 per share with a forward P/E of 37X. This investment is now trading at a multiple that is commensurate with its estimated forward average EPS growth rate of 25%, which equates to a 1.50 PEG ratio.

In our opinion, companies such as Whitewave Foods, the manufacturer of Silk branded almond milk and other plant based foods, should trade at a minimum of 1.5X the expected forward growth rates because its products have a secular trend that is propelling growth in excess of the overall market. When Whitewave Foods was trading under $20 per share, this represented a P/E multiple that equated to 1.0X its forward growth expectations. This equated to opportunity for us and over the last 12 months the company's stock rallied 94% from $19 per share to $37.

A less obvious investment leveraged to the expanding usage of lithium batteries is Modine Manufacturing. Modine Manufacturing does not manufacture lithium batteries or build electric vehicles like Tesla, however, the company is a global leader in the area of cooling and heat transfer technology. In fact, Modine Manufacturing is Tesla Motor's original equipment manufacturer for the company's lithium battery advanced cooling system. Thus, with the construction of the Tesla/Panasonic joint "Giga Factory" being built in Nevada, which is slated to double the world's manufacturing capacity for lithium batteries over the next several years, Modine Manufacturing's cooling technology will likely be in much greater demand. Right now, Modine Manufacturing's battery cooling systems line of business is relatively small, but this line of business along with its specialized HVAC systems used in Data Centers (the physical backbone of cloud computing) are poised for substantial growth.

Unlike Whitewave Foods, which we invested in early enough to reap substantial gains from the company's pure-play exposure to a widely recognized growing trend of healthy eating, Modine Manufacturing is a 100+ year-old manufacturing company operating in what is perceived to be a relatively boring industry. This makes Modine Manufacturing's growth opportunity is much less obvious. Because of this, its current valuation does not reflect the growth that we see in the coming years.

Similar to our in-depth understanding of the trends that are driving hybrid and plug-in electric vehicle drivetrains, we are beginning to get a similar understanding of the solar energy industry. Solar energy has come a very long way since its beginning in the late 1970's when it was seen as a fringe idea of hardcore environmentalists. Over the last decade, solar energy has transformed into a very legitimate source of electricity that can challenge traditional fuels such as coal, oil, and natural gas. In a Bloomberg article published by Tom Randall on October 29th, titled "While You Were Getting Worked Up Over Oil Prices, This Just Happened to Solar", Mr. Randall referenced a recent report from Deutsche Bank that stated "after years of struggling against cheap natural gas prices and variable subsidies, solar electricity is on track to be as cheap or cheaper than average electricity prices in 47 U.S. states -- in 2016"(assuming the U.S. maintains its 30 percent tax credit on system costs, which is set to expire that same year). The author goes on to states that "even if the tax credit drops to 10 percent, solar will soon reach price parity with conventional electricity in well over half the nation: 36 states". Our research of the industry mirrors Bloomberg article's stance on the price parity inflection point that will occur over the next couple years.

Mr. Randall ends the article with a projection from International Energy Agency which forecasts that "Solar will be the world's biggest single source of electricity by 2050". Based upon how far the technology driven economics of solar energy has progressed over the last decade, it does not seem to be a stretch to believe the International Energy Agency forecasts. Large solar energy projects are even becoming more prevalent right here in rural Central Pennsylvania. Just this month the Elizabethtown College announced that they are building a $6 million solar energy project that will supply 20% of the college's electricity needs going forward. Additionally, the new 1 million square foot Urban Outfitters warehouse being built in Gap, Pennsylvania will be using solar energy to power one half of this expansive warehouse facility's energy needs.

One company that has catapulted into a leadership position within the solar industry is SunPower Corp., a $4 billion vertically integrated pure-play on the growth in solar energy adoption. SunPower Corp. is 66% owned by Total S.A., the third largest integrated energy company in the world, and is the second largest company in the solar industry behind First Solar. Growth estimates call for SunPower Corp. to earn $1.14 in profits per share in 2014, steadily rising to $2.53 in 2017. Thus, the company is projected to generate annualized growth in profits over the next three years of 30.4%. With the stock's current P/E ratio at 28X, we believe that, given a long-term profit growth expectation of 30.4%, the market is not as confident in this company's growth as we are. The market's jaded view of the company is evidenced by a 24% short interest in the stock, which means that 24% of the outstanding stock in SunPower Corp. is in the hands of those betting against the company's success. Given this high level of negative sentiment, and a PEG ratio under 1.00, we believe that SunPower Corp. resembles the type of investment opportunity that we saw with Facebook two years ago.

At Seven Summits Capital, stocks such as SunPower Corp. usually show-up first in the investment portfolios that predominately have a growth objective. However, overtime, as we become increasingly familiar and comfortable with how the stock trades, that investment will tend to find its way into more conservative portfolios. Unlike most asset managers, we do not believe that equity portfolios should be invested homogeneously in a particular size or style of company. Investors can easily fool themselves into believing that they are mitigating portfolio risk by owning a large number of "safe" blue chip stocks. However, in reality this one dimensional version of diversification by number of stocks is a false panacea. Using a portfolio construction approach, we strive to own many different types of stocks (growth, value, mid-cap & small-cap), while managing to a client specific growth, income and volatility objective at the total portfolio level. This allows us to seek out equity investment opportunities from a very diverse universe of companies, which inherently maximizes desired risk management, while still achieving broad portfolio level objectives.

Over the next couple months, I plan to further elaborate on several of the long-term opportunities that we are finding among companies leveraged to certain secular trends that are being driven by technology and demographics. Thus, I intend to divert your attention from the 24/7 new cycle and instead, hope to relay some positivity as we enter the holiday season and 2015. **HAPPY THANKSGIVING!**

CURT R. STAUFFER
(C) 717 877 7422
(O) 717 735 0013
cstauffer@ssummitscapital.com