Spring 2018 Newsletter

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LEADERSHIP CHANGE

Leadership of the Fund changed hands after the Fall 2017 semester. Former Portfolio Manager Michael Canale, Chairman Nick Wiles, and President Anthony Battista, appointed the following members:

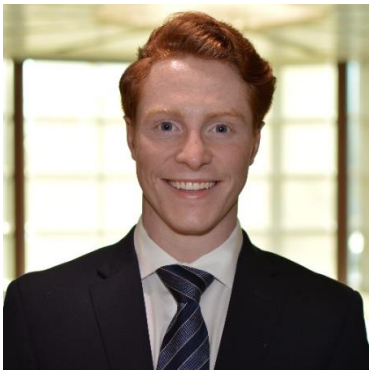
Kyle Menges, Portfolio Manager

Kyle is a junior and has been in the fund for four semesters. As the Portfolio Manager, he is responsible for leading the pitch process and for the overall performance of the portfolio. Furthermore, Kyle leads Fund workshops on investing, financial modeling, and valuation.

Yoav Barkai, Head of Operations

Yoav is a junior and has been in the fund for four semesters. In his role, Yoav focuses on the day-to-day operations of the Fund, including setting the schedule, arranging and leading club meetings, ensuring timeliness and quality of work, and coordinating with faculty and administration. Also, Yoav focuses on marketing for the Fund, both within UMass and externally to alumni and companies.

Jim Chappuis, Chairman



Jim is a junior and has been in the fund for five semesters. Jim's primary responsibility is to support the career development of all members of the Fund. His focus is on helping everyone get an internship or full-time job. He also works to create recruiting opportunities and helps lead MEF's recruiting process.

Sector Addition

This semester we added the REITs sector to our coverage, expanding our coverage from 8 to 9 sectors. Previously, REITs was lumped in with our Financials sector. We decided to make REITs its own sector for 3 reasons: 1) REITs had never been adequately followed or understood by our analysts covering Financials, 2) Members of the fund are interested in Real Estate investing specifically, and 3) We felt that we could find investment opportunities in the REITs sector given many REITs were trading below their Net-Asset values going into the semester.

PORTFOLIO

At the beginning of 2018, we outlined two main initiatives: 1) reducing our cash position and 2) refocusing on our core value investing strategy. At the beginning of the semester we held roughly 35% of our portfolio value in cash. This was a result of heavy selling this past fall when we sold 9 positions from the portfolio. In this current market climate, it makes sense that we would be selling more than we are buying however, we still need to be finding pockets of value in the market to put our money to work.

This is where our second initiative, to refocus on our value investing strategy, comes into play. At the beginning of the semester we led workshops on our Fund's value investing strategy which gave our analysts a solid framework for finding unique value opportunities in their respective sectors. As a result, we had some strong pitches this semester which enabled us to reduce our cash in the portfolio. This semester was arguably the strongest yet in terms of pitch quality. Our analysts did meticulous research, identified opportunities that fit into our Fund strategy, and performed scenario analysis in their models to show the risk/reward in making each investment.

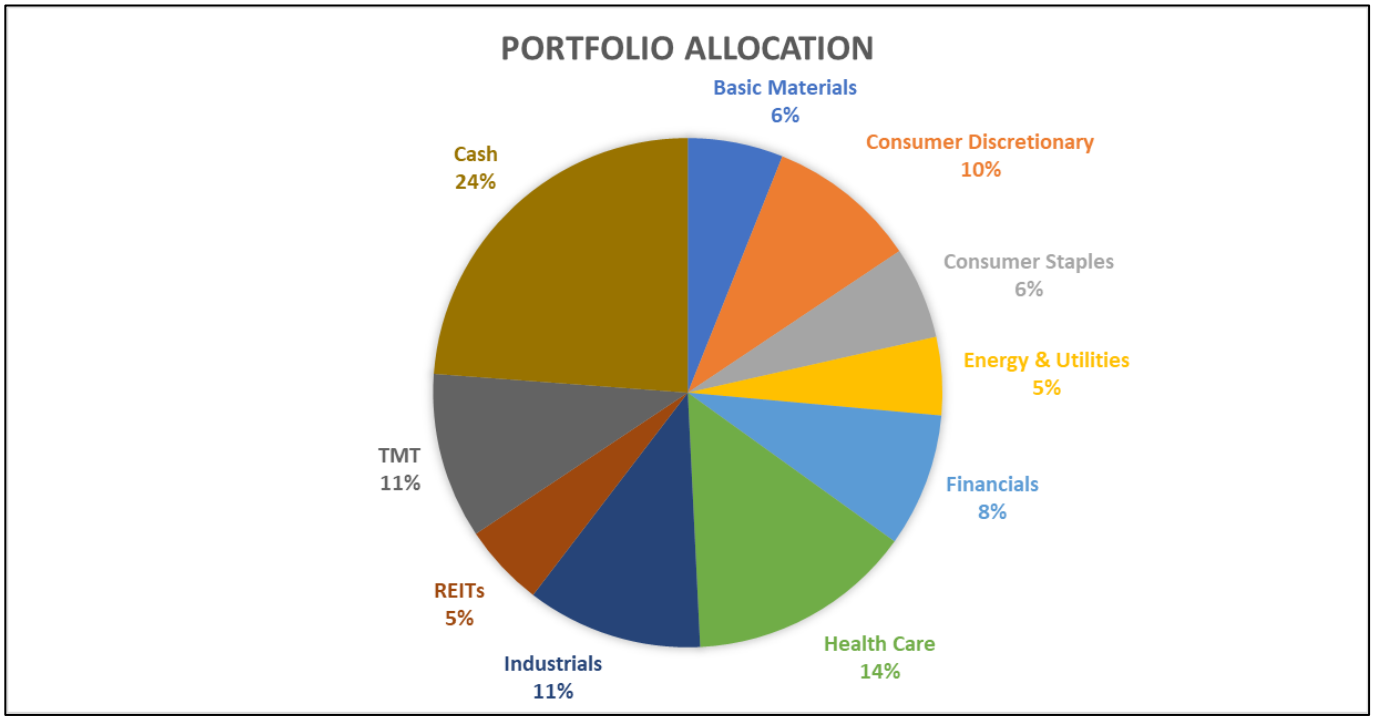
We added 4 stocks to the portfolio this semester: Gladstone Commercial Corp. (GOOD), Cardinal Health Inc. (CAH), Dick's Sporting Goods Inc. (DKS), and Primoris Services Corp. (PRIM). The equity report for Gladstone Commercial Corp. (GOOD) is appended to the newsletter. These additions to our portfolio allowed us to decrease our cash position by about a third, from $90,000 in cash down to $60,000 in cash. We now hold 26 names in the portfolio with an average position size of roughly $7,500.

This shows significant progress toward our long-term goals to have 20-30 stocks in the portfolio and about 15-20% of our portfolio in cash. We are in an ideal spot with 26 names in the portfolio and we currently hold 24% of our portfolio value in cash. We are very pleased with our progress considering that just two years ago we held 42 stocks in the portfolio. We are now a high conviction, high concentration equity fund and are excited about our long-term prospects.

PORTFOLIO PERFORMANCE VS. S&P 500 YEAR-TO-DATE

Year-To-Date Performance:

MEF Portfolio: -1.2% S&P 500: +2%



FULL-TIME JOB & INTERNSHIP PLACEMENT

One of the primary goals of our group is to place our members into top internships and full-time positions. Each year, our placements have gotten stronger. This year has been no exception. Below is a summary of our members' placements.

Full-Time Placements

Nick Wiles Citigroup Sales & Trading Boston, MA	Anthony Battista Wayfair Corporate Finance Boston, MA
Michael Canale Berkeley Research Group Management Consulting Boston, MA	Austin Flinn Alliance Global Partners Investment Banking New York, NY
Nick Ziner Goldman Sachs Internal Audit, Securities New York, NY	

Internship Placements

Kyle Menges Eaton Vance Equity Research Boston, MA	Jim Chappuis Miller Buckfire Investment Banking New York, NY
Yoav Barkai Pratt & Whitney Materials Planning Strategy Farmington, CT	Tom Glinski Goldman Sachs Equity Research New York, NY
Dan Cornelius Citigroup Sales & Trading New York, NY	Nate Hallock General Electric Financial Management Program Boston, MA
Penelope Martin Goldman Sachs Commercial Banking New York, NY	Nick Goetz Stifel Nicholaus Fixed Income Capital Markets New York, NY
Sophia Nolasco Fidelity Investments Investment Research Boston, MA	Dan Roytman J.P. Morgan Sales & Trading Boston, MA
Edden Nativ MassMutual Investments Investment Management Springfield, MA	Jack Stansky Environmental Systems Corporate Finance Acton, MA
Joseph Wong BNY Mellon Wealth Management Boston, MA	Hiep Nguyen Vietnam Investment Group Private Equity Ho Chi Minh City, Vietnam

End of Semester Awards

Best Sector Team(s):

REITs
Senior Analyst: Nick Goetz
Junior Analyst: Justin Crowley

Consumer Discretionary
Senior Analyst: Tom Glinski
Junior Analyst: Tim Costanzo

Best Junior Analyst Pitch:

Tim Costanzo with his pitch of Thor Industries (THO)

The analysts who won the following awards demonstrated outstanding work ethic throughout the semester and a deep understanding of our Fund's strategy. We were very pleased with their quality of work and attention to detail. Their pitches were some of the strongest we have ever seen, and they left no stone unturned in their research.

Gladstone Commercial Corporation (NASDAQ: GOOD)

Recommendation: BUY

INVESTMENT THESIS

We are recommending a long position on Gladstone Commercial Corporation (GOOD) with a target price of $19.39. Gladstone is a diversified Real Estate Investment Trust (REIT) with assets in the retail, industrial, office, and medical space.

Over the last year Gladstone has been hit hard due to rising interest rates. However, the fundamentals of this REIT have not changed. They have managed to increase rental income and FFO while also trimming their portfolio when necessary to maintain their focus on office and industrial properties. While they are exposed to the declining retail market, Gladstone pays close attention to the tenant before acquiring a property. We believe that the market is overweighting their retail presence and rising interest rates in determining their price. Therefore, in our opinion, Gladstone is fundamentally undervalued.

BUSINESS OVERVIEW

Gladstone Commercial is a REIT based in McLean, Virginia. The company invests in single and multi-tenant industrial and office buildings. Gladstone owns and operates 98 properties containing 11.5 million square feet of rental space. Gladstone has tenants from a diverse group of 19 different industries and has an astounding 97.8 occupancy rate. Gladstone has a fantastic track record as their occupancy rate has never fallen below 96%, and only 1 tenant has defaulted in the company's history. Furthermore, the company has paid out a monthly dividend for 156 consecutive months and did not decrease the value of the dividend during the financial crisis.

COMPANY DATA

Price: **$16.91**

Market Cap: **$460 mm**

Price/FFO: **10.98x**

Dividend yield: **8.09%**

Price Target: **$19.39**

Upside: **14.69%**

NAV/Share: **$23.08**

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INTEREST RATE ENVIRONMENT

Currently we are in an environment of rising rates. The current benchmark Federal Funds Rate is around 1.50%. Although leadership in the Fed has switched to Jerome Powell, over 2018 the Fed is still expected to raise rates 3 times. Recently, there has been speculation that it may even be 4 times as inflation numbers have been coming in stronger than expected. Stronger inflation pushes up the long end of the curve with investors demanding more yield as buying power is eroded. As rates rise investors will flock to risk free securities, such as the U.S. 10-year treasury bill, as opposed to high dividend yielding stocks such as REITs. Additionally, higher rates make the cost of borrowing more expensive, which will negatively affect a debt-heavy industry such as real estate. In this type of environment, it is important to look at the fundamentals of the REIT to ensure that they are priced fairly and not just devalued because of monetary policy.

REAL ESTATE ENVIRONMENT

The Real Estate Industry is extremely healthy right now. Just like the economy, the real estate industry flows in a cycle. The real estate cycle is about 16-18 years long on average, but the time frame obviously fluctuates. Currently, the industry is in the expansion phase. This means that there are declining vacancy rates as well as new construction. Most of this construction is in the industrial warehouse segment as companies are looking for more storage space due to their increasing web/shipping services. However, there has been a steep decline in the retail area in the past few years because of that same factor. More retail companies are going bankrupt due to minimal foot traffic which is putting a lot of pressure on REITs. While the price is declining for many of these companies, the underlying assets are not. Land and buildings normally appreciate over time, especially in this real estate environment. Although Gladstone does have a retail presence, we believe that their price has been hit harder than it should have been, as only 3% of their rent comes from retail. They have high occupancy rates as well as 33% of their rent coming from industrial properties, which will lead to sustained growth.

Competition

Gladstone Commercial competes against various companies nationwide, as well as within regional markets. Their main competitors include One Liberty Properties, Lexington Realty Trust, Cousins Properties Incorporated, and Forest City Properties. All these companies invest in industrial, office, and, to an extent, retail properties. Gladstone has a major advantage over all its competitors. Gladstone's competition focuses on location, while Gladstone focuses on its tenants. Gladstone and its competitors compete in secondary markets with middle market tenants. These factors make location less important and finding a stable tenant extremely important. Gladstone has a leg up on competition because it understands its role within the marketplace.

Gladstone Fundamentals

As mentioned above, Gladstone's competitive advantage is that when evaluating a property, they focus on finding a tenant that will fill the space before they buy it. With this tenant first mentality, the company is able to keep their occupancy rates above the industry average as well as minimize the risk of tenants defaulting on rent. Even though there are forces working against them, such as rising rates and a declining retail market, the fundamentals of their business have not changed. Gladstone Commercial has a dedicated management team that is taking measures to improve the business. Such measures include divesting from non-core assets such as their medical centers and trying to pay down some of their debt. We are very confident in the management team's ability to continue rental income growth as well as FFO growth, as they have done every year.
While REITs can be tied to increases in interest rates, and other external factors, we believe that the asset value and the sustainable business model are being undervalued currently.

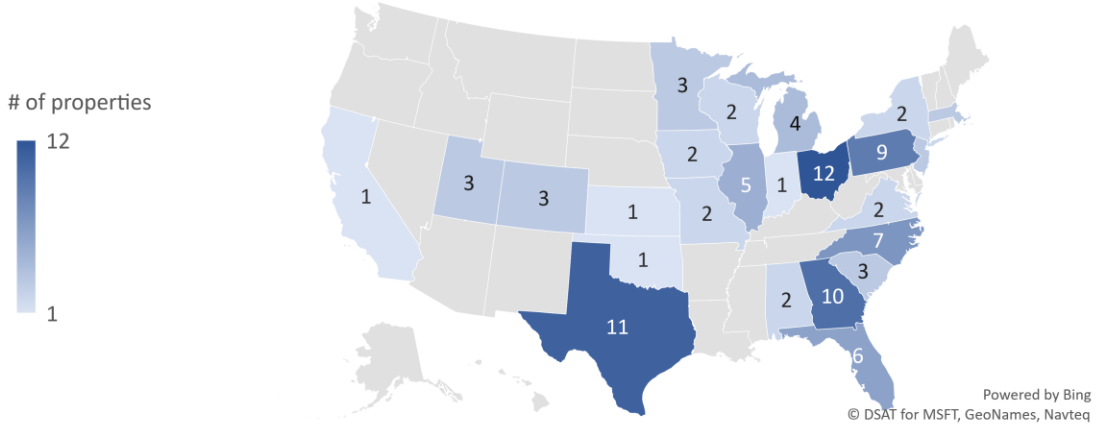
De-leveraging

Gladstone Commercial has been methodically deleveraging each quarter for years since they have been criticized for being heavily leveraged. The company has used more equity when refinancing mortgages and investing in new properties. Chief Executive Officer David Gladstone believes the company's current level of leverage is conservative.

The contrarian viewpoint

There are some unfavorable factors that some analysts believe will harm Gladstone in the future. Rising rates are harmful to REITs as investors flock to risk free assets with higher yields. Gladstone has a good amount of retail properties. As companies like Amazon become more prominent this will hurt retail revenues which in-turn could affect Gladstone's profitability.

Geographical Distribution of properties



MEF Minutemen Equity Fund

Table 6. Valuation

Current Price	16.91
Current Market P/FFO	14.16x
GOOD P/FFO Index	0.89
Adjusted P/FFO	12.54x
TTM FFO/S	1.55x
Target Price	$ 19.39
Upside	14.69%

Table 3. NAVPS

	2017A
Revenue	94,799
Property operating expenses	(7,688)
Base management fee	(4,959)
Incentive fee	(2,422)
Administration fee	(1,272)
General and administrative	(2,366)
Total NOI	**76,092**
Capitalization Rate	**7.25%**
MV Real Estate	1,049,134
Cash	6,683
Debt	447,380
Shares outstanding	26,358
Current price	$ 16.91
NAV/S	**$ 23.08**
Upside	36.51%

MODEL ASSUMPTIONS

To value Gladstone Commercial Corporation, we used an adjusted P/FFO multiple and applied it to their TTM FFO/S. To calculate their adjusted P/FFO multiple we looked at some of their competitors to get an industry average P/FFO multiple for each quarter over the last 8 years. We then created an index to see how much Gladstone's multiple varied from the average. We then took an average of the index and applied it to the current industry P/FFO multiple. This methodology resulted in a target price of $19.39, or a 14.69% upside. The other methodology we used was the NAV per share which is basically the implied value of all their assets. We calculated the NOI for 2017 and then used a weighted average cap rate of all their properties to find the market value of all their assets. After adding cash and subtracting debt we are left with the net asset value. Using this method Gladstone is currently undervalued 36.51%.

Table 7. Sensitivity Tables

		P/FFO								
	14.69%	10.54x	11.04x	11.54x	12.04x	**12.54x**	13.04x	13.54x	14.04x	14.54x
	1.35x	-15.85%	-11.86%	-7.87%	-3.88%	0.11%	4.10%	8.10%	12.09%	16.08%
	1.40x	-12.74%	-8.60%	-4.46%	-0.32%	3.82%	7.96%	12.10%	16.24%	20.38%
	1.45x	-9.62%	-5.33%	-1.05%	3.24%	7.53%	11.82%	16.10%	20.39%	24.68%
	1.50x	-6.51%	-2.07%	2.37%	6.80%	11.24%	15.67%	20.11%	24.54%	28.98%
FFO/S	**1.55x**	-3.39%	1.19%	5.78%	10.36%	14.94%	19.53%	24.11%	28.69%	33.28%
	1.60x	-0.27%	4.46%	9.19%	13.92%	18.65%	23.38%	28.11%	32.84%	37.58%
	1.65x	2.84%	7.72%	12.60%	17.48%	22.36%	27.24%	32.12%	37.00%	41.87%
	1.70x	5.96%	10.99%	16.01%	21.04%	26.07%	31.09%	36.12%	41.15%	46.17%
	1.75x	9.08%	14.25%	19.43%	24.60%	29.78%	34.95%	40.12%	45.30%	50.47%

		Cap Rate								
	36.51%	8.25%	8.00%	7.75%	7.50%	**7.25%**	7.00%	6.75%	6.50%	6.25%
	60,873.60	-33.33%	-28.16%	-22.65%	-16.77%	-10.49%	-3.77%	3.46%	11.24%	19.65%
	64,678.20	-22.98%	-17.49%	-11.63%	-5.39%	1.28%	8.43%	16.11%	24.37%	33.30%
	68,482.80	-12.64%	-6.82%	-0.62%	5.99%	13.05%	20.62%	28.75%	37.51%	46.96%
	72,287.40	-2.29%	3.85%	10.39%	17.37%	24.83%	32.82%	41.40%	50.64%	60.62%
% of NOI	76,092.00	8.06%	14.52%	21.41%	28.75%	36.60%	45.01%	54.04%	63.77%	74.28%
	79,896.60	18.40%	25.19%	32.42%	40.13%	48.37%	57.20%	66.69%	76.90%	87.93%
	83,701.20	28.75%	35.86%	43.44%	51.51%	60.15%	69.40%	79.33%	90.04%	101.59%
	87,505.80	39.10%	46.53%	54.45%	62.90%	71.92%	81.59%	91.98%	103.17%	115.25%
	91,310.40	49.44%	57.20%	65.47%	74.28%	83.70%	93.79%	104.63%	116.30%	128.91%

Gladstone Commercial Ticker: GOOD

Table 1. Income Statement

In thousands, except per share #'s	2011A	2012A	2013A	2014A	2015A	2016A	2017A
Revenues							
Rental Income	43,632	50,915	59,769	71,211	80,892	84,498	92,811
Tenant recovery revenue	344	355	1,574	2,080	1,753	1,489	1,988
Interest Income	-	-	-	465	1,135	385	-
Total property income	**43,976**	**51,270**	**61,343**	**73,756**	**83,780**	**86,372**	**94,799**
Expenses							
D&A	(14,149)	(16,831)	(22,827)	(28,865)	(35,288)	(37,517)	(42,795)
Property operating expenses	(986)	(1,588)	(3,348)	(4,711)	(5,296)	(5,889)	(7,688)
Base management fee	(700)	(949)	(768)	(2,798)	(3,474)	(3,930)	(4,959)
Incentive fee	(1,629)	(1,467)	(2,014)	(4,305)	(4,650)	(2,381)	(2,422)
Administration fee	(3,398)	(3,569)	(4,201)	(1,526)	(1,419)	(1,474)	(1,272)
General and administrative	(1,024)	(1,118)	(1,467)	(2,689)	(2,716)	(2,388)	(2,366)
Impairment charge	(1,497)	(1,594)	(1,655)	(14,238)	(622)	(2,016)	(6,835)
Interest expense	(17,076)	(20,226)	(24,351)	(26,197)	(28,014)	(25,902)	(24,570)
Total operating expenses before credits	**(40,459)**	**(47,342)**	**(60,631)**	**(85,329)**	**(81,479)**	**(81,497)**	**(92,907)**
Income before credits, currency, and disc	**3,517**	**3,928**	**712**	**(11,573)**	**2,301**	**4,875**	**1,892**
Other (expense) Income							
Gain on sale of real estate, net	-	-	-	1,240	1,538	242	3,993
Gain on debt extinguishment	-	-	-	5,274	-	-	-
Other income	84	127	101	174	14	343	52
Management fee credit	2,113	2,221	3,457	3,163	2,500	-	-
Total other income	**2,197**	**2,348**	**3,558**	**9,851**	**4,052**	**585**	**4,045**
Net (loss) before distributions	**5,714**	**6,276**	**4,270**	**(1,722)**	**6,353**	**5,460**	**5,937**
Distributions							
Distributions attributatble to Series C	-	(2,515)	(2,743)	(2,743)	(2,743)	(1,502)	-
Distributions to Series A,B, and D preffered s	(4,094)	(4,093)	(4,094)	(4,094)	(4,094)	(6,645)	(9,890)
Distributions to senior common stock	(62)	(113)	(300)	(542)	(1,007)	(1,011)	(986)
Total Distributions	**(4,156)**	**(6,721)**	**(7,137)**	**(7,379)**	**(7,844)**	**(9,158)**	**(10,876)**
Net (loss) income to common	**1,558**	**(445)**	**(2,867)**	**(9,101)**	**(1,491)**	**(3,698)**	**(4,939)**

Table 2. FFO/AFFO calculation

Net income	1,558	(445)	(2,867)	(9,101)	(1,491)	(3,698)	(4,939)
[+] D&A	14,149	16,831	22,827	28,865	35,288	37,517	42,795
[+] Impairment charge	1,497	1,594	1,655	14,238	622	2,016	6,835
[+] Losses on sale of assets	-	-	-	-	-	-	-
[-] Gains on sale of assets	-	-	-	6,514	1,538	242	3,993
[-] Interest income	(84)	(127)	(101)	(174)	(14)	(343)	(52)
FFO	**17,288**	**18,107**	**21,716**	**27,662**	**32,895**	**35,936**	**40,750**
weighted average common share outstanding	10,237	10,953	13,164	17,254	21,160	23,193	26,358
FFO growth	NA	4.74%	19.93%	27.38%	18.92%	9.24%	13.40%
FFO/share	**1.69x**	**1.65x**	**1.65x**	**1.60x**	**1.55x**	**1.55x**	**1.55x**
FFO	17,288	18,107	21,716	27,662	32,895	35,936	40,750
[-] Capital Expenditures	(1,844)	(5,557)	(5,176)	(6,347)	(6,689)	(5,875)	(9,216)
[-] Other Amortizations	(396)	(739)	(1,276)	(1,000)	(1,126)	(1,094)	(763)
AFFO	**15,048**	**11,811**	**15,264**	**20,315**	**25,080**	**28,967**	**30,771**
AFFO/share	**1.47x**	**1.08x**	**1.16x**	**1.18x**	**1.19x**	**1.25x**	**1.17x**

Table 4. Geography of buildings

		2017 rental revenue		cap rate per state	weighted cap rate
Alabama	2	1530.4	1.65%	6.89%	0.11%
California	1	765.2	0.82%	5.92%	0.05%
Colorado	3	2295.6	2.47%	6.35%	0.16%
Florida	6	7336	7.90%	7.17%	0.57%
Georgia	10	4649	5.01%	6.44%	0.32%
Illinois	5	3826	4.12%	8.27%	0.34%
Indiana	1	765.2	0.82%	8.27%	0.07%
Iowa	2	1530.4	1.65%	6.74%	0.11%
Kansas	1	765.2	0.82%	6.65%	0.05%
Massachusetts	3	2295.6	2.47%	6.33%	0.16%
Michigan	4	4327	4.66%	7.81%	0.36%
Minnesota	3	3703	3.99%	8.55%	0.34%
Missouri	2	1530.4	1.65%	7.63%	0.13%
New Jersey	3	2295.6	2.47%	7.89%	0.20%
New York	2	1530.4	1.65%	5.53%	0.09%
North Carolina	7	6036	6.50%	6.74%	0.44%
Ohio	12	9002	9.70%	8.93%	0.87%
Oklahoma	1	765.2	0.82%	5.72%	0.05%
Pennsylvania	9	10975	11.83%	6.64%	0.79%
South Carolina	3	4612	4.97%	7.14%	0.35%
Texas	11	15191	16.37%	7.30%	1.19%
Utah	3	4024	4.34%	6.42%	0.28%
Virginia	2	1530.4	1.65%	7.30%	0.12%
Wisconsin	2	1530.4	1.65%	6.65%	0.11%
	98	92811	100.00%	7.05%	**7.25%**