Keith Smith

Fund Manager, Bonhoeffer Fund

Fundamental Alternative Investments
Bond Like Equity Securities

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Keith Smith, CFA
Bonhoeffer Fund

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Alternative Investments

- Fundamental – driven by non-correlated sets of cash flows
  - Bonds (including private lending)
  - Royalties on operations or commodities
  - Re-insurance
  - Renting/leasing assets
- Synthetic – different mixes of existing asset classes
  - Factors
  - Underlying assets can change over time
  - Are dependent upon historical correlations to provide benefits

Bond-like Equity Securities

- Security structure or revenue model provides recurring first-lien claim on cash flow stream
- Credit-type situations (security structure)
  - Triple-Net lease real estate
  - Business development companies
    - Bank type underwriting (low loss ratios)
    - Proprietary deal flow
    - Specialty areas
      - Recurring revenues
      - Intangibles
      - Secured distressed (DIP & inventory)

Bond-like Equity Securities

- Leasing (revenue model)
  - Aircraft, ships, construction & industrial equipment, autos
  - Consolidation can provide economies of scale
    - Purchasing
    - Operations/leasing in a geographic area
  - Geographic clustering to consolidate demand
  - Cost effective sharing of asset (automation can reduce sharing cost)
  - More risky than credit situations due to short duration of leases but risk can be diversified across geographies and customer types
- Find companies doing something unique versus competitors in the market

Bond-Like Equity Security Analysis

- Credit analysis
  - Estimate the coverage ratios or understand the ratios used in underwriting process
  - Past track record of underwriting (gains/losses)
  - Volatility of past returns
  - Where did the team come from bank, real estate operations or investment bank?

- Relative yield/return analysis
  - Estimate expected return for yield plus growth in dividends over time
  - Estimate growth based upon payout ratio and potential increase in organic cash flows (i.e. contractual increases in rents)
  - Compare total return to similar bonds & equity in the value chain to see if these securities have the best return for unit of risk
  - Sometimes credit/leasing is the best place to invest in cyclical businesses

Bond-Like Equity Benchmarking

- Credit analysis
  - Determine where in customer's capital structure does the claim lie
    - Structural location in capital structure
    - Importance of asset to business
  - Credit analysis of customers
    - Weighted average credit rating/coverage ratio
    - Customer, geographic and industry diversification
    - Duration and rent escalation of leasing contracts
  - Leverage of the credit provider

- Relative yield/return analysis
  - Total return = yield based upon current cash flows + Growth
  - Growth
    - Increase in cash flows (from rent/lease payment increases)
    - Re-invested cash flows to fund improvements or more leases
    - Geographic/product expansion to new & existing customers
  - Pay-out ratio determines internal growth
  - These securities can be compared to customers' bond yields
  - Diversification & cash collection can reduce risk of smaller customers

Overview

- A diversified national provider of NNN lease financing (first-lien financing collateralized by real estate) for consumer services, experiential retail & mission critical manufacturing
  - 400 customers at 2,200 locations in 49 states
- Management
  - Built and sold two NNN lease firms (FFCA and Spirit) since 1994
  - Large proprietary deal flow (80%)
- Large runway
  - 2% market share of 200,000 firm target market (20,000 prospects examined – 2% close rate)
  - One of the largest firms in triple net lease space
- Growth benchmarks
  - 5-year BV plus dividend per share growth rate of 13% per year
  - 5-year AFFO per share growth of 7% per year

NNN Real Estate Industry Overview

- Leasing property to customers for mission critical functions (storefronts & manufacturing)
  - Typically longer term leases (10+ years) with extension options
  - Most if not all of the facility expenses are paid by lessor
  - Lease also typically have rent increases in them
  - Buying a package of a first-lien loan (lease) & the property
  - Major NNN firms (STOR, O & BNL) have outperformed the REIT index by 5% per year over the past 10 years despite having long term leases & lower FFO multiples
- Underwriting a key differentiator
  - Underwrite the lessor/customer’s business
  - Focus on growing firms/industries with moats
  - Value the use of real estate (collateral) if lessor defaults
- Cost effective way to run business that uses real estate but is not in the real estate business

Underwriting (STOR)

- Management team experience
  - Management team has experience in NNN lease investing since 1994
  - Team generated returns in excess of real estate comps with lower risk
    - FFCA (1994-2000) – 2.4% return/year above REITs
    - Spirit (2003-2007) – 3.0% return/year above REITs
    - STORE (2011-2017) – 3.9% return/year above REITs
  - Berkshire invested close to maximum allowed in 2017 at marketability adjusted 13.6x AFFO

- Tenant/Real Estate Underwriting
  - 75% investment grade leases (per internally generated model)
  - Average purchase price 82% of replacement value
  - Average interest coverage ration is 2.11
  - Top 10 customers represent 12% of portfolio
  - Average lease duration is 14 years & has a 1.8% per year lease escalator
  - Financial statements provided quarterly

Return Analysis (STOR)

- Total return analysis
  - Total return = yield plus growth
  - Current yield = 4.4% (70% payout ratio)
  - Growth (7.2% AFFO growth; 5.3% organic)
    - Increase rents (1.8% per year) - 2.8% AFFO growth
    - Re-invested cash flows (30% retention) - 2.5% AFFO growth
    - Portfolio changes & accretive acquisitions - 1.9% AFFO growth
- Lease portfolio analysis
  - 4.9% gross cap rate (cap rate plus escalators) less cost of debt
  - Investment grade credit (current interest rate – 4.5%)
  - Modest debt of 0.49x equity
  - Incremental return on equity of 11.4%

NNN Firm Valuations/Benchmarking

Valuation							AFFO		Debt/
	Share Price	Mkt Cap	Debt	MVIC	AFFO	Dividend	Multiple	Div Yield	MVIC
Realty Income	63.04	18357.25	6814.70	25171.95	3.22	2.64	19.58	4.2%	27.1%
National Retail	48.51	7629.94	3781.00	11410.94	2.86	2.00	16.98	4.1%	33.1%
STORE	**28.31**	**5997.62**	**2956.40**	**8954.02**	**1.88**	**1.32**	**15.06**	**4.7%**	**33.0%**
Broadstone	86	1812.62	1305.24	3117.86	5.66	5.16	15.19	6.0%	41.9%
Benchmarking									
	Lease		Cap Spread	Avg Lease	Top %				
	Escalator	Payout Ratio	less Debt	Term	5 client				
Realty Income	1.0%	82.0%	3.0%	9	12.0%				
National Retail		70.0%	4.0%	12	21.0%				
STORE	**1.8%**	**70.2%**	**4.9%**	**14**	**12.0%**				
Broadstone	2.0%	91.2%	4.9%	13	15.0%				

Valuation

- Current valuation
  - 15.1x AFFO (6.6% AFFO yield)
  - Using Graham Formula of fair P/E = 8.5 + 2g
    - With 5.3% organic growth, fair multiple is 19.1x
    - With 7.2% total growth, fair multiple is 22.5x
  - 4.4% dividend yield
  - Buying a first-lien loan portfolio (75% investment grade/25% high yield) with growing coupons
- Other quality underwriter in NNN space (Broadstone)
  - 6.0% yield with 4.4% organic growth from rent increases & re-investment (15.2x AFFO)
  - Privately offered but SEC reporting
  - Management team has commercial banking & real estate operations experience

Overview

- A business development company that provides senior financing (first-lien floating rate) for growth, acquisitions and restructurings
  - 49 loans across 17 industries
- Management
  - Built Foothill Capital specialty lending business since mid 1990s
  - Commercial Bank level underwriting experience
  - Large proprietary deal flow (99%) & first right to US originated TPG debt
- Specialty focus
  - Loans based upon intangible assets (recurring software revenues & licensing royalties)
  - First-lien distressed loans
  - Loan size just below syndication level
- Growth benchmarks
  - 5-year BV plus dividend per share growth rate of 10.2% per year
  - 5-year average return on equity of 11.7%

BDC Industry Overview

- Provide debt financing to middle market firms
  - Banks to firms who do not fit into banks' risk profile
  - Target market increased with Dodd Frank bank legislations
  - Underwriting more important than growth
  - Evaluate similar to banks (underwriting & costs)
  - Most BDC have high-risk loans which generate lower than average return on equity (5.6% average) which in combination with high distributions lead to declining book value (4% average decline) & discounts to book value.
- Underwriting a key differentiator
  - Underwrite the customer's business
  - Focus on growing firms/industries with moats
  - Proprietary vs. third-party sourced deals

Underwriting (TSLX)

- Management team experience
  - Management team has experience in specialty lending since mid 1990s (bought by Rick Kovacevich of Norwest/Wells Fargo)
  - Management team is value seeking (i.e. TICC activist investment)
  - Team generated good returns at Wells Fargo and since IPO (3/2014)
    - 13.3% per year on share price basis, 10.2% per year on BV basis
    - 3.2% per year for Vanguard High Yield fund
    - 2.4% per year for BDC index

- Underwriting/Fees
  - 94% first-lien floating rate secured loans
  - 0.5% loan loss rate per year since 2013
  - 3% of loans risk ranked 3 or higher rating
  - No non-accruals since 2012
  - Top 10 customers represent 35% of portfolio
  - Average loan maturity is 4.1 years
  - Fees are higher than average BDC (34% of net interest income) but net equity returns have yielded an average RoE of 11.7%

Return Analysis (TSLX)

- Total return analysis
  - Total return = yield plus growth
  - Current yield = 9.8% (85% payout ratio)
  - Growth (1.2% NAV growth per year)
    - Re-invested cash flows (15% retention) – 1.8% BV growth per year
    - Credit losses - 0.5% BV loss per year

- Portfolio analysis
  - 10.7% net interest margin (including fees) 7.0% without fees
  - Historical 0.5% credit losses per year
  - Investment grade credit (current interest rate – 4.3%)
  - Modest debt of 0.83x equity

BDC Firm Valuations/Benchmarking

Valuation							**NII**		**Debt/**
	Share Price	**Mkt Cap**	**Debt**	**MVIC**	**NII**	**Dividend**	**Multiple**	**Div Yield**	**MVIC**
TPG Specialty	**18.64**	**1215.33**	**877.40**	**2092.73**	**2.11**	**1.78**	**8.83**	**9.5%**	**41.9%**
Main Street	33.81	2055.65	955.80	3011.45	2.54	2.83	13.31	8.4%	31.7%
Golub	16.49	992.12	845.68	1837.80	1.28	1.36	12.88	8.2%	46.0%
Goldman Sachs	18.38	738.31	578.90	1317.21	2.00	1.8	9.19	9.8%	43.9%
Benchmarking									
	% Loan	**% Loan**	**5-yr**	**Exp./**	**Port Int.**	**Non-**	**Top 10**		
	>=3 Inv Rate	**1st Sr. Sec.**	**Avg RoE**	**NII**	**Coverage**	**accruals**	**Customers**		
TPG Specialty	**3.0%**	**94.0%**	**11.7%**	**34.0%**	**3.00**	**0.0%**	**35.0%**		
Main Street		73.0%	10.9%	21.9%		1.2%	16.5%		
Golub	12.0%	14.0%	8.8%	36.0%		0.7%	20.0%		
Goldman Sachs	8.0%	56.0%	10.8%	33.0%	2.20	0.6%	27.0%		

Valuation/Conclusion

- Current valuation
  - 8.9x earnings (11.2% earnings yield)
  - Using Graham Formula of fair P/E = 8.5 + 2g
    - With 1.2% organic growth, fair multiple is 10.9x
  - 9.5% dividend yield

- Catalyst
  - Increase in BDC leverage levels
    - TSLX increased mid-point target leverage level from 0.8 to 1.10
    - Received credit agency approval for increase with no change in investment grade rating
    - Under current conditions, can increase RoE from 11.7% to 13.3%

Overview

- A construction and industrial equipment leasing company that provides core and specialty equipment to customers in the US, Canada & UK
  - 715 locations across 46 states, 5 provinces & UK
- Business plan
  - Allocate generated cash flows to market expansion, M&A and/or share buybacks (generate 8 – 10% EPS growth)
  - Capital allocation plus organic growth will generate 15 to 20% EPS growth
- Large fragmented addressable market
  - $63 billion addressable North American market
  - Ashtead has 8% of market & top 3 players have 23% market share
- Specialty & cluster focused
  - Expansion of core business based upon clusters
  - Expansion of new equipment (non construction) types in clusters
- Growth Benchmarks
  - 5-year BV plus dividend per share growth rate of 52% per year
  - 5-year average return on equity of 32.9%

Equipment Leasing Industry Overview

- Provide equipment to construction & non-construction markets
  - More cost effective then purchasing for many customers
  - A group of local markets where equipment is rented & used for jobs
  - Large market ($63 NA billion) with 55% rental penetration
  - On average a mature market (2-3% market growth)
  - Fragmented market (top 3 players 23% of rental market; next 4 players have 4% combined)
- Clustering strategy a key differentiator
  - Initial market entry (early clusters) is via construction customers
  - Non-construction customers can dominate mature clusters
  - Largest firms in markets have a revenue (equipment selection) & cost advantage (higher margins)
  - Developing moats on a local/regional basis
  - Technology facilitates economies of scale moat

Clustering Strategy (AHT.L)

- Management team strategy
  - Equipment leasing is a local market business
  - In 2016, management rolled out 2021 plan to consolidate & expand market share in clusters with above WACC returns
    - Since 2013, team has generated 18% returns on investment (RoI) which is 8% above estimated WACC of 10%
    - EBITDA Margins have been maintained at 46% (9% above last cycle top in 2008)
    - EPS has grown by 50% over the past two years
    - Return on investment should increase as cluster mature (about 50% of stores are in mature cluster & generate RoIs of 29%)

- Clustering of rental locations
  - Provides for local economies of scale
  - Efficient sharing/utilization of equipment fleet
  - Technology can facilitate equipment
  - Introduction of non-construction equipment types (i.e. climate control & flooring systems) which provides product diversification
  - Large geographic reach provides demand diversification

Return Analysis (AHT.L)

- Total return analysis
  - Total return = yield plus growth
  - Current yield = 2.0% (15% payout ratio)
  - Growth (15 to 20% EPS growth per year)
    - Organic growth from cluster growth/expansion (7 – 10% per year)
    - Capital allocation of M&A or share buybacks (8 – 10% per year)
  - 5-year average RoI of 18% vs. tax adjusted 11% RoI for URI

- Leverage analysis
  - Conservatively financed (1.9x EBITDA vs. 2.8x for URI)
  - Investment grade credit (net interest rate – 3.8%)
  - Modest debt of 0.46x equity & 37% of borrowing base

Equipment Rental Firm Valuations/Benchmarking

Valuation							Earnings	EV/	Debt/
	Share Price	Mkt Cap	Debt	MVIC	Earnings	EBITDA	Multiple	EBITDA	MVIC
Ashtead	**16.25**	**7881.25**	**3603.00**	**11484.25**	**2.29**	**1849.7**	**7.11**	**6.21**	**31.4%**
United Rentals	102.53	8356.20	10013.00	18369.20	16.04	3596.90	6.39	5.11	54.5%
HERC	25.99	740.72	2239.90	2980.62	2.43	648.6	10.70	4.60	75.1%
Benchmarking									
	5-yr	5-yr	EBITDA	Rev/	5-yr Rev/				
	Avg RoI	Avg RoE	Margin	Employee	Emp Growth				
Ashtead	**18.4%**	**25.4%**	**45.6%**	**296,554**	**70.0%**				
United Rentals	10.6%	32.3%	46.9%	458,862	30.0%				
HERC*	N/A	12.5%	33.7%	358,061	N/A				
* 2018 as historical data not available									

Valuation/Conclusion

- Current valuation
  - 7.1x earnings (14.1% earnings yield)
  - Using Graham Formula of fair P/E = 8.5 + 2g
    - With 10% organic growth, fair multiple is 28.5x
    - With 20% total growth, fair multiple is 48.5x
  - 2.0% dividend yield
- Business is cyclical but cyclicality has been dampened
  - Via consolidation in clusters EBITDA margin has increased from 38% at last peak to 47% today
  - Increased geographic & non-construction diversification
  - Ashtead has generated the highest return on investment with the lowest leverage of NA Equipment Leasers (URI, HERC)
  - During GFC downturn, Ashtead generated trough RoI of 5%

Investment Terms and Contact Information

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Investment Terms

Annual Management Fee:	1%
Annual Performance Fee:	20%
Non-cumulative Hurdle Rate:	6%
High Water Mark:	Yes
Initial Investment:	$100,000
Subscriptions:	Monthly
Initial Lock-up:	1-Year
Redemptions:	25% per quarter after initial lock-up
Redemption Notice:	60 days written
Early Withdrawal Fee:	5%
Investor Status:	Accredited
Statement Reporting:	Monthly
Portfolio Manager Communication:	Quarterly
Audited Financial Statement:	Annual

Fund Information Request

Jessica Greer
Bonhoeffer Capital Management, LLC
Director of Marketing
jgreer@bonhoeffercapital.com

Portfolio Manager Contact

Keith D. Smith, CFA
ksmith@bonhoeffercapital.com
585.301.8342

www.bonhoeffercapital.com

Fund Offering Documents

Reference Fund Offering Documents for detailed information on the offering, the risk considerations and the compensation structure.