NOMADIC VALUE
INVESTMENT PARTNERS

July 13th, 2020

To partners and friends,

Much of our time spent on research was on companies we ultimately added to the portfolio, but during Q2 NVIP was able to attend two annual (virtual) meetings of private equity and public equity firms and held introductory or update calls with 21 investment managers and institutional LPs. We also looked at dozens of public and private companies to varying depths across 12 different industries.

Portfolio activity

We were quite active in the public portfolio. We added three new companies: One Medical, Ameresco, and Mercer International. We also rebalanced to target weights in existing positions in Berkshire Hathaway and MMA Capital. Cash is now down to the high teens percentages in new accounts.

In mid-May we made an initial position in **1 Life Healthcare, Inc.** (ticker: ONEM, aka One Medical), a tech-enabled primary care provider that we believe has nestled itself into a unique position between regional health systems and the self-insured employer patient base[1], solving problems for both as the health sector increasingly transitions to value-based care (VBC). The company was founded in San Francisco in 2007 after a platform acquisition of several walk-in primary care clinics and has, over time, internally developed its tech stack to fully execute a telemedicine-focused but high touch concierge approach to primary care. ONEM's client base is comprised of large self-funded corporate health plans, and most of ONEM's contracts with these plans have some form of VBC arrangement. ONEM's approach to care has driven high member engagement (average of 50% enroll), lower health costs (total plan savings of 8%), and high member satisfaction (NPS of 90) for their clients. Resultingly, ONEM today has 92 physical walk-in clinics, 7,000 corporate clients, and 455,000 enrolled members[2]. This membership growth has been an impressive 28% CAGR since 2014, while generating an average 40% gross margin over the same period.

ONEM has recently iterated on its growth model by targeting partnerships with large regional health systems. These partnerships allow for ONEM to essentially swap the per visit Fee-For-Service (FFS) billings that corporate clients pay when their employee visits a physical clinic, with a Per-Member-Per-Month (PMPM) payment from the health system, which is benefitting from ONEM's patient referrals to specialists and hospital services. We see merit on both sides of the exchange and importantly, as ONEM inks more of these partnerships in more cities around the country, the appeal of their offering to corporate clients with a national footprint only grows.

ONEM's historical growth rate could continue for years to come under this new partnership model as they ride two industry trends:

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[1] Self-insured corporate plans are health costs managed and paid directly by an employer, and not a health insurance company's plan that would be offered by the employer. Per the Accolade Inc's Form S-1 (ticker: ACCD) - 80% of employers with >500 employees pay for health benefits under a self-insured model.

[2] As of Q1 2020 per company filings.

Transition to VBC
Mentioned in our Q4 2019 letter, health systems hit roadblocks transitioning from FFS to VBC. We can think of these roadblocks as technical (patient data collection, data quality, and silos/not sharing), financial (introducing performance risk to revenues), and cultural (the way we've always done it). Despite enormous institutional friction, health systems must make an eventual shift. ONEM attacks each of these problems by virtue of being an entrepreneurial 3rd party and their position as primary care, which plays quarterback in a well-managed VBC model.

Customer acquisition
The commercial patient population is the most profitable patient cohort in the healthcare system, but unfortunately is a low to no growth pie[3]. Additionally, VBC adjusts incentives to reign in medical cost inflation, leading to a potentially reduced revenue outlook if successful. To make up for this shifting financial model, health systems need more recurring patients spending more per year[4]. ONEM has proven it has a more holistic offering than their point solution competitors[5], and it knows how to competitively sell this offering to HR departments. By ONEM's position as physical primary care in a VBC system, their relationship with the patient is enormously valuable to health systems as they help them grow total patients as well as a greater percent share of their total health spend.

We hired ONEM to our "farm team" by making it a 2% position. While we obviously see promise long-term, ONEM has some things to prove before it has a chance as a core position. Basically, ONEM shares the risk/reward of a late stage venture opportunity: a sizeable reward if our thesis tests true but little to no margin of safety should it not. On balance, we wouldn't put ONEM in the portfolio if we didn't think we could be right. Position sizing is always hard.

One risk to highlight is cash burn. Management has reiterated that cash burn should subside in a couple of years as they essentially "route densify" new clinic locations, and growth from there will be funded by positive cash flows. An investor must model for themselves how realistic this is. We are giving management the benefit of the doubt currently but watching very closely over the next several quarters. Another risk is that we bought ONEM when shares were trading in the high 20's, creating the company at over $3.45 billion of enterprise value. Optically, we agree this is a beer (or coffee!) spitting valuation on a company that generated $275 million in revenue last year. If we are wrong the shares could realistically trade for 1/3 this valuation, a significant consequence. But I think ONEM could be undervalued.

I've been working through how to value a business like ONEM. Hospital and/or specialist care comparables? Free cash flow 10 years out? With a company as strategically positioned as ONEM in an industry under significant change, we think smart money could be looking somewhere else to inform valuation.

One clue is from a conversation with an industry operator, where it seemed common knowledge that primary care acts as "loss leaders" for larger integrated firms such as United Healthcare (ticker: UNH, we own it) and larger health systems that have experimented with clinics. Large payers and systems do this to gain control of the care outcome (leading to higher integration and hopefully customer satisfaction), but it is also financially rewarding to grow your overall capture of a patient's annual spend.

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[3] Kaiser Family Foundation data from 2008 to 2018.
[4] Per a shrm.org survey of corporate self-pay plans, it is expected that healthcare spend for the average employee (and their dependents) will top $20,000 in 2020 when including the employee's deductible spend. If a health system can provide enough care and services, they can theoretically capture most, if not all, of this $20,000 of spend as their revenue.
[5] Conversations with a healthcare industry consultant revealed many corporate plans have 15+ different service providers rounding out their health benefits to employees, and many of these solutions have very low employee engagement.

Another clue is when looking outside of the healthcare sector, you can find comparables to ONEM's favorable business characteristics. Here's the question to answer: what would you pay for a business en route to millions of monthly subscribers that love your product, trust your business and give you ever-expanding scope, and who pass control of over $20,000 per year of Gross Merchandise Value (GMV)?

So, given that ONEM has an amazing product providing real solutions to all, gains control of healthcare spend, and solves long-term strategic desires of very large companies, I think ONEM should be valued higher up the income statement. Meaning, ONEM is worth more owned by a transitioning incumbent or a well-financed new entrant than standalone.

I am watching the market's reaction to what could be two key metrics a strategic buyer would want to see knocked out of the park. The number of members is an obvious one, which leads to more membership fees and PMPM revenue from health systems and, more importantly, higher strategic importance to a large buyer. In my view, it is realistic that ONEM could grow to over 2 million members in the next several years while riding the trends described above[6]. The second is the company's long-term, sustainable gross margin. What will it shake out to be? There's information in this number and its trend. Historically, the company has provided care at around a 35-40% gross margin. That's outstanding for primary care and it's their savvy use of technology and integrated delivery model that allows it. If this can be maintained while growing towards 2 million members or more, it should demand a high multiple on gross profit dollars.

In early June we made a 5% position in the energy performance contractor, **Ameresco** (ticker: AMRC). Energy performance contracting (aka energy services contracting, or ESCO for short) is a niche industry that has grown over the decades to provide an essential service of modernizing municipalities, K-12 schools, universities, and state and federal government buildings with energy efficiency and savings technologies. An ESCO is a design-build general contractor but is also different from typical general contracting in that it enters into energy performance contracts (ESPCs) on the equipment it installs. These contracts are unique in that the ESCO guarantees the expected energy savings, and then finances the equipment to the government entity. The goal is for the energy savings to pay back the equipment cost, interest expenses, and the ESCO's profit, allowing a budget neutral, off balance sheet CAPEX and longer-term cash flow savings to the government. ESCOs hold a special license to do this[7], and it acts as a sort of barrier to entry against fly-by-night competitors[8]. The ESCO model has grown over the last couple of decades from a mix of market development and improvements in technology. While the ESPC award process is cyclical in nature[9], ESCOs that manage this well are here to stay and enjoy a long-term and overall growing market niche.

AMRC is one of these ESCOs. It was founded in 2000 by an ex-employee of Noresco (one of the largest ESCOs), went public in 2010, and today is one of the leading ESCOs with a project backlog of over $2Bn. The founding management team is still in place and owns over 20% of the class A shares outstanding. A long-dated and highly aligned management team (who have voting control) has been important for maintaining the company's

[6] It is also important to note that ONEM has grown membership at > 20% year/year rate despite COVID, which has unfortunately slowed down rollouts of new clinics.

[7] The Department of Energy lists about 100 qualified ESCOs as of June 2020, but only about 10 ESCOs are at nationwide scale and actively compete across federal project opportunities.

[8] Government work is an administrative headache. ESCOs that are profitable have learned to be through many iterations building institutional knowledge. As a result, we see a wide dispersion in net income between competitors.

[9] Political cycles create bulges in planning, budgeting, and awards. However, as energy reduction targets become more aggressive over time despite government budgets becoming more strained, ESPCs pose a strong solution. An investor could realistically build a case that "this time is different" and that the industry could experience a much shallower cycle than in the past.

"energy geek" culture[10], which I believe helps the company not only underwrite contract bids better (knowing the risks and their costs), but also helps them win contracts when they aren't the lowest bid.

We wouldn't normally get excited about a cyclical industry with low single digit profit margins. However, AMRC has now taken their engineering abilities and pivoted the business model by focusing on commercial projects (think automotive factory or warehouse), where they do both ESPC-like arrangements as well as cash sales. This not only grows gross profit dollars with a much faster cash conversion than government work, but also gives them flexibility to invest into what I think will help double earnings over the next 5-7 years – wholly owning the solar PV projects they place on these customers' premises.

Y'all know I'm a raging solar bull. However, I will always caveat that viewpoint with, "you got to do it right." Right by me is owning solar directly and more specifically, developing these projects from scratch. Of course, like real estate developers, locking up the best projects is cut-throat competitive[11]. Cost advantages are rare across developers. But I think AMRC is now in a perfect position to develop in a competitive fashion. This comes from a mix of their engineering culture, their comprehensive energy efficiency offering which lowers allocable SG&A, and their flexibility and competency with financing. So, given the focus, competitiveness, and the industry's long-term trends, I think there's a strong chance AMRC can grow this portfolio at low teens rates for several years, effectively doubling today's roughly $90 million in EBITDA to nearly $200 million. In addition, we think we'll get more stability in earnings and overall profitability trending higher.

We made a small position in the Northern Bleached Softwood Kraft (NBSK) producer **Mercer International** (MERC) at quarter's end. MERC owns NBSK pulp mills in Germany and Canada, a lumber mill in Germany, and an Indian Sandalwood plantation in Western Australia. NBSK pulp is used in paper and tissue manufacturing due to its high strength but soft feel. "Market NBSK" is sold and shipped all over the world to manufacturers and happens to be one of the most volatile commodities in the world. While initially a boon to prices, a great inventory stocking pre- and during COVID's Q1 peak has not ultimately been kind to market pulp prices following, and "days of inventory" outstanding is at a historic level. In less than one year, the industry went from record prices and cash flows to battening down the hatches by significantly curtailing production. This curtailment should have market balancing effects over the next six months to a year. Interestingly, this time around older mills in British Columbia may not come back given issues of fiber supply in combination with increasingly unattractive CAPEX required to re-start production. Market experts don't see a chance for new capacity additions until at least 2022, and realistically it could be even farther out before truly competitive low-cost supply gets added in the industry. There's a strong chance that NBSK prices swing much higher as this supply/demand balance plays out over the near to mid-term.

Given that industry backdrop, we like where MERC sits. The company owns some of the newest mills in the industry, a unique position in Germany being the only pulp producer in the country, and a seasoned management team that's been executing since the company's formation in the early 2000's. I was specifically impressed listening to the CEO discuss operational efforts taken due to COVID. The management team is focused on mitigating risk. They've cut the dividend, deferred discretionary CAPEX, and are 100% focused on

[10] Channel checks have confirmed that the best and brightest energy engineers go to Ameresco.

[11] Commercial & industrial (C&I) solar projects have been a bonanza over the last 10 years. A market has developed around the entirety of project development (like utility scale) where there are developers for different stages, capital providers for different stages, brokers that help large corporations wanting to buy clean energy, standardized lease contracts, standardized Power Purchase Agreements (PPAs), etc. With this market development comes immense competition, and un-levered equity returns for projects purchased out of development hover around 7% as a result. My guess is that this trends lower over time.

employee safety as events unfold[12]. The company will likely generate positive cash flow this year (something most competitors won't do) and there aren't any near-term maturities of debt.

MERC has sponsorship. Specifically, the Chairman (founder) and CEO (C-suite since MERC's founding) both own a substantial number of shares, and there's a concentrated group of long-term, mindful owners on the shareholder roster. Capital allocation has been an impressive mix of waiting to buy assets at cyclically low prices, strong execution with facility upgrades (which reduces unexpected downtime relative to peers) and returning capital substantially but sustainably. Currently, management is expanding lumber production in their Germany-based mill. We like this expansion given the proximity to and near monopoly on the lowest cost fiber supply in the EU. Given significant beetle damage across the region, we expect MERC to realize cost advantages leading to a furthering of exports to the US and China over the next few years.

We are fortunate to have a couple decades of high-quality data on MERC, adding confidence when valuing the company on a range of NBSK pricing and input cost assumptions. When we normalize cash flows, add a bit of growth to production, and capitalize at a very reasonable multiple, we get to a stock price that's worth roughly 80% to 100% higher than today's price. The question, as always with cyclicals, is timing. We could be early--quite painfully early. However, we believe the probability is very low that when looking ahead NBSK prices and MERC's cash flows stay depressed over a full 5-year period. NBSK prices are way too volatile for that, and Asian demand is expected to increase despite the global recession.

We added to **Berkshire Hathaway**. I won't spend too much talking about this, but BRK is as attractively priced as it's been in some time. The press's and FinTwit's fascination with "Warren's lost it" is at a cyclical peak and is complete noise. However, the valid bear argument is that BRK is too big to compound at good rates going forward, and subsidiary company performance will be weak for the next couple of years with its high exposure to air traffic (Precision Cast Parts and previously held airline stocks) and holdings in "old economy" manufacturing and retail businesses. Also, short-term there's an unknown consequence of insurance claim payouts and/or refunds[13]. We wouldn't completely disagree with these judgments, and the optics are certainly bad when BRK doesn't buy back shares in a quarter with a substantial sell-down. However, with a long-term lens and given the management style of BRK (conservative talk and overperform), we will likely be quite satisfied in the future – whatever that looks like. Meanwhile, we've gotten into a range where 30%-50% of BRK is free. Are the actual growth prospects for Berkshire this dire? Berkshire is our largest position.

We topped up **MMA Capital** (ticker: MMAC), a utility-scale solar development mezzanine lender, as we believe the share price sold off from COVID fears but has remained depressed due to market technicals. Our observations this quarter confirm there's more demand for short-term debt capital than before COVID. The reason is project delays around permitting, product procurement, and construction site safety. Naturally, developers need more capital and pay more interest when it takes longer to complete a project. Developments targeted for completion in 2020 and 2021 are fully baked at this point, and our understanding is that utilities are working diligently to follow through on their grid interconnection commitments. The potential issue for MMAC is a slowdown of projects originally planned to begin construction in 2021/2022. These projects are in Power Purchase Agreement negotiation and utility permitting phases today. As with any industry right now, the lack of human interaction slows progress for anything coming new to the physical world, and we could see a negative ripple throughout utility scale developments. Additionally, given "contract risk" introduced to the 2021/2022 vintage developments, the cost of capital for developers has increased, even while it has decreased for

[12] David Gandossi, CEO of MERC, went into an extended monologue in their Q1 earnings call when asked about "how COVID-19 is affecting your business?" Details on operating adjustments made were immense with employee safety being 90% of his comments. Interestingly, from the POV of Mr. Gandossi, MERC has socially as well as financially benefitted from these changes and will likely continue these new operational approaches post-COVID.

[13] Buffett mentioned in the 2020 annual meeting that BRK has pandemic clauses in most of its business insurance lines. This isn't the case with many competitors.

completed projects selling into infrastructure funds. MMAC could see higher interest loans as a result, somewhat buffering a potential decrease in volume. On balance we think it's hard to predict right now what will happen to the 2021/2022 vintage, but ultimately we are betting this will be isolated and temporary and we've likely already seen the worst of it – even as COVID gets worse. The solar industry is impressively resilient[14] and today it is the most competitive source of energy in many electricity markets. Projects are going to get planned, financed, and built.

Sincerely,

Joshua Collinsworth

[14] Speaking from my own experience having worked in it, the industry has navigated an endless maze of state legislation changes, sporadic and now declining federal support, cut-throat competition, high profile fraudulent actors, all (and I mean ALL) the incumbent resistance, recessions, etc. Meanwhile, capacity additions to the grid have gone parabolic and support from the bottom up has only grown.