Dear Clients,

Since inception on March 9, 2017, our Wolf Hill Capital Composite has posted net returns of 21.03% versus total returns for the S&P 500 of 14.93% over the same time frame. In the fourth quarter, the composite posted net gains of 1.06%, versus total returns of 6.64% for the S&P 500.

| Wolf Hill Capital Composite Returns vs. Indices | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | MAR [1] | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | YTD [1] |
| **Wolf Hill Capital Management** | 0.49% | 8.57% | -1.92% | 0.18% | 7.24% | 3.36% | 0.80% | -0.92% | -6.08% | 8.60% | 21.03% |
| S&P 500 Total Return | 0.05% | 1.03% | 1.41% | 0.62% | 2.06% | 0.31% | 2.06% | 2.33% | 3.07% | 1.11% | 14.93% |

**Q4 Review**

During the fourth quarter global equity indices continued to grind higher in response to the historic passage of U.S. corporate tax reform and strengthening economic momentum in most developed market economies. In fact, December marked the 14th consecutive month of positive total returns posted by the S&P 500 - a remarkable feat that has not been accomplished in over 90 years. While the lack of market volatility accompanying this historic bull-market has garnered much attention, a closer look at the drivers of this epic rally reveal some interesting divergences among market sectors and investment categories. While the so-called FANG (Facebook, Apple, Netflix, Google) stocks and other large cap technology stocks have driven a disproportionate share of the market's gains in recent years, wide dispersion among market sectors has provided fertile hunting ground for stock pickers such as ourselves to add value. We continue to find highly asymmetric investment opportunities by sifting through often overlooked companies whose businesses have little or nothing to do with Artificial Intelligence, Block Chain, Cryptocurrency, or other buzzwords du jour.

Against this backdrop, our performance during the quarter was driven by gains in many of our core positions including Constellium (CSTM), Aimia (AIM CN), Tesla short (TSLA), Sanderson Farms short (SAFM), Express (EXPR), Kraton (KRA), and Quorum Health (QHC) and losses in Archrock Partners (APLP), Myomo (MYO), and our hedge book. In aggregate these seven winners contributed 1,650 bps, while losses in APLP, MYO, and our hedge book detracted approximately 1,016 bps from our Q4 performance.

**Constellium (CSTM)**

In recent quarterly letters, we discussed in detail our thesis behind our largest position, Constellium, and why we thought this aluminum fabricator offered the potential for a 4-5x potential return. As this remains our largest position due to price appreciation, a quick update is in order. During the quarter, CSTM partially recapitalized its balance sheet by simultaneously issuing 25 million shares of stock and issuing a new unsecured bond. The proceeds from these capital markets transactions were used to retire several issues of outstanding bonds and to strengthen the company's balance sheet. While these transactions served to partially de-risk the company's levered balance sheet, they came at a steep cost in terms of shareholder dilution. The net result is that the secondary stock sale took the wind out of the sails of those looking for a quick sale to a strategic buyer. That said, the de-leveraging impact of the recapitalization along with continued solid operational execution and secular tailwinds in CSTM's key end-market should provide the foundation for the next leg of CSTM's resurgence. In fact, as we put

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the finishing touches on this letter, Bloomberg News is reporting that Mumbai-listed Hindalco is close to announcing a transaction to acquire privately held CSTM competitor, Aleris Corp. for $2.5b. This would represent 12.1X LTM EBITDA multiple for Aleris, a rich valuation that highlights the scarcity value and desirability of domestic aluminum fabrication assets. Applying the same multiple to CSTM would result in a $30+ stock price, 3x where it is currently trading. Just saying…

**Archrock Partners (APLP)**

In our Q2 letter, we introduced readers to APLP, a master limited partnership that is the largest player in the fragmented natural gas compression space. As a refresher, we believed then, as we do now, that APLP is a terrific vehicle to express our bullishness on the long-term outlook for natural gas *production* growth. Recall, APLP's business is driven by growth in natural gas production as opposed to the price of the underlying commodity. While we have no view on the direction of the underlying commodity, we are highly confident in the long-term outlook for natural gas production growth. Per the U.S. Energy Information Administration "EIA", natural gas production is expected to grow 21% through 2021, driven by increased industrial usage, power generation, exports to Mexico, and LNG exports.

Despite this seemingly favorable backdrop, APLP units declined by 16% in the 4th quarter primarily as a result of investor anxiety concerning how the MLP corporate structure would be treated under the new tax regime. While we may be guilty of premature accumulation in the case of APLP, ultimately our view has been vindicated as APLP's parent, AROC, announced on January 2 that they will be buying in the remaining shares of APLP that they do not own at a 24% premium to APLP's year-end closing price. We anticipate holding our AROC shares after the transaction closes as our work suggests that substantial upside still exists for the combined company as production growth continues to increase and AROC begins to capitalize on the cyclical recovery underway by way of increasing pricing on new customer contracts.

**Newer Ideas**

**Sanderson Farms Short (SAFM)**

During the quarter we established a sizeable short position in Sanderson Farms, the third largest domestic poultry processor with approximately an 8% U.S. market share. We believe that SAFM and other domestic chicken processors are currently over-earning based on unsustainably high processing margins that are poised to mean-revert over the course of the next two years as industry capacity ramps up. We believe that fair value for SAFM is about $72/share, based on 12x mid-cycle earnings of $6.00/share, or 56% lower than the price at which we initiated our position.

Chicken production is a highly volatile, low-margin, commodity business with virtually no barriers to entry. The profitability of a chicken producer is primarily a function of two variables: the price of fresh, frozen, and processed chicken products, and the spread between feed costs (corn and soy) which account for 45% of total costs. Over the course of the past few years, SAFM has benefited from a perfect storm type scenario of elevated chicken prices due to a temporary curtailment in supply, and low feed costs. Over the past 6 years, SAFM has averaged $8.17/share in EPS, versus $12.30 in 2017. 2017's record earnings were driven by gross margins/pound of $.16 versus a 15-year average gross margin/pound of $.09. As is often the case in highly cyclical industries, when industry conditions tighten considerably, producers add capacity to take advantage of this favorable, often fleeting dynamic.

New capacity takes time to ramp up and often comes on-line just as industry conditions are beginning to roll over. Protein Industry analysts are currently forecasting supply growth of over 4% per year over the course of the next several years based on already announced capacity additions as many previously announced expansion projects come on-line. We anticipate this supply growth to continue to put downward pressure on chicken prices. Even if feed costs do not continue their recent upward trajectory, SAFM's 2018 earnings will likely fall substantially below current consensus earnings estimates.

**Knight Therapeutics (GUD CN)**

Knight Therapeutics is a specialty pharmaceutical company based in Montreal, Canada. Jonathan Goodman, of Paladin Labs fame, is the founder, CEO, and largest shareholder with a 15% stake. Between Paladin Labs 1996 IPO and its 2014 sale to Endo Pharmaceutical, Paladin Labs compounded at 30% annually, for a 100X return. Knight Therapeutics was spun out from Paladin Labs to shareholders of Paladin in early 2014 as part of the sale to Endo Pharmaceutical.

We believe Jonathan Goodman is turning Knight Therapeutics into Paladin 2.0. Knight's business model is to develop, acquire, license, market and distribute pharmaceutical products in Canada, Israel, and select international markets. Central to this business model is Goodman's expertise in capital allocation. Knight, and Paladin before it, has a proven play book for value creation in acquiring and in-licensing late stage or newly approved pharmaceutical products in Canada. Specifically, Knight acquires specialty drug marketing rights in countries that multinational drug manufacturers consider too small to move the needle. This includes drugs for Diabetic macular edema, tropical diseases, neurological disorders, HPV associated cancers, anti-aging skincare, and joint stiffness associated with osteoarthritis. Typically, rights are for countries outside of the US, Western Europe, Japan, and China. Knight also provides secured lending to small pharmaceutical companies generating mid-teen IRR's, and invests in select early stage pharmaceutical ventures to gain access to a pipeline of potentially interesting compounds.

Knight's business model centers on the rational allocation of capital by a highly experienced and incentivized management team. Acquisition targets are not chosen on the basis of Knight's ability to hike the price of acquired drugs, nor does Knight believe in financing acquisitions with debt. In 2014 and 2015 when serial acquirors were bidding up pharmaceutical assets, Goodman and Paladin were happy to take advantage of the sellers' market as the lone rational player. This allowed Knight to later buy assets at distressed prices. As an example, recently Goodman has been vocal about his desire to repurchase Paladin Labs from Endo Pharmaceutical, at a much more rational price.

Since its inception in 2014 with 2 employees, CAD $1mm in cash, and a single therapeutic pending FDA approval, Knight has raised CAD $685mm at increasing valuations and through various initiatives and strategic transactions generated CAD $178mm of net income. In recent months the stock has drifted lower - perhaps attributable to investor fatigue due to the methodical pace at which Mr. Goodman has been deploying capital. This has provided a wonderful entry point to acquire shares in Knight below it's current book value of C$8.50/share. Since Knight's book value consists primarily of cash and secured loans, it should provide a floor to the stock with upside asymmetry if Mr. Goodman is even remotely successful in replicating his play book at Paladin Labs, Inc. The following quotes from Mr. Goodman are instructive in terms of understanding Mr. Goodman's methodical and thoughtful approach towards capital allocation:

"Israel is a market that is basically the size of Quebec and it's crazy complicated. It's a market that no one cares about. I love markets that no one cares about because of the inefficiencies, because we can get great deals. And so I think that's where the deals will be."

*-Q2 2016 Conference Call (Aug 11, 2016)*

"Well, there is no question that it is a seller's market now, and -- which is why we're not buyers. You don't see us buying a lot of things, because we're -- we look for long-term IRR and we don't see it in this market, which is one of the reasons why we're -- why we embarked on our long-term licensing strategy, which allows us to gain access to late -- to products without joining the competitive fray. We don't have to compete when we're getting them automatically as part of our investment."

*-Q1 2015 call (May 13, 2015)*

"I would love to buy EBITDA. I just want to pay a fair price for it. I'm not ready -- I'm building Knight for my grandchildren, so I don't -- I'm not building it for the next quarter or the next year. So I'm not ready to overpay for an asset just to make numbers and certainly not ready to take on debt to finance it. We think that there will be products for sale. There will be EBITDA to acquire, but it's going to be later on in the year, first quarter next year, as things kind of unwind. I'm certainly hoping for that. And it will be purchased at a fraction of the price that people are paying for assets -- for what people paid for assets last year.

*-Q4 2015 call (March 24, 2016)*

**Aimia Inc (AIM CN)**

Aimia Inc owns and operates platform loyalty rewards programs on behalf of airlines, retailers, consumer product companies, financials, as well as companies in the automotive, technology, healthcare, telecom, and hospitality industries. Loyalty programs include Aeroplan in Canada, Nectar in UK, Air Miles in the Middle East, and Travel Club in Spain.

On May 11, 2017, Air Canada, Aimia's primary partner in the Aeroplan loyalty program, announced that they would not extend their agreement with Aimia beyond the scheduled 2020 expiration. Investors rushed for the exits on fears that cardholders cashing in their points would cause a "run on the bank", and that banks would abandon Aeroplan in favor of other loyalty program options. In response to this unexpected news, Aimia's board suspended the payment of quarterly dividends in an effort to buttress its balance sheet with a cash war chest over the coming years as management seeks to replace Air Canada with new loyalty partners. In the weeks following this announcement, Aimia's share price was eviscerated by over 80%. While existing shareholders were left holding the bag, we sensed an extraordinarily asymmetric investment opportunity to wade into this messy situation at an entry price of CAD $2.70.

In the course of our research on the loyalty rewards industry, we learned quite a bit about the incentives and motivations of each of the three parties in the loyalty program food chain: the credit card issuer, the loyalty program operator and the coalition partners. Loyalty businesses collect revenue up-front as credit card customers swipe their card. Customers are issued points, and the points are ultimately redeemed when customers earn enough points to redeem what they want. The unredeemed points reside on the balance sheet as a deferred redemption liability – in Aimia's case, $2.2b worth. This liability should be thought of as "float" similar to the manner in which an insurance company collects premiums up front and records a liability to account for future claims. Herein lies the beauty of the loyalty program business model – there can never be a "run on the bank" as customers rush to redeem all of their points at once for the following reasons: Card holders redeem points to get certain items that they want, principally travel, once they have accumulated enough points - not simply to get gift certificates for things they don't necessarily care about. Second, card holders have a limited window for travel due to constraints around vacation time, etc. Most importantly, loyalty programs can simply devalue points (a trip from Vancouver to Miami costing 50,000 points as opposed to 35,000 points) and gate points by creating black out periods around popular redemption periods.

Another popular bearish thesis around Aimia is the possibility of the credit card issuing banks deserting Aimia in favor of other loyalty program options. This is preposterous as banks pay $100-$500 per cardholder to sign up new cardholders - just on free points alone, not including marketing and overhead. They do this in the hope that the lifetime NPV of these cardholders will be in the thousands of dollars. Aeroplan cards are the most popular cards in Canada and are "front of wallet" for most cardholders. From the perspective of the card issuing banks, they certainly don't want to leave the popular Aeroplan program and incur millions of dollars of new customer acquisition costs – they may promote other programs, but they are unlikely to leave the program. As long as banks stay in the program and customers continue to use their Aeroplan card, the network effects grow, and the "run on the bank" scenario becomes increasingly remote. In fact, these concerns are not supported by recent data points, given that key performance indicators such as cards issued, gross spend, and miles accumulated are all growing in the two quarters since the announcement.

We believe that Air Canada's announcement of their intent to create their own loyalty program upon the expiration of their contract with Aimia could prove to be a hard-nosed negotiating tactic on the part of Air Canada CEO Calin Rovinescu, as the strategic logic of recreating a loyalty program in-house escapes us. As a former bankruptcy attorney, this negotiating approach would be consistent with his negotiating tactics with labor unions earlier in his tenure as Air Canada CEO. Even if Air Canada fails to come back to the negotiating table, we believe that Aimia will be successful in signing up alternative loyalty partners (cruise operators, casino's, etc) as the broad reach and popularity of the Aeroplan card should appeal to other potential loyalty partners.

Despite an approximate 50% increase in valuation since we initiated our position, Aimia is still incredibly mispriced with enormous upside optionality. At recent prices of CAD $3.75 the market is valuing Aeroplan at <2.5X EBITDA and we are getting Aimia's 49% stake in AeroMexico's loyalty program, PLM for free. PLM is on a $100mm EBITDA run rate and growing 20% annually. Using a conservative 10x multiple, Aimia's stake in PLM is worth an additional CAD $4/share. Our work suggests that by the time the Air Canada contract rolls off in 2020, Aimia should have about $4/share of net cash on the balance sheet. In short, we are buying $8 worth of assets for less than $4 today – and that assumes that Aimia's ownership in Aeroplan is worthless – an outcome that we deem to be exceedingly remote.

**Parting Thoughts**

We are proud of our accomplishments last year, returning 21% net to our initial investors over a partial year, despite remaining conservatively positioned throughout with only a 10% net market exposure on average. We added value on both sides of the ledger with longs outpacing the market while profiting handsomely from a handful of single name short ideas.

Looking ahead, despite the obvious benefits to S&P earnings as a result of tax reform and the improving economic backdrop, we remain disciplined in allocating capital to new ideas that don't meet our strict underwriting criteria for probability weighted expected returns. The recent speculative mania surrounding cryptocurrencies and blockchain technology give us further pause as the parallels to 1999/2000 and the dot-com bust are all too obvious. That said, we have a high degree of conviction in the outlook for our 10-15 core long and short positions, most of which have idiosyncratic value drivers. Naturally there will be winners and losers, but by underwriting positions with a large margin of safety, our deep value approach should continue to deliver over any reasonable time frame. Many thanks to those of you who have expressed interest and put faith in Wolf Hill as stewards of your capital. At year end, our largest positions were Constellium, Kraton, Archrock Partners, Tesla (short), Sanderson Farms (short), Aimia, and Quorum Healthcare. We finished the year 114% long and 96% short.

Best Regards,

Gary Lehrman