FRANK VALUE FUND

Frank Capital Partners LLC

UNCONSTRAINED INVESTING IN US EQUITIES

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Q2 18 LETTER TO SHAREHOLDERS

The Frank Value Fund Investor Class returned -0.08% YTD as of 6/30/18 compared to 2.65% for the S&P 500 TR Index. Please see the end of this letter for more performance information.

Why stick with value investing in this, one of the darkest hours in its history, when companies like Netflix have returned over 100% in 2018? Aside from the fact that fundamental value investing has nearly 100 years of long-term success, currently, the numbers on growth and momentum stocks are becoming too large to ignore – in a bad way. Let's take a look at Netflix.

In the past five years, Netflix stock has gone from $36.75 to $415.63. This is a return of 1031% or 62.44% per year. The market capitalization of Netflix is now $186 billion. Should it repeat this performance in the next five years, the company would be worth $2.1 trillion or roughly 10.8% of the entire 2017 Gross Domestic Product of the United States. Lowering this return to "only" 15% annualized would make Netflix a $374 billion company in five years which is bigger than 490 of the S&P 500 companies. The biggest is currently Apple with $229 billion of 2017 sales compared to Netflix's $11 billion.

At the subscriber level, Netflix enjoys 55 million US subscribers, which out of 126 million households is 44% market share. Assuming 100% of the households in the United States want and can afford a Netflix subscription, cornering the market would increase Netflix's US revenue from about $8 billion today to about $18 billion assuming no changes in subscription price. For comparison, Netflix is now planning $12-13 billion spending on content in 2018 albeit at the global level.

Add the 55 million US subscribers to the 64 million international and you get about 119 million global subscribers to the Netflix platform. This is an impressive feat for a company that was fighting with Blockbuster Video just a decade ago. Our argument is not with the quality of Netflix, we love *Stranger Things*, it is with the seemingly limitless valuation. Anyway, if we annualize the $12 per month on all those subs we get about $17 billion of revenue. Compare this to the actual trading value of Netflix which is more than 10 times this current revenue.

But revenue is growing! Netflix is taking over the world! Let's look at the world-taking-over scenario. According to some of the more aggressive analysts on Wall Street, Netflix could have 300 million subscribers by 2028. With a monthly charge of $12 per subscriber, this comes out to $43 billion of annual revenue. The current stock price is still 4.3x larger than this ten-years-from-today revenue number! Last year Netflix had an operating margin of 7.2%, meaning before interest on debt and taxes were paid, the company captured 7 cents out of every dollar of revenue as profit. Using a 7.2% operating margin on $43 billion of expected year 2028 revenue results in about $3 billion of operating income. This is an amazing accomplishment for any enterprise, but you must wait ten years *and* **ten years from today it is merely 1.7% of the current value of the business!** Compare that to the US Ten Year Government Bond which pays **2.8% today** without business risk.

What if margins increase with Netflix's success? At a 15% profit margin you get about $6.5 billion of pre-tax profit in 2028 or 3.4% of the current value of the business. Again, you must wait ten years to get paid 3.4% and everything must go perfectly for Netflix over this period.

We use these yields as part of our valuation process and we directly compare them to the risk free yields on treasuries. If you can get 2.8% from the US Government with no business risk, taking a risk on a business should pay you more. This is the difference between value and growth investing. Value prefers to buy something that already exists – say a stream of pre-tax profits from Proctor and Gamble which pays you, today, 5.8%. Growth is buying something that could exist in the future.

It is also important to note that these incredibly low and risky EBIT yields at this Netflix valuation are quoted to assume no further increase in the stock price. If Netflix trades at $415.63 in 2028 and everything goes right for the company, owners of the enterprise will finally be making a similar yield to what the 10 year Treasury was in 2018. All the while the treasury investor or the Proctor and Gamble holder are collecting coupons and dividends while growth investors get nothing from Netflix – no dividends and no stock price increases.

Although margins have increased in recent quarters, Netflix initially guided $7-8 billion of content spending for its subscribers in 2018, but a June 30th report by *The Economist* citing a Goldman Sachs assessment now shows the company will spend $12-13 billion. Revenue growth is rapid, but Netflix manages to outspend their growth. This affects margins and the balance sheet. Since 2013 Netflix has added over $6 billion of debt. Continuing their content spend will pressure margins and the balance sheet, adding to the valuation and business risk. Debt holders are always paid before equity.

Competitively, the media world has finally realized the path Netflix saw when it started its streaming service in 2007. Media and cable giants like Comcast, Fox, and Disney are desperately trying to consolidate and compete. With Disney starting its own streaming service in 2019 and pulling its movies from Netflix, a tough, deep-pocketed competitor with legendary content is on the horizon. Add this to Apple, Amazon, Hulu, YouTube, Twitch, and the other innumerable places to find something to watch, eventually cord-cutting becomes more expensive than sticking with cable. Not to mention the cable companies control the pipes the content flows through, and governments are creating risk to the current landscape with threats to Net Neutrality. High margins and high growth for Netflix are guaranteed by the current stock valuation, but the future looks a lot more uncertain.

This diatribe is attempting to prove numerically that most stocks are in a bubble. We have seen this before in 1999 and to a lesser extent in 2007, and in numerous cases, investors blind to the bubble lost nearly all their net-worth. Simply, if bubbles were sustainable valuation would never work in the long-term – we would always be in a burst-proof bubble! Instead, as mentioned, value investing has a long and successful history. Most investors cannot follow a value investing discipline because of periods like this, ergo this is why the discipline works in the first place! The Frank Value Fund still holds lots of cash and treasuries in addition to its few value stocks that we believe trade at reasonable valuations. When the bubble finally pops, the mini-declines we have seen over the past few years have shown our stocks can attract bidders while the market is falling. Either way, the current valuations on our holdings offer a lot more long-term downside protection than the thin-air under most issues, and the liquidity and safety we enjoy from our cash, treasuries, and short-term corporate bonds will flex its awesome optionality in the next, long-overdue bear market in US equities.

Thank you for your investments.

Sincerely,

Brian Frank

Frank Value Fund Lead Portfolio Manager

Performance as of 6/30/18	Average Annualized Total Returns					Total Return
	1 Yr. %	3 Yr. %	5 Yr. %	10 Yr. %	Since 7/21/04 %	Since 7/21/04 %
Investor Class (FRNKX)	-1.51	-0.97	2.68	6.23	6.13	129.22
Class C (FNKCX)	-2.18	-1.69	1.93	5.55*	5.38*	
Institutional Class (FNKIX)	-1.25	-0.71	2.94	6.55*	6.38*	
S&P 500 Total Return	14.37	11.92	13.41	10.16	8.91	228.86

* Represents an estimate based on the performance of the fund's oldest share class, adjusted for fees.

Please see our website for distribution information: www.frankfunds.com/distribution-history. Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. You may obtain performance data current to the most recent month-end by calling the Fund at 1-888-217-5426 or visiting our website at www.frankfunds.com. Returns include reinvestment of any dividends and capital gain distributions.

The information in this portfolio manager letter represents the opinions of the individual portfolio managers and is not intended to be a forecast of future events, a guarantee of future results or investment advice. Also, please note that any discussion of the Fund's holdings, the Fund's performance, and the portfolio managers' views are as of **July 11, 2018** and are subject to change without notice.