



# FRANK VALUE FUND

UNCONSTRAINED INVESTING IN US EQUITIES

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## Q2 16 LETTER TO SHAREHOLDERS

The Frank Value Fund returned 3.14% YTD in 2016 compared to 3.84% for the S&P 500 TR Index. Please see the end of this letter for more performance information.

I would like to devote this letter to our investment case for recent portfolio purchase Liberty Tax (NASDAQ: TAX). Though I believe TAX is an excellent investment, I am highlighting it here because I want to emphasize just how different the valuation and quality are for Liberty compared to the median stock. There is vast relative opportunity today in a select few businesses to find high quality and low valuation if one is willing to look outside market-index components.

Liberty Tax is the third-largest national tax preparation firm behind H&R Block and Jackson Hewitt. John Hewitt, the founder and CEO, owns 17% of Liberty, and he was also the founder of Jackson Hewitt, as well as a driving market force behind the industry's transition to using software for tax prep. Hewitt has been in the business since 1969 and is a proven, successful entrepreneur. Recognizing the large fragmentation of the industry in mom and pop businesses, Hewitt created a strong value-proposition in the Liberty Tax franchise model, making it the lowest cost of ownership in the industry. Currently, there are 4,000 Liberty Tax franchises in the US and Canada compared to 10,000 H&R Blocks.

Continuing his innovative tendencies, Hewitt led Liberty to launch wholly-owned Siempre Tax+ in 2015, a Spanish-language tax franchise model. Siempre Tax+ grew its locations 150% over the last tax season to 144 offices and does not appear to have any direct national competition.

The growth story of Liberty often causes it to trade at a premium to H&R Block. All of that changed in 2016. The IRS found a few Liberty Tax franchisees facilitating tax fraud, and although management stated this affects less than 2% of its offices, this, along with a weak tax season, caused a wave of selling in Liberty Tax stock. Since TAX is not part of the S&P 500 or Russell 2000, sellers faced a complete lack of buyers, and the stock price declined 50% in the last twelve months. Companies included in indices currently enjoy natural buyers, as ETF and index funds currently have net inflows. If you are unlucky enough to trade outside of a major index, the stock market has been a hostile place the past two years as outflows have plagued managers who traditionally buy these names. This is a key reason why active management has underperformed in the recent past. Inversely, it is also an opportunity to buy value stocks as they trade at sizable discounts like TAX does today.

Our research indicated that the reasons Liberty Tax declined 50% were short-term in nature and more to do with trading than fundamentals. At our purchase price, TAX trades at 4.6x EV/EBITDA, 16.6% EBIT/EV, and over a 10% FCF/EV yield. The S&P 500 is currently trading at 12x EV/EBITDA! This means if TAX doubles from here without growing EBITDA, it will still be trading at a 33% discount to the S&P 500. Heaping upside on a positive story, tax preparation is a recession-resistant business, while most companies are cyclical. Over the full economic cycle, you will see significant declines in much of the S&P 500's earnings, whereas Liberty has far less risk to the downside.

To put this another way, imagine both Liberty Tax and the median company in our universe cost \$100,000. Due to valuation, your \$100,000 purchase of Liberty Tax would produce \$10,000 per year in after-tax cash flow, whereas the

median company only provides \$2,000 (which is generous, a good chunk of our universe has negative free cash flow.) If both companies do not grow, after 10 years you have collected \$100,000 from Liberty Tax and only \$20,000 from the median company. We know from research that Liberty has both stronger growth prospects and more recession resiliency than the average company. Therefore we would expect free cash flow to grow over time, whereas the median company has less growth prospects and experiences a decline in cash flow during recessions.

The above shows why we devote our research efforts towards quality value companies. Over time, we believe investments like Liberty Tax will perform vastly better than the current median stock. Of course, we would love to own 25 companies like TAX, but the current market environment continues to make it exceedingly difficult to unearth these opportunities. Still, our opinion is owning a concentrated position in Liberty Tax will be a large boost to Frank Value Fund returns over the next several years, especially when compared to the market indices. The Frank Value Fund remains positioned conservatively, patiently waiting for more reasonable valuations. We continue to stress: valuations on most stocks are extremely risky here and likely to generate flat to negative returns over the next market cycle.

Thank you for your investments.

Sincerely,  
Brian Frank  
Portfolio Manager  
Frank Value Fund

#### Summary of Q2 16 Activity

##### Purchases:

Liberty Tax (NASDAQ:TAX)

CPI Card Group (NASDAQ: PMTS)

Office Depot (NASDAQ: ODP)

Office Depot certainly does not enjoy the competitive advantages and growth of our other holdings, but it is definitely one of the lowest valuation, profitable companies out there. After the Staples merger fell through in May, ODP stock price declined 50% and represents a special situation opportunity as merger arbitrage funds attempt to unwind their positions in a market hostile to low-growth value stocks.

##### Sales:

None. Our current portfolio is at least 50% cheaper than the median stock. Many of our holdings are increasing in value so far in 2016 but are not outpacing their fundamentals.

Performance as of 6/30/16	Average Annualized Total Returns						Total Return
	1 Yr. %	3 Yr. %	5 Yr. %	7 Yr. %	10 Yr. %	Since 7/21/04 %	Since 7/21/04 %
Investor Class (FRNKX)	-0.39	5.39	8.19	12.78	7.27	7.42	135.10
Class C (FNKCX)	-1.16	4.60	7.41	12.03*	6.52*		
Institutional Class (FNKIX)	-0.09	5.66	8.46	13.03*	7.52*		
S&P 500 Total Return	3.99	11.65	12.09	14.91	7.42	7.75	143.89

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

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