TRAN CAPITAL MANAGEMENT

Multi-Cap Growth | Third Quarter 2024

TCM
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Dear Clients and Friends,

We hope you're well and have had a great summer. The overall market, as measured by the S&P 500, was strong in the third quarter. However, underneath the top contributors, we believe there are many high-quality companies whose stock prices do not reflect their growth prospects. In fact, these are often leaders in their space with powerful ability to grow for many years. Investing is a special opportunity to own pieces of companies that provide essential services and products in growing markets. We view part of our craft is distilling the opportunities to be shareholders of some of the most innovative companies in the world.

As anyone who has owned a business knows, business conditions can be volatile. While value of a business doesn't always grow in a straight line over the short term, it can compound and generate a tremendous amount of wealth over the long term. For us, this resonates through buying or adding to positions when their fundamental performance is strong but not currently recognized in their stock price. We may be seeing some very interesting opportunities now as the market's return has been dominated by a handful of stocks, leaving many of the remaining companies' stock prices at attractive levels.

During the third quarter, the S&P 500 returned 5.89%, our Multi-Cap Growth Strategy returned 6.40% net of fees. Year-to-date, the S&P 500 has returned 22.08% while TCM's Multi-cap returned 16.87% net of fees. Over the past year, our portfolio has returned 34.83% net of fees while the S&P 500 has returned 36.35%. As we've discussed in prior letters, the S&P 500's returns have been dominated by just a handful of stocks. This continued in the third quarter with Apple, Tesla, and Meta Platforms being the three largest contributors to the market's return. We don't own Apple or Tesla because we think there are more exciting opportunities from valuation versus growth perspective; while this hurt our relative performance in the short term, we believe our portfolio holdings will generate more attractive returns over the long horizon.

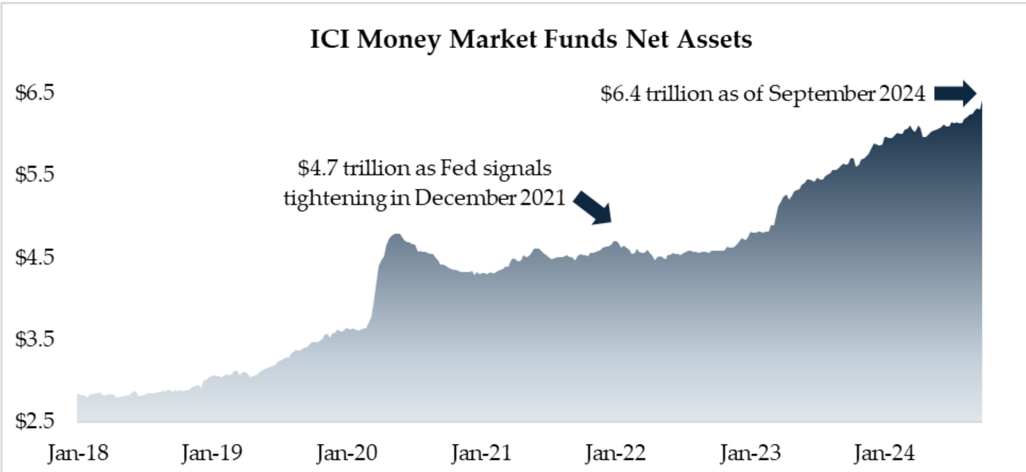
Looking at other indices, we would highlight that the S&P 500 Equal Weighted Index returned 15.16% while the S&P Midcap 400 and the Russell 2000 (small cap) returned 13.52% and 11.16% year-to-date, respectively. Thus, medium and smaller companies, whose growth prospects are often faster than the largest companies, have respectable returns, but less than that of the largest companies. Coincidentally, we are finding some interesting opportunities among mid-caps.

Index	Total Return (YTD)
S&P 500 (SPX)	22.08%
S&P 500 Equal Weighted (SPW)	15.16%
S&P Midcap 400 (MID)	13.52%
Russell 2000 (RTY)	11.16%

While we believe that over the long term, stock prices reflect company fundamentals, such as revenue growth, profitability, free cash flow generation, and capital allocation decisions, they can also move up and down for periods of time due to macro uncertainty. For instance:

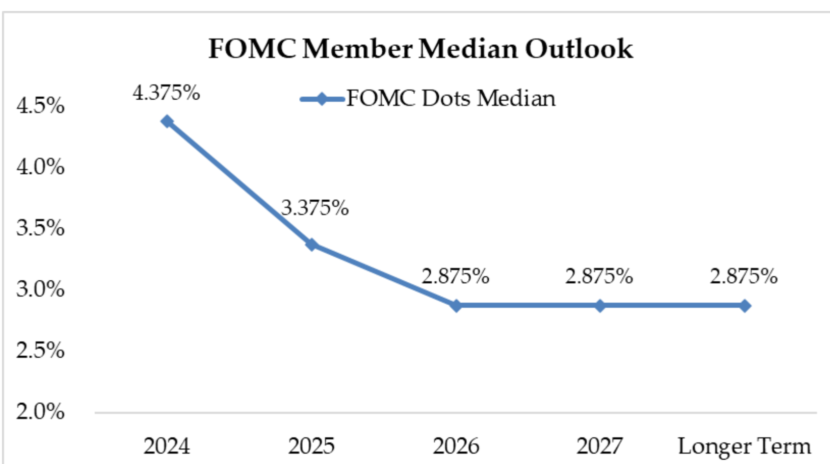
- The ongoing conflict in the Middle East can cause oil prices to spike and decrease consumer confidence in the short term.
- The U.S. is amid a very close Presidential election. The economic policies of the two candidates differ greatly and can have a material influence on capital markets.
- The impact of monetary policy and recent rate tightening cycle. Over the past two years, the Federal Reserve's war on inflation meant that as they raised the Federal Funds Rate from 0.25% to 5.25%, the value of stocks and bonds declined, particularly in 2022.

Perhaps these macro headwinds have factored into investor decisions to raised cash over the past two years. As shown below, total money market balances have grown from $4.7 trillion at the start of the Fed's tightening cycle to $6.42 trillion now. Further, macro headwinds may have been a contributing factor for investors to pile in on the largest companies like Apple, Microsoft and Tesla as a form of *flight to safety*. While this behavior is understandable, it also may present opportunities in the rest of the market, particularly as these concerns abate.



Source: ICI Investment Company Institution & Bloomberg

The U.S. Presidential election will be over (at some point), the conflict in the Middle East will hopefully abate, and – perhaps most germane to investing – **the Fed Reserve's war on inflation is coming to an end with the Fed's first step towards an interest rate easing cycle**. This is very important to investors as less restrictive monetary policy lower interest rates, which helps consumers and companies have more financial flexibility, spurs corporate actions like mergers and acquisitions, and provides funding for new companies. We believe that we are at the beginning of an important inflection point in the capital markets. With over 80% of our portfolio different than the S&P 500, we are excited about the prospects for our investments.



Source: Federal Reserve Board & Bloomberg

Portfolio Positioning

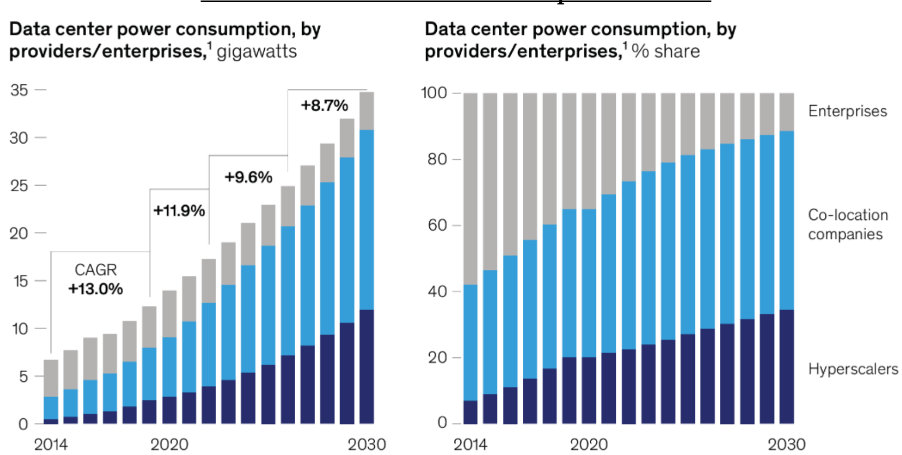
For the remainder of this letter, we'd like to highlight two holdings in our portfolio that are not widely known but whose fundamentals may accelerate over the next few years: **Talen Energy (TLN)** and **AMN Healthcare Services (AMN)**. While Talen has significantly outperformed and appreciated 55% since we purchased it in May, AMN has declined ~30% since our initial purchase. In both cases, we continue to see attractive upside relative to our appraisal of intrinsic value, and we've added more to AMN to take advantage of the dislocation in shares.

In our last letter, we highlighted **Talen Energy (TLN)**. Talen is a leading independent power producer that produces and sells electricity and capacity into wholesale power markets, primarily the PJM Interconnection (Pennsylvania-New Jersey-Maryland electricity grid). Talen's electricity generation is critical to meet the increased power demand from data centers, hybrid and electric cars, and electrification? of homes and businesses. The company has made a lot of progress since our initial purchase. First, Talen has successfully uplisted their shares from over-the-counter to the Nasdaq exchange. Second, they passed some milestone checks with Amazon's Web Services related to the planned data center campus on its Susquehanna nuclear facility, releasing $300 million from escrow to Talen. Third, PJM's capacity auction for the 2025-2026 delivery year cleared at nearly $270 per MW-day, up from $37.5 per MW-day for 2023-2024. And finally, they updated their growth prospects at their first investor day and authorized an additional $1 billion in share buybacks. On top of this, Talen continues to market their energy assets to potential customers.

Our research suggests that Talen can earn more than $1.5 billion in EBITDA in 2026 (up from ~$770 million in 2024) with upside optionality from higher than expected capacity auction results, faster AWS ramp, another datacenter deal and more (i.e. monetizing its crypto coin mining facility). Applying a 10x EV/EBITDA multiple (a discount to their leading competitor's multiple of 20x), Talen's price target could be over $260 per share compared to today's price of $180 share, before assuming any benefits from buybacks. We believe Talen can buy back over 20% of its market cap over the next few years by deploying 70% of its free cash flow towards shareholder returns. Layering in this upside pushes our price target to ~$280 per share. **As Talen transforms its business model from a cyclically exposed power producer to a predominantly contracted earnings stream through datacenter deals, we believe the stock can re-rate from its current 10x 2026 FCF multiple to somewhere in the 15x-20x range, or 5-7% FCF yield, an incremental +50-100% upside.**

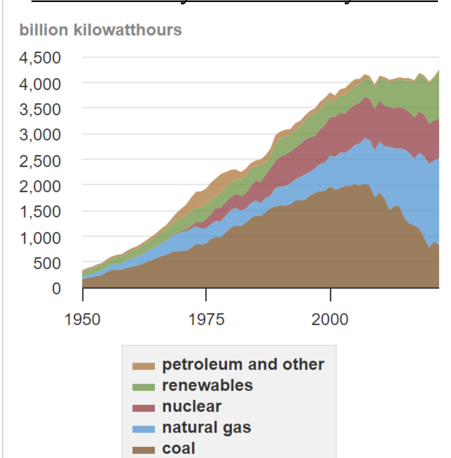
Talen remains significantly under-owned. Over the next year, Talen will become eligible for inclusion in various indices, including the Russell and S&P. These events will broaden potential investors' knowledge of Talen and attract new shareholders. In the meantime, we are encouraged by management's focus on its core business of creating contracted cash flows with its assets and divesting assets to return value to shareholders.

U.S. Data Center Power Consumption Forecast



Note: McKinsey subsequently increased their forecast from 35 GW to 50 GW in 2024.
Source: McKinsey, January 2023

U.S. Electricity Generation by Source

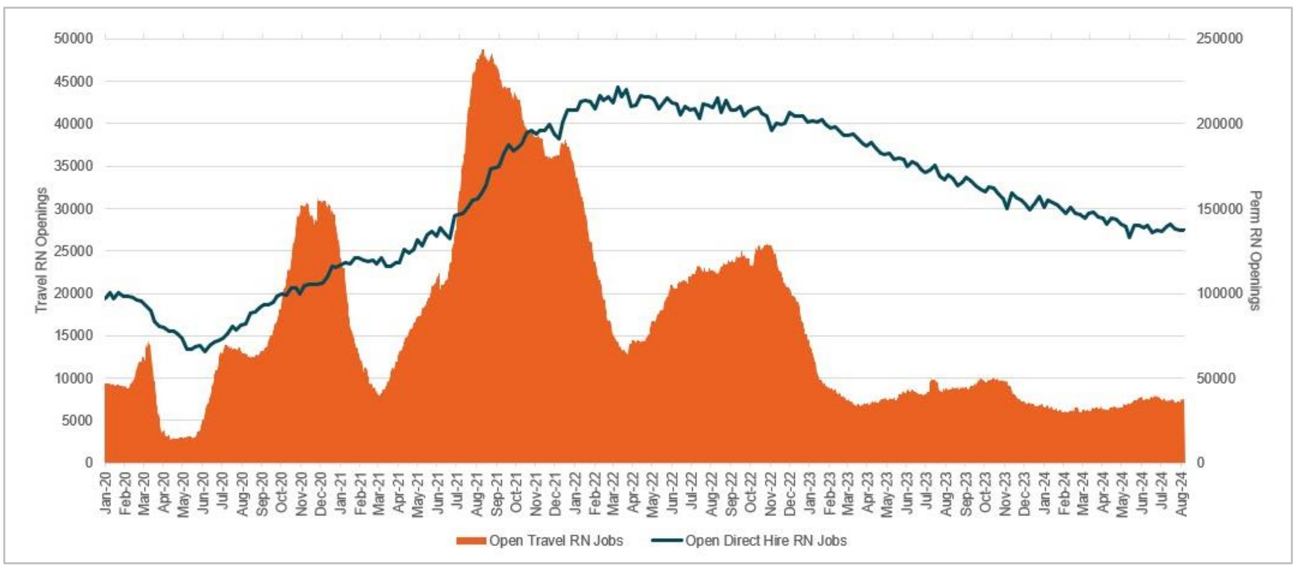


Source: IEA, June 2023

While we are excited about the current technology wave, we are also pleased to find opportunities in non-technology companies whose stock prices appear very attractive. We believe constructing our portfolio with a variety of companies in different sectors helps diversify our portfolio and reduce risk while capturing different streams of growth. **AMN Healthcare Services (AMN)** is a leading temporary healthcare staffing company focusing on travel nurse staffing and management. During the pandemic, demand for nurses spiked, driving up staffing volumes and bill rates. AMN's stock peaked at $129 in November 2022. Over the past two years, hospitals have cut back on travel nurses as demand normalized and hospitals looked to cut costs. This reversal in temporary staffing and bill rates led to a slip in AMN's stock price and valuation multiple, which created an opportunity for us to build a position.

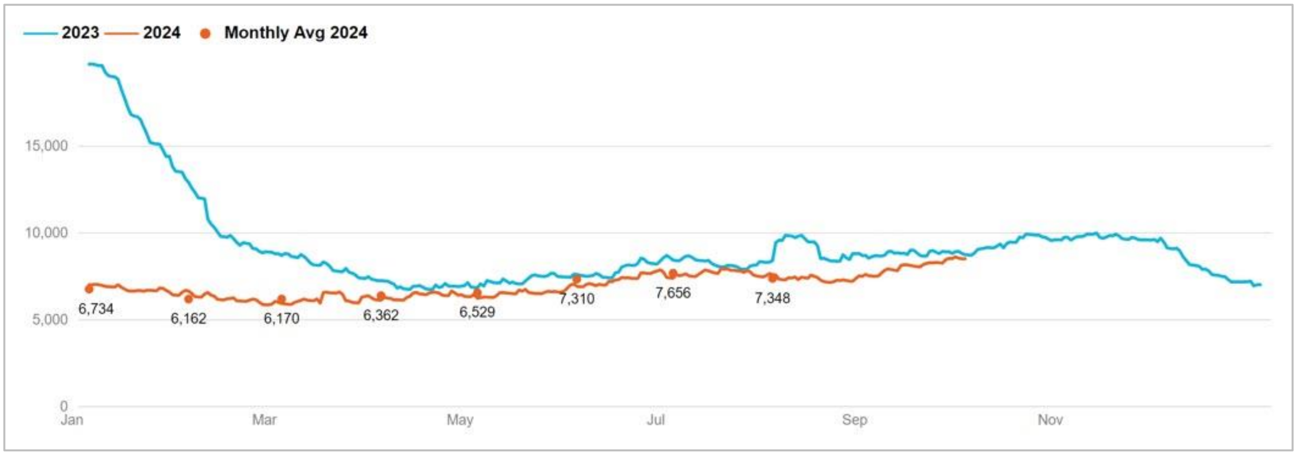
Our research suggests that the demand/supply dynamics for nursing are tipping in favor of nurses. There is a shortage of nurses and often temporary or travel nurses is one of the best solutions for hospitals and operating rooms to remain open to serve patients. We believe that of the 4 million registered nurses, just over 3 million currently work in a clinical setting. Many nurses are leaving their profession due to exhaustion. Sadly, we are not graduating enough nurses to compensate for retirements. Thus, we believe that over the next few years, wages for nurses will increase and companies like AMN will see an acceleration in their revenue and profits.

The chart below from Aya Healthcare depicts the volume of travel nurse jobs (in orange) and direct nurse hire jobs (blue line) through the pandemic. Aside from winter seasonality, both direct and travel nurse job volumes have steadily declined since the heights of the pandemic in 2022.



Source: Aya Healthcare

Looking closer at the number of open nursing jobs in 2023 and 2024, we see a potential bottoming of open nursing jobs with recent trends pointing to a pickup in demand. As of October, open nursing jobs are only 2% lower than the same time in 2023. As demand increases, bill rates should follow.



Source: Aya Healthcare

We initiated our position of AMN in the low $60s when it was about a $2 billion market capitalization company. The stock has since declined to under $40 per share due to a slow staffing recovery and news that AMN's CFO will depart to join a private equity backed company. **The short-term timing doesn't concern us as we believe it is not a question of if but when demand outstrips supply for nurses. AMN has shrewdly re-hired its prior CFO, who drove a 4x increase in revenue and 13x increase in EBITDA over ~10 years.** Given the recent slide, we added more to our position. At current prices, the stock is selling for 12x estimated 2024 P/E, or 13% FCF yield. AMN continues to provide critical nursing care and generates free cash flow, which we believe will be directed towards high-returning buybacks at these levels. Our analysis suggests that AMN can earn ~$5 per share by 2027. Applying a more normalized multiple of 17x, AMN may be worth over $85 per share in a few years.

Looking Forward

We believe that the fundamental drivers of companies like Talen and AMN Healthcare are strong, especially over the next three-to-five years. While there are a lot of macro uncertainties, we don't believe these macro headwinds will derail the growth prospects of our portfolio companies. Moreover, when our portfolio companies' stock prices decline for non-fundamental reasons, we often add more if the underlying thesis remains intact. This is often the case when we buy companies that provide critical products and services in the industries where they operate.

As the market eventually broadens out and relies less on the concentrated performance of a few mega-cap companies, we believe our portfolio of high-quality compounders will gain further recognition for their attractive fundamentals, driving attractive returns for the years to come. Thank you for your support and interest. If you have any questions, please feel free to contact us at (415) 461-3800.

Sincerely,

Quoc K. Tran
Chairman & CIO

Michael N. Im
Co-PM & Director of Research

Eric A. Winterhalter
President

Important Disclosure

Performance is provided as supplemental information and is based on the Non-Taxable Multi-Cap Growth Equity Composite. Performance results reflect all income, gains and losses and the reinvestment of interest and other income. All rates of return are reported "NET" of fees. Additional information regarding the policies for calculating and reporting returns is available upon request. A complete listing and description of all TCM composites and performance results is available upon request.

The 1-year, 3-year, 5-year and 10-year net of fees returns of the Non-Taxable Multi-Cap Growth Equity Composite as of September 30, 2024, are 34.83,1.73, 11.00, and 9.85 respectively. The 1-year, 3-year, 5-year and 10-year returns of the S&P 500® Index as of September 30, 2024, are 36.35, 11.91, 15.97 and 13.38 respectively. 3-year, 5-year and 10-year performance figures are annualized.

The S&P 500® is an unmanaged stock market index and is not available for direct investment. The S&P 500® Index represents the stocks of 500 leading U.S. publicly-traded companies from a broad range of industries. The performance of an unmanaged index reflects no deductions for fees, expenses or taxes which would affect performance of actively managed assets. The volatility of the S&P 500® Index may be greater or less than the volatility of the portfolios in the composite.

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Select assets shown; additional Non-Taxable Multi-Cap Growth Equity investment information is available including the complete portfolio upon request.

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