# March 2019 Investor Letter

## REVIEW OF 1ST QUARTER PERFORMANCE

The Fund gained 19.78% in the first quarter recovering sharply from the late year sell-off in 2018

## RESEARCH SPOTLIGHT – SVB FINANCIAL GROUP

Strong franchise providing Commercial Banking to Venture Capital firms and their venture-backed investment companies

Dear Gator Financial Partner:

We are providing you with Gator Financial Partners, LLC's (the "Fund" or "GFP") Q1 2019 investor letter. This letter reviews the Fund's investment performance for the 1st quarter of 2019, presents our investment thesis on SVB Financial Group, which is the bank holding company for Silicon Valley Bank, and discusses the Fund's current net exposure and positioning by sub-sector.

## 1ST QUARTER PERFORMANCE

For the 1st quarter of 2019, we outperformed the Financials sector benchmark and the overall market. The Fund gained 19.78%. Fannie Mae preferred stock, NMI Holdings, OneMain Financial and Syncora were top contributors to performance. The largest detractors were Bimini Capital Management, Kingstone Companies, UBS Group, and Community Bankers Trust.

| | Q1 2019 | Total Return Since Inception[1] | Annualized Return Since Gator's Inception[1] |
|---|---|---|---|
| Gator Financial Partners, LLC[2] | 19.78% | 729.06% | 21.74% |
| S&P 500 Total Return Index[3] | 13.65% | 178.84% | 10.01% |
| S&P 1500 Financials Index[3] | 8.66% | 104.16% | 6.86% |

The Fund's portfolio rebounded nicely to begin 2019. Several of our non-bank financials, including OneMain Financial, NMI Holdings, and Sallie Mae, recovered sharply from the December selloff. The stock performance of private equity managers was strong to start the year. As mentioned above, two of our largest contributors during the quarter were Fannie Mae preferreds and Syncora.

[1]The Fund's inception date was July 1, 2008. [2]Performance presented assumes reinvestment of dividends, is net of fees, brokerage and other commissions, and other expenses an investor in the Fund would have paid. [3]Performance presented assumes reinvestment of dividends. No fees or other expenses have been deducted.

We wrote in our January letter that the Fannie Mae preferreds had started the year strong based on speculation that the Trump Administration would potentially end the conservatorship of Fannie Mae and Freddie Mac. The first part of the process was the confirmation hearing for Mark Calabria, the nominee to run Fannie's regulator, the Federal Housing Finance Authority ("FHFA"). In early April, the Senate confirmed Calabria's appointment. We expect the next step will be an announcement by the Treasury Department detailing their plan for recapitalizing Fannie Mae and Freddie Mac. We continue to own our preferred shares.

Syncora continued to make new gains in Q1. The driver of the gains was an early March announcement by the company that they had engaged an investment bank to run a sales process for the entire company and/or the company's insurance subsidiary. With book value close to $7 and potential additional value in the company's loss reserves for Puerto Rico, we think there are a couple of scenarios for additional gains from the current price. The simplest scenario is management sells the entire company and shareholders receive cash. A second scenario is they could sell just the insurance subsidiary, the company would make a large one-time cash distribution to shareholders, and shareholders would keep a stub position in the remaining shell company with approximately $2 billion of net operating loss tax carryforwards ("NOLs"). We believe the market is correctly interpreting the announcement of a sale process as positive new information. Our largest concern with our Syncora position had been the possibility that management would use the company's cash to acquire a business in order to monetize the NOLs. We note that recent NOL shell companies that have made acquisitions have had poor results, such as Real Industry, Bluestem and WHIM/Nationstar. With the announcement of the sales process, we believe our worst-case scenario is most likely eliminated.

Among the detractors during the quarter was our position in UBS. Our positions in Barclays and Credit Suisse also lagged during the quarter although they were not among our largest detractors. The underperformance was driven by a combination of lower interest rates globally and a difficult quarter from a capital markets perspective. All three of these companies have significant capital markets businesses. We continue to own our positions. We believe the valuation of each company is compelling, and each company is beginning to return capital to shareholders through redeeming high-cost preferred securities, increasing dividends, and/or stock buybacks.

We continue to think the long positions in our portfolio are inexpensive firms with growing businesses. In the last two months, we have added to our short portfolio of small and mid-cap regional banks. We believe the competition for deposits is going to become more intense and restrain net interest margins for these banks .

## RESEARCH SPOTLIGHT – SVB FINANCIAL GROUP

We started a position in SVB Financial (ticker: SIVB) during the 1st quarter. SVB Financial is the bank holding company for Silicon Valley Bank, which has a strong franchise providing commercial banking to venture capital firms and their venture-backed investment companies. Over the past 20 years, SIVB's stock has returned 17.3% annually compared to the S&P 500 returning 5.9% and the bank index returning 2.6%. These returns are a testament to the bank's strong franchise.

Despite SIVB's strong franchise and great long-term track record, SIVB's stock has underperformed since the market's highs last September. Here are some of the concerns that we've heard from other investors.

- SIVB is the most asset-sensitive bank, so with the Fed further pausing interest rate increases and potentially cutting rates, SIVB is the most exposed bank to lower rates;
- The venture investing community has been on fire for the past few years and valuations for late stage venture companies are high so SIVB will experience a much tougher environment when the current venture capital environment reverses;

- SIVB will have less warrant income in Q1 due to the delayed IPO calendar created by the federal government shutdown in January;
- During its Investor Day in early December 2018, SIVB's management guided forecasts for deposit balances to decline for Q4 due to expected distributions by Venture Capital funds to their limited partners; and,
- SIVB has periodically guided to higher expense growth than Wall Street has expected so they can continue to invest in and expand their franchise.

We think these five concerns have pushed SIVB's stock down to a level that is compelling. While these concerns are valid, we believe each is temporary and will not diminish the long-term franchise value of SIVB.

In addition to the recent underperformance of SIVB stock, here is what we find attractive about SIVB.

### 1.) EXTREMELY ATTRACTIVE DEPOSIT BASE

SIVB has one of the best deposit franchises in the country. SIVB has had a long-term focus on the venture capital community. The bank has built strong relationships with venture capitalists. They bank the venture firms and their funds, they bank the venture portfolio companies, and they bank the executives at the venture portfolio companies. When a portfolio company gets funding from a venture firm, they receive cash and deposit it at a bank. SIVB estimates it has a 60% market share among venture-backed portfolio companies. SIVB is also different from other banks in that it has moved excess deposits off of its balance sheet into money market funds and other similar short-term deposit replacement products. These off-balance sheet client assets generate fee income for SIVB and do not require equity capital support like an on-balance sheet deposit would. A few other metrics that demonstrate the quality of SIVB's deposit franchise are the 56% loan-to-deposit ratio and the total cost of funds of 0.20%. For comparison, Bank of America, which is arguably regarded as the best national deposit franchise, has a loan-to-deposit ratio of 69% and a cost of funds of 1.12%.

### 2.) CONSISTENT DOUBLE-DIGIT LOAN AND DEPOSIT GROWTH

Since 1999, SIVB has grown loans per share and deposits per share at 15% and 13%, respectively. By looking at these metrics on a per share basis, we are adjusting for acquisitions, stock buybacks, and equity issuances, and get something close to the organic growth rates. The growth rates of loans and deposits have been strong for 20 years.

### 3.) EARNINGS ESTIMATES ARE TOO LOW

We believe the earnings estimates are too low for SIVB. We have noticed that the sell-side is mostly conservative on SIVB's estimates because of the volatility of their warrant income. We believe the sell-side's estimates for 2019 are even more conservative because they don't factor the December 2018 Fed rate hike that already occurred. And we believe the messaging from SIVB management about conservative deposit growth at its Investors Day in December 2018 has caused the sell-side to lower its forecast of deposit growth too far. We've already seen evidence that SIVB management was too conservative on their deposit guidance in December 2018 and beat that guidance when they reported earnings in January 2019.

### 4.) SIVB'S POSITIONING WITHIN VENTURE COMMUNITY IS A TRUE FRANCHISE

Over the past 30 years, SIVB has built strong relationships with the venture and private equity communities. These relationships have extended to the portfolio companies of these investment firms and the principals of both the investment firms and portfolio companies. We believe the network of relationships gives SIVB a banking franchise where firms and executives are less price sensitive on their loans and deposits in exchange for access to the SIVB network.

### 5.) HIGH RETURN ON EQUITY

With Fed Funds between 2.00% and 2.25%, SIVB reported a 20% return on tangible equity ("ROTE"). This ROTE is in the top 5% of banks and should lead to higher growth rates and a premium valuation.

### 6.) REINVESTMENT OPPORTUNITIES

SIVB's high organic growth rate and high return on equity allows the bank to reinvest more of the capital it generates. This is different from most banks who may generate high returns on equity but do not have the same reinvestment opportunities. For example, U.S. Bancorp generates a +20% return on equity, but it has only grown loans and deposits per share at 5% and 9%.

### 7.) SIVB IS A BENEFICIARY OF AN EASING REGULATORY ENVIRONMENT

One of the major regulatory rollbacks Congress passed was the raising of bank asset levels from $50 billion to $250 billion before major regulatory programs are implemented. SIVB is about to cross the $50 billion asset level, so it will not have to deal with major regulatory issues such as the CCAR stress testing process, resolution planning, Liquidity Coverage Ratio (LCR), and Risk Management.

### 8.) SIVB WILL REGAIN ITS PREMIUM VALUATION

SIVB is trading for 11x 2019 earnings per share estimates ("EPS"). For the previous 10 years, SIVB has usually traded between 15x and 22x EPS. We think it will regain a premium valuation as current fears fade.

### 9.) SIVB IS GENERATING EXCESS CAPITAL, AND MANAGEMENT HAS STARTED BUYING BACK STOCK

With rising interest rates, SIVB's return on equity is above 20% and greater than its organic growth rate, so the bank is generating more capital than it can reinvest. Since SIVB doesn't pay a dividend, management has started to use the excess capital to repurchase stock.

## BEAR CASE:

Although we think the bullish investment thesis for SIVB is compelling, we always consider the bear case. Here are the main bearish points as we understand them and our reasons that we can still own the stock despite these points:

### 1.) SIVB FACES INTEREST RATE HEADWINDS IF RATES DECLINE

SIVB is one of the most asset-sensitive banks, so with the Fed becoming dovish, SIVB's earnings are at risk due to lower rates. A bank is asset-sensitive when its earnings increase due to higher short-term rates. SIVB is the most asset-sensitive bank because its assets are mostly floating rate loans and it has the lowest cost deposit base in the country.

We note that the bank's management has said that they are layering in interest rate hedges to reduce the asset sensitivity. We don't love interest rate hedging of this kind because we think it is costly, and if it works, the stock's valuation will not reflect the value of the hedges.

In our view, we think the Fed is in more of a pausing rates phase than an actual cutting rates phase, so we don't think SIVB's earnings will go down. If the Fed does cut rates, we believe SIVB's long-term growth rate will be unaffected. In fact, the bank's loan growth may mitigate the earnings impact of lower rates. We believe the low valuation is already pricing in several rate cuts by the Fed.

### 2.) TECHNOLOGY START-UP VALUATIONS AND VELOCITY MAY BE UNSUSTAINABLE

We are reaching cyclically high levels of venture capital investing. SIVB's earnings could decline in multiple ways in a venture investing downturn. The last VC downturn took close to 20 years to recover prior peak levels.

We may be near a peak in venture investing, but what if the peak is 4-5 years away? We haven't seen a runaway IPO market for tech IPOs, yet. Yes, some tech unicorns have had down rounds and lost value, but there continues to be significant innovation in the venture community.

### 3.) SIVB'S TECHNOLOGY LENDING IS VULNERABLE TO RECESSION

SIVB's technology lending is actually high-risk but is currently disguised by low current losses. SIVB's technology lending has also expanded significantly since the Internet Boom/Bust.

### 4.) SIVB MAY HAVE BEEN GROWING CAPITAL CALL LOANS TOO FAST

SIVB fastest growing loan category is Capital Call loans to private equity funds. These loans are facing increasing competition from many banks because they have experienced almost no credit charge-offs in their history. This category of loans has grown substantially since the Great Financial Crisis and is relatively untested in a recession.

We note this is a valid criticism. The growth rate that SIVB has experienced may slow and spreads may tighten due to competition. SIVB management would say they have the best customer franchise with the private equity funds, so they expect to be able to maintain or grow their market share. In our experience, private equity fund managers are economic players and would be willing to move business to another bank for a better rate. We are less concerned about the credit performance of these loans because we think there is low likelihood of default by private equity funds, and SIVB will have multiple avenues to recover on any defaults.

### 5.) SIVB'S GAINS FROM WARRANTS MAY BE UNSUSTAINABLE

As part of its lending business, SIVB typically receives warrants in the borrower. Since SIVB has a large portfolio of lending clients, it also has a large portfolio of warrants. Each quarter, a small portion of these companies have liquidity events, which allows SIVB to book warrant gains. Some critics claim that the warrant income will dry up when the venture investing cycling dries up. We think investors already discount warrant income, so SIVB's stock does not have a lot of embedded premium in its stock price due to potential warrant income.

### 6.) SIVB IS TAKING ANOTHER SHOT AT INVESTMENT BANKING

SIVB recently announced the acquisition of Leerink Partners, an investment bank focused on the healthcare and life sciences sector. The theory is SVB will be able to capture the investment banking business of their biotech clients who are now just commercial banking clients. The secondary plan is to expand the investment bank to other sectors such as technology. The two criticisms of this deal are the high price ($280 million cash) and the fact that SIVB had an investment bank 15 years ago (SVB Alliant) that they had to close.

## PORTFOLIO ANALYSIS

Below are the Fund's five largest common equity long and short positions. All data is as of March 31, 2019.

| Long | Short |
|---|---|
| Zions Bancorporation (stock & warrants) | Northwest Bancshares, Inc. |
| Syncora Holdings | Meridian Bancorp |
| Ambac Financial Group | UMB Financial |
| SunTrust Bank | American Homes 4 Rent |
| KKR & Co. Inc. | Invitation Homes |

From this list, we excluded ETFs and fixed income instruments such as preferred stock.

## Sub-sector Weightings

Below is a table showing the Fund's positioning within the Financials sector[4] as of March 31st:

[4] "Financials sector" is defined as companies included in the Global Industry Classification System ("GICS") sectors 40 and 60, which contains financial and real estate companies.

| | Long | Short | Net |
|---|---|---|---|
| Alt Asset Managers | 16.51% | 0.00% | 16.51% |
| Capital Markets | 3.21% | -1.00% | 2.21% |
| Banks (large) | 38.14% | -8.12% | 30.02% |
| Banks(small) | 1.71% | -9.27% | -7.55% |
| P&C Insurance | 4.58% | 0.00% | 4.58% |
| Life Insurance | 0.00% | 0.00% | 0.00% |
| Non-Bank Lenders | 31.39% | -1.76% | 29.63% |
| Processors | 0.00% | 0.00% | 0.00% |
| Real Estate | 3.20% | 0.00% | 3.20% |
| Exchanges | 0.00% | 0.00% | 0.00% |
| Index Hedges | 0.00% | -2.41% | -2.41% |
| Non-Financials | 0.00% | 0.00% | 0.00% |
| **Total** | **98.74%** | **-22.54%** | **76.20%** |

The Fund's gross long exposure is 98.74%, and its net exposure is 76.20%. From this table, we exclude fixed income instruments such as preferred stock. Preferred stock positions account for an additional 9.9% of the portfolio.

## CONCLUSION

Thank you for entrusting us with a portion of your wealth. On a personal level, Derek Pilecki, the Fund's Portfolio Manager, continues to have more than 80% of his liquid net worth invested in the Fund.

As always, we are available by phone whenever you want to discuss the Fund or investing in general.

Sincerely,

Gator Capital Management

Gator Capital Management, LLC

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All performance results are based on the net asset value of the Fund. Net performance results are presented net of management fees, brokerage commissions, administrative expenses, and accrued performance allocation, as indicated, and include the reinvestment of all dividends, interest, and capital gains. The performance results represent Fund-level returns, and are not an estimate of any specific investor’s actual performance, which may be materially different from such performance depending on numerous factors.

The market indices appearing in this letter have been selected for purposes of comparing the performance of an investment in the Fund with certain well-known equity benchmarks. The statistical data regarding the indices has been obtained from Bloomberg and the returns are calculated assuming all dividends are reinvested. The indices are not subject to any of the fees or expenses to which the funds are subject and may involve significantly less risk than the Fund. The Fund is not restricted to investing in those securities which comprise these indices, its performance may or may not correlate to these indices, and it should not be considered a proxy for these indices. The S&P 500 Total Return Index is a market cap weighted index of 500 widely held stocks often used as a proxy for the overall U.S. equity market. The S&P 1500 Financials Index is a market cap weighted index of financial stocks within the S&P 1500 Super Composite Index we used as a proxy for the Financials sector of the U.S. equity market. An investment cannot be made directly in either index. The Fund consists of securities which vary significantly from those in the benchmark indices listed above. Accordingly, comparing results shown to those of such indices may be of limited use.

Statements herein that reflect projections or expectations of future financial or economic performance of the Fund are forward-looking statements. Such “forward-looking” statements are based on various assumptions, which assumptions may not prove to be correct. Accordingly, there can be no assurance that such assumptions and statements will accurately predict future events or the Fund’s actual performance. No representation or warranty can be given that the estimates, opinions or assumptions made herein will prove to be accurate. Any projections and forward-looking statements included herein should be considered speculative and are qualified in their entirety by the information and risks disclosed in the Fund’s Private Placement Memorandum. Actual results for any period may or may not approximate such forward-looking statements. You are advised to consult with your own independent tax and business advisors concerning the validity and reasonableness of any factual, accounting and tax assumptions. No representations or warranties whatsoever are made by the Fund, the General Partner, or any other person or entity as to the future profitability of the Fund or the results of making an investment in the Fund. Past performance is not a guarantee of future results.

The funds described herein are unregistered private investment funds commonly called “hedge funds” (each, a “Private Fund”). Private Funds, depending upon their investment objectives and strategies, may invest and trade in a variety of different markets, strategies and instruments (including securities, nonsecurities and derivatives) and are NOT subject to the same regulatory requirements as mutual funds, including requirements to provide certain periodic and standardized pricing and valuation information to investors. There are substantial risks in investing in a Private Fund (which also are applicable to the underlying Private Funds, if any, in which a Private Fund may invest). Prospective investors should note that:

- A Private Fund represents a speculative investment and involves a high degree of risk. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment in a Private Fund. An investor could lose all or a substantial portion of his/her/its investment.

- An investment in a Private Fund is not suitable for all investors and should be discretionary capital set aside strictly for speculative purposes. Only qualified eligible investors may invest in a Private Fund.

- A Private Fund's prospectus or offering documents are not reviewed or approved by federal or state regulators and its privately placed interests are not federally, or state registered.

- An investment in a Private Fund may be illiquid and there are significant restrictions on transferring or redeeming interests in a Private Fund. There is no recognized secondary market for an investor's interest in a Private Fund and none is expected to develop. Substantial redemptions within a limited period of time could adversely affect the Private Fund.

- Certain portfolio assets of a Private Fund may be illiquid and without a readily ascertainable market value. The manager's/advisor's involvement in the valuation process creates a potential conflict of interest. Instances of mispriced portfolios, due to fraud or negligence, have occurred in the industry.

- A Private Fund may have little or no operating history or performance and may use performance information which may not reflect actual trading of the Private Fund and should be reviewed carefully. Investors should not place undue reliance on hypothetical, pro forma or predecessor performance.

- A Private Fund may trade in commodity interests, derivatives and futures, both for hedging and speculative purposes, and may execute a substantial portion of trades on foreign exchanges, all of which could result in a substantial risk of loss. Commodities, derivatives and futures prices may be highly volatile, may be difficult to accurately predict, carry specialized risks and can increase the risk of loss.

- A Private Fund's manager/advisor has total trading authority over a Private Fund. The death or disability of a key person, or their departure, may have a material adverse effect on a Private Fund.

- A Private Fund may use a single manager/advisor or employ a single strategy, which could mean a lack of diversification and higher risk. Alternatively, a Private Fund and its managers/advisors may rely on the trading expertise and experience of third-party managers or advisors, the identity of which may not be disclosed to investors, which may trade in a variety of different instruments and markets.

- A Private Fund may involve a complex tax structure, which should be reviewed carefully, and may involve structures or strategies that may cause delays in important financial and tax information being sent to investors.

- A Private Fund's fees and expenses, which may be substantial regardless of any positive return, will offset such Private Fund's trading profits. If a Private Fund's investments are not successful or are not sufficiently successful, these payments and expenses may, over a period of time, significantly reduce or deplete the net asset value of the Private Fund.

- A Private Fund and its managers/advisors and their affiliates may be subject to various potential and actual conflicts of interest.

- A Private Fund may employ investment techniques or measures aimed to reduce the risk of loss which may not be successful or fully successful.

- A Private Fund may employ leverage, including involving derivatives. Leverage presents specialized risks. The more leverage used, the more likely a substantial change in value may occur, either up or down.

**The above summary is not a complete list of the risks, tax considerations and other important disclosures involved in investing in a Private Fund and is subject to the more complete disclosures in such Private Fund's offering documents, which must be reviewed carefully prior to making an investment.**

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