TRAN CAPITAL MANAGEMENT

Partners Strategy | Second Quarter 2025

Dear Clients and Friends,

Thank you for your continued support and interest. A lot has happened since our 1st quarter letter. In that letter, we had discussed how U.S. economic conditions as expressed by employment levels, inflation trends, and household balance sheets were in good shape, and that the 1st quarter's negative market returns were driven mostly by self-inflicted wounds stemming from our government's surprisingly large and hostile tariff announcement on April 2nd. We postulated that as bilaterial deals took shape, the Trump administration would claim some victories and pivot to lowering taxes and reducing regulations, which would create a positive environment for stock prices to recover.

While there has been progress on both points, the escalation of conflict in the Middle East between Israel and Iran, and the speed at which U.S. became involved potentially threatened this rebound in equities. As we write this letter, the U.S. involvement and successful bombing of three Iranian nuclear facilities on June 21st appears to have neutralized Iran's nuclear ambitions, taking out a material risk in the Middle East. President Trump has also pushed Israel and Iran to a cease fire, paving way for a potential diplomatic solution. Remarkably, the stock market absorbed these scares and rebounded throughout the quarter. We believe that as these risks decline, the stock market will continue to rally.

Equity returns were positive in the 2nd quarter with TCM's Partners Strategy returning 18.2%, bringing our year-to-date return to 8.8%, net of fees. The S&P 500 and S&P Mid-Cap 400 indices returned 10.9% and 6.7% in the second quarter, respectively, bringing the first half returns to 6.2% and 0.2%. The path to these returns has not been smooth, but we believe that over time, our portfolio's profit growth should generate continued stock price appreciation.

Volatile times can be difficult to navigate. We try not to overreact at market extremes. Doing so may lock in negative returns and miss market recoveries. Our experience has shown us that some of the best days and weeks often follow some of the worse days in the stock market. Instead, we use volatile times to double-check our assumptions in our portfolio companies and initiate positions in other high-quality companies whose stock prices are down because the market is selling off. The first half of 2025 gave us such an opportunity, and we added a select number of companies that we believe have a long runway for growth.

Portfolio Positioning

In our last letter, we highlighted adding **GE Vernova (GEV)** to the portfolio amid market turmoil. So far, our entry point has been attractive with the stock appreciating over 60% since our first purchase. During the 2nd quarter, we added several new names to the portfolio, one of which was **Fair Issac Corporation (FICO)**.

Fair Isaac was founded in 1956 as a pioneer of using predictive analytics and data to help businesses make more informed decisions. We know Fair Isaac for their FICO scores. Financial institutions like banks, credit card companies, auto and other lenders use FICO scores to predict how likely an applicant is to repay loans on time, allowing them to make more consistent and structured underwriting decisions. From a consumer perspective, FICO scores democratize borrowing by using factors like income, historic payment patterns, and outstanding debt to determine ability to repay instead of discretionary reasons. For these reasons, FICO scores have become the industry standard for underwriting.

Fair Isaac enjoys an entrenched industry-standard product, steady pricing power, and strong margins. Most of the company's revenues come from royalties from the Scores segment. Additionally, they leverage their intellectual models to offer software subscriptions for origination and risk assessment. For these reasons, Fair Isaac has long traded at a significant premium to the market. We found an attractive entry point during the 2nd quarter when Fair Isaac's stock sold off on concerns that the Federal Housing Finance Agency (FHFA) would impose regulatory changes to address the high closing costs for homes via savings from credit scoring.

Our research suggests that the fears over changing from a "tri-merge" to "bi-merge" credit scoring are likely unwarranted as this would potentially introduce adverse outcomes, including lower and inaccurate FICO scores for consumers. For this reason, mortgage industry trade groups have also been against a bi-merge approach. Further, even in such a worse-case scenario, the ~30% dip in Fair Isaac's share price was extreme relative to the potential earnings impact. We believe the likely approach will be the introduction of a competitive credit scoring metric such as VantageScore. Our research suggests that Fair Isaac's product is highly entrenched in the mortgage industry and that the switching costs to a competitive score (even at parity effectiveness) is too high for mortgage originators, MBS investors, and the overall ecosystem; not to mention the added confusion and complexity from having to explain to consumers why they were rejected for a mortgage application or why they have a higher rate due to a differing VantageScore. We believe Fair Isaac can offset any small amount of lost volumes through pricing levers, added services, a recovery in the mortgage market, and growth in non-mortgage markets such as auto loans and credit cards. We believe FICO scores are essential for financial underwriting and that Fair Isaac's long-term competitive advantages have not changed. As such, the recent setback in the stock price is an attractive setup for long-term gains.

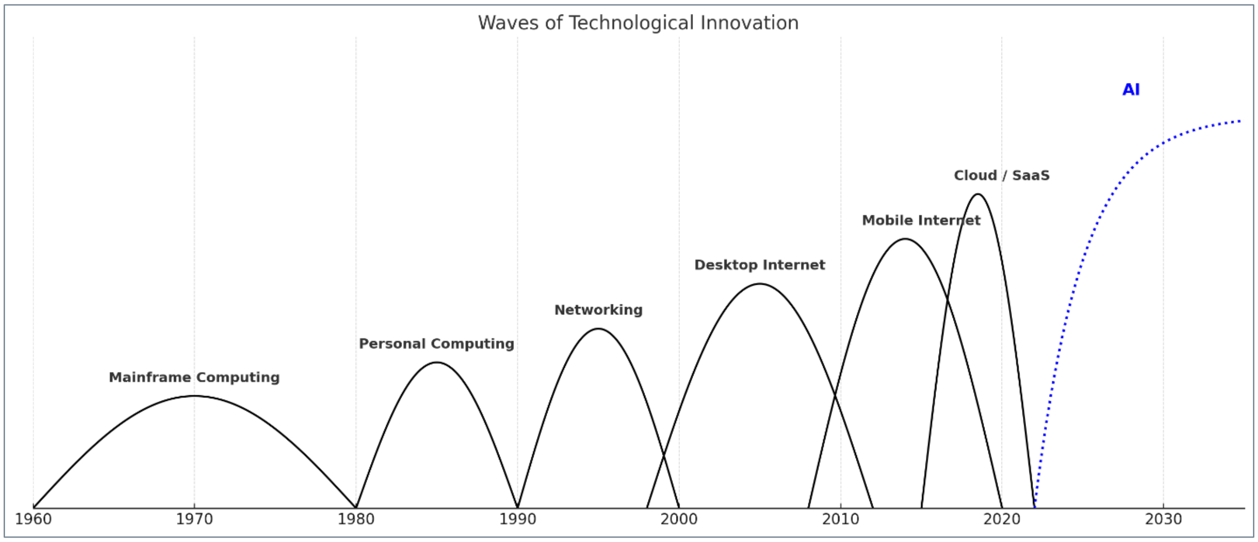
To fund our new purchases, we had to raise cash from other holdings. **In assessing which companies to trim or sell, we take into consideration the company's valuation compared to our estimate of its intrinsic value, any changes in moat or thesis, position in the cycle, and concentration of risks and exposures in the portfolio. Additionally, in cases where stock prices are down, we consider whether there could be benefits from tax-loss harvesting.** This means we sell a stock that's down, wait at least 30 days and repurchase it. This enables us to use that loss to offset capital gains in other positions. We also find this helps us remove biases when determining whether to reenter our position.

We'd like to highlight a few positions we sold in the second quarter. During the quarter, we sold **Builders FirstSource (BLDR)** to fund our purchase of Fair Issac. We still very much like Builders FirstSource, but we wanted to maintain (rather than increase) our overall exposure to our housing-related stocks while also harvesting the loss in Builders. We also sold **Jefferies Financial Group (JEF)**. We invested in Jefferies under the thesis that the bank was well positioned to benefit as capital markets pick up. However, as the markets sold off in March and April, we concluded that we were too early and decided to harvest that loss. We will reconsider Jefferies and other financial stocks soon.

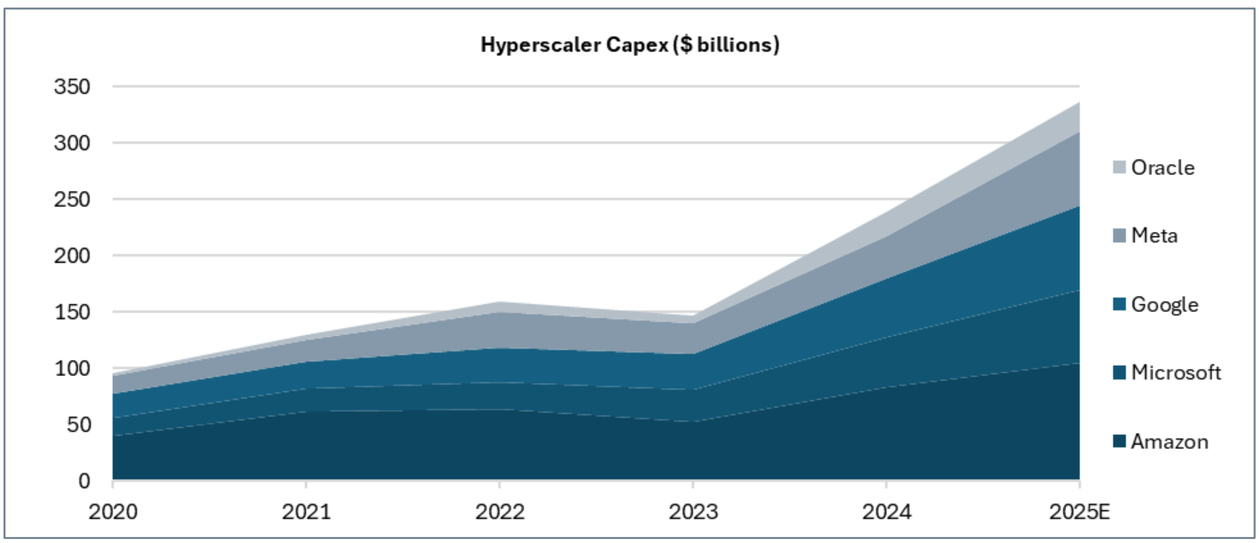
Finally, we trimmed our position in **Talen Energy (TLN)**. Many readers will remember that we initially purchased Talen in the 2nd quarter of 2024 at an initial price of ~$115. Talen trades at $295 today – a home run. We've written about our Talen thesis multiples in the past – that Talen is particularly well positioned to supply electricity to the PJM grid and that the company was poised to for attractive earnings growth and a potential re-rating in valuation as it secured long-term contracts for its generation, particularly its nuclear facility at Susquehanna. **During the quarter, Talen updated their power purchase agreement with Amazon Web Services, expanding the agreement from one of two generators at its nuclear facility to both generators. This meant that Talen secured long term contract for roughly half its power generation until 2042.** Not surprisingly, the market reacted positively, and Talen's stock price appreciated over 47% in the quarter and over 150% since our initial purchase. In our previous letter, we highlighted that Talen's stock price declined in the first quarter due to short-term regulatory hurdles, but that our confidence in the company's prospects gave us the fortitude to hold on. We are glad we did. With Talen rising to over 10% of our portfolio, we concluded it would be prudent to trim the position. We believe there is still upside to Talen's stock price today and it remains one of our larger positions.

Looking Forward

Stepping back, our thesis in Talen is driven by our belief that we are at the forefront of the next major technological growth cycle. We've written about how major waves of innovation in the past, like PCs and smartphones, brought forth decades of productivity improvements and innovation. We believe that the AI wave is still in the early innings of growth.



Source: TCM, Coatue East Meets West 2025



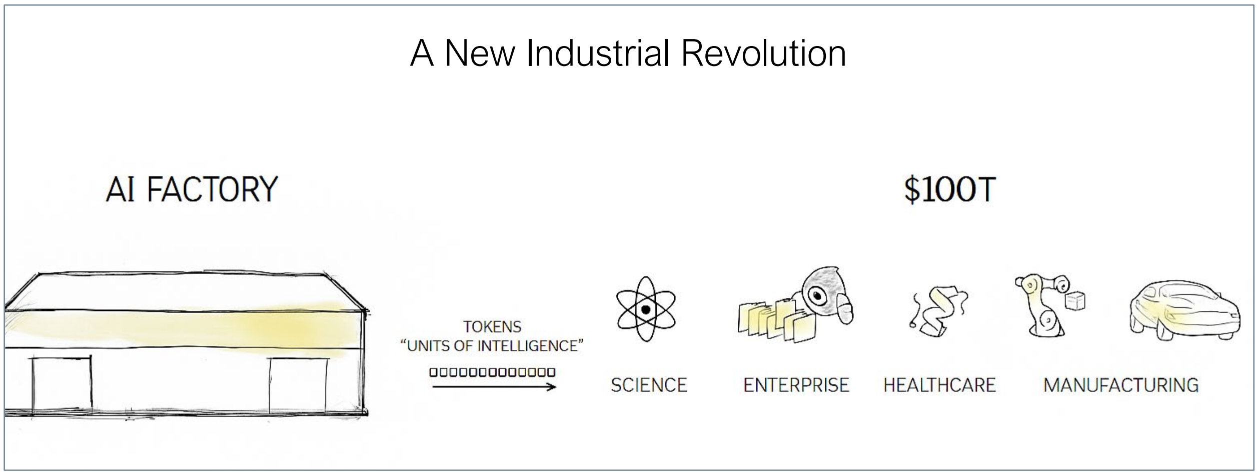
Source: TCM, Bloomberg estimates, Company Filings

One of the foundational infrastructures needed to support the growth of AI are data centers. Investments in data centers can be seen in the increase in capex spending from the largest technology companies (above). A less discussed driver of data center investments is by sovereign governments, or Sovereign AI.

In our previous letter, we highlighted the trillion dollars of data center commitments in the U.S. through partnerships like *Project Stargate.* Other countries are joining in the AI investment cycle. Countries like Germany, France and Switzerland are investing in AI data centers. **At Nvidia's GTC conference in Paris this May, Jensen Huang stated that AI computing capacity in Europe will grow by a factor of 10 in just 2 years from 2024 to 2026.** Similarly, according to *the European Data Center Market Landscape 2025-2030* report, the value of European data centers is expected to grow at a 12.8% CAGR from 2024 to 2030. Not to be left behind, the Middle East is partnering with OpenAI to build a massive data center in the UAE. This is in addition to an AI campus being planned in Abu Dhabi. Finally, Asian countries like

Japan are courting data centers to be built in their countries. These commitments support our positions in many of our technology companies.

Despite the recent excitement and success in AI, most of the applications so far have been for consumer use. Whether it's using ChatGPT to generate content or deep dive into interesting topics, most current usage remains on the consumer side. As AI advances over the next few years, we believe agentic AI will be deployed in industrial, financial, healthcare and professional services. Using AI agents, businesses can become more efficient, allowing for revenue growth with minimal headcount growth, lifting margins. Meanwhile, advances in AI will pave the way for robotics, drug discovery, and new implications for national security. These markets will only increase the demand for AI semiconductors, software applications, and reliable energy to power those ecosystems. We are excited to follow these developments and believe we have many investments that will continue to benefit from the AI wave.



Source: TCM, Nvidia Annual Meeting 2025

Investing during volatile times is difficult. However, by focusing on leading companies that provide an essential service, we believe that we can ride through periods of uncertainty and generate attractive earnings and stock price growth. Thank you for your support and interest and if you have any questions, please feel free to contact us at (415) 461-3800.

Sincerely,

Quoc K. Tran
Chairman & CIO

Michael N. Im
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Important Disclosure

Performance is provided as supplemental information and is based on the Partners Strategy 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 and 5-year net of fees returns of the Partners Strategy Composite as of June 30, 2025, are 13.04, 14.40 and 12.25 respectively. The 1-year, 3-year, and 5-year returns of the S&P 500® Index as of June 30, 2025, are 15.16, 19.70 and 16.65 respectively. 3-year and 5-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.

Benchmarks and financial indices are shown for illustrative purposes only and are provided for the purpose of making general market data available as a point of reference only. Such benchmarks and financial indices are unmanaged, assume reinvestment of income, do not reflect the impact of any trading commissions and costs, management and incentive fees, and have limitations when used for comparison or other purposes because they, among other reasons, may have a different trading strategy, volatility, credit or other material characteristics (such as limitations on the number and types of securities or instruments). No representation is made that any benchmark or index is an appropriate measure of comparison.

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

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