



10/16/2020: Alex's Collective Note, POWW Updates and A2 Milk Company (A2M) Review

Operators,

Brandon here. Hope y'all are having a great weekend! This week was pretty quiet for the portfolio. Most names are either in an uptrend, or forming beautiful consolidations (NTDOY & CDLX, specifically). We'll cover POWW updates and highlight a new name on our watchlist.

Here's the upcoming earnings dates for our companies:

- Interactive Brokers (IBKR): October 20th
- Sandridge Energy (SD): October 28th

Alex's *Collective* Market Note

Before we dive into our topics, here's Alex with your regular scheduled *Collective* note:

"Here's my most recent *Collective* note. It's titled [Underwriting the Future](#). I discuss the hyper-efficiency of the market over the short-term and subsequently why we have to move our analytical range out further in time because that's where the inefficiencies are, which is just another way of saying that's where we'll find large mispricings (aka. asymmetric bets). I end the discussion with pitching the bull case for a semiconductor stock and lay out how we can structure this trade using options to potentially [20x our risk or more](#)."

Now back to the portfolio.

POWW Updates: Recent Uplisting Request & Price Decline

POWW had a brutal end to the trading week. The stock traded down over 15% at one point Friday before closing the day down 12%. I scoured the net in search of any breaking news or recent filings. Nothing immediate to explain the price shaving.

But I did find two news pieces.

On October 8, the company [filed for uplisting](#) on the NASDAQ Stock Exchange. If they do uplist, it would add 14M shares to their balance sheet, while providing *much needed* attention to the company's story. We could infer that the potential share dilution caused the price decline. But I don't think so.

The other bit of news was from the NY Post. The [article revealed](#) that POWW took \$1MM in PPP money during the COVID-19 crisis. Check out the click-bait title below:



BUSINESS EXCLUSIVE

Bullet maker got \$1M in COVID-19 aid even as sales exploded

By Noah Manskar

October 15, 2020 | 5:20pm | Updated

As they say, any press is good press for a micro-cap company, right? I don't think *this* was enough to cause the 12% decline. But again, we're left to wonder.

Here's what we do know. The company's share price now sits right on long-term support at \$2. Check out the weekly chart below:



POWW reports earnings in early November. All signs point to record sales, solid gross margins and positive EBITDA. If we get that, look for shares to explode.

Along with monitoring our existing portfolio companies, we're constantly searching for new opportunities to bolster our book. Our watchlist has 22 names and grows each week. Some names represent current bargains. While others are *fantastic* companies we hope to trade at lower prices in the future.

Let's review one of those names: A2M Milk



A2 Milk Company (A2M): Temporary Hiccup Presents Opportunity Within Channel

A2M sells A2 protein type branded milk and related products in Australia, New Zealand, China, other Asian countries, and the United States. They offer fresh milk under the a2 Milk brand; and infant formula under the a2 Platinum brand.

A2 protein milk makes it easier for some people to digest the delightful dairy. And consumers love it. One of their milk products has [5/5 Amazon Rating](#) with 360 reviews. And their a2 Platinum infant formula has a 5/5 with 70+ reviews on Google. That's not bad!

The company also scores a decent 66 on the MOCS rating system.

Along with a great product, A2M is a *fantastic* business. Here's what they've done over the last five years:

- Increased GM from 43% to 56%
- Increased Operating Margin from 15% to 32%
- Grown EPS from \$0.04 to \$0.52
- Generated 40%+ 5YR Average ROIC

The company's never screened "cheap". They've routinely traded between 14-21x EBIT and over 30x normalized earnings. For much of the last two years, the company's traded over 7x EV/Sales. This makes sense given how great of a business it is.

When people think of milk companies, they think of declining milk consumption. Yet A2M generates over 80% of their sales from infant nutrition. This business segment has grown 30%+ annually and generates healthy profits. Plus, there will always be babies to drink formula.

Infant formula is a great business. Mothers to newborns want to find a formula that works and stick with it. Once a baby familiarizes itself with a formula, moms are slow to switch. After all, why take the risk of an allergy or having your child reject a new formula?

What Is The Opportunity?

A2M's success hangs on two variables: **global growth and ecommerce penetration**. The company's mainly sold products in Australia, New Zealand, Europe and China. The two factors for A2M's growth going forward are the US and Chinese markets.

China has an estimated \$20B infant formula market. The US comes in at \$5B. China's market alone is 60x the company's home New Zealand market.

Second, eCommerce will represent a larger portion of the company's total sales over the next five years and will be the catalyst for A2M's growth in the US and China.



Why Does The Opportunity Exist?

A2M's stock fell over 30% from July to early October. Due to COVID, the company reported lower sales and revised FY revenue downwards on the heels of a major slowdown in Chinese sales. According to the report (emphasis mine), *"The company forecast revenue between NZ\$725 million (\$474.95 million) and NZ\$775 million for the six-months ended December 2020, compared with NZ\$806.7 million reported a year ago."*

Despite the bad news, the company believes these issues are short-term. Are they material? Yes. But only for a little while. The company is still on track to deliver \$1.8B NZD for the year.

There's still a good amount of risk with the bull thesis. The largest one is China. Like future growth, China represents the company's biggest potential red flag as the company opens up its own private labels to sell infant formula to Chinese consumers. Another risk is geopolitical tensions between Australia and China. China has suspended beef imports from Australia before. So why not do it with milk if they wanted?

Third, A2M relies on strategic partnerships with suppliers and distributors to reach the Chinese/Asian region. Failure to maintain these relationships would have severe consequences for the company's Asian operations.

Valuation

The current stock price assumes ~9% revenue growth, 31% EBITDA margins, a 10% discount rate and a 16x EV/EBITDA exit multiple. A2M's historically grown revenues over 20% annually, so 9% seems like a low hurdle. Especially if the company can penetrate eCommerce markets and resume their historical Chinese sales trends.

The stock also trades at the bottom of its upward trend channel on the weekly chart (see below):

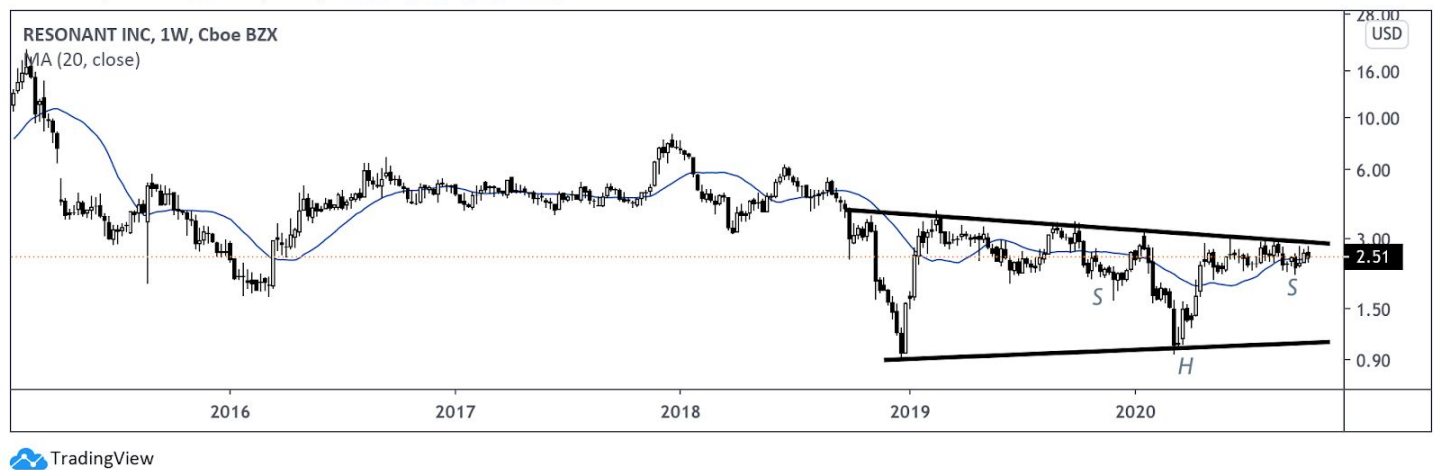


If price holds at this level and turns higher, it would present a decent Reward/Risk entry opportunity. We're still doing more work on the name and will update with any new information and/or if we take a shot on the long side.

Classical Trade Set-ups

LONG: Resonant, Inc. (RESN): Symmetrical Triangle w/ Inverse H&S

rockvuecap published on TradingView.com, October 16, 2020 09:16:47 EDT
BATS:RESN, 1W 2.51 ▲ +0.02 (+0.8%) **O:2.64 H:2.80 L:2.38 C:2.51**

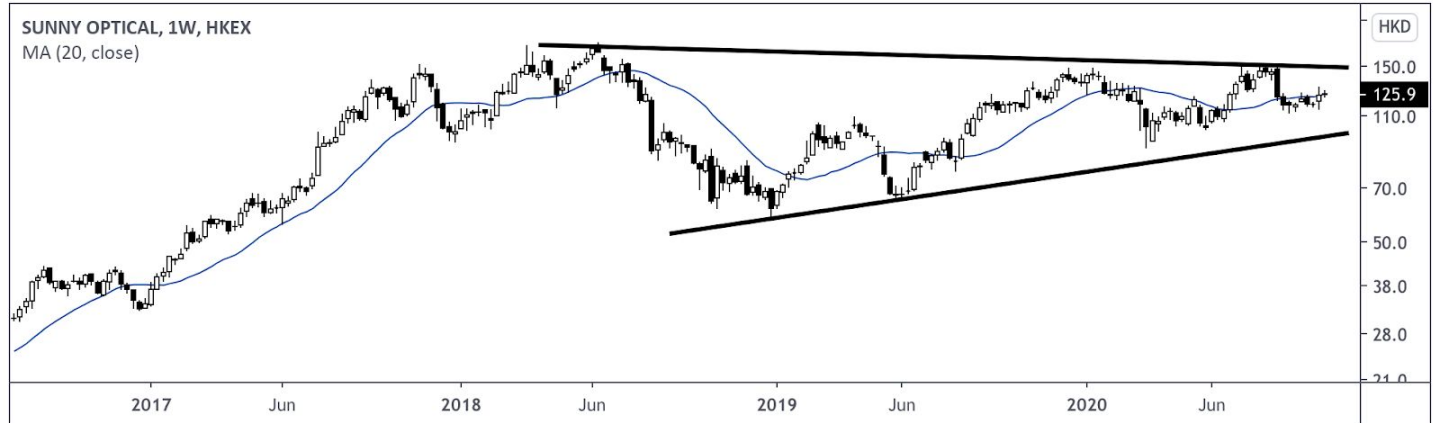


- 2% Breakout: \$2.95
- Profit Target: \$5.85
- Stop-Loss: \$2.10
- Reward/Risk: 3.42x



LONG Sunny Optical (2382.HKEX): Symmetrical Triangle

rockvuecap published on TradingView.com, October 16, 2020 09:20:45 EDT
 HKEX_DLY:2382, 1W 125.9 ▲ +0.2 (+0.16%) O:127.0 H:129.2 L:124.2 C:125.9

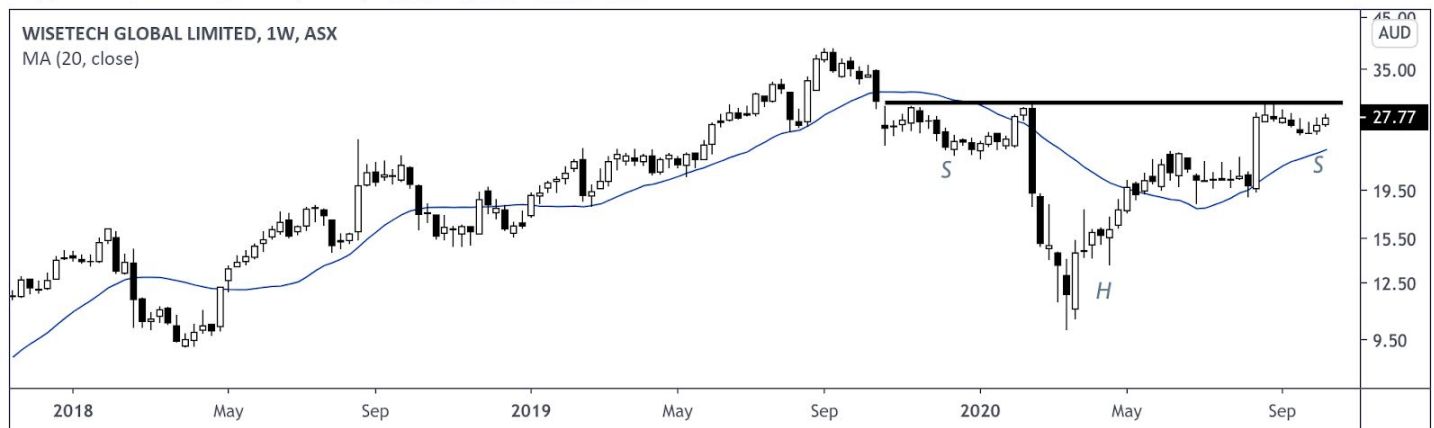


TradingView

- 2% Breakout: \$152.69
- Profit Target: \$255.50
- Stop-Loss: \$126.70
- Reward/Risk: 3.95x

LONG Wisetech Global (WTC.ASX): Inverse H&S

rockvuecap published on TradingView.com, October 16, 2020 09:26:03 EDT
 ASX_DLY:WTC, 1W 27.77 ▲ +0.43 (+1.57%) O:26.84 H:28.26 L:26.64 C:27.77



TradingView

- 2% Breakout: \$30.49
- Profit Target: \$48.84
- Stop-Loss: \$25.37
- Reward/Risk: 3.59x



LONG Ferrari (RACE.MIL): Cup & Handle

rockvuecap published on TradingView.com, October 16, 2020 09:27:57 EDT
 MIL_DLY:RACE, 1W 162.65 ▲ +4.20 (+2.65%) O:155.20 H:163.25 L:153.90 C:162.65



TradingView

- 2% Breakout: \$171.97
- Profit Target: \$223.30
- Stop-Loss: \$151.65
- Reward/Risk: 2.53x

LONG Fevertree Drinks PLC (FEVR.LSE): Inverse H&S

rockvuecap published on TradingView.com, October 16, 2020 09:30:42 EDT
 LSE_DLY:FEVR, 1W 2167 ▲ +57 (+2.7%) O:2135 H:2249 L:2054 C:2167



TradingView

- 2% Breakout: \$2,489.82
- Profit Target: \$4,034.00
- Stop-Loss: \$1,907.00
- Reward/Risk: 2.65x

