02/20/2021: Earnings Season Arrives In MO's Portfolio

Good morning Operators,

Earnings season is in full swing, and a handful of our portfolio companies reported this week. We'll review each earnings report and provide an updated view of our long-term thesis, underlying fundamentals, and how we're thinking about valuation.

Here's who we're covering this week:

- Ammo, Inc. (POWW)
- frontdoor, inc. (FTDR)
- Betterware de Mexico (BWMX)
- Nic, Inc. (EGOV)

Let's start with our largest position, POWW.

POWW: Growth, Growth, and More Growth

POWW had a great earnings report. You can read the full filing here. Here are the highlights:

- Revenue increased 500% QoQ and 282% for Nine Months Ended.
- Gross Margin reached 20% -- an increase of 163%
- Operating Expenses as % of sales decreased 28%
- Adjusted EBITDA grew 295% QoQ

77% of POWW's revenues ($12.4M) came from its ammunition sales, with the remaining from its casings division. The company generated $3.4M in gross margin, the highest in its history. It's important to note that POWW is **just now starting** to leverage its fixed cost base.

POWW's on pace to hit its ~30% GM and 10-12% EBITDA run-rate margin targets. Barring any significant manufacturing/R&D investment, POWW should meet those metrics in the next 12-18 months.

The earnings call was a significant disappointment as analysts/investors failed to ask *meaningful* long-term questions. For example, the most exciting part of POWW's business is its international/military application. Yet, no one asked about it. The company's military business does ~70% gross margins vs. its retail segment.

I'm working on getting Fred Wagenhals (or POWWs CFO) on the podcast soon.

One last thing before we go. POWW issued a Letter of Intent (LOI) to acquire GunBroker.com. For those unfamiliar with the website, GunBroker is the world's largest online marketplace for gun enthusiasts to buy, sell, and trade guns/accessories.

The offered purchase price of $240M equals ~6x GunBroker's current EBITDA. GunBroker is an excellent acquisition as it helps POWW capture the DTC vertical -- removing middlemen retailers from the equation. POWW can generate higher margins on its product while capturing a new 6M+ membership base by going straight to consumers.

Traditional ammo makers **must** pay attention to POWW after the GunBroker.com LOI. POWW is a ~$540M enterprise. Sturm Ruger (RGR), an industry stalwart, is worth ~$1.24B. Crazy to think that one-day, POWW could be a larger business than RGR.

frontdoor, inc. (FTDR): Grew Revenue, Increased Retention, Paid-off Debt

FTDR reported Q4 earnings Thursday (02/17). The company grew revenue 8%, increased customer retention from 73% to 76%, and paid-down $100M in LT debt. You can read their earnings presentation here. Let's break down these figures.

The company ended the year with $1.47B in revenue, $270M in EBITDA, and $175M in FCF. A $100M reduction in LT debt brings FTDR's Net Debt/EBITDA to 2.1x (from 3.7x in 2018). The stock trades ~3x current sales and 26x this year's FCF. Those valuations don't *scream* cheap, which is why we're not adding here.

Let's assume FTDR grows revenue ~10% per year for the next four years, giving us $2.2B in revenue. Let's also assume they do ~20% EBITDA margins on that revenue or $439M in 2024 EBITDA. Applying a 16x multiple on that EBITDA gets us $7B in EV. Subtract ~$500M in net debt, and you get $6.5B in shareholder value or **$76/share.** That's ~42% upside from the current price.

There are a few catalysts that *should* help sustain double-digit revenue growth for the foreseeable future:

- Low-interest rates on mortgages
- COVID-catalyzed move from cities to suburbs
- More people spending time at home

More homeowners translate into more FTDR home warranty customers. And thanks to COVID, people are spending more time at home. More time at home means a higher number of service calls on home appliances (reinforcing the need for something like American Home Shield). CEO Rex Tibbens explained this concept in the earnings call (emphasis mine):

> *"Over the last year,* ***consumers have stayed home far more, which has increased both our value proposition and demand for our product.*** *We believe t****his is a structural change in consumer behavior and will be a tailwind for demand and customer retention for years to come.*** *We intend to use dynamic pricing to manage the shift in behavior closely."*

FTDR also leveraged its recent *Streem* acquisition to help deliver better service to homeowners during the COVID crisis. *Streem* allows home service technicians to provide "on-site" troubleshooting without *actually* being onsite if you're not familiar. Check out *Streem's* website for more information.

The most exciting part about FTDR's business is their AHS ProConnect roll-out. ProConnect connects AHS policyholders to qualified/licensed contractors to fix *any* home problem. They're competing directly with Angi Home Services. We'll continue to monitor how their product takes to market. But given their installed AHS policyholder base, having ProConnect is an excellent value-add for its customers and a no-brainer for home repairs.

Betterware De Mexico (BWMX): Massive Growth & Still Cheap

If POWW was the fastest grower in our portfolio this year, BWMX stands alone in second place. The company reported **killer** Q4 and 2020 earnings. Check out these stats:

- Net revenues increased 229% QoQ to MXN 2.6B and 135% YoY to MXN 7.26B.
- Gross Margins stayed >50% at 55% for the year, resulting in ~MXN 4B Gross Profit.
- Increased EBITDA 254% YoY to MXN 807M
- Increased Net Income 448% QoQ to MXN 635M

Of course, the cherry on top is the company's leverage ratio reduction from 0.5x to -0.01x. BWMX is now a net-cash positive, high margin business growing top-line 200%+ with 250% annual EBITDA growth.

What would you pay for this business? 10x Sales? 30x EBITDA? Those multiples sound reasonable given the above growth metrics and financial strength. But try again.

BWMX trades ~11x *current* EBIT and 3x *current* revenues. You read that right -- 11x EBIT for a business growing EBITDA 250%. We're looking to add to our 5% position on pullbacks.

Nic, Inc. (EGOV): Stellar Earnings, Lackluster Takeover Bid

EGOV quietly reported one of its best earnings reports of all time. I say "quietly" because while releasing earnings, the company announced a takeover bid from Tyler Technologies (TYL). TYL offered $2.3B for our portfolio company.

Chalk this up as the first time I'm *upset* about a takeover -- even at 25% above our cost basis. Check out EGOV's accomplishments during Q4:

- Revenue increased 62% QoQ to $141M.
- Operating Income (EBIT) increased 104% to $23.9M.
- Net income increased 79% to $17.8M.
- Adjusted EBITDA increased 77% to $29.8M.

More importantly, Same State Revenue (SSR) increased 22%, representing an incremental increase of $88M. EGOV's FY 2020 results were equally as impressive:

- Revenue increased 30% to $460.5M.
- Operating Income (EBIT) increased 40% to $87.4M
- Net Income increased 36% to $68.6M.

EGOV's FY 2020 results are why I'm upset about TYL's $2.3B takeover bid. At that price, TYL pays 5x current revenues and ~26x current EBIT. If we estimate ~8% revenue growth in the next four years, we get $670M in 2024 revenue. EGOV should do 26% EBITDA margins on that revenue for $176M in 2024 EBITDA.

That means TYL paid 13x our estimates of 2024 EBITDA. EGOV is worth more than that as a standalone business. First, the company's seemingly slow sales adoption cycle ramped up due to COVID. Second, governments are slow to adopt digital-first technology. But when they do, they choose one provider and don't look back. EGOV could've generated annuity-like revenue from a **much larger** customer base as a standalone company than it does today.

A 20x multiple on EGOV's 2023 EBIT seems appropriate. That gives us $3.34B in EV. Add back $226 in net cash, and EGOV sports $3.56B in shareholder value or $52.44/share. That's 54% higher than TYL's takeover price.

I'm upset about the takeover because it means we have to reallocate that capital into an equal/better investment opportunity. Luckily we have countless ideas to deploy the cash, but what if we didn't? Takeovers present **serious** reinvestment risk if there's no fish in the idea pond.

New Ideas Coming Next Week

I've got a list of eight SPAC mergers to go through this weekend and the coming week. I'll share my favorite companies from that list next weekend. There's **a lot of junk** in SPACs right now. We've spent the last month culling potential SPACs to find these eight names.

Be on the lookout for those write-ups next weekend.

We're also finding **significant** opportunities in Russia -- expect write-ups on those companies as well.

