03/04/2021: Rocket Companies (RKT) & GlobalTrans Invest (GLTR)

RKT and GLTR are the two newest editions to the MO Portfolio. Though we're bullish on RKT, we **did not** expect a 70%+ upside breakout a day after we bought. I'll repeat it: **the timing on that entry was pure luck**. We used the short-squeeze opportunity to take 1/3rd profits and right-size the position to ~5% of our book. Despite the wild stock price action, RKT remains a terrific business with long-term structural tailwinds at its back.

GLTR is another fantastic business with massive infrastructure advantages against its peer in the boring Russian railway industry. Here's what the company's done in the last five years:

- Expanded Gross Margin from 21% to 38%
- Expanded EBIT Margin from 16% to 31%
- Grown ROC from 15% to 27%

Yes, it's a Russian company. And yes, Russian stocks are *always* cheap. That said, GLTR sports an 18% dividend yield and trades for 4x current EBITDA. At 40bps risk, it's worth a bet.

Rocket Companies (RKT): A Pure-Play on Secular Housing Growth

RKT is the best mortgage lender in the United States. In 2019, the company processed 541K loans, leaving companies like United Wholesale Mortgage (339K loans) and Wells Fargo (232K loans) in the dust. By the end of Q1 2020, RKT commanded a 9.2% market share. For comparison, the company had a ~1.3% share in 2009.

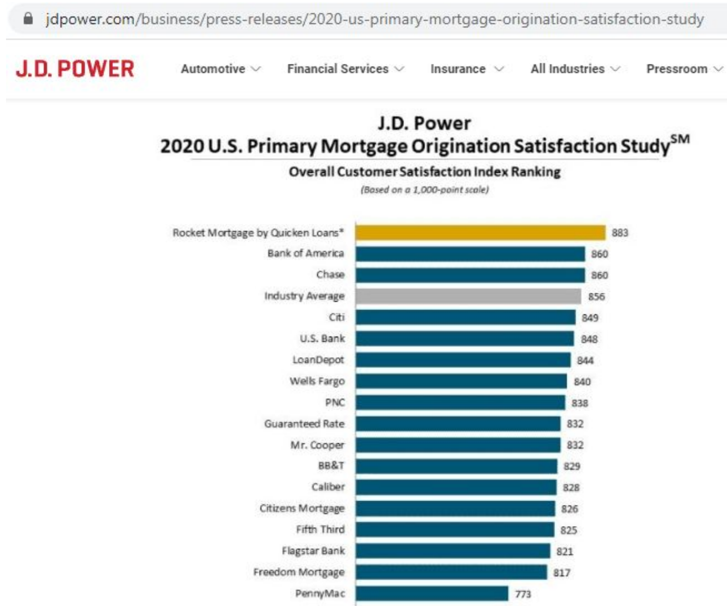
Last year, RKT processed $320B in mortgage originations, generated $15.7B in net revenue, and sported a 91% net client retention rate.

There are three reasons why RKT is the best mortgage lender in the country:

1. Defensible data
2. Best-in-class online experience
3. Seamless application process

RKT processes more loans than any other lender, allowing them to collect the country's largest mortgage-lending dataset. Data on mortgages is precious not only to RKT but to banks, credit cards, and any other business that wants verifiable data on a customer's creditworthiness.

But the data is more than a valuable resource to other businesses. It allows RKT to provide the fastest mortgage approval processes in the industry. Customers can close on an RKT mortgage in as little as 16 days and refinance in 8 days. With increasing amounts of data feeding the algorithm, approval/closing times will shrink towards instant.



Second, RKT has the best-in-class online experience. This matters becuase millennials are the next wave of first-time homebuyers. And millennials do *everything* online, primarily through their smartphones.

Third, RKT has the best application process. Customers apply for a mortgage through RKT's fully online application portal. RKT can instantly verify income and employment, a process that takes days for other mortgage lenders.

For example, United Wholesale Mortgage only allows customers to track and manage their loans online. RKT says goodbye to paper and brings a much-needed digital-first product to homebuyers. Which lender would you choose?

RKT's Business Model: Direct To Consumer (DTC) & Partner Network

RKT has two business segments: DTC and Partner Networks. DTC is straightforward where the company engages with customers through direct acquisition channels. Think of DTC as a first-time homebuyer that saw an RKT commercial while watching golf. RKT's DTC business generated 62% of 2020 loan volume.

The company's Partner Network is more interesting from a long-term value creation perspective. In short, RKT partners with the nation's leading real estate brokers and connects them to pre-approved RKT mortgage homebuyers. Joining the Partner Network is a no-brainer for real estate agents. RKT provides agents with:

- Approved mortgage
- Confirmed contact information
- Verified purchase timeframe
- Exclusivity
- No upfront fees

For agents, partnering with RKT means less time chasing leads and more time closing on home sales. The best part about the network is that it's exclusive. Brokers must meet the following criteria to join:

- Must work for an eligible brokerage
- Must have completed Rocket HomesSM Verified Partner Agent training (annually)
- Must be a licensed, full-time agent with a minimum of 24 months of experience
- Must be a full-time agent with a minimum of eight closed transactions in the last 12 months (exceptions granted for low volume markets)
- Must complete the Client Central agent profile
- Must be in good standing with Rocket Homes

The Powerful RKT Network Effects

The Verified Partner Network creates powerful network effects. Each additional agent on the platform increases the value of RKT's Partner Network. In turn, more agents using RKT's infrastructure means more loans originated/processed through RKT. More processed loans mean more data to feed the RKT mortgage application algorithms, providing faster approval times.

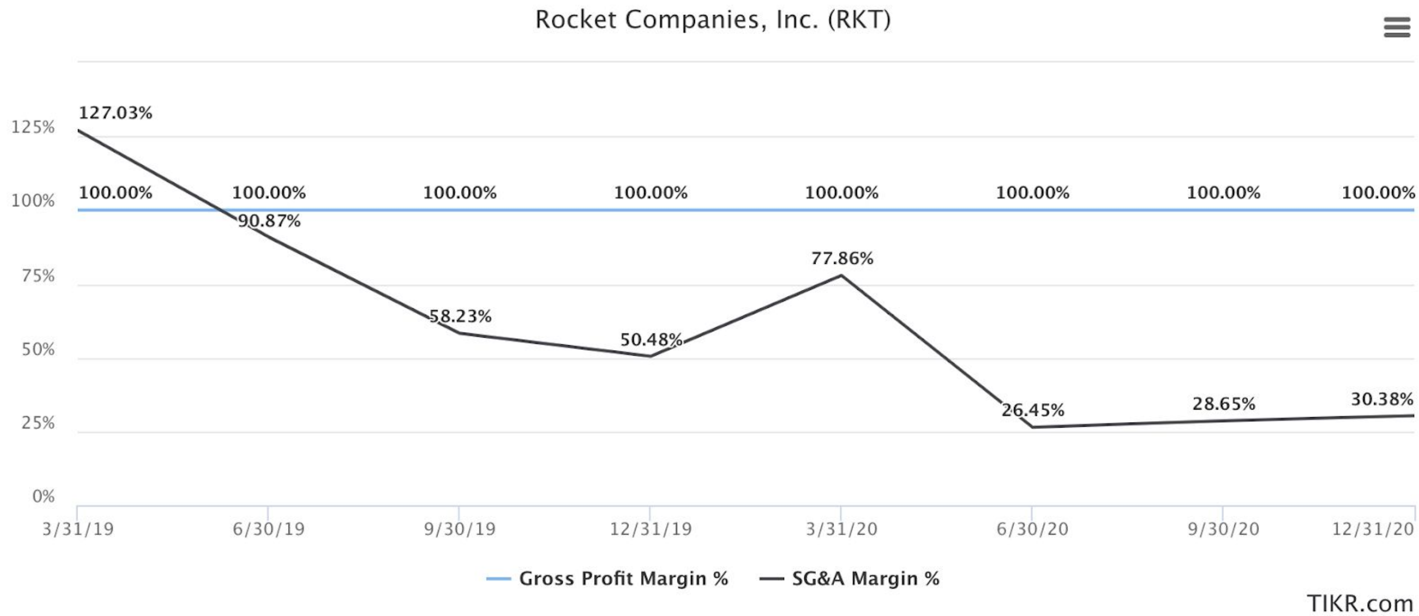
Faster approval times and better online experiences mean more DTC customers using RKT's mobile application process, which means more revenue and profits. These market-leading profits allow RKT to reinvest into its business and expand marketing at higher incremental rates than its peers. In short, RKT stays top-of-mind when consumers think, "who should I use for my mortgage application?"

Financials: Massive Growth & Operating Leverage

There's no doubt COVID-19 was a catalyst for RKT. The company pulled forward months (years?) of mortgage originations as families fled cities and flocked to suburban landscapes. We see this in RKT's 2020 income statement (see below, via TIKR.com):

Income Statement	12/31/17	12/31/18	12/31/19	12/31/20
Revenues	696.64	820.37	950.22	1,074.26
Interest And Invest. Income (Rev)	159.58	200.93	250.75	329.59
Other Revenues	3,396.63	3,287.58	4,053.84	14,576.86
Total Revenues	**4,252.85**	**4,308.87**	**5,254.82**	**15,980.71**
% Change YoY		***1.3%***	***22.0%***	***204.1%***
Gross Profit	**4,252.85**	**4,308.87**	**5,254.82**	**15,980.71**
% Change YoY		***1.3%***	***22.0%***	***204.1%***
% Gross Margins	***100.0%***	***100.0%***	***100.0%***	***100.0%***
Selling General & Admin Expenses	(3,015.30)	(3,172.60)	(3,670.17)	(5,241.31)
Depreciation & Amortization	(68.81)	(76.92)	(74.95)	(74.32)
Other Operating Expenses	(215.87)	(214.75)	(339.55)	(701.59)
Other Operating Expenses	**(3,299.98)**	**(3,464.27)**	**(4,084.68)**	**(6,017.22)**
Operating Income	**952.88**	**844.61**	**1,170.14**	**9,963.48**
% Change YoY		***(11.4%)***	***38.5%***	***751.5%***
% Operating Margins	***22.4%***	***19.6%***	***22.3%***	***62.3%***

Last year saw a mind-numbing 204% increase in revenue with a 62% operating margin! RKT expanded its EBIT margins by 40% during the same year they increased revenue by 200%. The company's leverage came from its relatively fixed SG&A expense the last three quarters (see below):



Lower SG&A expenses should continue as the company expands its customer base, captures zero-cost refinance loans, and maintains a dominant market share position.

Thinking About Valuation

Before the 70% spike on March 2, RKT traded ~17x normalized earnings. It is not bad for a company to expand operating margins with the largest market share in the largest asset class industry. RKT should continue to lead the mortgage origination market over the next 3-5 years. It's hard for a competitor to match RKT's data advantage and brand awareness (don't believe me? Watch Golf Channel over the weekend).

That said, 2020 was a banner year for RKT, and it will take the company time to pass last year's hurdle. Analysts forecast a -19% revenue decline over the next two years with EBITDA margins compressing to 40%. Here's how we think the next few years might play out (via Finbox.io):

(USD in millions)		Input Projections				
Fiscal Years Ending	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25
Revenue	15,981	13,104	10,483	9,842	10,350	11,557
% Growth	*204.1%*	*-18.0%*	*-20.0%*	*-6.1%*	*5.2%*	*11.7%*
EBITDA	10,027	6,028	4,298	3,937	3,623	4,045
% of Revenue	*62.7%*	*46.0%*	*41.0%*	*40.0%*	*35.0%*	*35.0%*

Let's assume a 15x EBITDA multiple on our 2025 figures. That gets us ~$61B in EV compared to its current EV of $34B, or a 79% upside from current prices.

We're long RKT at $24.30 with stop-losses around $18-$19/share.

GlobalTrans Invest (GLTR): Russia's Leading Railway Operator

GLTR is a leading freight rail transportation group with operations across Russia, Belarus, Ukraine, Kazakhstan, and other countries. The company operates one of the largest railcar fleets in the region, providing sophisticated transport logistics for significant companies operating in critical industries: metals, mining, oil/oil products, and construction.

The company has ~72.4K cars in its fleet and owns 94% of its fleet outright. It splits its fleet into two types of cars: universal gondola (63% of the fleet) and tank cars (29% of the fleet). GLTR makes money by transporting four types of goods (percentage of revenue):

- Metals (36%)
- Oil/oil products (36%)
- Coal (17%)
- Construction materials (4%)

GLTR has a 10YR+ track record of delivering excellent service to its 500+ blue-chip customers. Timing and accuracy of delivery are what matters most in railroads. Companies that consistently deliver on both create strong partnerships with customers. The company has long-standing relationships with Russia's largest industrial companies.

The company generates substantial free cash flow and returns most of it to shareholders via dividends. To the tune of an 18% yield! Founders/insiders own ~43% of the company and maintain conservative leverage (0.82x Net Debt/EBITDA). GLTR can continue to support its dividend with ~10x FFO/Interest Expense.

You can buy GLTR for 5x NTM EBITDA, giving us a 20% yield at current prices. There are a few reasons this opportunity exists:

- It's a Russian company. Russian companies are perenially cheap and tend to stay that way. Most US investors are apprehensive about buying a piece of Mother Russia.
- It's a boring railroad and not a high-growth tech company with free lattes for employees.
- It's dually-listed on the LSE and MOEX, making it hard for US-based investors to buy the company.

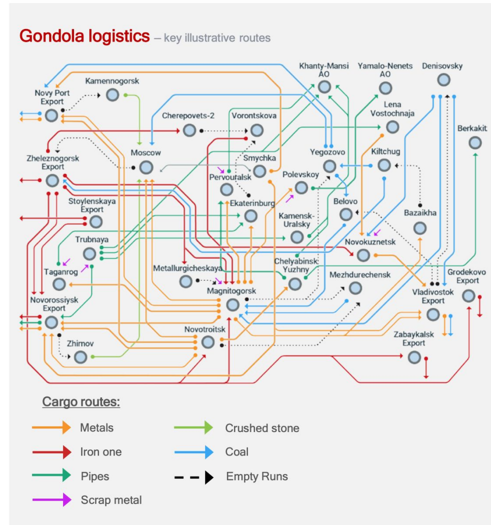
Let's get after it.

What Matters Most: Relationships, Service Contracts & Sensible Capital Allocation

The GLTR thesis isn't complicated. If the company continues to generate massive cash flows, pay its dividend, and buyback stock, shareholders should do *very* well. To do this, GLTR needs to maintain its successful operations. It does that in three main ways:

1. Keep relationships with blue-chip customers.

2. Reduce its Empty Run Ratio
3. Maintain an honest, sensible dividend policy



Moving freight cargo is a complicated job, and GLTR is an expert. Industry expertise creates an ever-growing competitive advantage against competing railways. First, switching your railway company is cumbersome. You must learn new routes, develop new relationships, and bet that the new company is as reliable as your former partner.

Second, a railway company's failure to deliver material means longer lead times, fewer profits for the industrial company, and unhappy customers.

If a company has an existing relationship with GLTR, what's the reason to switch? Even if a competitor charges a lower price per cart, would you want to take the time (and risk) to learn a new logistics system and familiarity with delivery times?

Take this review from one of GLTR's largest customers, Gazprom Neft (emphasis mine):

> *"At Gazprom Neft, we have worked with Globaltrans since 2004. As our preferred transportation partner, their capabilities and expertise have, over many years, e**nabled us to deliver cargo to our customers efficiently and on schedule and to address multiple other issues that arise during transportation**."*

Given the above complications, GLTR signs multi-year service contracts with its customers. As of February 2020, the company had 64% of its revenue booked under multi-year service contracts. These contracts create higher revenue visibility and greater confidence in FY cash-flow estimates.

There is a risk of customer concentration. GLTR's top five customers account for 63% of its revenue. Should any of these customers leave (particularly Rosneft at 23%), it would create severe headwinds for positive cash generation.

Russia's Railway Industry: Important For Asian Expansion

Russia's economic prosperity hinges on its railway industry. Co-Founder and Chairman Sergey Maltsev explained this phenomenon in the 2019 Annual Report (emphasis mine):

> *"Russia's future economic prosperity remains inextricably linked to the health of its rail network, **which accounts for about 87% of all non-pipeline freight turnover**. Rail freight has been one of the great success stories of deregulation in Russia, and as we enter a new decade, the long-term prospects for the sector remain attractive.*
>
> *Looking ahead, as the economy seeks to pivot towards Asia, **the need for reliable freight rail transportation becomes even more pressing.** The provision of adequate freight carrying capacity on the rail network to respond to demand will be a crucial enabler for further growth. **Without greater***

capacity, Russia will struggle to accommodate the expected growth in commodity flows to Asia.*”*

In short, there are clear long-term tailwinds for Russia’s railway infrastructure. The railway companies that take the bulk of that long-term growth will have strong, long-term relationships with their industrial customers. That puts GLTR at the heart of those who stand to benefit most.

GLTR’s Capital Allocation Policy: It’s All About Shareholders

What attracted me most to GLTR was its stance on capital allocation, specifically returning cash to shareholders. It’s not something you see every day in a Russian company, given the horror stories of public entities as shadow piggy banks for the KGB.

GLTR destroys these stereotypes. The company has a robust yet balanced capital allocation strategy. Put simply: any excess cash flow not required for expanding the business returns to the shareholders (subject to a Leverage Ratio).

Here’s how Sergey defines the policy (emphasis mine):

> *“With a focus on maximizing shareholder value,* ***the policy boosts pay-outs during low investment cycles and limits them in periods when sizeable expansion opportunities meeting Globaltrans’ strict return criteria are identified****; and — Having a clear formula linking dividends to Attributable Free Cash Flow and Leverage Ratio providing flexibility and transparency in capital allocation.”*

It’s simple and sustainable. If the company has nothing better to do with the cash, they return it to shareholders. If, however, they find an attractive deal that meets their return requirements, they’ll reduce the dividend. No matter the choice, the result is positive for shareholders.

Leverage Ratio	Dividends, % of Attributable Free Cash Flow
Less than 1.0x	Not less than 50%
From 1.0x to 2.0x	Not less than 30%
2.0x or higher	0% or more

Let’s talk about the Leverage Ratio. The ratio determines how high GLTR can pay their dividend depending on their net debt levels to EBITDA. You can see the rate on the left.

By anchoring their dividend amount to a percentage of available free cash flow, GLTR will always have enough cash to meet their current CAPEX needs and interest payments (which are ~7% per annum).

The company introduced this enhanced dividend policy in 2017. You can see the difference in dividend amounts in the chart below.

The company also released a share buyback program during 1H 2020. A buyback program gives GLTR another quiver in its capital allocation policy that further bolsters shareholders' returns. At ~5x EBITDA, we should expect some buybacks.

Can GLTR Maintain Its Dividend?

Maintaining the dividend is the only thing that matters. If GLTR can keep its dividend, investors will enjoy ~18% returns per annum. Let's see the cash flow breakdown.

During 1H 2020, GLTR generated RUB 13.8B in cash from operations. After taxes, interest, lease payments, and maintenance CAPEX, we get RUB 7.87B in FCF. The company then uses this RUB 7.87B for expansion-related expenses and dividends.

Again it goes back to the return policy above. If the company doesn't have any growth cap-ex requirements, all that cash goes to shareholders.

GLTR makes enough EBIT pay its interest payments nearly 10x over. The company should have little trouble covering its dividend in the 10%+ range for the foreseeable future.

What Can Go Wrong To Break The Thesis?

There are a few primary concerns with the GLTR bull thesis. First, there's exposure to the Russian currency ruble (RUB). The current RUB depreciation makes Russian commodities more attractive to foreign customers. Should the RUB appreciate against other currencies (like the USD), it would reduce foreign countries' incentive to buy from Russia.

Second, GLTR could over-leverage themselves, which would reduce the company's ability to pay dividends. Remember, the company pays zero dividends if leveraged 2x or higher. I don't think this will happen given the company's committed stance to dividends, but it's worth tracking.

Third, we could see the news that GLTR is a front for some Russian oligarch regime and a secret piggy bank for Russia's most affluent. That's a major red flag and would require us to liquidate the position immediately.

Fourth, GLTR could lose its largest customers who would drastically reduce revenue and attributable free cash flow. 63% of their revenue comes from their top five customers.

