03/06/2021: February Month-End Portfolio Review

Operators,

February was another good stretch for the MO portfolio. We ended the month up 19.02%, outpacing January's 14.18% return. The S&P 500 returned 0.99% in February, meaning we outperformed the index by ~1,900bps. Please note that consecutive double-digit monthly returns are **not expected** and **highly unlikely** to continue in the future.

I know you're not supposed to say that running a newsletter. But what Alex and I do is more than a newsletter. It's a fundamental way of thinking about markets, portfolios, ideas, and strategies. We're not here to sell you "*consistent monthly returns*," whatever that means.

Our mission is to provide you with a framework to analyze markets, make rational/informed decisions, manage risk appropriately, and have a hell of a fun time doing it. Our portfolio will swing wildly from the S&P 500's performance for the simple reason that *we don't own the S&P 500*. Our book looks *much different* than the collection of the US' top 500 businesses.

As we did last month, we'll review our top five performers and bottom five detractors. Within those names, we'll discuss valuation, thinking about the future, and position sizing.

Grab a cup of coffee (or, if you're like me, a Celsius) and dig in!

MO Top 5 February Performers

1. Manolete Partners (MANO): +42%
2. Kura Sushi (KRUS): +33.44%
3. Ammo, Inc. (POWW): +29.44%
4. Nic, Inc. (EGOV): +28.56%
5. Grayscale Bitcoin (GBTC): +27.25%

Manolete Partners (MANO): Illiquid w/ High Asymmetric Payoffs

Manolete Partners (MANO) is UK's leading third-party insolvency litigation finance (TPF) company. They command ~67% of the TPF market. MANO plays a crucial role in returning funds to creditors, particularly the HMRC. The company buys 80%+ of their claims, giving them full control of the outcome. The average case settles in 11.5 months, with MANO getting paid ~12 months post-settlement.

We bought our 4% stake between 02/23 - 02/24. You can read our write-up here.

The company sports a robust business model with significant operating leverage. Since 2016, MANO's grown revenue from GBP 4.8M to GBP 18.68M as of 2020 (57% CAGR). They've expanded gross margin 2,200bps from 55% to 77% and increased EBIT margins by 1,430bps from 38% to 52.5% during that time.

MANO also has a long history of delivering exceptional returns from its insolvency claims portfolio. The company's made 567 claim investments since 2010. In 353 (62.3%) completed cases, MANO's delivered (on average) 187% ROI, 2.87x MoM, and a 133% IRR. They also boast a 90% success rate on purchased claims.

Today, the company's buying more cases, expanding its in-house litigators' network, and returning capital to shareholders. COVID will further exacerbate the need for litigation finance, offering a long runway for continued litigation investment.

The stock sits near its 2019 IPO offering at GBP 93M. If MANO executes and expands its share in total insolvency cases claimed, the company should be worth GBP 560M. That's a 500% upside from current prices.

The most frustrating part of MANO is its illiquidity. Many Collective members reported difficulties buying their stakes. Given the liquidity constraints, we're keeping the position at ~4%. A 4% position isn't terrible given the ~500% upside in the stock. Should MANO increase its liquidity, we'd buy more in size (like what happened with POWW).

A common question we get from *new* Collective members is, "I just joined; when should I buy the stocks in your portfolio?" MANO is amid a beautiful pullback to its 50MA, which is an excellent spot for new members to initiate a position (if you get filled, of course).

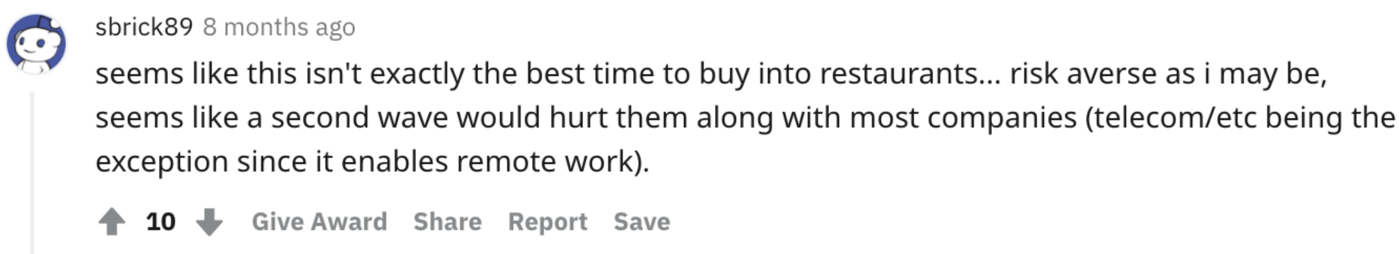
Kura Sushi (KRUS): The Perfect Re-opening Investment

Kura Sushi USA, Inc (KRUS). operates revolving sushi bar restaurants in the United

States. The company's restaurants offer Japanese cuisine and a revolving sushi service model. It operates 24 restaurants in five states.

KRUS is a patent-protected, technology-first sushi restaurant. The company offers high-quality sushi at low prices thanks to robotic rice makers, automated dishwashers, and a conveyor-belt delivery system. Such technology enables KRUS to offer lower prices while maintaining healthy operating margins. KRUS flies under-the-radar of most investors IPOing around $150M. Its parent company has over 30 years of success in Japan. We think KRUS can grow into a 300-store empire generating $50M in annual FCF.

The company hit new all-time highs in February after returning 33.44%, benefiting from the rotation into "re-opening" stocks. Eight months ago, I posted my thesis on the *Security Analysis* Subreddit community. Going forward, I should use the community as another contra-sentiment indicator. Here's my favorite reply to the post:


sbrick89 8 months ago

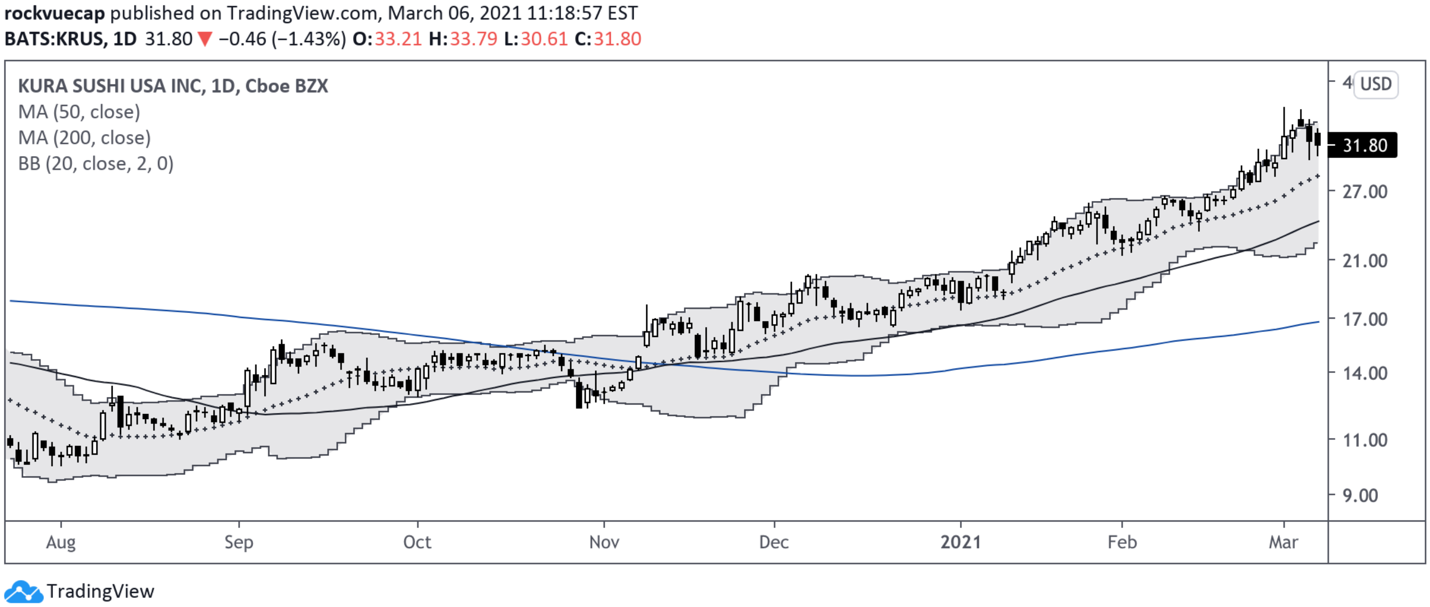
seems like this isn't exactly the best time to buy into restaurants... risk averse as i may be, seems like a second wave would hurt them along with most companies (telecom/etc being the exception since it enables remote work).

10 Give Award Share Report Save

Back to business. KRUS now trades at a $266M market cap. If the company continues to execute its store-opening strategy, we think KRUS can do ~$50M in annual FCF.

That's a 5x multiple at the current stock price. KRUS has strong backing from its parent company (Kura Sushi Japan) which gives KRUS access to above-average financing terms should they need it. KRUS usually runs debt-free but added ~$3M in LT debt over the last twelve months as it pursues its store expansion policy.

The stock ~6.70% of our portfolio. We'll look to add on any aggressive pullbacks towards its lower Bollinger Bands (BB). Ideally, we'd scoop shares around the 50MA (see below):



Ammo, Inc. (POWW): A Busy Month For Our Largest Position

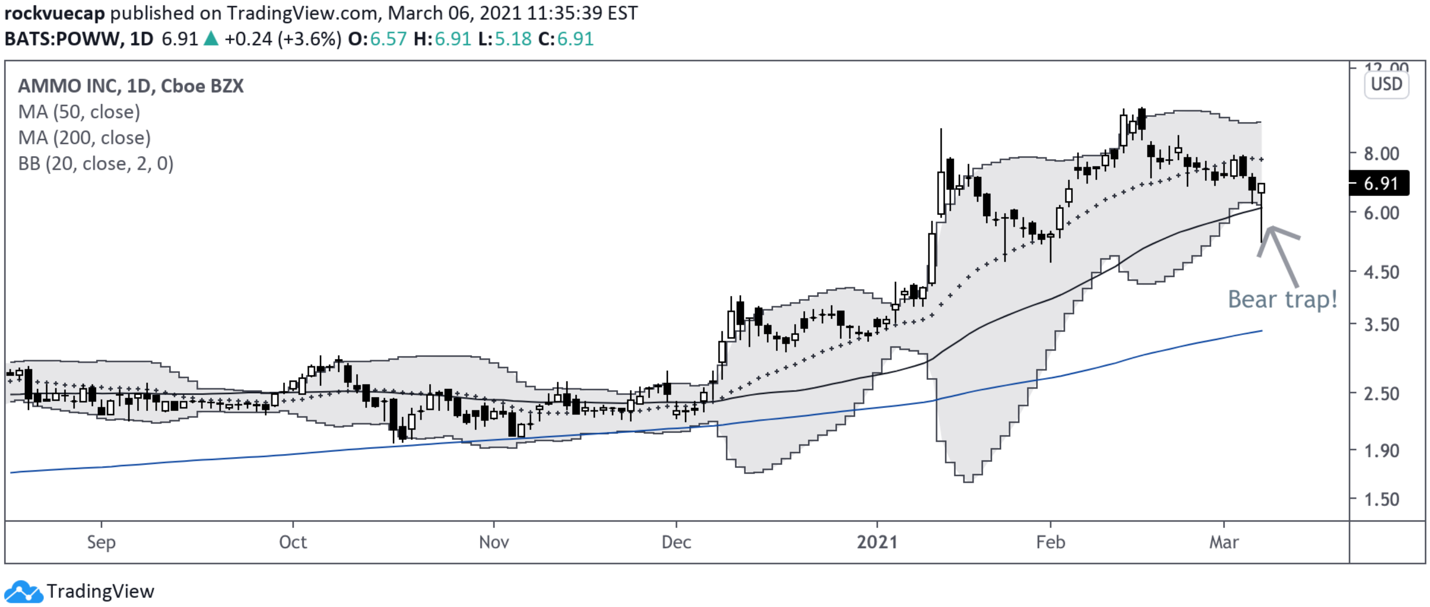
POWW had an eventful month. The company knocked earnings out of the park. They generated $16.6M in revenue vs. $2.2M last year. Backing out non-recurring expenses, POWW generated positive EBITDA.

POWW also announced an LOI to buy GunBroker.com. GunBroker.com is the world's largest online marketplace for guns, ammo, and accessories for those unfamiliar. They boast 6M, active members, generate $200M in revenue and $40M in annual EBITDA. POWW paid ~$240M in cash/stock for the business, giving them a purchase price of ~6x EBITDA.

Management didn't explicitly say what their plans are for the acquisition, but I have a couple of theories. First, buying GunBroker.com gives POWW direct access to 6M hardcore gun-lovers, enabling them to go direct-to-consumer. The DTC model cuts out the middle-man and allows POWW to sell directly through the website. Direct sales increases margins because POWW won't have to give "wholesale discounts" to suppliers like Bass Pro Shops and Sportsman Warehouse.

Heading into FY 2022, POWW expects to generate $120M in revenue and further positive EBITDA. If they do that, it would be *another* year of triple-digit revenue and EBITDA growth.

New Collective members received a great buying opportunity this week as POWW traded to its 50MA, broke sharply below it, and only to rebound hard and close the day (03/05) **up** 4% (see below).



Another way you can play this trade is by selling put options at the $5 strike. Selling puts allows investors to buy the stock at the price they want **and** pay a lower cost basis. If the stock continues higher, the investor keeps the premium they sold.

If you want to learn more about this strategy, find Kulok in the Slack channel. He's our put-selling wizard and will answer any questions you have.

Nic, Inc. (EGOV): Low-Ball Takeover In Portfolio Company

Ugh. EGOV joined this month's top performers after Tyler Technologies (TYL) announced a takeover bid at a $2.3B market cap or $34/share. While we're happy with a 25%+ bump in a decent-sized position, TYL's proposal is a low-ball offer. EGOV would've generated higher returns for us as a standalone business for decades.

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.

We have half our position in the portfolio on the off-chance TYL gets their act together and offers a more attractive deal.

Grayscale Bitcoin Trust (GBTC): The Gift That Keeps Giving

GBTC is a trade, not an investment. As such, we play it a bit differently than a longer-term, high conviction bet. The trust rose 27.25% during February as Bitcoin bounced along its 50MA.

We have a ~5% position in GBTC and will continue to take profits as it extends above its Bollinger Bands. We have stop-losses at $28.30 for more profit-taking.

Now let's examine our bottom-five detractors.

MO's Bottom Five Performance Detractors

1. Bidstack (BIDS.LSE): -10.96%
2. XP, Inc. (XP): -6.38%
3. S&W Seed (SANW): -6.20%
4. GlobalTrans Invest (GLTR.LSE/MOEX): -2.52%
5. Cresud S.A.C.I.F.Y.A. (CRESY): -2.31%

Bidstack (BIDS.LSE): Venture-Bet on In-Game Video Game Advertising

Bidstack, Inc. (BIDS) is a provider of native in-game advertising that is dynamic, targeted, and automated, serving the global video games industry across multiple platforms. Its proprietary technology is capable of inserting adverts into natural advertising space within video games.

BIDS created the first SSP advertising platform allowing advertisers/brands to purchase native programmatic in-game advertising inventory at scale, even targeting the individual's unique demographic data. Unlike traditional video game advertising, BIDS allows brands to change their marketing campaigns in real-time without changing the integrity or feel of the game.

You can read our full write-up here.

The stock's down ~50% from our original cost basis. The drastic mark-to-market paper decline in the stock price shouldn't concern Collective members. We sized this position small (1% of capital) because we viewed this as a highly asymmetric, potential-zero value bet. In short, BIDS is either a billion-dollar business or a zero. The value hinges on its ability to get its tech right and create a two-sided marketplace between video game creators and advertisers.

BIDS released its 2020 annual report on February 1 and highlighted the following:

- Revenues for the year ended 31 December 2020 of c.£1.70m (2019: £140k);
- Loss before tax for the year ended 31 December 2020 of c.£7.18m (2019: £5.36m);
- Available cash resources as of 31 December 2020 of c.£2.35m (2019: £3.15m);
- Net assets as of 31 December 2020 of c.£2.45m (2019: £3.61m); and
- Total headcount as of 31 December 2020 of 69 (2019: 20).

Shareholders weren't happy with the increased operating losses and sold heavily. We anticipated increased operating losses because the company a) hadn't prioritized revenues and b) is building out its team.

Now that the technology and team are in place, BIDS can shift focus to product-market-fit. During the year, it moved a few advertisers from "test spend" to "on-plan." "On plan" means advertisers now believe in the effectiveness of the medium and are allocating *serious* advertising dollars to it.

With any venture-like, micro-cap investment, expect its share price to fluctuate around its intrinsic future value wildly.

XP, Inc. (XP): Building Brazil's Largest Brokerage Business

XP is the largest independent broker in Brazil. It operates a technology-driven platform providing financial products and services. They offer 750+ investment products to 2.6M+ clients with R536 B in Assets Under Custody (AUC).

There are four points to our bull thesis:

- Interest rates have declined from 15% in 2015 to 5.5%
- Brazilians have increased their risk appetite in the face of lower interest rates as they search for higher returns.
- The big banks that control 90% of investment assets can't offer the products clients want in a low-interest-rate environment.
- Over time, trillions of dollars in client assets will flow from the banks to independent brokers.

You can read our entire thesis here.

The company reported Q4 earnings and crushed it. Here are some highlights:

- Net income increased 30%
- EBIT increased 42% YoY
- Assets Under Management (AUM) increased 62% YoY.

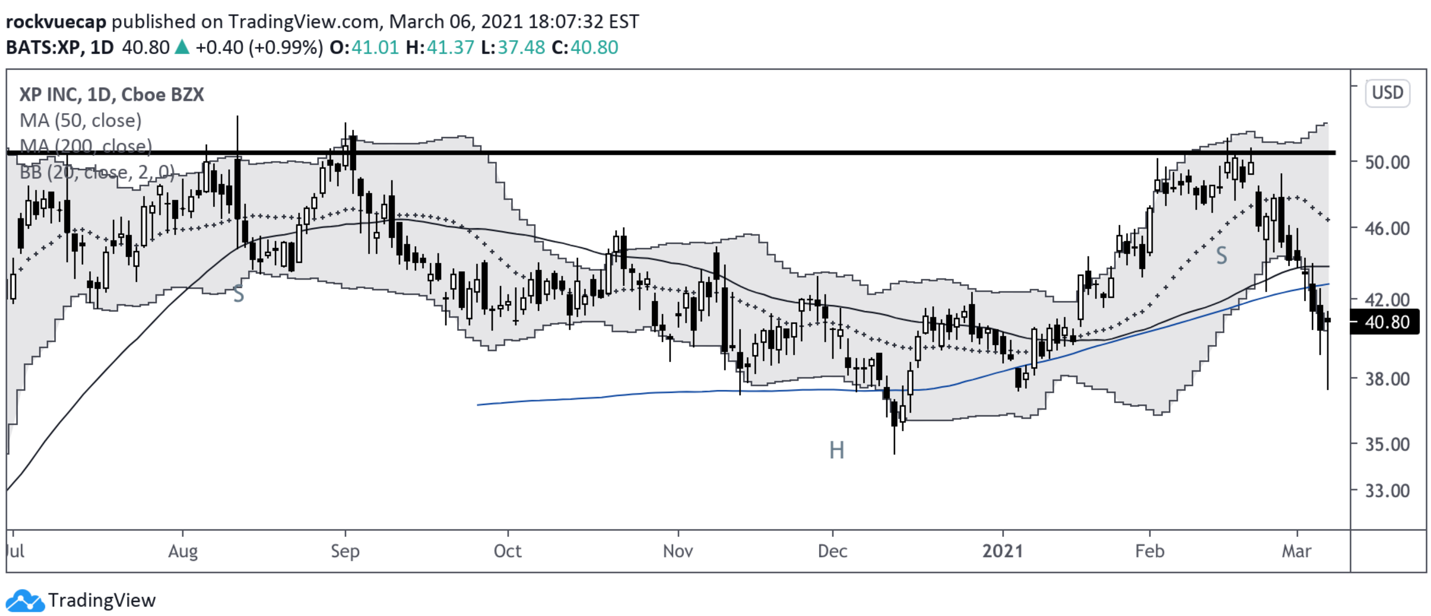
- The number of clients increased by 63% YoY.

XP's Q4 earnings report confirmed part of our thesis. XP is the **go-to** brokerage for Brazilians that want more meaningful investment choices, fewer fees, and a fully digital online experience.

We valued the company based on its retail business alone. Retail is XP's largest business, and underwriting only that portion allowed us to see how much of XP we'd get for free at the given retail multiple. For example, you're paying ~34x our estimate of 2024 retail net profits at the current stock price.

In other words, you get XP's institutional, issuer services, insurance, and banking businesses for free. XP's other companies are certainly worth more than $0. But the right-tail of that distribution remains impossible to measure with any level of precision.

The stock closed this week 13% below our cost basis. It flirted with our initial stop-loss but rallied hard into the Friday (03/05) close. New Collective members have an ideal buy point here with a clear initial stop-loss based on Friday's low (see below).



S&W Seed Co. (SANW): Finally Some Positive News

S&W Seed is a global agriculture producer engaged in the breeding, production, and processing of various seed crops such as alfalfa, stevia, sorghum, sunflower, and corn.

The company was [one of the first businesses I wrote about] after joining Macro Ops full-time (back in 2019!). I still cringe when I read it.

That said, SANW continues to execute its growth strategy by developing herbicides addressing the sorghum crop. Last Thursday (03/04), the company won EPA approval for the launch of Double Team Sorghum Cropping Solution. This approval allows SANW to provide its sorghum herbicide solution -- a significant win commercially.

The stock has *severe* selling pressure around $4/share. You can see the resistance on the monthly chart below:

Our SANW bet is a bet on CEO Mark Wong. Wong is a 40YR industry veteran with a history of selling his businesses for high-teens EBITDA multiples.

In the early 1980s, Wong built Agrigenetics, one of the first three founding companies to bring plants into the biotech space. Agrigenetics caught Lubrizol's eye and, in 1985, bought the company for $150M ($357M in 2019).

Less than ten years later, Wong led Agracetus; a company focused on developing and commercializing value-added genes in soybeans. Monsanto bought the company in 1992 for $250M ($456M in 2019). If those two examples weren't enough proof, how about one more? In 2005, Wong sold Emergent Genetics -- an international seed company that garnered the second largest market share in cotton globally -- to Monsanto (again) for $325M.

We'll continue to hold as long as Wong executes his strategy and doesn't give us a reason to sell.

GlobalTrans Invest (GLTR): Newest Portfolio Addition

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

We initiated a starter position on 03/02, but it met the bottom-worst performer's criteria in February. There are a few reasons that the share price would/should decline in the near term:

- It's a Russian company. Russian companies are perennially 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.

That said, the company gushes free cash flow and sports one of the most shareholder-friendly capital allocation policies I've ever seen in *any* company -- not just from a Russian entity.

Here's what I mean. 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.

Currently, the company pays a ~18% dividend to shareholders if there are no better investment alternatives. Second, GLTR's net debt ratio is modest 0.80x, far lower than the 2x needed to remove the dividend entirely.

We paid ~5x EBITDA for our shares. At that price, we're happy to wait and collect our 18% coupons. Despite the risks associated with a Russian investment, the potential returns warranted a starter position with the potential to increase it to a core holding.

Cresud S.A.C.I.F.Y.A. (CRESY): Sold The Equity, Kept The Warrants

CRESUD produces essential agricultural commodities in Brazil and other Latin American countries. Their products include wheat, corn, soybeans, cotton, sunflower, and sugarcane.

The company will benefit from long-term secular commodity tailwinds. That said, the stock hit our stop-loss on Wednesday (03/03), forcing us out of our equity position. Around the same time, CRESY issued a rights offering. The rights offering entitled shareholders (as of February 17th) one right for every common share and one warrant for every right they bought.

We spoke to a few Collective members, as well as brokerages, and are under the impression that we'll keep our rights (and subsequent warrants) even though we sold the equity. If that **isn't** the case, we will update you on that information.

We're still long-term bullish and will look to re-enter should the stock consolidate at lower levels or break out of its long-term inverse H&S pattern (see below):

rockvuecap published on TradingView.com, March 06, 2021 18:32:00 EST
BATS:CRESY, 1W 4.46 ▼ −0.09 (−1.98%) **O:**5.12 **H:**5.17 **L:**4.30 **C:**4.46

TradingView

Watchlist Updates & March Thoughts

Last week's volatility allowed us to add a handful of high-quality businesses to our watchlist. After the min sell-off, some of these businesses trade at <14x multiples on the current EBIT. Be on the lookout for a report in the next week/weekend with our findings.

The MO portfolio is off to a rough start in March. We're down a shade over 5% for the month. That said, you should judge Alex and me on our long-term track record (as far back as that goes). If we're *any* good at this stock-picking/trading game, you'll see it in a long-term market-beating CAGR. You won't find it in monthly or quarterly return figures.

Unfortunately, running a newsletter requires more frequent updates than quarterly/annual letters. That's why we write these monthly reviews. But please, do not read into any single monthly performance (both good or bad!). We don't get excited about double-digit up months, and we don't get upset about double-digit down months.

We care about our process and how well we stick to our approach (while red-teaming every belief we hold about markets and investing).

If you have any questions, please don't hesitate to shoot us a message on Slack or via email. We love conversing and learning from this beautiful community of like-minded market speculators.

