MO Weekly Equity Note: 06-26-2021

Cardlytics (CDLX): Mistake of Omission & Business Update

Operators,

This weekend we're diving into Cardlytics (CDLX) and addressing our mistake of not buying shares when we should've.

In a nutshell, The company is an advertising platform in banks' digital channels. CDLX partners with financial institutions to run their banking rewards programs that promote customer loyalty and deepen banking relationships.

These relationships allow CDLX to see what consumers buy and where they buy. In turn, they use this data to help marketers find potential customers at scale.

CDLX is a name we've owned in the past with great success. We bought our first shares for around $82. Here was our thesis at the time (emphasis mine):

> *"CDLX can continue to grow revenues at above-average market rates for the next five years. In doing so, they'll leverage their initial investments in their Cardlytics Direct platform and go from loss-making to net income positive.* ***CDLX is founder-led, sports zero debt and $20M net cash and grows at 40%+ per year.*** *Mr. Market's selling the company for* ***4x EV/Sales.*** *This is much too cheap.* ***A mere 6x multiple on conservative estimates of 2024 sales gets us $2.6B market cap (or $100/share)****. That would represent a 24% annualized return over the next five years."*

You can read the entire write-up here.

The stock ripped after we bought and within a month hit $134/share. We sold our entire position in three chunks at $134.50, $135.78, and $121.51. In short, we bought at ~4x EV/Sales and sold in double-digit multiples. Not bad for a month's work.

Today, we remain on the sidelines waiting for lower prices. The problem, of course, is that we *did* get lower prices.

Luckily there is always something to learn. We'll first examine the error, why it happened, and outline why it won't happen again. Then, we'll end with a CDLX review and how we're thinking about re-entry plays.

Grab your coffee and dig in!

The Re-Entry That Wasn't: Why It Happened & How We'll Fix It

On March 27, we released our *Macro Ops Shopping List*, profiling companies we'd love to own at lower prices. Cardlytics, frustratingly enough, was the first company.

Here's what we said at the time (emphasis mine):

> *"The company expects to hit $370M in revenue by 2022.* ***If we could buy CDLX for $90/share, we'd pay 7.7x sales for the business.*** *At that point, the company should generate ~$35M in EBITDA as it leverages its fixed cost base.*
>
> *So while we'd pay more than we did in August for the same business,* ***we're getting a company that is EBITDA positive and building on its powerful flywheel with consumers, advertisers, and bank partners.****"*

CDLX churned higher after we issued the report and reached a high of ~$144/share by the end of April. On May 4, the company announced its quarterly earnings. Results came in 46% below analysts' estimates and sent shares crumbling.

At first, the price fell below $100, then $95, then $90. CDLX eventually traded around $85/share before bottoming out.

Remember, our target re-entry price was around $90/share. Yet we didn't buy. There are two reasons why:

1. Lack of codified order entry process
2. Focusing on other businesses/investment ideas

Here's how we've corrected these errors.

Lack Of a Codified Order Entry Process

Every week, we review stocks we've researched that we want to buy at lower prices and verify that we set a price alert for that stock. Then, as soon as the price alert triggers (assuming fundamentals are consistent/improving), we buy our stake (starter or full).

Focusing On Other Businesses/Investment Ideas

We will *always* research new ideas because it's what gets us excited … finding businesses that nobody else has heard of has 5-10x potential over the next 3-5 years. That said, we *need* to spend more time on the names we've already researched.

Reviewing these names when their share prices collapse allows us to act quickly with a pre-loaded understanding of the company. We can buy dips faster and with greater confidence to take advantage of short-term price volatility.

Alright, now onto the business update.

Cardlytics (CDLX): Reviewing The Business

CDLX connects advertisers to an engaged audience using a bank's pre-existing mobile app while offering a coveted win-win-win for all parties involved: **Customers, Advertisers,** and **Banks.** Here's how.

Customers win because they receive targeted, cash-back offers on products they *already* routinely purchase inside an app they frequently use.

Banks win because it drives higher engagement with their mobile banking apps while offering tangible rewards and a reason for users to return to the platform.

Finally, **Advertisers win** because they can target customers that routinely purchase their products while receiving high-value ROAS insights.

So far, the CDLX offering works better than almost any digital advertising medium out there. According to the company's 10-K, CDLX delivers a roughly $30:1 return on ad spend (ROAS). This trounces the industry average of ~$2.87:1.

CDLX Benefits From Network Effects

CDLX becomes more valuable the more users (marketers, banks, consumers) it has on the platform. The **company will process and analyze roughly 1 out of every 2 purchase transactions in the US at scale.** It's hard to imagine the value of such data.

There are two main advantages to CDLX's model: **Monopoly Status** and **First Mover Advantage.**

Currently, FI's have three options when it comes to adding an in-app rewards platform that they can monetize:

1. Build it themselves
2. Choose CDLX
3. Go without

The first option (build it themselves) sounds attractive, but banks won't do it, and marketers won't use it. Building a platform like CDLX Direct requires a bank to use their purchase data and purchase data from other large banks. Why would a competing bank offer its data (even if compensated) to have a competitor build a rewards platform?

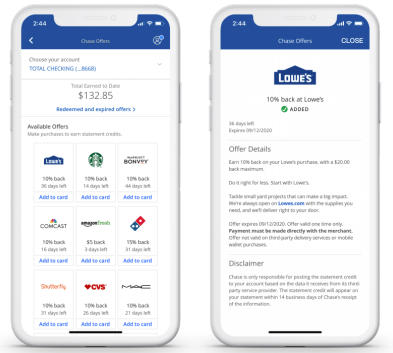
Secondly, by building it themselves, banks would lose out on CDLX's powerful network effects. Marketers love using CDLX Direct because the platform's corralled 168M MAUs in one place. A DIY approach would result in siloed rewards programs and small MAU bases.

CDLX understands these dynamics, which is why they've moved quickly to secure most of the big bank's limited purchase history data. Banks usually choose three-year contracts with CDLX, creating a durable moat other competitors can't penetrate.

Meet The Players: Financial Institutions & Marketers

CDLX partners with Financial Institutions (FI's) like Chase, Bank of America, and Wells Fargo. These banks then integrate CDLX's Direct Platform into their existing mobile banking apps, allowing their customers to score discounts on products they already buy.

To incentivize these FI's, CDLX pays *FI Shares,* which are negotiated, fixed-percentages of CDLX's billings to marketers (less consumer incentives).



FI growth is vital to CDLX's platform success as more banking customers create a stronger incentive for marketers to spend advertising dollars on the CDLX Direct Platform.

As of last quarter, the company boasted 168M MAUs. To give context, that's fourth behind Facebook (FB), Alphabet (GOOGL), and Amazon (AMZN). In fact, CDLX generates more MAU's than Snapchat (SNAP) yet trades at ~4% of the market cap.

Then there are the Marketers. Marketers have an incentive to use the CDLX Direct Platform because they can target consumers that already repeatedly purchase their products. Let's take Starbucks, for example.

The CDLX Platform can identify consumers that regularly shop at Starbucks. Marketers, in turn, can deliver targeted ads to those *specific* customers inside the shopper's mobile banking app. Along with improved ROAS tracking metrics, marketers benefit from advertising in a non-fraudulent/non-invasive way as the shopper already uses her mobile banking app.

Early Signs of Success w/ US Bank

A great example of CDLX's success is its recent integration with FI partner, US Bank. Here are some stats from the bank's initial test run:

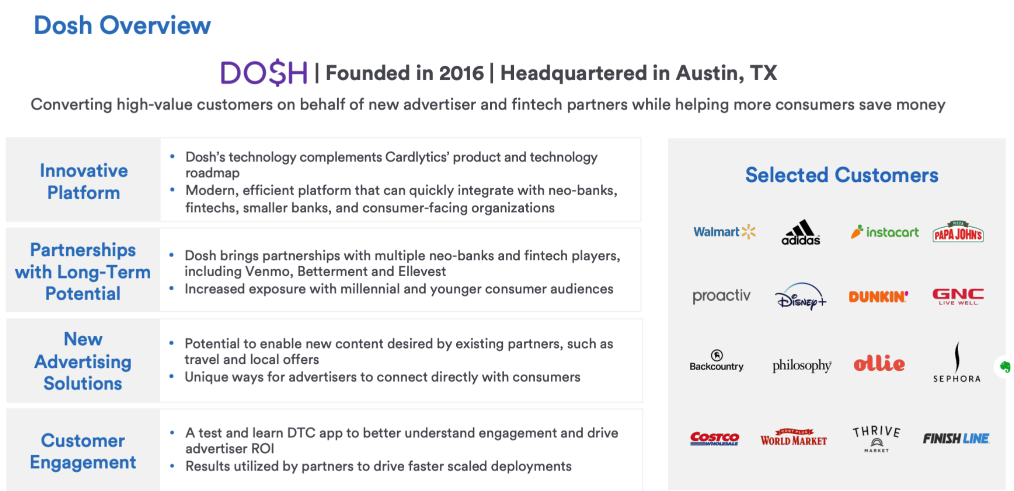
- 1 in 2 consumers activated an offer in their first two weeks from the Rewards Hub
- Visits to Rewards Hub increased by 50%
- Activation Rates up 49%

In other words, CDLX turns a bank's mobile app into a frequently-visited consumer destination for discounts and cash-back offers. Banks love the increased engagement, marketers love activated cash-back rewards, and customers love saving money. Win, win, win.

What's New: Dosh & Bridg Acquisition

CDLX bought two new companies since our initial report: Dosh and Bridg. Let's start with Dosh.

Dosh is like a miniature CDLX, connecting high-value customers to fintech/neobank partners on behalf of advertisers. In other words, Dosh provides CDLX-like technology to neo/internet-first banks (think Venmo, Betterment, Ellevest). Current Dosh advertiser customers include Walmart, Adidas, instacart, and Disney (to name a few).



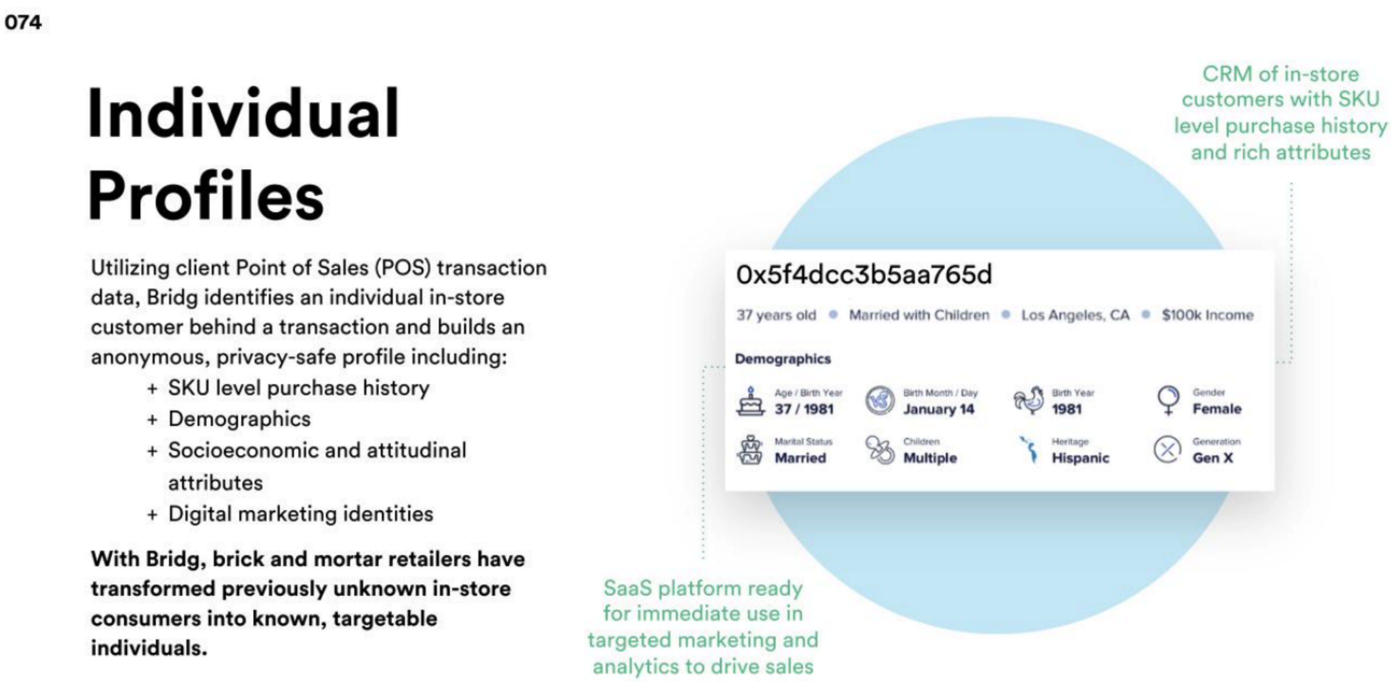
The DOSH acquisition allows CDLX to expand its single-source banking platform to a younger consumer audience and offer new content by existing partners like travel and geo-local discounts.

Next, there's Bridg, which sports one of the most incredible advertising technologies I've seen in recent memory. Bridg is the first platform that identifies and engages unknown in-store retail customers. Sounds crazy, right? Here's how they do it.

Bridg uses Point of Sale (POS) transaction data to identify individual in-store customers. After the transaction, Bridg builds an anonymous, privacy-safe profile which includes:

- SKU level purchase history
- Demographics
- Socioeconomic attributes
- Digital marketing identities

The result is a CRM of in-store customers with SKU-level purchase history and marketable demographic attributes, all bundled into a simple SaaS platform (see below).



Our Next Steps With CDLX: Valuation & Trade Management

At this point, we must ask two fundamental questions:

1. Is CDLX a better company today than when we sold?
2. Do we want to buy the company at the current price?

CDLX is a significantly better company today than it was when we first found it. The company has signed more FI partnerships (like US Bank) and extended its reach to penetrate neobank fintech consumers. Yet you won't see this progress in CDLX's financials as COVID halted nearly all advertising spend.

Two levers matter to CDLX's future revenue and earnings growth: **Monthly Average User (MAU) Growth** and **Average Revenue Per User (ARPU) Growth**

CDLX has grown MAU's at a ~40% CAGR since 2018 (65M to 168M). During that time, ARPU has steadily declined from $2.30 to ~$1.20. Declining ARPU makes intuitive sense as it takes a while for new users to reach the spending level of mature FI partners.

Founder/CEO Lynne Laube offered her thoughts on ARPU over the next few years in early June (emphasis mine):

> *"Yes. Yes. **I mean we're not stressed about $2.30 anymore.** It's just -- COVID set us back a bit. It's just a matter of time. It's more, Andy is exactly right. **How do we get to 8, 9, 10, 12,** that most type of ARPU numbers, is where our focus is now."*

Laube isn't worried about hitting their pre-COVID ARPU levels, but in fact, has her sights set on double-digit ARPUs.

Let's assume CDLX grows its MAU base ~20% per year for the next five years, a conservative assumption given their 40% historical growth rate. By 2026 we'd get 418M MAUs on the CDLX Platform.

Now, let's assume the company reaches pre-COVID ARPU by 2023 ($2.30) and hits $4.00 by 2026. That gets us a roughly 26% 3YR ARPU CAGR, not unreasonable. Remember, CDLX generates ~$30:1 in ROAS. It makes sense why more marketers will spend a more significant portion of their advertising budget within the platform.

Under those ARPU and MAU assumptions, we'd end 2026 with ~$1.67B in revenue (418 * $4.00/user), or roughly 2.25x EV/2026E Sales.

We can also assume CDLX doesn't grow beyond its $2.30 ARPU floor Laube mentioned in the Investor Conference. If that's the case, we'd still end 2026 with ~$916M in revenues, or 4x EV/2026E Sales.

What Price Do We Want To Buy?

Currently, the stock trades for ~$128/share or $4.2B market cap. Subtract the company's $422M net cash position, and you get $3.75B in Enterprise Value.

Turning to the charts, CDLX is at the upper boundary of its bull wedge/channel pattern. Ideally, we'd want *at least* one swing low towards the support line before initiating a position.

That said, we're not ruling out the opportunity to get a starter position should the stock break the upper boundary on the weekly timeframe. We'd want a weekly close above the boundary line.

We've set price alerts to trigger at the 50MA and lower support levels ($87). Be on the lookout for a trade alert should CDLX trade below $90/share.

