MO Weekly Equity Note: 08-21-2021

Updated Thoughts on Cardlytics (CDLX)

Operators,

Back in June, I mentioned we'd revisit Cardlytics (CDLX) should it ever trade back below $90/share. Well, here we are. CDLX shares fell over 30% after a self-inflicted earnings miss. Today, the stock trades around $82/share. Here's the exciting part. Our most bullish price target is roughly $1,050/share, implying over 1,000% upside at the current stock price.

If you haven't read our original CDLX thesis, you can find it here. We also shared our updated thoughts on the company in June, which you can read here.

Today we'll cover the latest earnings report and review our framework for understanding potential intrinsic value.

We've packed a lot of information into this note, so grab your favorite beverage and let's get after it.

Management's Self-Inflicted Estimate Miss

CDLX's core business performed well during the quarter. Platform billings rose 111% with adjusted contribution rising a further 123%. Yet despite the success, the results fell below management's expectations. Hence, the self-inflicted wound.

Here's co-founder Lynne Laube's take (emphasis mine):

> *"While we grew Cardlytics platform billings 111% and adjusted contribution 123% from Q2 2020, we fell below our guidance.* ***This was driven by us forecasting a faster recovery than we realized in travel, retail and restaurants …*** *I want to reiterate that while we're disappointed in the miss,* ***our business is performing well.****"*

COVID hurts CDLX more than other advertising platforms because of its industry specificity. For example, the five main advertisers that spend on CDLX's platform include:

- Grocery and Gas
- Restaurant
- Retail
- Travel & Entertainment
- Direct to Consumer

Each of those industries took a hit during the heat of COVID. Frustratingly enough, however, the post-COVID recovery also hurt CDLX's business. Here's what I mean.

Consumers flooded restaurants, shopping malls, and highways as restrictions lifted nationwide. The sudden demand shock forced businesses in the above industries to siphon all spending on the most important line items. For example, restaurants needed cooks, waiters/waitresses, and delivery drivers.

Retail stores needed part-time and full-time employees again.

In other words, these industries didn't *need* to advertise to drive demand. They needed workers.

Lynee explained the reasons for the spending decline during the call (emphasis mine):

> *"We believe advertisers spent less than we forecasted for 3 reasons.* ***First, there were labor shortages; second, retailers and restaurants had supply chain issues;*** *and t****hird, there was an increase in consumer demand, reducing the need for advertising with several key clients.*** *For example, several of our key client restaurants pause their marketing because they couldn't purchase enough critical ingredients. A men's clothing client halted all of their marketing spend when they realized their supply chain couldn't deliver the inventory they needed to maintain customer selection. As a result, s****ome marketing budgets across our client base were actually paused in Q2, something we rarely see in our business and/or push to Q3.****"*

Taking a long-term view, paused marketing budgets in Q2 don't matter. Over time, advertising spending *will* normalize back to trend growth levels.

Step back from the short-term quarterly blip, and CDLX's core business is executing brilliantly. Lynne noted that the company is "*ahead of plan on every single initiative that we have discussed for the last several quarters.*"

One such initiative is the addition of neobanks and digital payment platforms.

Updates on Dosh & Bridg Integrations

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.

CDLX is now live with 8 neobanks and fintech platforms, including Venmo. Moreover, the company has another 14 neobanks and fintech platforms coming online in the next quarters. Management revealed that one partner includes *"one of the most innovative fintechs in the U.S."*

Each neobank and fintech platform brings new MAUs to CDLX's core business.

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.

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 SaaS platform.

CDLX closed on a large home improvement store client during the quarter and has a pipeline of leading retailers and restaurants in the works. Additionally, the company's received positive feedback from the Bridg technology. Here's Lynne's take (emphasis mine):

> *"One of their key partners had this to say about their product, quote, understanding all of our customers and their engagement levels allows us to deliver a differentiated customer experience.* ***Bridg has enabled us to complement the deep insights we have around our loyalty members with an understanding of our unknown in-store customer purchase behavior, along with the ability to reach these individuals to develop an optimal customer relationship.*** *We now have a* ***true holistic view into our customer base that was not possible before.****"*

Think of Bridg as an X-Ray device on retail consumer spending. With Bridg, retailers see "beneath the skin" to spot spending patterns/behaviors. In turn, retailers can target specific customers based on their specified spending habits.

Why This Matters: Potential Intrinsic Value Much Larger Than Previously Expected

The more time I've spent studying/thinking about CDLX, the more I realize that its future intrinsic value is likely ***significantly larger*** than previously thought.

Now there are myriad unknowns with this bet, which means a probability-weighted scenario analysis makes the most sense. So as a thought exercise, I broke down two potential 2026 scenarios and one blue-sky 2031 scenario.

I should reiterate that there are only two critical drivers for CDLX's long-term value creation: **ARPU Growth** and **MAU Growth**. CDLX's future value creation hinges on the company's ability to add more users and spending per user over time.

Alright, onto the scenarios.

Scenario 1: Historical MAU Growth w/ Return To US Bank ARPU

Our first scenario assumes historical MAU growth of ~18% per year as ARPU expands to what US Bank generated on the old CDLX platform, ~$2.30.

These assumptions get us 382M users in 2026, generating ~$895M in annual revenue.

The company's historically generated 36-38% gross margins, so we'll keep those in our assumptions. Over time, however, CDLX should develop substantial operating leverage as its business model requires little capital to fund its growth.

We're assuming SG&A margins shrink from 47.5% of revenues to 20% of revenues, resulting in a ~16% EBIT margin.

You can see the breakdown of our model below.

Assumed MAU Growth	18.00%	*historical growth				
Year	2021	2022	2023	2024	2025	2026
MAUs	167	197	233	274	324	382
Average Revenue Per User (ARPU)	$1.36	$1.52	$1.69	$1.89	$2.10	$2.34
Implied Growth Rate	11.50%					
Total Revenue	$227.12	$298.82	$393.16	$517.28	$680.59	$895.45
Gross Margin	$81.76	$107.58	$141.54	$186.22	$245.01	$322.36
Margin %	36.00%	36.00%	36.00%	36.00%	36.00%	36.00%
SG&A Margin	-$107.88	$119.53	$137.61	$155.18	$170.15	$179.09
Margin %	-47.50%	40.00%	35.00%	30.00%	25.00%	20.00%
Operating Income (EBIT)	-$26.12	-$11.95	$3.93	$31.04	$74.86	$143.27
Margin %	-11.50%	-4.00%	1.00%	6.00%	11.00%	16.00%

If we assign a 15x multiple on 2026 EBIT, we get ~$2.15B. Discounted over five years at a 10% discount rate gets us shareholder value of ~$1.33B, or **$43/share.**

This first scenario is with a *highly conservative* ARPU growth rate. We also didn't give CDLX credit for any future gross margin expansion.

Lynne mentioned that the company sees $2.30 ARPU as the "floor" number during the earnings call. In other words, $2.30 is a given assumption that they'll make *at least* that.

Interestingly, management said they're focused on building ARPU to $8-$12. I know. That seems like a stretch. But there are a few ways they get there, like:

- Expanding self-service platform
- Transitioning more users to the newer CDLX platform interface
- Adding more neobanks and traditional banks
- Increased usage from push notifications feature
- SKU-level offerings to retail clients

Let's move to our second scenario.

Scenario 2: 20% MAU Growth w/ ARPU Hitting $5 By 2026

Our second scenario assumes ~20% MAU growth over the next five years, with ARPU reaching $5 by 2026. These assumptions give us 416M MAUs and ~$2.1B in revenue by 2026.

Next, we're assuming CDLX improves gross margin ~400bps to 40% as they scale their digital offering. This results in ~20% run-rate EBIT margins by 2026 or $420M in EBIT.

Given the company's improved margin profile and sustained growth, we're assuming the market values the business at ~20x EBIT for a 2026E EV of $8.4B. Discount that EV back at 10% over five years, and you get a current value of ~$5.12B or $167/share.

Assumed MAU Growth	20.00%	*historical growth						
Year	2021	2022	2023	2024	2025	2026	**Enterprise Value Calculation**	
MAUs	167	200	240	289	346	416		
							Price per Share	82.16
Average Revenue Per User (ARPU)	$1.36	$1.77	$2.30	$2.99	$3.88	$5.05	Shares Outstanding (m)	32.057
Implied Growth Rate	30.00%						**Market Capitalization**	***$2,634***
							Less: Net Cash	57.21
Total Revenue	$227.12	$354.31	$552.72	$862.24	$1,345.10	$2,098.35	**Enterprise Value**	***$2,577***
Gross Margin	$81.76	$131.09	$207.27	$327.65	$524.59	$839.34	**20x EBIT Multiple**	$8,393.41
Margin %	36.00%	37.00%	37.50%	38.00%	39.00%	40.00%		
SG&A Margin	-$107.88	$141.72	$193.45	$258.67	$336.27	$419.67		
Margin %	-47.50%	40.00%	35.00%	30.00%	25.00%	20.00%		
Operating Income (EBIT)	-$26.12	-$10.63	$13.82	$68.98	$188.31	$419.67		
Margin %	-11.50%	-3.00%	2.50%	8.00%	14.00%	20.00%		

This scenario assumes that CDLX adds more neobanks and fintech companies to its platform. It also assumes that it'll convert existing clients to the new CDLX platform *and* successfully introduce a self-service offering.

Scenario 3: Top-Down 10YR TAM Approach For Blue Sky Scenario

Our last scenario takes a top-down TAM approach to identify potential revenues, EBIT, and enterprise values.

Digital advertising spending reached $378B in 2020 and by 2024 should reach $646B. Let's assume that digital ad spend grows ~3.5% from 2024 to 2031 for a total of $814B.

Yet this isn't CDLX's actual addressable market. FB and GOOGL, for example, generated $230B in digital advertising revenue in 2020, or 61% of the industry TAM. Assuming both FB and GOOGL customers stick with those platforms, we end 2031 with ~$317B in addressable revenue.

This is where things get wild. Let's assume that CDLX manages to grab 2% of its $317B addressable market over the next ten years. Again, that's excluding the two biggest players in the space. 2% of $317B is $6.35B in annual revenue.

Assuming roughly 45% gross margins and 25% EBIT margins, you're left with $1.6B in operating income. We can then apply a 20x exit multiple on that EBIT to get $31.75B in EV. Discount that back over 10 years at 10%, and you get a $12.2B business (~$400/share).

That's at only 2% market share! Here are what the numbers look like at 4%, 5%, and 10% market shares, respectively:

TAM %	2%	4%	5%	10%
Annual Revenue	$6,350	$12,701	$15,876	$31,751
ARPU	***$15***	***$25***	***$27***	***$44***
Gross Profit	$2,858	$5,715	$7,144	$14,288
Operating Income	**$1,588**	**$3,175**	**$3,969**	**$7,938**
20x Exit Multiple	$31,751	$63,503	$79,378	$158,757
10% Discount	$12,241	$24,483	$30,604	$61,208
Implied Share Price	**$401**	**$803**	**$1,003**	**$2,007**
Upside % from Current	489.46%	978.93%	1223.66%	2447.33%
10YR IRR Estimation	***48.95%***	***97.89%***	***122.37%***	***244.73%***

Two things shock me when I look at this chart. First, at only a 5% market share, CDLX is worth ~$30.6B or $1,003/share. That's an implied 10YR IRR of 122%.

Yet, the most critical part of this chart is the ARPU figure. Even in the most extreme TAM percentage case (10%), CDLX maxes out at $44 in ARPU. Luckily, we can stress test this against GOOGL and FB.

As of 2019 data, GOOGL generated $137 in ARPU, with FB (the US and Canada) generating $112. In other words, even in our most bullish scenario, CDLX still generates 35% of what FB and GOOGL capture.

Combining all four above TAM percentage scenarios, we arrive at an average $32.14B enterprise value or $1,050/share.

Concluding Thoughts: Remember The Win-Win-Win

Cardlytics competes with two of the strongest digital advertising companies in history: **Facebook** and **Google.** Collectively, those two companies comprise ~61% of total digital advertising revenue. At face value, CDLX seems like the weaker player. After all, they have fewer MAU's and have a more challenging time convincing advertisers and banks to partner with them.

But here's what most investors miss. CDLX is the only platform out of the three that can **provide accurate advertising spending figures** to its clients. On the CDLX platform, advertisers see *actual purchases* inside consumers' banking apps.

This is a vastly better proposition for advertisers because if they spend with GOOGL or FB, they don't *really* know their return on advertising spend (or ROAS). For example, a consumer could be watching TV and see an AD for a couch. After watching the ad, they decide to buy the sofa. Then, they open Facebook on their phone and see the exact same couch ad.

Suppose that a consumer goes and buys a couch online. In that case, FB will claim that revenue is generated as part of its advertising campaign. Even though the decision to purchase was sparked by the television ad.

Why does this matter? Over time, more advertisers will realize they can get a more accurate ROAS figure through CDLX and shift the bulk of their ad budgets to CDLX. In turn, CDLX will capture a more significant share of the digital advertising spending market than most investors assume.

So, all this to say that we'll be putting a starter 3% position in the company come Monday. We'll also look to sell puts on any downside move to capture premium and increase our position size.

Over time, we want to make CDLX a 10-15% position and look to do this in 3-4 bets.

