An Equity Note

Brandon Beylo

brandon@macro-ops.com

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- Metathesis Hypothesis on The Importance of Online Review Platforms
- TrustPilot Bull Pitch

Companies Mentioned

1stDibs (DIBS)
Yeti (YETI)
Lululemon (LULU)
Figs, Inc. (FIGS)
Peloton (PTON)
TrustPilot (TRST)

Notes From Dan McMurtrie's Real Vision Interview & Valuing Online Trust

I'm a simple man. I see Dan McMurtrie content, and I devour it like Alex will consume social media once he returns from meditating in the caves of Sweden (or something like that).

Anyways, McMurtrie did an excellent interview with Mike Green of Real Vision this Thursday (10/21). He touched on "The Inner Game of Investin," one of my favorite topics.

We'll break down McMurtrie's interview and highlight my favorite quotes and topics during the first half of this Equity Note.

Then, we'll dive into a metathesis I'm developing around online/offline commerce and the role trust plays in purchase decisions. This thesis is very much in beta mode, and I encourage you to provide feedback/pushback during points of disagreement.

But before we dive in, I want to take this time to acknowledge that the markets ***did not*** collapse in Alex's presence. Time to readjust our hit-rate on the ol' Alex-is-leaving-so-buy-puts indicator.

Jokes aside, I can't wait to get Alex back. So let's get after it.

The Inner Game of Investing w/ Dan McMurtrie

Dan McMurtrie is the founder/portfolio manager of Tyro Partners. Tyro is a process-driven, fundamental, long-short equity hedge fund.

The fund's compounded capital at a 25% CAGR over the last five years. But McMurtrie *only recently* burst onto the scene after Tyro's famous Dating whitepaper (which you can read here).

McMurtrie's latest interview dives deep into decision-making optimization, utility versus intrinsic value, and pockets of market inefficiencies.

Let's explore each of these ideas with my "Best Hits" from the interview. Note that text in bold is my emphasis.

On health and decision-making …

> *"And what I started reading into was how your decision making got changed based on the conditions you're in. And what I found is that your body is exposed to certain things for very extended periods of time,* ***your ability to make even basic decisions is completely impaired****. And that's a really complicated topic, because as you mentioned, it can go into your health, I can go into your social circle, it can go into what your current level of risk is, what's going on in the market."*

Optimal decision-making isn't the result of "more reps" in front of the trading screen. Like weightlifting, most of the *actual* work happens outside the gym (or screens) -- while we sleep or rest.

I can scan thousands of charts, looking for the perfect horizontal breakout pattern. But if I sleep like crap and my diet mirrors that of a Willy Wonka outtake, I'm screwed. I won't take the trade. I won't make the optimal choice.

The same thing happens in fundamental, bottom-up investing. Cliff Sosin of CAS Investment Partners explains decision-making as a our function of two things: **serendipity** and **a prepared mind**. Here's the quote (and I'm paraphrasing):

> *"It doesn't matter if you spend all your time preparing your mind for an investment opportunity but forgo the time needed to allow serendipitious opportunities to surface."*

In other words, if you spend *all your time* reading 10-K's and new S-1 filings, you forfeit your brain's ability to deeply think about the potential opportunities in front of you.

On self-isolation and hard times …

> *"I've tried to structure my life to where people hit me over the head. What I'm doing it is you start to go through a hard time, you start to self-isolate. So, on a given day, one of the things we started tracking was how many inbounds we have, how many outbound we have, how many conversations we're having.* ***One of the things you'll notice during times of extreme stress for money managers, or really anything else is that number will drop by 60%, 70%, 80%, sometimes more.****"*

As a natural introvert, isolation is comfortable. But sometimes comfortable can kill. The beauty of a place like the *Collective* is that we can share in our struggles and engage with high-quality people when things go wrong.

I'm frequently reminded of the creation story in the Bible. Adam lived by himself for a while. But at some point, God decided it wasn't good for man to live alone. There's a lot to extrapolate there.

It's not good for investors and traders to live alone. Iron sharpens iron and a three-corded rope is stronger than one.

On seeing fat pitches …

> *"And so, what you're trying to do to stay in baseline so that* ***you can just see the fat pitches again.*** *You're* ***not trying to optimize the hard problems.*** *I think one of the things is, especially when you're stressed, your brain is trying to solve the hardest problem it can because you think about that subconsciously as removing the most stress."*

Solving (optimizing) hard problems is a social status symbol like angel investing or buying crypto kittens. It's addicting and allows you to showcase intellectual dominance over others.

But that's the *wrong* optimization problem in investing. Buffett said it best when he uttered, "I'm looking for two-foot hurdles."

Anecdotally I've experienced this in semiconductor investing. Last year I spent a month dissecting the semicondutor space and its ptoential AI applications. Yet the industry moves so fast, I wonder what the value is of that research today.

We solve this problem by optimizing for fat pitches. By waiting for ideas that appear so obvious that it *feels* like a no-brainer. The Pabrai 'hit-with-a-two-by-four' feeling.

Here's how we implement this "wait for fat pitches" mantra in our research process. We segment our research into three buckets:

- Current 3-5x potential in 3-5 year ideas
- VC-type bets with 100x potential and high probability of going to zero
- ROIC Champs -- stocks that have increased ROIC at a 5% CAGR or higher the last five years

In other words, we're learning about businesses we can invest in *today,* bets we can make for *tomorrow*, or companies we hope fall in price in the future. It's evergreen content, nothing wasted.

On playing the game in front of you …

> *"That's really what kills you as an investor, because the* ***world is whatever currently works.*** *Somebody's trying to figure out how to hack it and circumvent it. It's very much like poker.* ***If everybody's playing in a certain way, somebody is going to figure out how to exploit that.*** *Everybody's playing really tight, people are going to figure out how to exploit that loose, people can exploit that."*

We're *huge* fans of Bruce Lee at Macro Ops and one of our favorite quotes from him is "be like water."

Being like water means going with the flow of the market. Not fighting upstream to earn returns "your way."

Here's a perfect example. I'm not a fan of "shitcos" and energy stocks. Alex loves them and trades such instruments with great success.

Yet the fact remains that energy stocks have carried our portfolio while my longer-term online/consumer/SaaS names lag.

That's why it's vital to "be like water."

On asking the fundamental questions …

> *"And that's really the question is **what do I need to have a view on in order to take XYZ risk?** And what can I manage? That's the core question … . **I want the bets that I need to know the littlest about**, and a little about the world that contract that portfolio, because I'm essentially getting a higher Sharpe in terms of my process, regardless what the security path looks like."*

As Howard Marks says, asking fundamental questions is the essential thing in investing. But again, it's hard to do in practice.

Why? Because asking fundamental questions begets opaque and often-times lower probability answers.

It's easy to provide a specific answer to a question like "what will next quarter's margins look like?"

But that's the *wrong* question. Instead, we should ask, "how will customers view this company's value proposition in 5-10 years compared to where its competitors are positioned?"

The latter question is significantly more fundamental (and important) than the prior ponderance but more challenging to answer.

Fundamental questions require "large" answers based on consumer psychology, switching costs, incentive structures, and industry dynamics.

However, the great thing about fundamental questions is that you don't need a lot of them to develop an investment thesis.

Take 1stDibs (DIBS), for example. DIBS is a straight bet on (roughly) one fundamental view: **Over time, people will get comfortable spending thousands of dollars for luxury design pieces online without seeing them in person.**

On utility vs. intrinsic value …

> *"So, we're trying to look at those types of things, and also try to figure out, we're going to analyze the business, we're also going to look at the security, **what utility does the security offer to investors who are looking at it?** And there are situations where over a short period of time, **what a security ultimately offers is a***

> ***way to take a large portfolio's correlation down a little bit and add a little bit of return****, and people are going to buy for that. It's going to become self-fulfilling."*

Utility versus intrinsic valuation is a fascinating idea and a candidate for a more extended, separate essay. The main point McMurtrie makes is that people buy stocks for myriad reasons. Frankly, most of them are *unrelated* to a company's discount to intrinsic value.

Usually, investors buy stock to receive (as McMurtrie says) a specific utility. Maybe it's particular exposure to an ESG thematic. Or perhaps it's to window-dress the portfolio before an LP meeting.

It's easy to miss these utility-driven purchase decisions as fundamental investors. Why? Because there's a tendency to believe that *all* market participants are like us … searching for great businesses at discounted prices.

Reality is far different.

So how can we position ourselves to capture utility value? Be like water and understand how incentive structures and constraints drive allocations and fund flows.

On fads becoming permanent …

> *"But one of the archetypes we look for in new strategies is* ***something that in the past they're looked down upon or considered foolish all of sudden starts working****, and possibly might be it continues to work due to a structural change."*

Looking foolish in the past before becoming commonplace is an entire investment thesis in one sentence. Think about all the cult stocks you know: Yeti, Peloton, Lululemon, etc.

What did all these companies have in common? *All of them* looked foolish at the beginning, mostly from a price standpoint.

You probably heard questions like: How many people would pay $400 for a cooler? Who would want an iPad on a stationary bike for a monthly subscription? You paid *how much* for yoga pants?

Every purchase looked foolish in the beginning. But today, there's Yeti coolers and LULU leggings everywhere.

We believe FIGS fits this thesis perfectly and you can read our thesis here.

On not losing your mind …

> *"So, just* ***put yourself in a position where you're not going to lose your mind*** *and you continue to do the average thing, you'll have absolutely fantastic results."*

At Macro Ops, we're *ruthlessly* focused on risk management and downside protection. We're firm believers in Greenblatt's mantra, "if you focus on the downside the upside will take care of itself."

Downside protection starts in the investor's mind and with taking care of your physical and mental health.

Why is downside protection so important in investing? Let's use a hypothetical portfolio's return figures.

Suppose we're running XYZ Capital with $10M in AUM, and we spend the first five years compounding at 25% CAGR. That gets us to $30.5M by the end of our fifth year.

But then the unthinkable happens. We make wrong bets, hold too long, and compound our errors by revenge trading. We end Year 6 with a 45% drawdown.

That sends us back to $16.8M in AUM and erases three years of 25% annual returns.

Finally, let's assume the fund generates ~18% per year until year ten after the 45% drawdown. That gets us to $32M in AUM by the end of year ten. In other words, *exactly where we were in year 5.*

Ouch.

Now suppose instead of a 45% drawdown, the fund only lost 15%. In that scenario, we'd end year 10 with over $50M in AUM, close to double our Year 5 figure.

The lesson: **don't put yourself in a position where you'll lose your mind and blow up.**

I hope you enjoyed the Best Hits version of Dan's latest interview. If you haven't had a chance to check out my podcast with Dan, listen to it here. You can also read the podcast transcript here.

Meta-Thesis Idea (Development Stage): The Role (& Importance) of Trust in Commerce

One idea that's consumed my thoughts lately is a "trust layer" in commerce and the importance of online reviews for consumers.

The metathesis hypothesis goes like this: **How valuable would the world's leading online review platform be in a world where online reviews are the strongest signal of consumer trust and a must-have metric for all companies?**

We can test this hypothesis with data. For example, we've seen an **11% decline in trust for global consumers between 18 and 65.** Additionally, **89% of consumers globally check reviews online before making a purchase.**

Let's assume two things from that data. First, consumer trust is essential and must be retained by companies. Two, almost every consumer uses online reviews in her purchase-making process.

From here, we can cross-examine the data on how companies use online reviews with how consumers respond. The above study noted that **62% of consumers globally would stop using platforms they knew were censoring reviews.**

On the other hand, 64% of consumers *prefer* to buy from a responsive company over one that appears perfect.

Finally, **55% of consumers would prefer to use an open platform to share online reviews.**

What does all this mean? First, companies can't hide bad reviews nor fake positive ones. Today's consumers can smell it from a mile away. Instead, consumers prefer honest companies. Bad reviews, if handled properly, *increase* consumer trust than 100% 5-star reviews.

Second, more than half of consumers want their reviews posted on an open platform—one without bias from Google, Facebook, or Amazon.

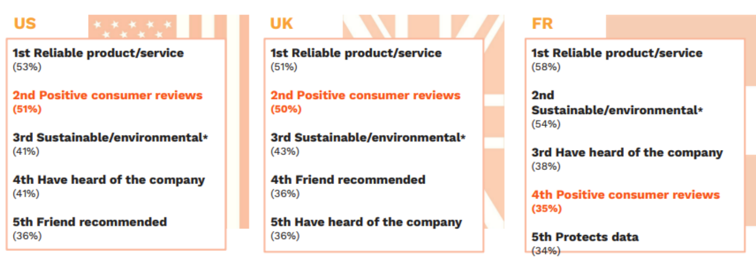
Let's review what we learned. Consumers are losing trust in brands at an alarmingly fast rate. 21% of consumers aged 18-24 trust brands less than they did a year ago.

Given the loss in trust, consumers are increasingly dependent on peer reviews for products and services before purchase.

Here's why this matters: **Increased dependence on peer reviews creates a flywheel effect making it impossible for businesses to ignore the value of online reviews, which leads to increased company engagement. Increased company engagement leads to increased importance (and value) of the online review platform for both consumers and businesses.**

This idea isn't just a raw hypothesis. It's confirmed in shopping data.

For example, both the US and the UK rank "Positive Customer Reviews" as the ***second most crucial*** factor when purchasing (see right).



Online reviews are a form of social proof -- a powerful decision-making heuristic we use every day. Online review platforms are second only to "Family and Friends" when ranking trust.

As we mentioned earlier, online reviews aren't just for consumers. Businesses can leverage online review platforms to engage with customers, foster stronger relationships, and put out fires in public for potential shoppers to see. It's free advertising that influences consumers more than any TV ad or radio slot.

This hypothesis backed by the above data is nice, but how will it make us money?

Enter TrustPilot (TRST).

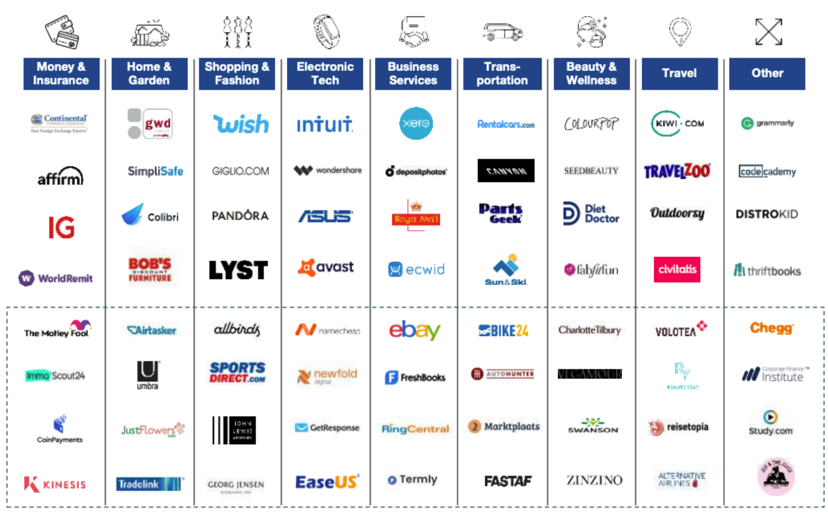
TRST is a leading online independent review platform serving the US, UK and International markets. You've undoubtedly heard and/or seen TRST ratings and reveiws online. You may use them today.

The company was founded by Peter Mühlmann in 2007. Today, TRST has reviewed over 600K websites, has 73K active domains on the platform, and generates $134M in annual recurring revenue (ARR).

To date consumers have generated a cumulative 144M reviews with businesses sending 44M review invitations per month.

TRST operates in a massive addressable market of roughly $50B and comprises both online and offline businesses from nearly every possible industry (see below).

Diverse spread of businesses using Trustpilot



The company's grown top-line revenue at a 30% CAGR since 2015 while sporting 80%+ gross margins.

Here's the exciting part. While the company generates sustained 30%+ top-line growth in its core UK and international markets, there remains *tremendous opportunity* for US expansion.

For example, TRST's the UK and International business grew revenues 40%+ Half-over-Half 2020-2021. The US during that same time, 6%.

And since May 2020, the US has grown 10% while the UK and international counterparts have risen 30%.

So how does TRST crack the code on US growth? It will take a combination of the above flywheel. More users trust the TRST platform for independent reviews, and more businesses take those reviews seriously and respond to customers. All of which further engagement and increase the value of the TRST platform exponentially.

Of course, that leaves valuation. There's one simple (albeit crude) method we can use. Remember our metathesis above: **How valuable would the world's leading online review platform be in a world where online reviews are the strongest signal of consumer trust and a must-have metric for all companies?**

We can use some grammatical algebra to rewrite the hypothesis as the following: **What if a company's TrustPilot rating became as crucial as its Moody's or S&P Credit Rating?**

Let's assume that comes true. In that world, what would TRST be worth? S&P and Moody's are worth ~$70-$76B in market cap. Surely TRST would fall somewhere along those lines. Let' say there's a 5% chance TRST becomes as valuable as those rating agencies. That's still an implied market capitalization of $3.6B, nearly twice TRST's current market cap.

Concluding Thoughts

TRST is a founder-led company with a massive addressable market growing top-line revenue at 30%+ annually while generating 80%+ gross margins.

The company's core review platform benefits from massive network effects as more consumers and businesses engage in the platform, increasing its value over time.

There might even come a time when a company's TRST Rating matters as much (or more) than its credit rating. If that's true, the current enterprise value is massively mispriced.