Saturday, November 06, 2021

An Equity Note

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Companies Mentioned

- ➢ Cardlytics Inc (CDLX)
- ➢ Redfin, Inc. (RDFN)
- ➢ Nintendo (NTDOY)
- ➢ XP, Inc. (XP)

Trades Mentioned

- ➢ Adding to CDLX long position
- ➢ Waiting for weekly bull reversal bar in XP
- ➢ Adding to RDFN long position on wedge breakout

MO Portfolio Q3 Earnings Blitz: Cardlytics (CDLX), Redfin (RDFN), and Nintendo (NTDOY) & XP, Inc. Update

Whew … what a wild earnings week for our portfolio. Most of our current holdings reported earnings this week, and there's *a lot* to digest.

This weekend we're focusing on CDLX, RDFN, and NTDOY. We'll also touch on former portfolio member XP's latest earnings as the company continues to execute flawlessly.

Finally, we'll discuss a few trades in the works for next week, as well as some new stocks on my research radar.

Let's get after it.

Cardlytics (CDLX): Firing On All Cylinders

CDLX reported earnings on Tuesday (11/02) and crushed it. Here are some topline financial highlights:

- ➢ Revenue increased 41% YoY to $65.0M
- ➢ Billings increased 59% YoY to $98.4M
- ➢ Gross Profit rose 68% YoY to $24.5M
- ➢ Net loss to shareholders was -$44.5M compared to -$15.4M

Now to the business KPI metrics:

- ➢ Monthly Active Users (MAUs) increased 6% to 170.6M
- ➢ Average Revenue Per User (ARPU) increased 24% to $0.36
- ➢ Bridg (latest acquisition) generated $12.7M in ARR

And if you haven't read the earnings deck, check it out here. You can also read our original write-up here.

Along with the attractive top-line growth metrics, CDLX also executed its plan to roll out its new digital ad platform. This new platform features product-level offers, updated imagery (can show product photos, etc.), dynamic pricing, *and* self-service.

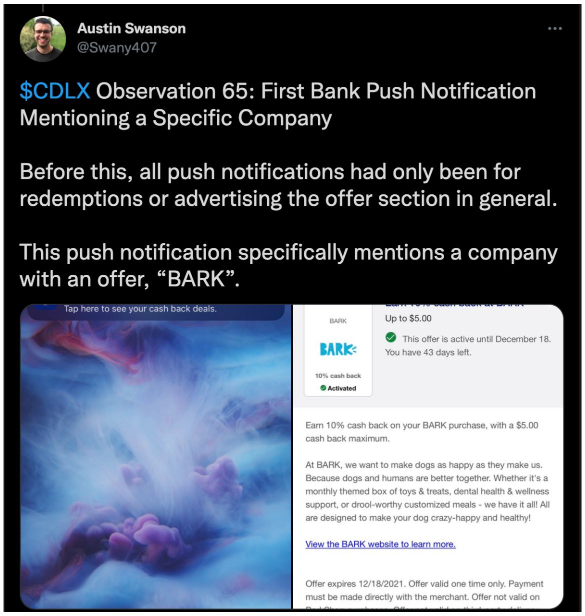
Here's the exciting part. CDLX has already migrated 99% of its current campaigns to the new platform.

CDLX's digital platform sets the stage for rapid adoption of the company's new advertisement portal: *Ad Manager*.

CDLX's New Ad Manager: Some Growing Pains Ahead

Ad Manager allows clients to offer product-level deals and advanced imagery within native banking channels. US Bank, one of CDLX's leading banks, is the first to adopt the new ad portal.

Austin Swanson (follow him on Twitter here) posted an example of US Bank using the new ad platform (see right).



Now, US Bank can push company-specific offers to consumers' phones instead of a generic "you have a new offer" message.

The company aims to have >50% of its MAUs connected to the new ad portal by the end of 2022.

Migrating its MAUs to the new ad portal will take time due to increased complexity.

First, CDLX's new platform allows updated imagery which increases the available options for advertising clients.

Second, the Ad Manager will support a self-service platform. This allows businesses *and* ad agencies to create campaigns without hand-holding from CDLX.

Of course, fewer hand-holding means CDLX and its bank partners (FIs) must create strict (yet comprehensive) rules of play for advertiser campaigns.

The Massive Potential in Self-Service Advertising

CDLX's self-serve advertising portal is exciting. The company can generate high sales margins because they remove the hand-holding onboarding process.

In turn, CDLX can capture the long-tail of advertising spend like the local mom-and-pop or neighborhood restaurants and retail outlets.

Self-service also allows CDLX to work with ad agencies in a much greater capacity. In fact, the company noted that they're working with ad agencies *for the first time* this quarter. Here are co-founder/CEO Lynne Laube's comments (emphasis mine):

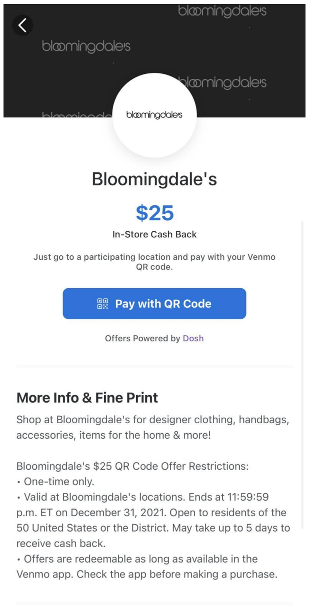
*“So I want to be clear with investors that **we are working with agencies basically for the first time ever.** We started building an agency sales team for the most part this year. While we've had the occasional agency client, in the past, it was only when the advertiser that we went directly to referred us to that agency. **So we're now directly calling on agencies for the first time ever.** And I think some of those stats that I gave sort of show and prove the momentum.”*

So far, the results from ad agencies are solid. Advertising spend from agency accounts grew >150% during the third quarter of 2021 compared to the third quarter of 2020. Ad agency spending still represents <10% of the platform’s total advertising spending despite the growth.

New Acquisitions Working Well

Finally, let’s touch on CDLX’s newest acquisitions: Dosh and Bridg.

Dosh’s integration is off to a great start. Austin Swanson highlighted a recent Dosh offer within his Venmo account (see right).



Let’s shift to Bridg. Bridg won contracts with a large home improvement retailer (HD or LOW possibly) and several well-known restaurant brands.

Additionally, Bridg saw one restaurant client increase spending by 400% during the quarter. From reading various Tegus calls during the quarter, my bet is that it’s Panera.

Trade Alert: Add To Position Next Week

CDLX traded wildly ex-earnings but made a clear advance above its 200MA on Thursday. YTD, the stock is down ~40% and commands a $3B market cap.

We will add to our existing position on Monday to get CDLX back around ~6-8% notional exposure.

We’ll continue to increase exposure as the company executes and moves into a confirmed uptrend on longer-term time frames (weekly, etc.).

Redfin (RDFN): Grinding Away & Taking Share

RDFN reported earnings Thursday (11/04) with solid results. Here are some highlights:

- Revenue increased 128% YoY to $540M
- Gross profit increased 37% YoY to $127M
- Net loss was $19M compared to a loss of $34.2M last year

- RedfinNow grew revenues by >1,000% while selling homes above its forecasted price
- Saved brokerage customers more than $80 million in fees

RDFN's earnings come on the heels of Zillow's announcement to end its iBuying business. This was *big* news that sent shockwaves through the remaining players like RDFN and OpenDoor (OPEN).

Yet as we discussed in our original write-up (read here), iBuying isn't the main reason we're bullish on RDFN. Our bull thesis for RDFN hinges on the company's ability to create the best incentives for the 130K+ independent real estate agents.

You can read our *Variant Perception* below:

> ***Our Variant Perception:*** *If real estate commissions go to zero, agents will join a brokerage that offers security, inbound deal flow, and transaction bonuses tied to deal closures (not home prices). RDFN is the only company that's built a business model around a salaried agent.*
>
> *More agents on the RDFN payroll means more homes viewed, sold, and bought through the RDFN platform.*
>
> *In addition, more homes on its platform allow RDFN to cross-sell other services like mortgages, title insurance, and iBuying. In turn, RDFN takes the entire home buying/selling process and creates a seamless, online-first experience for its customers at the lowest cost possible.*

But let's quickly address RDFN's iBuying strategy.

CEO Glenn Kelman isn't a "move fast and break things" operator. He's methodical and calculating. For example, here's Glenn on a podcast describing the painstaking process of opening new RDFN markets (emphasis mine):

> *"We had to get the website perfect, just right.* ***We weren't launching in that area until we made it perfect."***

That's why it came as no surprise to hear Kelmann's thoughts on iBuying in the earnings call (emphasis mine):

> *"The answer is that* ***Redfin isn't an iBuying company at all.*** *It's part of what we do, but it's not who we are. The way we define ourselves is as the company that* ***offers homeowners the most complete set of options for selling one home and moving to another****, where iBuying is one of those options."*

Kelman further reiterated the importance of RDFN's patient, methodical approach to iBuying, saying (emphasis added);

> *"iBuyers that live or die on whether a homeowner chooses just one option, the cash offer, can thrive only when market conditions favor iBuying.* ***Redfin can be more flexible.*** *When home prices are uncertain or when it becomes costly to borrow the money for buying houses, Redfin can buy fewer houses and list more.* ***That flexibility is more important than scale.****"*

We love Kelmann's approach to iBuying. It gives us confidence that he'll crack the code and create the one-stop shop for the next generation of home buyers.

This hypothesis shouldn't take long to test, either. Kelman noted that the largest group of millennials will turn 33 -- peak home-buying age over the next few years.

How will this group buy homes? What platform will they use? Our bet is RDFN.

One thing missing from the earnings call, however, was an insight into agent churn. Our *big bet* with RDFN is that it will become the de-facto employer for the 130K+ independent real estate agents out there.

High agent churn could strike holes into that thesis, which would cause us to re-evaluate the opportunity and position size.

Q4 2021 Guidance: Sustained Growth

Turning to Q4 guidance, RDFN sees:

- Total revenue between $585M-$606M, representing a YoY increase between 139% and 148% compared to Q4 2020
- Total net loss between $36M-$31M, compared to total net income of $14M in the Q4 2020

Currently, the company stands at a ~$6B enterprise value. This implies a ~2.5x EV/Sales multiple on 2022 estimates for a company growing top-line revenue at a ~50% CAGR.

Here's how we're thinking about position sizing.

Trade Alert: Wait For Confirmed Uptrend Breakout

RDFN is in the tail end of a 9-month bull wedge. While we like our current notional exposure (~6%), we'll look to add on a weekly confirmed breakout from the wedge.

This wedge breakout would also give newer *Collective* members a chance to enter their first positions and other members that haven't added in size.

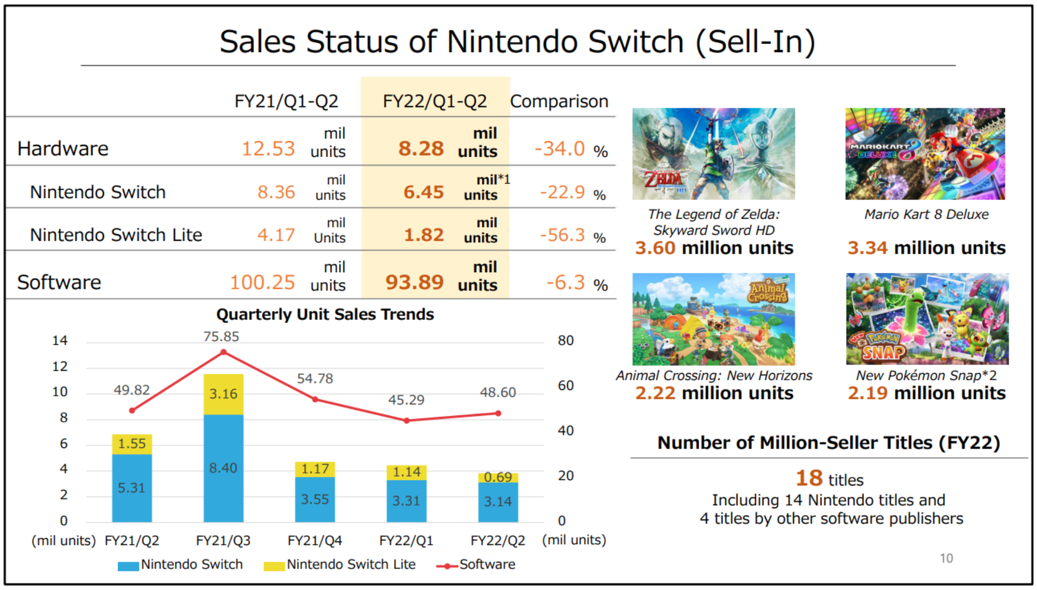
Nintendo (NTDOY): Have We Reached Peak Pessimism?

Nintendo (NTDOY) reported 1H 2022 earnings Thursday with mixed results. Here are some highlights:

- ➢ Net sales declined 19% to 624B yen
- ➢ Gross Profit improved by 3.3% to 59.7%
- ➢ Operating profit declined 24.5% to 219B yen (35% margin)
- ➢ Net profit declined 19.4% to 172B yen (27.5% margin)

NTDOY wasn't immune to the global semiconductor supply shortage. In fact, the company's president hinted that they might not meet existing Nintendo Switch hardware demand due to the scarcity.

The company even reported a -34% YoY decline in hardware sales from 12.53M units to 8.28M units.



Besides the chip shortage, last year's figures coincided with the release of *Animal Crossing: New Horizons*, which drove significant hardware sales creating a high hurdle.

However, one financial bright spot is the company's gross margin improvement. NTDOY's gross margin improvement confirms part of our original bull thesis (which we wrote here and here): **software and digital sales will comprise a more significant portion of total revenue, thus boosting margins.**

Animal Crossing Hints At Future Potential

Speaking of *Animal Crossing*, NTDOY released its Version 2 update to the delight of *millions* of gamers. You can gauge Twitter sentiment here.

Animal Crossing is an example of NTDOY's shift from hardware to software/digital sales. The latest update comes with an expansion pack users can buy for $25. The add-on lets players own a vacation home while expanding the playable map. New features also include farming.

Now, these updates seem trivial to most investors. But they're *vital* to our bull thesis as NTDOY shifts from hardware cycles to high-margin digital sales.

Most console/PC games come with decades of microtransaction revenues and expansion-pack sales. Not NTDOY. NTDOY is in the *early innings* of this revenue model, with decades of IP to capitalize on.

The Wall Street Journal created an excellent piece about NTDOY and *Animal Crossing,* which you can read here.

NTDOY's Wall of Worry: New Game Releases

Aaron Edelheidt of Mindset Value was one of the loudest NTDOY bulls on the Interwebs. He even discussed his love for NTDOY when I had him on my podcast (listen here).

That love affair ended this month as Aaron sold his remaining NTDOY shares in his fund. You can read his entire Q3 letter here. But let's focus on his NTDOY exit.

Here's Aaron's explanation on why he sold (emphasis mine):

> *"I mention this because Nintendo's valuation is low, yet it fell 18% during the quarter. The stock has 30% of its market cap in cash on its balance sheet and is generating a ton of cash flow, and is quite inexpensive on earnings estimates, and that is without valuing its stake in Niantic or the Pokémon Company. And as I have written in the past there is ton of optionality to Nintendo and their IP.*
>
> *The problem is that this year* ***Nintendo has dramatically underperformed in the one area I thought it would be strongest: new game releases.*** *Frankly, I've been shocked at how mediocre the new game releases have been."*

Our take: **If your bull thesis hinges on new game releases then you're missing the forest from the trees**

NTDOY's long-term (5+ year) thesis isn't about creating/launching new games. It's about monetizing current IP at software-like margins while embedding as many Switch devices into gamers' hands as possible.

The company has (arguably) the second most-valuable IP behind Disney. It is in the early innings of *actually* monetizing that asset. They're opening theme parks and creating movies with star-studded casts.

Mario, Luigi, Yoshi … are *Lindy* creations. Characters that have lasted decades and will continue to last decades.

We have great respect for Aaron and share his sentiment on cannabis stocks. But we disagree here.

NTDOY Trade Alert: Watching For 200WMA Support

With Cathie Wood and Aaron Edelheit out of the picture, will NTDOY stock finally rise? We don't know.

But we can examine past price action history to gauge where price might head. Here's what the chart shows.

NTDOY is at its 200WMA support line for the fourth time in five years. Each of the other three times it tested the 200WMA it has acted as support (see below).

In other words, NTDOY has all the ingredients for a **turnaround** trade:

- Bulls throwing in the towel
- Prominent momentum players (ARKK) exiting their entire position
- Solid, long-term fundamentals
- Bullish chart setup

We're looking for price to hold current support before thinking about getting long. If anything, a bull reversal here allows us to get aggressive with risk management by placing stops below this fourth support level.

XP, Inc. (XP): Watchlist Name Ripe For Reversal?

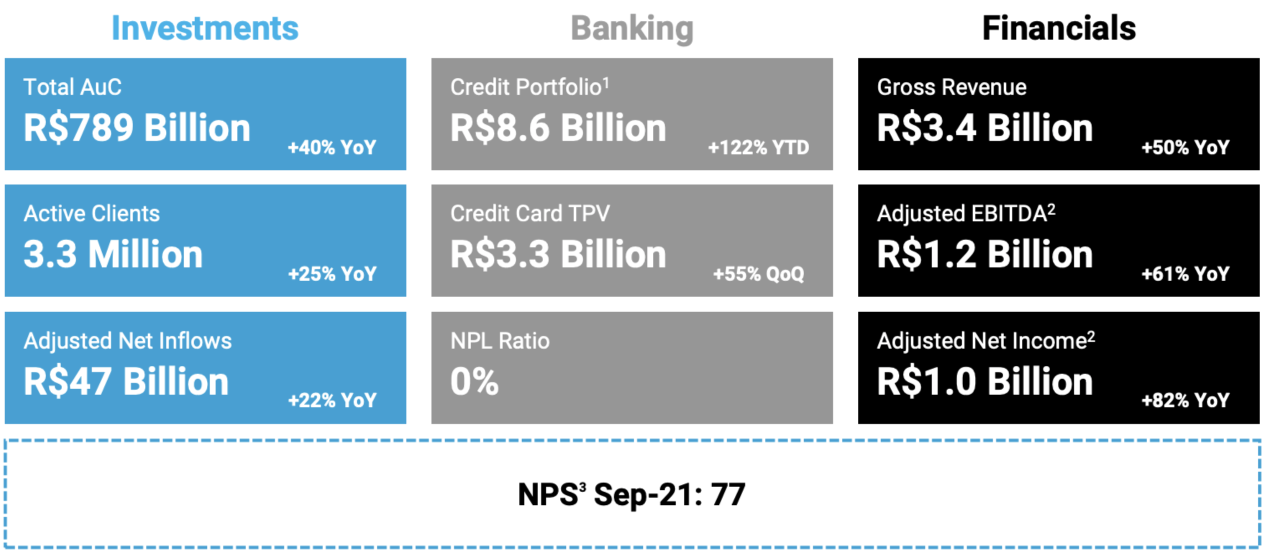
XP is the largest independent broker in Brazil. It operates a technology-driven platform providing financial products and services. They offer 750+ investment products to 3.3M+ clients with R789 B in Assets Under Custody (AUC).

You can read our thoughts on the company here and here.

XP is an excellent example of our risk management protocols. The company's done nothing but crush earnings, take market share and expand margins. Yet its stock price flails below its moving averages on long-term charts.

That said, the company released its Q3 earnings Wednesday (11/03) and continued to execute its business plan.

Check out the highlights from XP's earnings deck:



XP seems to set new revenue and AUC records every quarter. Additionally, the company's 77 NPS rating is one of the highest in the industry.

The company has a *massive* runway for continued revenue and AUC growth. For example, by 2024, non-bank companies will hold ~25% of total investable assets or ~R3.5T. That's 30% CAGR from 2019's R900B. In comparison, non-bank institutions in the US hold ~87% of investable assets.

There are a couple margin-related milestones worth mentioning, too. This quarter XP generated over 70% Gross Margin, the highest in company history. Moreover, if you back out XP's significant investments in technology growth and headcount, the company would've generated over 40% EBITDA margins, another company record.

It's hard to overstate the size of XP's addressable market. Take its core retail business, where management sees total AUC growing 4x from its current levels by 2024. The opportunity for rapid revenue acceleration is there.

XP's Insurance Business: Aggressively Taking Share

XP's Insurance business is also taking share in a massive market. The company started its insurance operations two years ago (2019) and has quickly scaled to 2.5% of all AUC ($5B). This pales in comparison to the BRL 1T addressable market in front of it.

Recent data looks suitable for XP as the company's insurance segment took 50% of *all net inflows* into the BRL 1T market.

XP Trade Alert: Confirmed Weekly Reversal Bull Bar

XP remains in a downtrend on the weekly time frame, and we're patiently waiting for a re-entry signal.

We think price action is offering such an opportunity over the next couple of weeks. XP should put in a solid weekly bar this week, setting us up for an ideal entry on new highs next week. This comes after nearly 8 consecutive weekly bear bars. You can check out the chart below.

Other News & Notes: New Research Ideas

We have plenty of new ideas in the pipeline that could make the list of worthy write-up candidates. Some ideas include **Basic-Fit (BFIT), iRobot (IRBT), Kholsa Ventures (Nextdoor),** and **Angelalign Technologies (6699.HK)**.