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An Equity Note

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What's Inside:

- ➢ Updated our thoughts on AUTO and DSRT
- ➢ DSRT released 2H 2021 Operational Results
- ➢ Tegus released the first AUTO expert call
- ➢ We update our MOCRO models to reflect higher confidence in AUTO's competitive advantages

Companies Mentioned:

- ➢ Desert Control (DSRT)
- ➢ Coca-Cola (KO)
- ➢ AutoStore Holdings (AUTO)
- ➢ Ocado (OCADO)
- ➢ Auttobotics
- ➢ Fabric

MO Equity Note: Updated Thoughts on AutoStore (AUTO) & Desert Control (DSRT)

Merry Belated Christmas from MO HQ to all our Collective family members!

We hope you had a wonderful holiday with family and friends. We're excited for the end of 2021 and ready to attack 2022.

We dive into our latest Norwegian ideas (AutoStore & Desert Control) this weekend with updated news and commentary. We'll examine DSRT's latest H2 2021 operational update and AUTO's most recent Tegus call.

Finally, we'll update you on other news and notes surrounding portfolio and watchlist companies.

Let's get after it.

Desert Control (DSRT): Second-Half Confirms Operational Success

DSRT uses its patented liquid-nano-clay (LNC) technology to turn deserts into gardens. Doing so reduces desertification, reduces water consumption, and increases forestation.

These are **significant** problems with **massive** price tags. The UN estimates that desertification and deforestation combine for over $490B in annual preventative expense.

Check out our original write-up here for a refresher.

Anyways, the company released its 2H 2021 Operational Update on Monday (12/20), which you can read here. DSRT did *a lot* during the second half. Check out some of the highlights:

- ➢ **Expanded from 10 to 51 employees**
- ➢ **Entered into a strategic partnership in the Middle East**
- ➢ **Expanded operations into the US**
- ➢ **3x increase in LNC production capacity**
- ➢ **Ready for commercialization in the UAE**

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DSRT also completed construction on a new R&D facility in Norway. This facility will centralize all IP research and protect future developments against patent infringement. Additionally, the company will launch its **first US pilot program** with the University of Arizona (UofA) in Q1 2022.

Speaking of DSRT's pilot program with UofA, the company also outlined its US expansion plan for 1H 2022 and beyond. Along with Arizona, DSRT will target California, Nevada, and New Mexico for its initial US commercialization.

Then there's the UAE partnership.

On December 15, DSRT agreed with Mawarid to create a joint venture sales and distribution company. DSRT will own 49% and Mawarid 51%. The percentage split provides the JV with "local entity" advantages. It allows them to sell into governmental agencies, publicly funded projects, and private enterprises.

Besides the local entity benefits, the JV structure allows DSRT to focus on R&D and creating the best possible product. Think of it like Coca-Cola (KO) and its bottling facilities. KO partners with local bottling companies and delegates everything *not* related to making that magic syrup.

It's important to note the size of Mawarid's reach in the MENA region. For example, Mawarid manages more than 200,000 hectares of land, including 13 million forest trees, 550,000 date palms, nature reserves, landscapes, and agricultural land.

DSRT Poised For Commercialization in 2022

The company is still in the development/pilot stage with its first customer cohorts. Still, we should see revenue generation in 2022.

Remember, the company should generate operating losses until ~2023 as it leverages its fixed-cost investment in R&D and firm expansion. However, by 2023, DSRT expects rapid scalability, with EBITDA margins increasing from 17% to 31% by 2025.

According to TIKR, DSRT expects to increase revenues by 220% CAGR from $12M in 2022 to $90M by 2025 (see below).

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Actuals & Forward Estimates	12/31/21 E	12/31/22 E	12/31/23 E	12/31/24 E	12/31/25 E	CAGR
Revenue	0.84	11.92	34.96	59.74	88.92	220.4%
% Change YoY		*1,316.2%*	*193.4%*	*70.9%*	*48.8%*	
EBITDA	(2.56)	(2.05)	5.89	17.39	27.86	
% Change YoY		*20.0%*	*387.5%*	*195.3%*	*60.2%*	
% EBITDA Margins	*(304.6%)*	*(17.2%)*	*16.9%*	*29.1%*	*31.3%*	
EBIT	(2.75)	(4.33)	1.10	11.13	20.09	
% Change YoY		*57.4%*	*125.4%*	*915.1%*	*80.5%*	
% EBIT Margins	*(326.7%)*	*(36.3%)*	*3.1%*	*18.6%*	*22.6%*	
EBT Normalized			0.33	10.32	19.32	
% Change YoY				*3,000.0%*	*87.1%*	
% EBT Margins			*1.0%*	*17.3%*	*21.7%*	

We bought our original stake at a ~$155M market cap or ~1.7x 2025E revenues. Suppose DSRT produces results remotely close to the above estimates. In that case, the value of our shares will likely rise by orders of magnitude.

Add to that a potential uplisting and widespread adoption from all ESG-related mutual funds and ETFs, and you've got a recipe for rapid share price acceleration.

At this point, all we care about is revenue growth. Revenue signals customer adoption, which the company needs before thinking about scaling and profitability. We'll update you on any progress as it happens.

Alright, let's check out the *other* Norwegian company we love … AutoStore.

AutoStore Holdings (AUTO): Tegus Call Confirms Market Dominance

AUTO is an Automated Storage and Retrieval System (ASRS). It uses patented robotic technology to provide 24/7 order fulfillment capabilities at a fraction of the storage space. The company has led the cube storage movement since 1996. They've installed over 750 AUTO storage units globally for Puma, Gucci, DHL, and Siemens.

You can check out our original write-up on the company here.

Now to the news. First, the company lost its lawsuit against Ocado.

After talking with a hedge fund friend (and former OCADO bull turned bearish/agnostic), the result doesn't materially impact any business in either direction.

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Sure, the win would've given AUTO near-complete market control. But AUTO remains the clear leader with the most substantial installed base in the industry.

However, AUTO's stock plummeted on the news. Shares are down 35% from their IPO highs and are below the IPO price.

Despite the abrupt share price collapse, the company trades at a commanding 25x NTM EV/Sales and ~52x NTM EV/EBITDA. Too rich for our blood, given the current market environment.

That said, **we'll always favor a falling share price amidst solid (and/or improving) business fundamentals.**

Today we'll examine AUTO's first-ever Tegus call from the Vice President of Global E-Commerce at DHL. We'll then update our valuation and estimates of future returns in our MOCRO model, given today's lower share prices and failure to win the OCADO trial.

What DHL's E-Commerce Business Reveals About AUTO & Broader Industry

Here's the TL;DR version of the DHL Tegus call:

- **Logistics partners (like DHL) have specific criteria for choosing warehouse automation providers.**
- **There are a lot of companies entering the space, most of them venture-funded.**
- **Currently, there's a duopoly between Ocado and AUTO.**
- **AUTO is the clear leader with multiple barriers to entry against the competition.**

Let's unpack each of these findings.

First, the VP of E-Commerce at DHL uses a four-part framework for evaluating companies like AUTO. Here's the framework:

1. Proven use case of what they're trying to achieve that they have already implemented with a similar business
2. Credibility and reliability of the company. They'll ask for references and feedback from current users surrounding reliability.
3. Technology around the hardware and software. Questions like "how easy is it to integrate this into my existing Warehouse Management System (WMS) or my ERP?
4. Data protection and cybersecurity questions around on-prem vs. off-prem storage, etc.

Scalability is also critical. DHL's VP of E-Commerce noted that (emphasis mine):

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> *"The following element is the reach of the company. So that's actually the big one when we talk about like strategic partners because what we see is* ***many companies are actually developing solutions in one market, but they don't really have the ability to scale.***
>
> *And that for us is a problem.*
>
> *There are a couple of companies today.* ***There are very few companies really that have global scale.*** *Even if everybody is talking about global scale, the truth is* ***very few companies have the ability to roll out into new markets.****"*

If the above frameworks resemble the framing of a house, then scalability is the concrete foundation underneath. Here's what I mean.

It's nice to have the latest technology, the strongest financial backers, and solid references. But if you can't scale with your customers (especially massive customers like DHL), what's the point in using your product?

Scalability is where AUTO shines. In fact, the only two companies that can scale with global customers are Ocado and AUTO. But here's another deciding factor. AUTO was built for any type of business. Ocado, on the other hand, specializes in grocery stores.

Here's the Tegus expert's take on this (emphasis mine):

> *"And the main difference between, I think, Ocado and AutoStore are that* ***Ocado has been developed primarily for grocery concept*** *when AutoStore has been developed for all the other categories of product.*
>
> *And why it matters, it matters because* ***bin size and logics behind on the software side and so on will be different for groceries****, which are a very small number of SKUs, high velocity compared to maybe a* ***consumer electronics company that will have a lot more location and will require a lot more storage being to be deployed because they just have a lot more SKUs to be served.****"*

Said differently, AUTO doesn't compete with Ocado because Ocado has a narrow target customer. That leaves most companies (like DHL) with one choice, AUTO. Here's what DHL says about their choice to use AUTO (emphasis mine):

> *"So AutoStore is I think in my assessment and what we've seen in the market is they are the most advanced.* ***They are the most global, and they are the ones that have truly right now, proven technology,*** *at least to my sense …*
>
> *I think right now,* ***I think AutoStore is by far the best solution.*** *It's also the one that have the most experience space to be also fully transparent."*

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What About The Competition?

Ocado aside, small competitors like Auttobotics and Fabric jockey for market share. However, these competitors lack the scale, R&D capabilities, and customer references that AUTO enjoys.

Yet these competitors *do* have customers. The reason? Flexible financing. Currently, AUTO negotiates contracts with large upfront payments, frequently in the tens-to-hundreds of millions of dollars. Competitors like Auttobotics come in and say, "hey, we'll build this for you for $X and you can pay us over time for the installation."

While that model *sounds* appealing, I wonder how much of that model is financed by venture-capital funds willing to accept significant upfront losses and negative EBITDA margins.

DHL's Plans For Widespread AUTO Adoption

One interesting note from the call is DHL's automation penetrate rate across its warehouse systems. The expert noted that ~4-5% of DHL's warehouses use automation systems like AUTO.

Over the next decade, however, DHL expects to have ~30% of its warehouses fully automated with AUTO's robots and software. That's a 6x increase and confirms AUTO's thesis that we're in the early innings of automation adoption.

Updating AUTO's MOCRO Model

There are a few things we can update in our AUTO MOCRO model. First, the company's share price. **The stock is below its IPO price and now offers a potential 37% 10YR IRR without changing our critical fundamental drivers.**

Second, we're updating our bear case to reflect a better company than what we anticipated over the next decade. There is little competition in this space, and its most significant competitor (Ocado) isn't designed for widespread industry acceptance.

Hypothetical 10YR IRRs	
Invest Date	2021
Exit Date	2031
Hold Period (y)	10
Year 10 Share Price	
Base Case	$15.80
Bear Case	$3.73
Bull Case	$30.83
10 Year IRR	
Base Case	36.47%
Bear Case	0.96%
Bull Case	80.67%
Blended IRR	39.37%

To do that, we're increasing our revenue CAGR and gross margin percentage a few points to reach 26% average revenue growth and 67% average gross margin.

We've also updated our EBIT margin to reflect AUTO's sustaining scaled network effects and R&D advantages.

Then we updated our bull scenario EBIT margins to reach ~45% run-rate, which matches management's expectations.

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These changes result in a ~39% potential 10YR IRR at the current stock price. 12% of that IRR increase came from the stock price change, 2% from updated quantitative assumptions.

Other News & Notes: Call w/ RSKD & New Ideas

Riskified's stock has collapsed 70% from its IPO price. The company now has ~40% of its market cap in cash while adding more customers than any other point in its history.

There are a few significant risks with the RSKD bull thesis, most notably the impact of PSD2 regulations in Europe. Any transaction over EUR 30 requires Two-Factor Authentication (2FA). RSKD *says* they've expected this, but we want to know how much damage PSD2 will cause to its long-term revenue capabilities in Europe.

So, we've scheduled a call with management for Monday, December 27th. We'll take notes from the call and report them in next weekend's Equity Note.

Finally, I recently hosted a Twitter Spaces (12/23) on "The Best SPAC Ideas of 2022 & Beyond." The recording of that Spaces will be released as a podcast tomorrow (12/27). One Twitter user, Andrew Cosgrove, pitched a Canadian steel company Algoma Steel Group (ASTL).

I haven't dug into the fundamentals yet, but I know one thing. ASTL will generate ~$450M in adjusted EBITDA this quarter. **Its market cap is only $1B.** We'll send out a write-up once we've done the work.

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