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An Equity Note

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- Portfolio Trade Updates
- Market Crash Shopping List (Part 2)

Companies Mentioned:

- Five Below (FIVE)
- MeridianLink (MLNK)
- Revolve, Inc. (RVLV)
- Restoration Hardware (RH)

MO Equity Note: Portfolio Updates & Market Crash Shopping List (Part 2)

Another ho-hum week in markets, right? This is what happens when Alex travels outside the state of Texas (don't worry, we're working on the Alex Traveling Inverse ETF).

I can't remember the last time I saw such crazy price action in individual stocks (maybe March 2020?). Like Carvana (CVNA), large-cap companies are trading like penny stocks. Meanwhile, the broader indices print 4-5% price swings like it's nothing.

These are exciting markets. However, our risk management protocol shines in these market conditions.

Our portfolio is sitting on its most significant cash position in three years. This week, we put some of that capital to work -- tactically and carefully. Let's review our closed trades for the week.

- **Sold April $70 Puts on Square (SQ) for a 2% notional position if assigned.**
- **Took partial profits in GME, ARKK, and BTCUSD shorts.**
- **Sold Paladin (PDN.ASX) when it closed below our risk point in Australia's market overnight.**
- **Added a 25bps long to our core Corn Position.**
- **Added a second-leg long in ARLP on a midline lookback breakout.**
- **Shorted & covered UVXY FOMC trade for a slight loss.**
- **Added another 25bps risk to BFIT long with FBO tactical trade.**
- **Sold 50% of our Long Soybean position at a 3.4R profit target.**

Now, onto this weekend's Shopping List!

Market Crash Shopping List (Part 2)

We've got five more ideas to add to our Market Crash Shopping List. Check them out below with brief descriptions of the opportunity, why it exists, and why we're excited about the set-up.

Five Below (FIVE)

Five Below (FIVE) is a leading high-growth value retailer offering trend-right, high-quality products loved by tweens, teens, and beyond. FIVE is an easy-to-understand business.

The company builds 9,000 square foot stores across America that generate over 100% ROICs within a year of construction. Through FIVE's "Eight Worlds" concept, teens and tweens enjoy the diverse treasure-hunt shopping experience via FIVE's "Eight Worlds" concept. These Eight Worlds include: Play, Tech, Create, Party, Candy, Style, Room, New & Now.

There are three main themes woven throughout FIVE's Eight Worlds concept. These themes are:

- Craze Trends: Fidget spinners, selfie-sticks, and slime
- Licensed Trends & Brands: Disney, LEGO, and Star Wars products
- On-Trend Stuff (Relevancy): Basketballs, gaming headsets, and mugs

FIVE's store layout catalyzes a "land and expand" shopping behavior from its customers. For example, a kid might initially want a basketball or a new phone charger. Yet upon entering, she finds her favorite candy and a new makeup bundle she saw on TikTok. Initially, a $5 order quickly turns to $20 or more.

We can extrapolate the land-and-expand idea into where FIVE decides to build its stores. FIVE strategically builds its stores in high-traffic centers. I know. You're thinking to yourself, "Obviously, Brandon. Why would a store not build in a high traffic area?" The point goes deeper than that, though. FIVE targets teens and tweens. This demographic relies on its parents for transportation (as they don't yet have their driver's license).

Genius Location Strategy

FIVE understands this and places their stores next to mom and dad's favorite shopping destinations like Dick's, Wegman's, Costco, or Target. The company's data also confirms this land-and-expand idea.

For example, 48% of FIVE's customers visit their stores after another stop in the shopping center. In other words, Mom takes her kids with her to shop for groceries. The kids beg Mom to take them to FIVE when she's done her shopping. Finally, the kids leave with a couple babushkas for $20 and change.

What About Competitors?

There are many competitors in this space like Spencer's and Hot Topic. So why is FIVE so successful? FIVE is safer for kids and, thus, easier for parents. Hot Topic and Spencer's sell more "adult" products in their stores alongside the tweens trinkets.

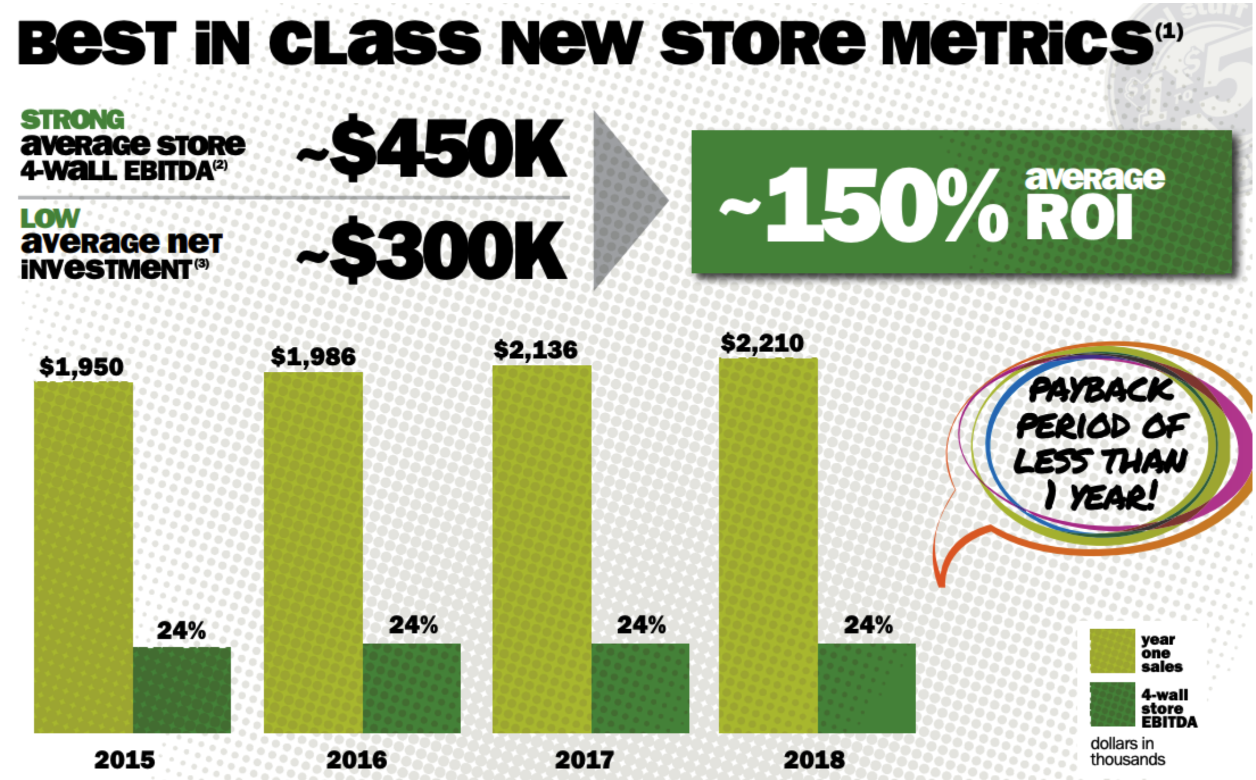
FIVE doesn't offer anything materially suggestive. Instead, it focuses on trends that matter to teens and tweens. Additionally, the company doesn't need to provide the highest-quality merchandise. Parents know their kids will break things. Breaking a $5 item feels better than a $30 item.

World-Class Unit Economics

The most attractive aspect of a FIVE investment is the company's per-store ROICs, which are incredible. Each FIVE store requires ~$300K in initial investment. This includes store build-out, inventory, and cash pre-opening expenses (like marketing, labor, and utilities).

Here's the crazy part.

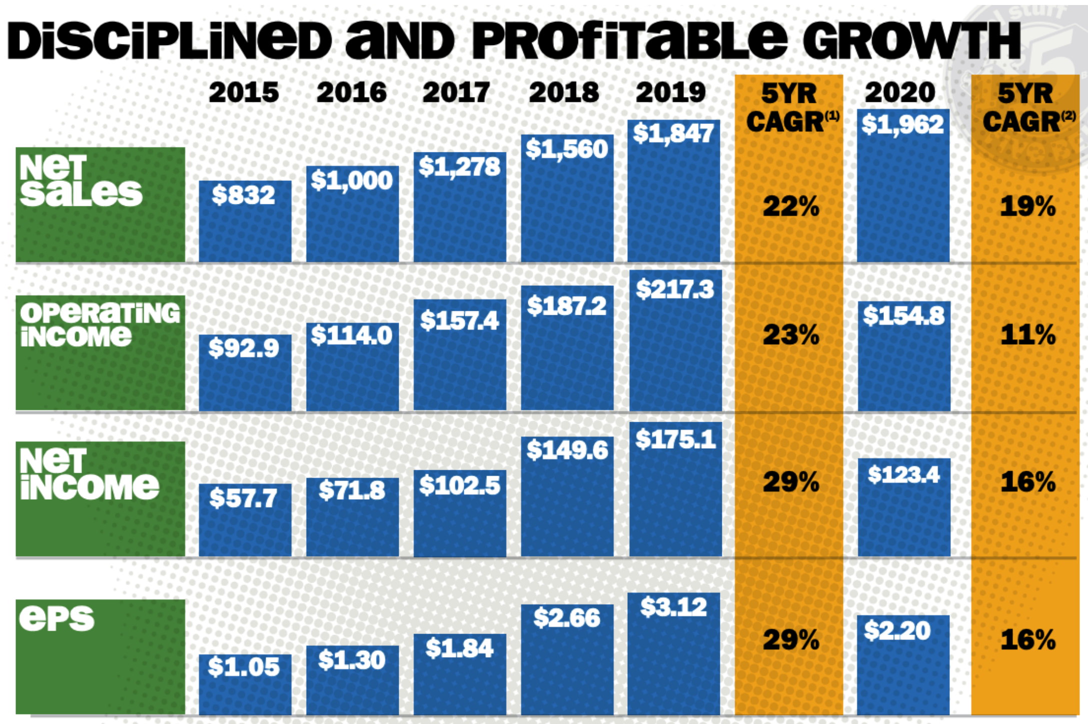
Each new FIVE store generates ~$450K in 4-wall EBITDA within the first year of opening. That's a 150% average ROI within a <1 year payback period. It's hard to overemphasize how profitable a unit economic model like that is for a business and its shareholders.



In fact, we can think of FIVE like a broken vending machine. You put $1 in the FIVE vending machine, which spits out $1.50. The strategy at that point is clear: funnel as many dollars through the vending machine as possible while it's "broken."

That's precisely what FIVE's management has done. The company reinvests its earnings into new store openings. It's another reason management doesn't pay dividends or issue significant buybacks. The returns are too good in its existing investments to do anything else.

FIVE's financials also confirm the company's reinvestment strategy. The company's grown sales, operating income, and EPS by 22%, 23%, and 29% on a 5YR CAGR basis, respectively.



FIVE has a fortress balance sheet to internally fund its store growth. The company sits on $400M+ in cash with no long-term debt (excluding store leases).

Additionally, FIVE has another $225M in an available line of credit should it need it. Of course, the above numbers reflect the company's past success. How can FIVE replicate the prior five years?

How FIVE Grows From Here

There are four main growth levers the company can pull over the next decade:

- **Grow store base**
- **Reinvest in "Wow" Merchandise**
- **Increase Brand Awareness**
- **Scale Systems & Infrastructure**

FIVE estimates that they can grow to 2,500+ stores throughout the United States. If that's true, the company is currently halfway to that goal. Going forward, FIVE plans to aggressively expand in states like CA, TX, FL, NY, and PA.

More stores in FIVE's network mean a wider assortment of cheaper products for its customers. The company networks with 800+ global vendors that provide FIVE with the latest products hand-picked by FIVE's internal "Trend-Driven Merchandise Team." Scale matters in FIVE's business. The more stores it has, the more product it can buy from its vendors. The more product it buys from its vendors, the lower per-unit cost it can negotiate.

Third, FIVE has years of coiled revenue growth in its younger stores (<2-3 years after opening). Stores open for less than two years sport a 32% brand awareness. Stores open within the last 2-3 years aren't much better at 44% brand awareness. In other words, these low brand stores (180+) have years of more robust revenue growth ahead as they normalize to FIVE's mature store, 62% brand awareness.

Finally, FIVE is experimenting with a "Five Beyond" section within its stores. As the name suggests, "Five Beyond" sells specific items for more than $5 (often $30 or higher). Adding these items increases the store's per-basket average price. It allows the store to generate higher incremental revenues per square foot.

Thinking About Valuation

Despite falling 34% from its all-time highs, FIVE isn't screaming cheap (3x NTM sales and 20x NTM EBITDA). But think about it this way. The last time FIVE traded below 20x NTM EBITDA was May 2018! The company historically trades at a premium to the market (around 25-28x EBITDA) on a normalized basis.

We can do FIVE's valuation on the back of a napkin. The company plans to reach 2,500+ stores on a run-rate basis. As of 2018, new stores generated ~$2.2M in year one revenues with 24% EBITDA margins (~$530K).

FIVE is almost halfway to its run-rate store count, with 1,310 stores left to build. We can use our revenue and EBITDA figures to estimate the incremental sales and EBITDA from FIVE's additional 1,300 stores (see below).

- Number of stores left to build: 1,300
- Average Sales Per Store (Year 1): $2.2M
- Average EBITDA Per Store (Year 1): $530K

That gets us $2.86B in incremental revenue and $686M in EBITDA to reach 2,500 stores. Remember that doesn't include the company's existing stores revenue and EBITDA. Currently, the company trades at a $9.7B Enterprise Value or 12x 2025E EBITDA.

Over time, the company will reach 2,500 stores, generating higher average EBITDA margins as it matures and increases brand awareness.

Let's check the technicals.

FIVE's Technicals

Our game plan is to wait for FIVE to find its 200MA (around $140/share) before putting in a strong reversal bar on the weekly chart. We don't need to add risk to our book, and we're happy waiting on the sidelines for our price.

MeridianLink (MLNK)

MLNK provides cloud-based software solutions for banks, credit unions, mortgage lenders, specialty lending providers, and consumer reporting agencies in the United States. It's software solutions enable financial institutions to streamline loan decisioning, account opening, deposit taking, loan origination, and customer collection workflows to help drive higher client retention.

MLNK helps banks and credit unions do their job better in layman's terms. The company serves 1,900+ banks and credit unions (63 of the leading 100 credit unions and ~60% of the Forbes' 2021 Best Credit Unions and Banks).

The company sells a sticky solution for customers that rarely change backend service providers. As such, MLNK has experienced 40%+ QoQ revenue growth, 88% recurring revenues, and 48% EBITDA margins.

Consumer lending experienced a step-function increase in adoption rates due to COVID-19. MLNK's growth rates should stay elevated as legacy banks and credit unions adopt a digital-first approach to their business. Another catalyst for MLNK's future growth is the significant opportunity across consumer lending wallets. For example, MLNK has identified five key markets it believes it can win (shown below):

- Loan Origination: $5.8B
- Account Opening & Point of Sale: $2.4B
- Portfolio & Lending Performance: $1.0B
- Collections: $0.6B
- Data Access: $0.3B

That's a $10B TAM up for grabs, of which MLNK has captured only ~2.5% market share.

MLNK helps banks achieve four key growth drivers:

- **Increase Revenues:** MLNK enabled Pathways Credit Union to double revenues and increase underwriting volume by 20%.
- **Improve Efficiency:** Kohler Credit Union used MLNK to shorten its account opening-to-funded loan process. Kohler went from 1 day to 22 minutes.
- **Reduce Costs**: MLNK reduces the amount of manual work needed from bank employees.
- **Reduce Risk**: Through automation and AI, MLNK can capture and report regulatory requirements faster (and more efficiently) than the manual alternative. Additionally, the company's software can enable hard stops during loan processes to prevent potential threats and fraud.

How MLNK Makes Money

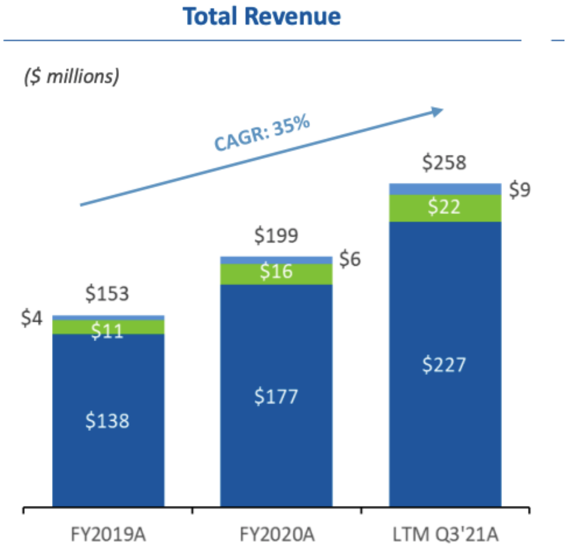
The company generates nearly all of its revenue from Subscription Fees, which MLNK charges on a per-application or per-closed-loan basis. Customers usually sign three-year, non-cancellable contracts.

You read that right.

Customers cannot cancel without paying a penalty fee to MLNK. On the non-mortgage loan side (think auto, personal, and credit cards), MLNK charges on a per-application basis. Customers pay these charges regardless of the final decision on the application (denied or accepted).

Let's break down MLNK's revenue further. 66% of the company's revenue comes from Lending Solutions (think consumer, mortgage, auto, etc.).

The remaining 34% of revenue comes from Data Verification Solutions. MLNK's Lending Solutions has grown at a 26% CAGR since 2019, expanding from $113M to $170M as of Q3 2021. The company's Data Verification Solutions has also experienced strong growth, with sales increasing from $39.4M in 2019 to $87.5M as of Q3 2021 (~40% CAGR).



So why now? MLNK sits at the inflection point of a significant increase in IT spending by legacy banking institutions. In 2019, Financial Services companies spent ~$10B on SaaS products/tools to improve operations.

By 2024, that spending figure will jump to $19B. There are a couple of drivers for this increased spending.

First, the company noted that 85% of global banks surveyed in 2018 said "digital transformation" will become a key business priority in the coming years.

Second (and in that same survey), 60% of global banks said they would increase their investment in cloud technology.

These are long-term tailwinds that enable MLNK to maintain its 25%+ revenue CAGR.

MLNK Valuation: 5% FCF Yield For A Highly Sticky, Highly Profitable Business

The company currently trades at ~21x FCF (4.8% FCF yield) or 16x NTM EBITDA. There is some debt on the balance sheet. MLNK has $428M in first-lien debt against $93M in cash, giving it a ~2.6x Net Debt/EBITDA multiple. There are a few ways equity holders win.

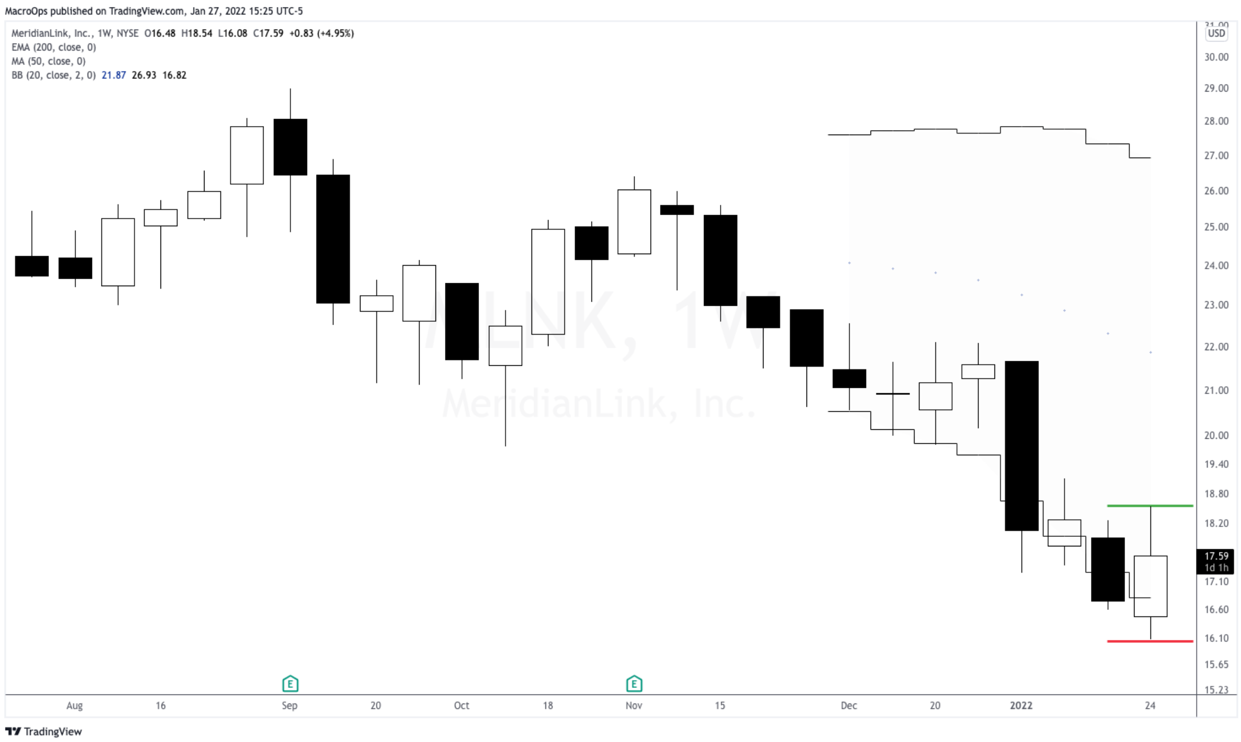
First, MLNK de-leverages the book and reduces its net debt balance. Second, the company has one of the stickiest products in banking infrastructure. MLNK signs three-year non-cancellable contracts with 63%+ of the top credit unions in the US.

Over time, they should capture more revenue per bank logo and a more significant share of new logos, resulting in many years of double-digit revenue growth.

A few years from now, MLNK expects to generate over $90M in FCF for a 5%+ FCF yield. And remember that FCF yield increases as the company reduces its debt burden!

A 5%+ FCF yield for a double-digit revenue grower with a highly sticky backend banking software product doing 40%+ EBIT margins sounds intriguing. It's certainly worth its spot on the Market Crash Shopping List.

Let's turn to the charts (remember, we're focusing on the weekly time frames!).



MLNK printed a bullish reversal bar this week after last week's bar closed below its lower Bollinger Band. To go long, we'd need the price to move above the past week's highs. We'd place our stop a tick below last week's lows if triggered.

Revolve, Inc. (RVLV): The Fast-Fashion Choice For Gen-Z & Millennials

RVLV uses a proprietary algorithm to provide shoppers the hottest and latest fashion trends from thousands of new and emerging brands.

The company solves two problems millennial shoppers face. First, big-box retailers offer too many SKUs, while specialty retailers lack discovery and reach.

RVLV curates over 1,000 new styles per week with limited availability. This increases customer retention and average sale price. RVLV's growing their own brand sales, generating higher gross/profit margins.

They've only tapped 3% of their TAM and command an attractive LTV/CAC model. Finally, they sport a highly cash-generative business model, have a founder-led management team, and no debt.

We first wrote about the company in August 2020, which you can read here. Since then, the stock's risen over 140% but is now 50% from its all-time highs. In fact, the stock currently trades at our original estimate of fair value (~$43/share). So what's to like today?

The RVLV Customer Value Proposition

First, the original thesis remains intact. RVLV provides the best shopping experience for young teens on the internet. The company constantly curates each shopper's experience based on their individual shopping preferences.

If Sally loves buying rompers, RVLV will show her the latest rompers available in the newest colors. Naturally, the curated experience changes as the consumer change shopping habits.

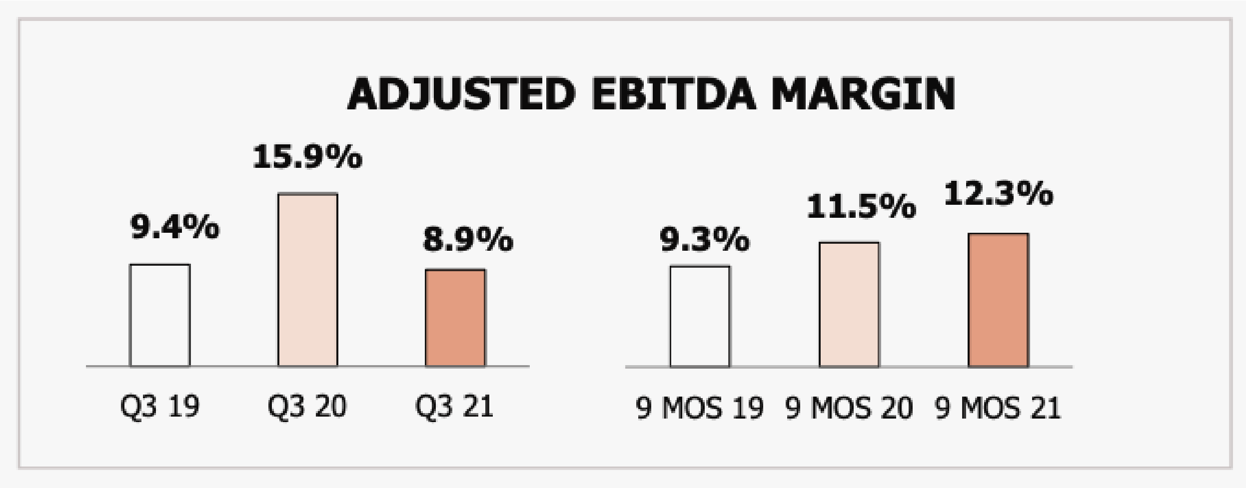
RVLV's personalized curation not only benefits the customer but the company's product team. RVLV can spot trends (or soon-to-be) faster than its competitors because it can see Its customer's purchase order frequency and trends.

As I wrote in the August report, "They're then able to provide 1,000+ new styles each week from new/emerging brands and their own in-house brand. That creates a scarcity effect with RVLV's shoppers. What's here this week might not be available next week. Constant curation means more full-priced sales and less inventory."

RVLV Margin Improvement Exceeded Initial Expectations

Some things have changed since we first wrote about the company. In fact, the company's exceeded our initial expectations on growth and EBITDA margins. Last quarter (Q3), RVLV generated 62% YoY revenue growth (58% QoQ).

Net income and adjusted EBITDA sported two-year CAGRs of 32% and 22%, respectively. The company also beat our 12% 2024 EBITDA margin estimate by three years, generating 12.3% margins during 9 months 2021.



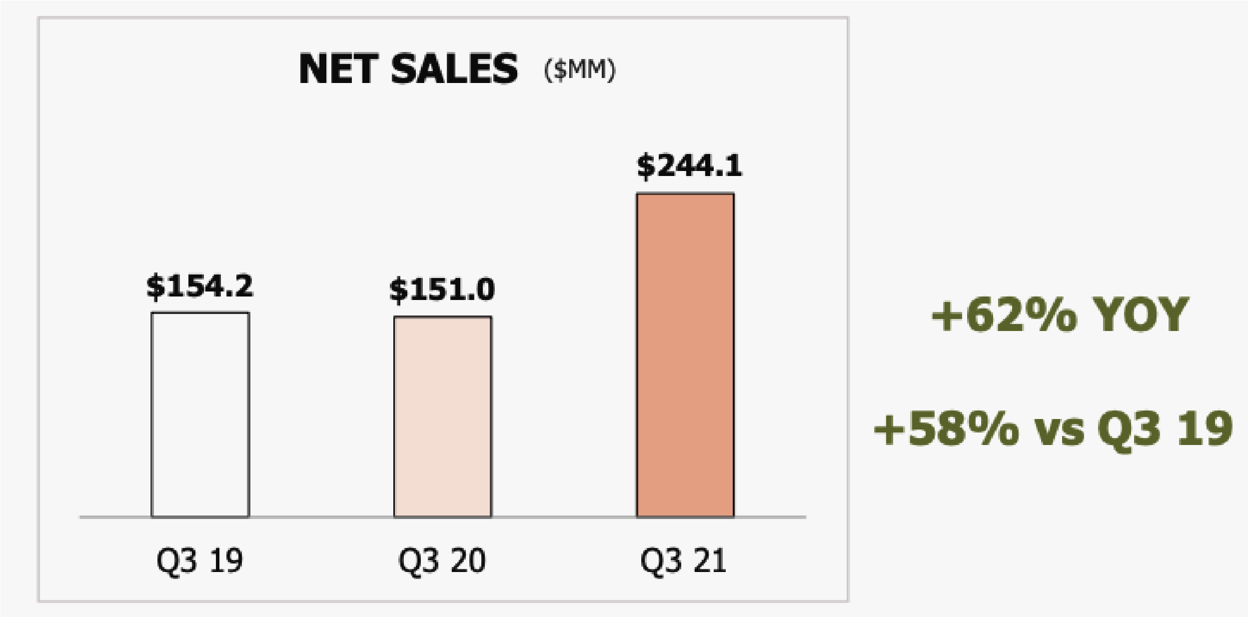
What's Ahead + Valuation

RVLV has two business segments: Revolve and FRWD. Revolve is the company's leading brand, featuring dresses, swimsuits, shirts, and the like.

FRWD is the company's online destination for premier luxury fashion.

Think 1stDibs, but for fashion products like Burberry sweaters, Balenciaga tops, and Bottega Veneta purses. RVLV's vision is to convert more RVLV customers into FRWD customers. Here's how co-founder Michael Mente explains the idea (emphasis mine):

> *"One big aspect of that is that we've been stronger and a lot more heavily invested into cross-marketing REVOLVE and FRWD.* ***FRWD has always originated because we knew that the millennial consumer would -- ultimately will shop luxury and she's going to want a luxury experience that's really focused on her****. And I think ultimately, that positioning of FRWD compared to our competition as luxury for that younger generation, I think, is really shining as the demographics continue to age.*
>
> *And that's really showing through in terms of how we're crossing over the REVOLVE customer to the FRWD customer.* ***I think it's crystal clear to me that if you're spending nearly $300 on a REVOLVE card or a REVOLVE shipment, it's a high, high probability you're going to spend $1,000 to $2,000 on a handbag or a splurge pair of shoes.*** *And it was clear that they were just getting it from elsewhere.*
>
> *And now that she's learning that she can get all of that product from us with that same level of trust and that same level of curation, that same level of service, combined now with integrated loyalty rewards, we see that customer on the REVOLVE side going to FRWD on a very consistent basis over the past few quarters."*



So far, it's working. FRWD segment sales and gross profits increased 95% and 121%, respectively, YoY.

RVLV has a long runway for robust revenue growth. International sales, for example, comprise 19% of the company's total revenue.

That's a massive market the company thinks they can tap. Mente elaborates on the international opportunity (emphasis mine):

> *"The international part of the -- **if you're looking long term, the international piece I think is massive. I think ultimately, to get to the tens of billions of revenue that I think we can do over the long term, I think ultimately, we have to be a global business, which I think is great because our brand is global and our marketing is global.** So a lot of the things that we do, Instagram, for example, there's no country lens, there's no boundaries there. So we have a massive international following. But what we have to do is built kind of like the consumer experience to be on par with the domestic consumer experience."*

What about valuation? Currently, you can buy RVLV for <3x NTM sales and a 2.5% FCF yield. The company estimates 18% top-line revenue growth over the next four years, with EBITDA margins expanding from 12.5% to 15% during that time.

In other words, RVLV is trading for ~12x 2025E EBITDA and 1.75x 2025E sales. Both multiples appear cheap if they execute on estimates. So how do they get there?

We should see continued international expansion, more customers buying FRWD products, and stabilized gross margins. I expect short-term EBIT margin compression as the company ramps marketing spending to capture more of the international market.

RVLV has grown revenue by ~20%+ each of the last 18 years. Should they hit their targets over the next few years, why shouldn't they trade at mid-5s sales multiples and at least a market EBITDA multiple or higher?

Let's examine the technicals.

RVLV's chart isn't as clean as MLNK's, but there are a couple things to like. First, the stock undercut last week's lows before closing above its lower Bollinger Band. Second, RVLV has support around the $39/share level.

This creates an attractive risk/reward set-up should price break above the prior week's highs (green line). We would then place our stop-loss below the $39/share support level.

Restoration Hardware (RH): Differentiated Luxury Furnishings w/ Long Runway For Internation Growth

RH is a luxury home furnishings retailer that sells furniture, lighting, textiles, bathware, decor, outdoor, and garden, amongst other things, through three main channels: Retail Galleries, RH.com, and its Source Books.

The company was the first to provide luxurious furnishings at scale to the mass retail population. RH took what was usually reserved for ultra-wealthy individuals in posh galleries and made it accessible for anyone with a flair for the luxury design.

There is little direct competition in RH's luxury furnishings niche.

Think of a competitor like Pier 1 Imports. Pier 1 offers higher-end furnishings but fails to capture the luxury experience that RH commands. There are no Pier 1 Galleries in beautifully architected buildings.

CEO Gary Friedman elaborated on RH's competitive advantage in the company's latest earnings call (emphasis mine):

> *"The RH business vision and ecosystem, the long view.* ***We believe there are those with taste and no scale and those with scale and no taste. And the idea of scaling taste is large and far-reaching. Our goal to position RH as an arbiter of taste for the home has proven to be both disruptive and lucrative as we continue our quest to build one of the most admired brands in the world.***
>
> *Our brand attracts the leading designers, artisans and manufacturers, scaling and rendering their work more valuable across our integrated platform, enabling RH to curate the most compelling collection of luxury home products on the planet.*
>
> *Taste can be elusive, and we believe no one is better positioned than RH to create an ecosystem that makes taste inclusive, and by doing so, elevating and rendering our way of life more valuable."*

It's worth mentioning that Friedman is a visionary CEO in the luxury design space. He reminds me of Steve Jobs. Wild and audacious. Someone who shows the customer what they wanted without knowing they wanted it.

Friedman is the second-largest shareholder in the company behind Fidelity (he owns 8.63%), a few basis points ahead of Buffett and Berkshire Hathaway.

RH is as much a bet on a visionary jockey as it is the fundamentals of the business.

Anyways, back to RH's Ecosystem of Luxury.

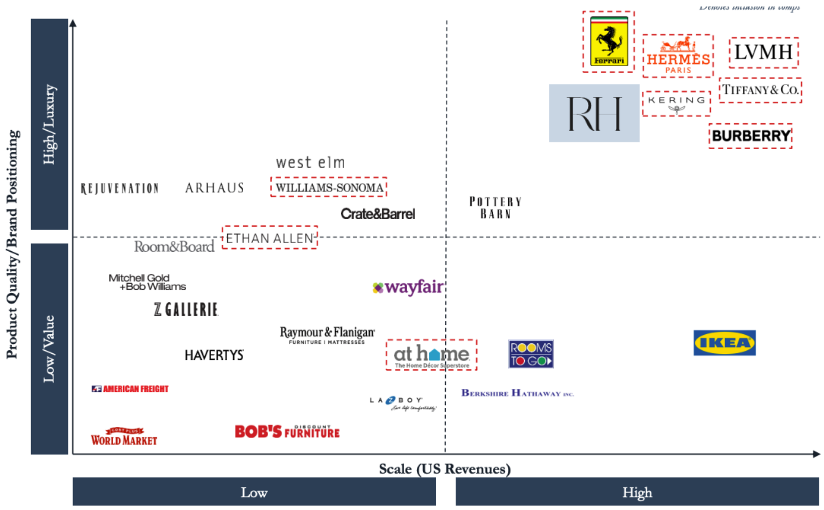
A large part of creating an ecosystem of luxury Involves RH's galleries and Members Program. The company has 24 design galleries, each averaging 33K square feet.

These new galleries boast hospitality services like restaurants, bars, wine vaults, and presentation rooms with available furnishings for purchase.

Then there's the RH Members Program, which feels like a Costco Membership. RH Members pay $150 annually to receive 25% off all items and an additional 20% off sale items.

RH Business Model vs. Conventional Luxury Furniture Retail

There are significant differences between the conventional luxury furniture retailer and RH's business model. For example, the traditional luxury furnishings market is marked with product inaccessibility, lack of price transparency, and lackluster product assortment.



On the other hand, RH removes the time and complexity from luxury furniture retail. Customers work directly with an RH Interior Designer while buying their products directly from RH.

This compares to the conventional model, where competitors outsource the product assortment to myriad retailers and dealers under different labels.

Positioned as a luxury retailer, RH benefits from luxury retail margins. The company generated 25%+ EBIT margins on an LTM basis.

That compares to Ferrari's 21%, Kering's 25.5%, and Hermes's 28.5%. RH generates higher EBIT margins than LVMH, Tiffany, and Burberry.

For example, the average price point for a couch on RH is $13,595.

This compares to $3,295 for Williams & Sonoma (WSM) and $769 for Wayfair (W). Like 1stDibs (DIBS), RH captures its highest possible price point in the consumer market.

Its average customer sports a Household Income (HHI) of $175K.

Let's go back to those Design Galleries.

RH's Superior Design Gallery Unit Economics

Western Investment Club provides an overview of RH's Design Gallery unit economics versus Legacy Galleries. You can see the breakdown on the right.

There are a couple things to note. During the first year of operations, a new store generates $31M in sales and $8.7M in cash (after rent expense).

It costs RH ~$19.5M to build a new gallery. However, RH receives kickbacks in landlord contributions (because RH is an anchor tenant) for ~$15M.

That means that RH's net investment per store equals ~$5.5M. In other words, RH generates $8.7M in cash from a store that costs $5.5M to build.

That translates to a 0.63 year payback period. RH gives FIVE a run for its money on unit economics!

Legacy vs. Design Gallery Unit Economics

(in thousands)	Legacy Gallery	Large Design Gallery
Net Sales	**12,500**	**31,050**
Leased Selling Sq. Ft.	7,500	42,000
Exterior Selling Sq. Ft.	0	10,500
Total Selling Sq. Ft.	**7,500**	**52,500**
Rent	1,308	1,975
Occupancy % of Sales	10.5%	6.4%
Rent/Selling Sq. Ft.	**$174.4**	**$37.6**
Cash Generation	**$2,942.0**	**$8,700.0**
% of Sales	23.5%	28.0%
Total Capex		**19,500**
(-) Landlord Contribution		(15,000)
(+) Inventory Investment		1,000
Net RH Investment		**5,500**
Payback period (years)		**0.63**

Growth Engine: International Expansion

The beauty of RH's current price is that you can buy the business's US operations for ~14x normalized earnings while getting all European growth for free. Europe offers RH another market to penetrate its luxury design ecosystem.

For example, 35 cities in Europe have at least 1 million people. Additionally, there are 214 cities with at least 1 million people in Asia. This compares to the US and Canada, which sport 10 cities and 3 cities with 1 million people.

RH will make its European splash this year with its first gallery opening in the UK and Paris in late 2022. The company also has lease deals for galleries in Munich and Dusseldorf, which should open in 2023. The international opportunity is enormous. Capturing 2-3% of the UK's luxury furniture market would add $600M in revenue.

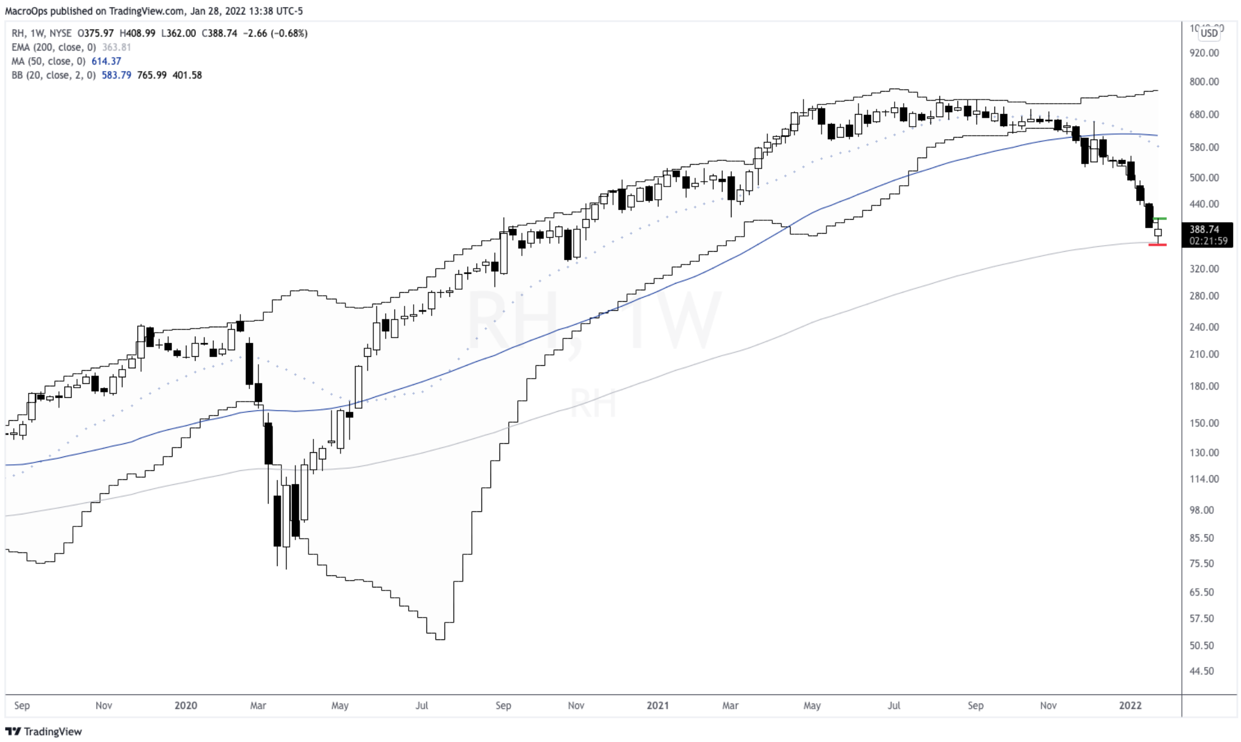
Valuation and Technicals

RH is down nearly 50% from its August 2021 highs ($745/share). Currently, the business trades for ~14.6x normalized earnings and an 8% FCF yield.

Between international expansion and future demand for luxury furnishings (people need to furnish all the newly built homes!), RH has a clear path to double-digit revenue growth at luxury-design EBIT margins (25%+).

You can buy RH today for ~7x 2025E EV/EBIT, good enough for a 14% estimated FCF yield.

Then there are the technicals, which are equally as attractive.



The stock held its 200MA weekly while printing a mean reversal long set-up bar. We want to get long on a breakout above this week's highs with a stop below the weekly lows (subsequently below the 200MA).

This set-up allows us to get a sizeable notional position at a critical support level with minimal risk.