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## An Equity Note

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### What's Inside:

- *Reviewing MIPS After Its 60%+ Share Price Decline*
- *Notes From Most Recent Capital Markets Day*
- *SEK 2B+ Revenue by 2027*
- *50%+ EBIT Margins*
- *50% Dividend Payout*

### Companies Mentioned:

- *MIPS AB (MIPS)*

# Equity Note: Reviewing MIPS After Recent Decline + Capital Markets Day

Summer is in full swing as markets whipsaw more violently than a Stephen Speilberg movie plot.

We're in **Default Nothing** mode at Macro Ops. Trade small. Trade infrequently. Sit on our hands and do nothing but research and wait for fat pitches.

MIPS is one of those potential fat pitches. Shares are down 64% YTD and are approaching "buy it and forget it" prices. We believe you can underwrite a 25% IRR at SEK 400, which is <10% below the current price.

I'll dive into MIPS's presentation in this weekend's *Equity Note*. I'll explore key value drivers, future revenue, and earnings estimates and update our thesis/valuation of the company.

Markets like these are great for spending a few hours watching Capital Markets Day presentations and reading IPO prospectuses. And that's what we're doing.

Let's get after it.

## MIPS AB (MIPS) Capital Markets Day Notes

MIPS presented its 2022 Capital Markets Day last month. You can download the 80-page slide deck here.

Think of MIPS as an "Ingredients Brand" within Helmet Safety. The company makes patented helmet safety components which it sells to helmet manufacturers across the sports, motocross, and safety sectors.

You can check out their business model below.

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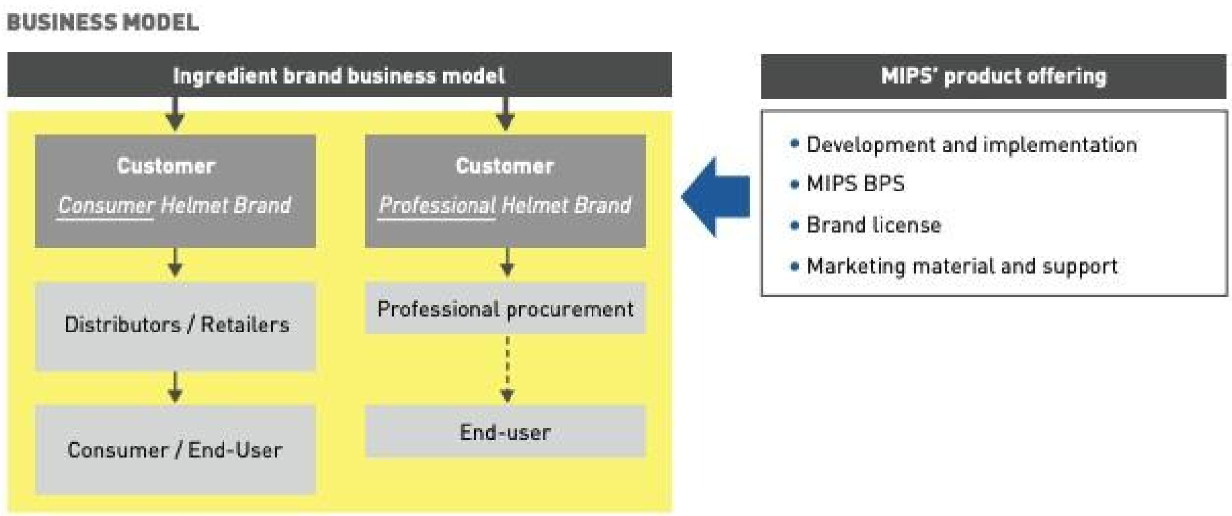


MIPS's products are COGS for consumer and professional helmet brands. And since they're a minor part of the final cost of making a helmet, MIPS can charge higher prices and generate supernormal profit margins.

Check out the company's three-year revenue growth and margin expansion (2019-2021):

- **Revenue Growth:** 47% CAGR
- **EBIT Margins:** +1,300bps (41% to 54%)
- **Dividends per share:** SEK 3 to SEK 5

The company's killed it the past five years. In fact, they've grown beyond their initial expectations.

Today, MIPS sees a **more extensive** market opportunity and a chance at **beating** its prior guidance of 40% long-term EBIT margins.

Here are the company's updated long-term goals:

- **SEK 2B in Revenue by 2027 (initially SEK 1B by 2025)**
- **>50% EBIT Margins (initially >40%)**
- **50% Dividend of Net Earnings**

These are ambitious goals, but ones MIPS can accomplish. Let's start with revenue growth.

## MIPS Can Grow Revenues At 20%+ For A While

MIPS generated SEK 608M in revenue last year. They'd need to generate ~23% revenue growth per year to reach SEK 2B. This is something they've done before. For example, the company grew revenue at a 47% CAGR from 2018 - 2021.

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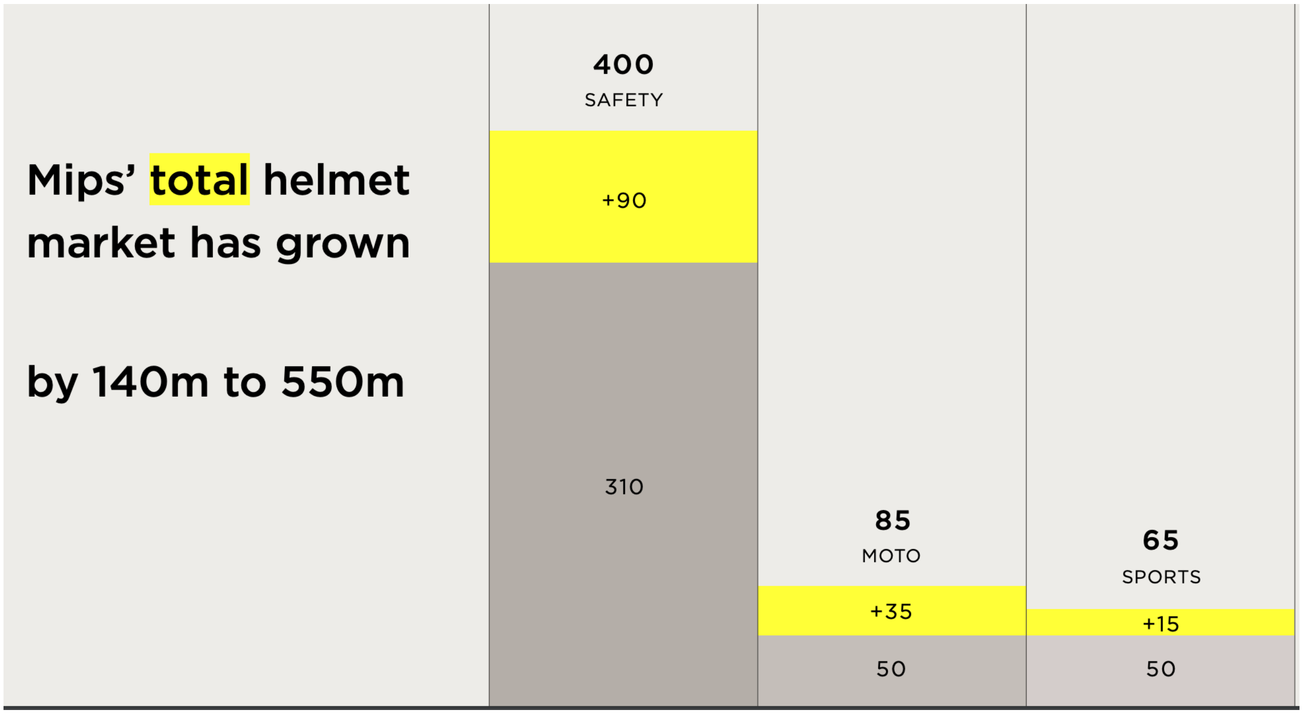
*"But Brandon, most of that revenue growth came from MIPS capturing a greater share of their massive addressable market. Is it reasonable to assume they'll grow at that pace given the current TAM?"*

Good question! MIPS addressed this in the presentation. The company believes its TAM has grown by ~140M to ~550M addressable helmets (see below).




MIPS also grew its focus (read: "Serviceable") market by an additional 65M to 195M helmets.

In other words, though MIPS has enjoyed years of near-50% revenue growth, it's still *barely* captured its addressable market. So far, the company has captured **2% of its TAM** and **6% of its focus market.**

**The Bottom-Line:** MIPS shouldn't have trouble growing its top-line by 23% per year for the next six years.

## MIPS Model Allows For Sustainable 50%+ EBIT Margins

Then there's the 50%+ EBIT margin goal. MIPS generated 50% EBIT margins for the first time last year. There are two main drivers of the company's margin maintenance.

First, MIPS is an Ingredients Brand. This means it sells lower-cost COGS to helmet manufacturers like Bell, etc. MIPS can charge whatever it wants for its product because it translates to increased sales at higher per-unit prices than non-MIPS branded helmets.

Check out this quote from a Forbes article (emphasis mine):

> *"The **Mips label usually adds twenty to forty bucks to the price** – but simply do not buy a helmet that does not have it, there's no sense in that, and every major manufacturer offers Mips."*

The second main driver is MIPS's asset-light business model. The company generates over 70% gross margins. They'll spend ~7% of revenue on SG&A and ~5% on R&D. The rest of the OpEx is highly scalable.

CFO Karin Rosenthal explains MIPS's ability to generate 50%+ EBIT margins (emphasis added):

> *"Then if we look at our cash generation, we have really strong cash generation capabilities. So we have an asset-light business model. **We only have outsourced production** and we also **only hold limited finished goods inventory.** We **invoice at delivery** of our products and we will continue to invest in our intellectual property and our own testing facilities, but **we don't need to invest in our manufacturing.**"*

Remember, MIPS is an Ingredients Brand, not an asset-heavy manufacturer. You're buying the brand on the side of the helmet.

## Cash Flow Variance Continues To Improve, Too …

Here's the crazy part.

MIPS's margins, revenues, and cash flows have grown over the last three years. The company gets *more efficient* at generating cash as it grows.

Below is MIPS's Cash Flow Variance analysis for 2020-2022 LTM.

| **Core Operating Profile** | | | |
|---|---|---|---|
| **Metrics** | **2022 LTM** | **2021** | **2020** |
| GM% | 73.11% | 73.19% | 72.88% |
| SG&A% | 16.92% | 17.27% | 21.10% |
| ***Op. Cushion%*** | ***56.19%*** | ***55.92%*** | ***51.78%*** |
| A/R% | -27.04% | -33.06% | -38.90% |
| Inventory% | -1.96% | -1.64% | -0.82% |
| A/P% | -7.40% | -11.51% | -9.04% |
| Prepaids% | 0.00% | 0.00% | 0.00% |
| Accruals% | 0.00% | 0.00% | 0.00% |
| Deferred Revenue% | 0.00% | 0.00% | 0.00% |
| **WC%** | **-36.40%** | **-46.22%** | **-48.77%** |
| **Core Op. Profile%** | **19.79%** | **9.70%** | **3.01%** |
| $ Generated (Lost) for $ | $0.20 | $0.10 | $0.03 |
| | | | |
| **FCF Growth Profile** | | | |
| **Metric** | **2022 LTM** | **2021** | **2020** |
| Core Op. profile% | 19.79% | 9.70% | 3.01% |
| Tax% | 0.00% | 0.00% | 0.00% |
| Cap Exp% | -0.60% | -0.66% | -2.74% |
| **Free cash%** | **19.18%** | **9.05%** | **0.27%** |

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MIPS has improved on *every* metric. They're generating *higher* Operating Cushions while *reducing* A/R and A/P headwinds. The result is a business that produces nearly $0.20 in profits for every $1 in incremental revenue growth.

This was a 16% improvement from the 2020s ~$0.03 for every $1 revenue growth.

This brings me to my last point.

## What's With The Share Price?

MIPS is a much better business today than it was two years ago. Yet you wouldn't think that if you saw the stock chart.

**The company trades at the same price it did in November 2020.** Back when it boasted a whopping 3% Core Operating Profile and a roughly breakeven FCF Growth Profile.

What's the catch? Where's the skeleton in the closet?

There are a few reasons why the share price is down 64% YTD and back to 2020 prices.

First, despite being down 64% YTD, the stock trades at ~12x NTM sales and 40x FCF. That won't pass a standard value screener.

Second, MIPS trades on the Swedish Stock Exchange outside the scope of most large/institutional US investors.

Third, multiple compression got to MIPS. In December 2021, MIPS commanded – and I'm not joking – a 36x EV/Sales valuation. Not EBITDA; sales!

That said, MIPS hasn't seen its valuation this low since 2019 when it generated 44% EBIT margins on SEK 268M in revenue.

Finally, let's discuss valuation.

## Valuation: Not Quite There Yet For 25% IRRs

You heard it here first. MIPS probably rockets from here without us on board because we couldn't justify buying without *at least* a 20-25% 5YR IRR estimation.

Here's my quick back-of-the-envelope math (you can check out my full model [here]).

Assuming MIPS grows revenues by 25% annually and generates 73%+ gross margins and 54% EBIT margins, you end 2026 with over SEK 1B in EBIT. Let's assume multiple compression and value MIPS at 8x sales and 30x EBIT.

That gets us ~SEK 902/share or SEK 24B in shareholder value. Finally, we'll assume an 85% probability of success to arrive at a probability adjusted~SEK 770/share in shareholder value (or an 18% 5YR IRR).

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## Concluding Thoughts

I have two angels on my shoulder. One angel says I'm splitting hairs, and MIPS will *never* get this cheap again.

The other angel says I'm being a *good* value investor, waiting for *my* price, my *perfect* pitch.

I don't know which angel is right. But right now, it's default "Do Nothing" mode.

# Portfolio Moves

### Buys

- ➢ **BOUGHT** Long in USDCNH

### Sells

- ➢ **EXIT** Full Long in Bitcoin (BTCUSD)

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