Portfolio Intelligence Report (PIR): 11.12.2022

"Know what you own and why you own it." - Peter Lynch

Happy Saturday!

This weekend, we examine new developments/commentary within our portfolio companies.

Our Strategic Basket … We dive into CLPT's earnings report, review a Forbes video where Jim Chanos outlines his $SQ bear thesis (disc: he's short), and discuss $LLY's crazy share price action on Friday.

Our Thematic Basket … We highlight EGY and LEU's latest earnings reports.

Let's get after it.

Strategic Basket Update: CLPT, SQ, and LLY

Total Basket Highlights (including non-updated positions):

- ➢ Current Average Return: -17.06%
- ➢ Current Notional Exposure: 18.57%

ClearPoint Neuro (CLPT)

CLPT is a neurological platform company that enables neurosurgeons to perform minimally invasive procedures under real-time MRI guidance. The company provides these solutions through its ClearPoint Neuro Navigation System, or CNNS.

You can read our write-up on the company here (starts on page 4).

The company also released a new Investor Presentation, which you can read here.

CLPT reported Q3 earnings on Tuesday (11/08). Here are the highlights (YoY):

- ➢ Revenue increased by 13% to $5.1M
- ➢ Gross Profits grew by 22% yo $3.71M
- ➢ Partner PTC Therapeutics granted full marketing authorization for Upstaza treatment (which will use CLPT SmartFlow)
- ➢ Added new biologics and drug delivery partners to reach 50 total partners
- ➢ Multiple FDA clearances: ClearPoint Maestro Brain Model, Prism, Laser Therapy System, and Navigation Software

The company grew despite historically high case cancellation rates and supply chain disruptions from COVID-19.

CEO Joe Burnett described the company's growth saying, *"We have now installed a record 10 new systems globally year to date and have the largest active capital funnel in our history."*

CLPT also expanded gross margins by 700bps to 72% due to increased service revenues. All bullish signposts remain green.

Below are some of my favorite quotes from the earnings call (emphasis added).

On PTC's Upstaza therapy product …

> *"Arguably, our biggest milestone in the past 3 months was the first commercial patient treated with PTC's Upstaza gene therapy products for the treatment of AADC deficiency in Europe under CE Mark authorization.*
>
> *Our multiyear strategy has played out as expected, where the labeling for Upstaza includes our SmartFlow Cannula directly in the surgical guide as* ***the only infusion cannulas to be used in combination with this gene therapy.***
>
> *To say it another way,* ***the very first gene therapy ever approved for direct injection into the brain is co-labeled with our device*** *and the marketing authorization for administration of a therapy."*

It's hard to overstate the importance of this partnership. Our bull thesis hinges on CLPT's ability to lock in doctors/surgeons into using *only* CLPT products/software for drug delivery to the brain.

Each gene therapy partnership increases that stickiness. And CLPT has a pipeline of 50 partners to further develop customer lock-in.

Back to the earnings call.

> *"We believe this first approval, along with the exhaustive bench, preclinical and clinical testing required for submission, is a sign of things to come for many of our approximately* ***50 active partners that could see a similar path to approval.***
>
> *Our goal for our SmartFlow family of cannula products is to achieve co-labeling globally across multiple partners and indications, and that* ***ClearPoint is the go-to delivery mechanism for pharma delivery to the brain and spine.****"*

On ClearPoint Maestro Brain Model …

> *"Currently,* ***we now have installed 10 systems year-to-date****, which is a new record with a couple of months still to go in 2022. We have more than* ***40 additional hospitals in our active funnel****, which again is the strongest installation and capital funnel that we have had in our history."*

On Cash Burn …

> *"As Danilo mentioned earlier, **a significant portion of our cash burn went toward working capital, including prepaid inventory and expenses and raw material and component purchases.** We believe some of these inventory purchases **will start to slow down here** in the fourth quarter, which will be offset by inventory of new products, for example, laser systems to support the limited market release."*

CLPT has ~$40M in cash on the balance sheet. That's good for another six quarters at the current burn rate of ~$6-7M/quarter.

Burnett says the company has enough cash to hit its mid-term growth ambitions and will reduce operating burn in Q4.

There's a non-zero chance CLPT will issue equity to fund operations next year. We'll monitor the company's cash burn and adjust our probabilities over time.

Finally, I want to reiterate our valuation case for CLPT.

Management has already stated its goals for its FNN business: 100 cases a year from 100 clinical partners or 10,000 annual cases.

At ~$10,000 per case, that gets us $100M in annual revenue from its FNN segment alone over the next five years. Then there's the Biologics and Drug Delivery segment.

It's impossible to predict how much revenue this business segment will generate over the next few years. However, we can use WST as a proxy. WST generates billions of dollars in revenue from its disposables/delivery mechanism business.

It's not a stretch to think **CLPT could create hundreds of millions, if not billions, in revenue should the company become the delivery mechanism of choice for all neurological drug therapies.** Our cone of potential outcomes remains extremely wide.

Block, Inc. (SQ)

Block (SQ) provides merchant seller services through its "Square" product to over 2 million businesses. Popular products include Square Invoicing, Payroll, Square for Restaurants and Square Capital. The company also serves 47M+ consumers through CashApp.

You can read our write-up on SQ here.

Jim Chanos did an interview with Forbes last week where he outlined his SQ short thesis.

Chanos's short thesis is that SQ is "inherently unprofitable" due to stock-based compensation (or SBC).

We agree with Chanos that SQ loses money after adding back SBC, and we that discussed in last week's PIR.

However, Chanos fails to say that SQ *chooses* to invest in R&D, product, and marketing through the income statement.

They're forgoing today's profitability to gain a more significant share of tomorrow's profits.

But tomorrow's profits aren't guaranteed. We should discount SQ's ability to reach profitability in our valuation models. However, the company continues to increase revenue and gross profit growth while leveraging SG&A spending (see below).

Ratios | TIKR.com	3/31/22	6/30/22	9/30/22
Margin Analysis:			
Gross Profit Margin %	32.7%	33.8%	35.1%
SG&A Margin %	22.2%	21.0%	19.4%

We believe SQ can continue this trend and print "real" profits in the coming quarters.

Eli Lilly (LLY)

LLY discovers, develops, and markets human pharmaceuticals worldwide. If you've heard of Trulicity, you know LLY. The bull thesis is that LLY's tirzepatide drug could more than double its current revenue base over the next 5-10 years while expanding EBIT margins by 1,000bps.

Check out our LLY thread in Slack if you haven't already. It's a great way to get up to speed on the thesis.

You can read last month's *PIR*, where I shared my notes from an interview with an LLY postdoctoral researcher in the company's Discovery Unit.

This week, a fake tweet cost LLY billions of dollars in market cap. I'm serious. A fake account (with a blue check mark) pretending to be LLY tweeted, "We are excited to announce insulin is free now."

We live in crazy times.

The tweet also slashed the market caps of Novo Nordisk and Sanofi. LLY closed at its mid-line this week. It's a decent setup to either add to your position (for existing Collective members) or to establish a long position (for new Collective members).

We've selected our DOTM structure and will roll half our equity position into DOTMs early next week. Stay tuned for a trade alert.

Thematic Basket Update: EGY and LEU

Total Basket Highlights (including non-updated positions):

➢ Current Average Return: +1.48%
➢ Total Notional Exposure: 37.68%

VAALCO Energy (EGY)

EGY is an independent energy company that acquires, explores for, develops, and produces crude oil and natural gas in West Africa. Specifically, EGY owns wells in Egypt, Canada, Gabon, and Equatorial Guinea.

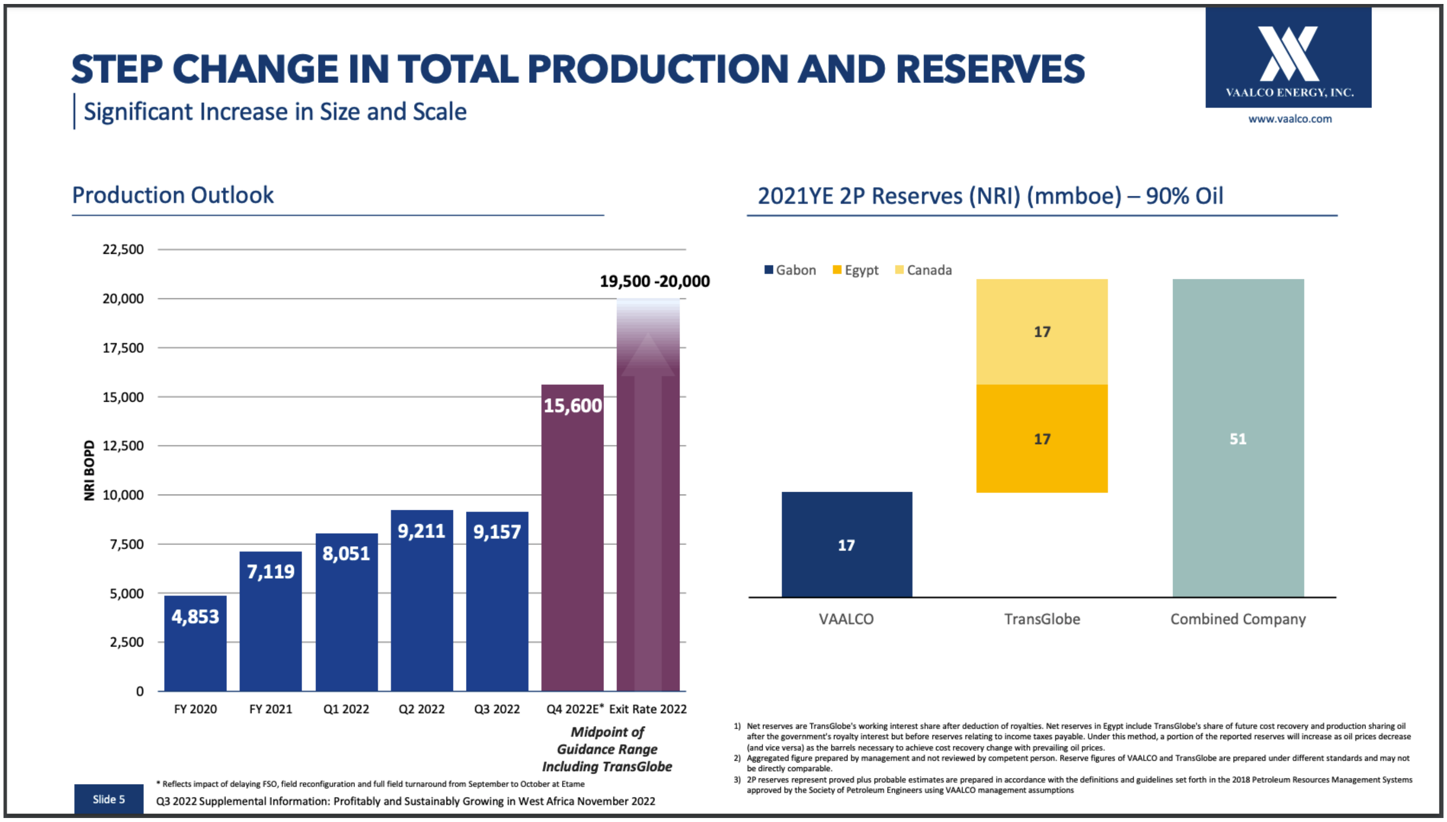
The company reported record quarterly results on Tuesday (11/08). Here are the highlights (Q3):

➢ Product increased by 19% to 9,157 Barrels of Oil per Day (BOPD)
➢ Sold 731,000 barrels of oil
➢ Generated $42.4M in Adjusted EBITDAX
➢ Reported $33.3M ($0.56/share) in Adjusted Net Income

➢ $103.61 average crude oil sale price

EGY also published a new Investor Presentation, which you can read here.

This is the first quarter as a combined company since the merger of TransGlobe. The "new" EGY is a debt-free, cash-flowing beast with an excellent production outlook. Check out the chart below from the Q3 earnings presentation.



The company expects to produce ~15,600 BOPD in Q4 and exit 2022 with nearly 20,000 BOPD production.

Additionally, the combined company now has 51 mmboe of reserves compared to EGY's 17 mmboe before the merger.

One significant risk with any E&P is a crash in the underlying commodity price. EGY has hedged ~326,000 barrels of oil for Q4 2022 and ~301,000 barrels in Q1 2023 through "collars" (i.e., by selling calls at $120-$122 and buying puts at $65-$70).

Another thing to note is that the company's $30M buyback is "money good" at $80/barrel of oil.

Let's move on to the balance sheet. EGY has $69M in cash, its highest cash balance since 2014. More importantly, the company has **zero** long-term debt.

EGY can finance operations *and* capex expansions with cash from operations. This leaves more cash available for shareholder returns like dividends and buybacks. As we mentioned last week, EGY plans to **double** its annual dividend in 2023 and buy back $30M of stock.

The company generated ~$18M in free cash flow during the quarter and trades at ~4.4x annualized FCF (22% yield).

To recap, you get a 22% FCF yield, a 4.6% annual dividend, and another 0.4% yield from the $30M buyback.

Check out the daily chart below. EGY is shaping up for an inverse H&S breakout.

We'll patiently wait for a breakout, collect our dividends, and enjoy the buybacks.

Centrus Energy (LEU)

LEU supplies nuclear fuel and services for the nuclear power industry in the United States, Japan, Belgium, and internationally. The company operates through two segments, Low-Enriched Uranium (LEU) and Technical Solutions.

LEU generates lumpy sales and earnings, and Q3 came in on the wrong side of the lump. The company lost $6.1M in net income on only $33.2M in sales. During Q3 2021, LEU generated $42M in net income on $91M in revenue.

Hence, the lumpiness.

The stock dropped 30%+ the next day. But it's not all doom and gloom.

LEU announced a new $150M contract with the DOE on Thursday. By Friday, the stock had increased by 29% from its earnings lows. Here's an excerpt from the DOE announcement (emphasis added):

> *"The Department of Energy said late on Thursday that it and Centrus Energy's American Centrifuge Operating, LLC will share the $150 million cost 50-50 to demonstrate production of a fuel called high assay low enriched uranium, or HALEU.*
>
> *The contract will enable production at the company's plant in Ohio of 20 kilograms of HALEU, enriched up to 19.75% by the end of 2023, the DOE said. Output is expected to continue in 2024 at 900 kilograms a year, depending on congressional appropriations, with additional options to produce more material under the contract in the future, it said."*

This is a **big** win for LEU and nuclear energy in general.

We continue to hold our ~2.5% notional position through the lumpiness. Of course, as long as the lumpiness moves up and to the right.

Portfolio Performance Update

- November (month-to-date): -2.44%
- Q4 2022 (to-date): -1.45%
- YTD (as of 11/11): +14.06%