Graham & Doddsville

Spring 2024

An investment newsletter from the students of Columbia Business School

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Welcome to Graham & Doddsville

Meredith Trivedi, Managing Director of the Heilbrunn Center. Meredith leads the Center, cultivating strong relationships with some of the world´s most experienced value investors and creating numerous learning opportunities for students interested in value investing.

Professor Tano Santos, the Faculty Director of the Heilbrunn Center. The Center sponsors the Value Investing Program, a rigorous academic curriculum for particularly committed students that is taught by some of the industry´s best practitioners. The classes sponsored by the Heilbrunn Center are among the most heavily demanded and highly rated classes at Columbia Business School.

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CSIMA Columbia Student Investment Management Association

We are pleased to bring you the 49th edition of Graham & Doddsville. This student-led investment publication of Columbia Business School (CBS) is co-sponsored by the Heilbrunn Center for Graham & Dodd Investing and the Columbia Student Investment Management Association (CSIMA). In this issue, we were lucky to be joined by five investors who have plied their craft across geographies, asset classes, and market cycles.

The first interview you'll find is with **Jennifer Oppold**, founder of Alpine Peaks Capital. We discussed her path to investing and her process of identifying potential long and short ideas. We also dug into her positions in IPAR, HEICO, and Trex.

Next is with **Adam Patinkin**, founder of David Capital Partners. We discussed how his background has helped him succeed in investing, his emphasis on catalysts in his investment philosophy, and his short position in Brown-Forman. We also discussed his long ideas on Vistry, eDreams ODIGEO, and Lifecore Biomedical.

Then a fascinating interview with **Freddy Brick**, from Muddy Waters. We discussed his background, activism in short-selling, and Muddy Waters' short positions in Fairfax, and Blackstone Mortgage Trust.

Then is **Noah Snyder**, founder of Snöboll Capital. We discuss his influences, his portfolio's geographic exposure, and his long ideas on Vitec Software Group and Kelly Partners Group.

Lastly, editor Richard Lalane ('24) had an exclusive interview with **Shayan Mozaffar**, Founder & CIO at 10x10y and Adjunct CBS Professor for *The Analyst's Edge*, about finding your edge and sharing it with the world.

We continue to bring you stock pitches from current CBS students.

In this issue, we feature the winners of the 2023 UNC Alpha Challenge, Joe Ferguson ('25), Garrett Wallis ('25), and Susan Liu ('25) for their long thesis on Janus International Group (NYSE: JBI).

We also feature the winner of the 2024 Artisan International Growth Stock Pitch Challenge, Amar Kashyap ('24) for his long thesis on Enstar Group LTD (NASDAQ: ESGR).

You can find more in-depth interviews on the *Value Investing with Legends* podcast, hosted by Tano Santos and Michael Mauboussin, Head of Consilient Research at Counterpoint Global at Morgan Stanley Investment Management and adjunct faculty member at Columbia Business School. Recent interviewees include Kim Lew, John Armitage, Nicolai Tangen, and John Rodgers.

We thank our interviewees for contributing their time and insights not only to us, but to the whole investing community.

G&D Editors

27th Annual CSIMA Conference - February 9th, 2024

Sergio Rosado Gomory (‘24) Tom Marmarelli (‘24), and Shin Lutondo (‘24)

Sallie Krawcheck (‘92)

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For inquiries, please contact: valueinvesting@gsb.columbia.edu

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Jennifer Oppold

Jennifer Oppold founded Alpine Peaks Capital in 2017 after spending a decade at Select Equity Group, a fundamentally focused investment manager. She is the Portfolio Manager at Alpine Peaks, which offers an equity long/short strategy and a long only strategy. Both make concentrated, long-duration investments in high quality small and mid-cap companies. In 2001, Jennifer received an AB cum laude from Princeton University. Jennifer began her career with McKinsey & Company from 2001 to 2003, advising multi-national corporations on strategy and operational efficiencies. From 2003 to 2007, Jennifer attended Harvard Business School and Harvard Law School, from which she earned her MBA and JD cum laude in 2007. She is originally from Salt Lake City, Utah and now lives in New York City with her husband and three children.

Editor's Note: This interview took place on April 5th, 2024.

Graham & Doddsville (G&D): Thanks for being with us today, Jennifer. We're thrilled to be interviewing you and really excited for all the topics we're going to cover. We'd like to start by discussing your background, your initial interest in investing, and then of course how you've evolved that into a successful investing career.

Jennifer Oppold (JO): Of course, thank you so much for having me. I'm really looking forward to the discussion today. As background, I grew up in Salt Lake City, Utah. Investing was a dining room table conversation for me growing up. My dad had a JDMBA and worked as a lawyer, but he managed his law firm's 401k plan and was a securities lawyer and so was actively involved in investing as well. My mom went back to business school at the University of Utah when I was growing up and then worked for a local advisor called Wasatch Advisors based in Salt Lake City. So, between those two influences, I became aware of investing, and it was always an interesting thing on my radar.

I went to Princeton undergrad and after that I worked for McKinsey for a couple of years. And it was interesting work, but one thing is that we were always moving on to the next assignment before having a sense as to whether our recommendations on the completed assignment were effective. And I didn't love that component of it. To me, I like the feedback loop of investing where you definitively know if your thesis was right or wrong. After processing that career experience and thinking through which direction I wanted to take my own career, I decided to refocus on investing. With that in mind, I went back to graduate school and did a joint MBA at Harvard Business School and a JD at Harvard Law School. Over those four years, I was fortunate to have plenty of time to take a lot of classes. Ultimately, I went to work for a firm called Select Equity Group during my last summer, which was a great experience and just reconfirmed everything that I had hoped and thought about fundamental, value-oriented public market investing. I joined Select Equity Group full time after I graduated in 2007 and really enjoyed it. Ultimately, I worked there for 10 years and became the associate portfolio manager on their domestic hedge fund. That experience confirmed that investing was an interesting field and one that you can continue, I think, to grow in and build a really interesting career in because it is always evolving and there are always new companies and new industries to learn about. And you can never rest on your laurels, so to speak. I think if you try to do that, you will quickly be humbled in this market.

G&D: The opportunities for constant learning and growth resonate with all of us and are part of our interest in getting into the field. Are there investors, mentors, or

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books that have had a significant impact on you, your career, and your philosophy?

JO: Absolutely. From a book perspective, I like several of the value investing classics. I'd mention Seth Klarman's *Margin of Safety*. I really enjoyed Guy Spears' *The Education of a Value Investor* and Mohnish Pabrai's *The Dhandho Investor*. And then there's an old book Ralph Wanger wrote called *The Zebra in Lion Country* focused on small cap investing that's more specific to our space, but his thoughts and comments on investing in smaller companies definitely resonated with me. Beyond that, I think not unusually, I enjoy reading Warren Buffett's and Jamie Dimon's annual letters. Generally I enjoy authors who are thinking deeply about the space and how it's evolving, particularly if they write with a dash of humor. And then I was fortunate to work at a place where the portfolio managers really did have an open door. The 10 years at Select Equity helped me grow and develop as an investor.

"I like the feedback loop of investing where you definitely know if your thesis was right or wrong."

G&D: With the benefit of knowing your background, we'd like to discuss your fund. Tell us about the fund, what drove you to launch it, how you chose the name, and other key decisions you've made.

JO: The name is actually a bit of a funny story. As background, I come from an entrepreneurial family. I'd always admired what my former boss built from scratch at Select Equity. And as I reached a certain point in my career where I felt ready, building my own firm was something that I really wanted to try.

When I was launching Alpine Peaks, I tried to think of a name that would resonate on a personal level. And as you may know if you've looked into this, a lot of names out there have already been trademarked. I'm from Salt Lake City, and I was looking at all the mountains I love to ski on. None of those were available. I grew up fly-fishing and so initially I was going to name the firm Lost River Capital, because the Lost River is my favorite fishing spot up near Sun Valley. A couple of friends politely poured cold water on that idea, and I realized that no one wants to give their money to a firm called Lost River Capital. Ultimately, I decided on naming the firm Alpine Peaks given that skiing is one of my favorite activities.

G&D: Great. And tell us a little bit about the way your background and investment philosophy shape the way that you construct the portfolio and how you think about investing.

JO: Yes, absolutely. I went through the financial crisis almost immediately after I graduated from business school and started my investing career. And I think that's been very powerful in shaping my outlook. In particular, it really made me value clean balance sheets and companies that generate a lot of cash because if you have that financial profile, it gives you many more strategic options and greatly reduces the likelihood that you'll be caught in an emergency situation, or have a going concern risk. In 2008 and 2009 I saw a lot of companies with otherwise decent businesses, which were limited in their ability to respond to the crisis due to heavy leverage. Sometimes, the debt had been taken on for something that seemed sensible at the time, such as a large acquisition, but if it was done just before the financial crisis those ostensibly sensible choices left many companies in a tough position. And that was powerful in shaping my outlook; I can sleep better at night if our companies have clean balance sheets that enable them to weather turbulent markets. Those are also the companies that can take share when their competitors are distracted dealing with a crisis, or lack the financial resources to be making the investments in their businesses that

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they should be.

G&D: That's very interesting. Now that you've been live for about six years, what do you think you got right and what would you have done differently?

JO: The biggest change I made early on was deciding to have the fund be a little bit more concentrated. I started with closer to 30 names in our long portfolio. Now we have 21, so we have focused that down quite a bit. I came from a firm that had core positions as well as a number of nursery positions and started with that mental model in mind, but ultimately decided that I prefer to be focused on our highest conviction ideas. And so I think that's been a good thing for us. And if you can find these great businesses, it gives you that runway where you can continue to get to know and grow with a business. If you can find it at a great entry point, then that compounding can be very powerful over time. Our average holding period is trending close to six years.

G&D: And appreciating that we'll always be time constrained in this industry, how do you think about allocating your time between evaluating the existing portfolio, looking at new ideas, and whether more of your time is spent on the long or the short side?

JO: That's a great question. So I'd say generally we spend about half of our time continuing to research existing ideas where the work is never done. They're entering new markets or acquiring new companies that you want to look into or they've hired new leaders and you want to dig into their background and think about their potential efficacy. The other half of the time we spend on new ideas. We don't use Wall Street research actually, so it takes us a number of months to get to know a company. Many years we only initiate a handful of new long positions, but we maintain a watch list of companies of interest that we know well, and we want to continue to ensure that we are adding new prospects to that funnel over time.

And then to back away from the research side, I probably spend 10% to 15% of my time managing the portfolio, speaking with investors, and doing other things that are non-investment related. But I'm fortunate to have found a great CFO who takes the vast majority of that off my plate. And I'd say that for anybody thinking of becoming a portfolio manager and starting their own firm, if you can find somebody like that who can really be your partner, it can allow you to focus the vast majority of your time on investing, which I think is what most of us love to do.

> ***"I can sleep better at night if our companies have clean balance sheets that enable them to weather turbulent markets."***

G&D: Absolutely. Before we move on, we'd be interested to double click on one of the things you mentioned, which is you eschew sell-side research. Can you tell us more about that decision?

JO: To be clear, we eschew it when we're getting to know a company. And it's not because we think poorly of the quality of Street research. There are a lot of great analysts who work on the sell side, but I do think it's hard to come out with a de novo point of view about who has a better product or is winning or losing market share if you start out with somebody else's preconceptions. And so instead, we do the work ourselves. It takes us longer, but reading through the 10Ks, the recent investor day presentations, speaking with the management team, and so forth can help you build a differentiated understanding of the company and its competitive position.

We are big believers in the trust but verify approach. So we try to talk to customers or distributors or whoever's relevant and see if they

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view the product or market in the same way as the management team. Maybe the company is telling you that people love their leading-edge technology, but then when you talk to people in the market, you actually find out that they're the cheapest product or something like that. There can be different views, and we want to make sure that message is consistent.

We do sometimes use Street research at the end of our process, particularly if we see somebody on the street who has a really divergent view. Obviously, we do want to ensure that we've taken into account bullish and bearish arguments. And then similarly, if we own something and there is a note that's moving its stock significantly on a given day, we'll read that note just to understand if there was something the analyst learned about the market or about the company that we should be considering and could perhaps be material to our own investment thesis.

G&D: Great. When you are doing your screening and exploring different ideas, what about an idea tips you off that this is something you want to sink your teeth into?

JO: There are a lot of qualitative things that we look for, but when we're thinking about screening, there are really five financial attributes that we look for. We like to see durable revenue growth, strong operating margins, good returns on invested capital – usually in the mid-teens or higher – and low debt. Over half of our companies are either net cash or very close to it, and we typically want companies with less than two turns net debt to EBITDA. And finally, we like very strong free cash flow, usually equivalent to or better than then net income.

"We have found that companies with those financial characteristics tend to have strong competitive moats around their business."

We have found that companies with those financial characteristics tend to have strong competitive moats around their business. The underlying business can be very different – we have HEICO, which makes generic aftermarket aviation parts, or Medpace, which conducts outsourced R&D trials for small biotech firms – but if they're able to put up that financial profile over a number of years, there's something that they're doing that's hard to replicate. Otherwise, you would see those returns get competed away much faster.

Outside of screening, we also find that conferences tend to be a great source of ideas. We love going to an industry conference, whether it's consumer or technology or healthcare or industrial, you name it. You can go and listen to 20 or 30 companies across the course of a few days and hear what the CEOs are excited about, what they're worried about, what their new products are that they're jazzed about. And that can be really helpful, and we can usually come away from that with a number of ideas both long and short that we're interested in looking at further.

G&D: It sounds like balance sheet quality is really a deciding characteristic to either go long or short. The longs, they typically have healthy balance sheets, low debt loads, and high free cash flow conversion. And then the shorts are almost the inverse. What other factors make a really good short?

JO: From our point of view, a heavy debt load alone would never make something a short, just as valuation alone wouldn't. And so we do like companies with a lot of the opposite financial characteristics, but we are always looking for a catalyst too. There are a lot of companies that have challenged balance sheets, are relatively slow growth, and have mediocre profitability but that alone wouldn't make a company a short for us. We like to see companies that have set

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out overly aggressive financial targets, for instance. Often, it's the longer term targets. We tend not to trade around somebody saying, "Oh, we think they'll meet or beat next quarter by 5 cents."

Consensus tends to not be hugely helpful to us in the small and mid-cap space as A, there don't tend to be a lot of analysts on the sell side focused on those companies. And B, since they're smaller companies, they're often not really maintaining them in real time. Sometimes I get asked, "What's your divergent view versus consensus?" And that's not how we frame our approach because it's not a hugely helpful benchmark in what we do.

So looking for catalysts, we like companies that put out overly aggressive targets. Often we find companies that have recently spun out overly aggressive targets or sometimes new management teams do that. Those can be good short setups for us. Also, we will short companies that have great businesses, but for various reasons are going through a tough period in their business. I think we'll touch on it a little later, Trex is a company that we're long now and that we love. But Trex was one that was a good short for us post-COVID, essentially as there had been a lot of inventory restocking that had helped support sales. And then it created really tough comparisons the following year at the same time that rising interest rates hit demand for decking from homeowners. At that time we still admired the quality of Trex's long-term business model. But we recognized Trex had a real boom in demand that created a tough situation it had to work through for the next year to get back to baseline demand.

"So looking for catalysts [for shorts], we like companies that put out overly aggressive targets… [including] high quality businesses facing short-term issues."

We like having a few of those high quality businesses facing short-term issues in our mix of shorts as well because from a portfolio management perspective, if you get a "dash for trash" where higher beta names really rally, things that have sold off hard can be up 50% or 100%, whereas your names that held up well might be up 10% or 20%. That kind of beta mismatch can be uncomfortable on the short side. So, it's nice to have a mix. You don't want your entire short book being these heavily levered high beta companies if possible.

G&D: We get the sense reading your letters and having this conversation that you do a lot of work to establish a deep understanding of the business, but sometimes based on where the business is trading, it won't be actionable just based on the valuation. A concept that we pulled out of your letters is "already underwritten names." Can you talk about that as part of your idea generation process and the number of names you keep "on the bench?"

JO: That is true, we do try to set valuation aside when we're first getting to know a company. So if a company has those financial characteristics that we mentioned and has been able to deliver that repeatably over the years, then we think it's well worth our time to get to know the company regardless of whether it's timely at that exact moment or not. But the drawback of that is that once we've done that work, it's often not timely. One of the things we like about the small mid-cap space is it tends to be volatile, which can give us what we call a "value moment" to use as our entry point.

We're looking for at least 25% upside to our estimated fair value. But frankly, in a tough market we can get a lot more than that. So once we've done the process on our companies, they go on a list, which we informally call our "universe." And I keep

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that tied to Bloomberg with approximate price targets. We're not actively maintaining these models, but that helps alert us when something is hitting an interesting price. At that point we can brush it off pretty quickly.

And then we're asking ourselves, "Is there some permanent impairment of the business model where this is cheap for a reason?" Possibly something has happened, perhaps a competitor came out with a better gadget, and the sell-off may be well-deserved. But oftentimes, companies sell off due to market momentum rather than intrinsic problems, in which case it might be a good long at that point. Each of us has a list of names on our hot list and prices we'd love to see them hit where you can use those opportunities in a downturn to potentially upgrade the portfolio.

G&D: How do you think about portfolio construction, balancing long and short positions, and position sizing? And what does risk mean to you?

JO: I like to move relatively slowly with our position sizing; we will build in and out of positions. I'd caveat that if you realize something doesn't hold with your thesis, then we would move more quickly. But barring that, typically when you're entering at an interesting price, there's some reason in that moment why it's trading at a discount. And so we want to give ourselves some dry powder to be able to continue building the position at a lower valuation. And often we're also continuing to work on digging into whatever is driving the sell-off.

The truth is that things rarely sell off when everything is in a Goldilocks situation. And so we like to slowly build up and down positions. Our core position size is around 5%, give or take. We will go up to as much as 10%. That's our limit on the long side. And we purposely keep our shorts smaller. Our typical position is 1% to 3%, but the maximum position size is 5% on the short side.

"For every company we have both our long-term fair value price target of what we think the business is worth, and a recessionary price target."

G&D: And it looks like the short book turns over anywhere from 20% to 50% on a quarterly basis. Can you talk about closing out those positions and initiating new ones?

JO: Yes, absolutely. We do try to actively trade our shorts. I think one of the biggest process lessons we've implemented over the last six years is developing the concept of recessionary prices. For every company, we have both our long-term fair value price target of what we think the business is worth, and a recessionary price target. We build our financial models back about 20 years so we can see multiple economic cycles, provided that the company has been public long enough. And that really helps us understand how much revenue typically drops in a downturn, how much operating margins typically fall, and the trough multiples that investors put on that business.

The result is not what I think of as a fair value per se, but it is where you could reasonably expect the company to bottom out if it goes into a downturn. And one of the open questions for us in the last few years has been, "Are we going to tip into another recession?" This was a long-winded way of circling back to your question about how we trade our shorts, but it really helps us set a risk-reward for every position in our portfolio as well as force rank them against each other, where we can see the upside to that long-term fair value, and then the downside to that recessionary price. We flip those for shorts, where your upside is hitting that recessionary price. That framework is key to trading our shorts actively.

And actually volatile

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markets like in the last couple of years can be enormously helpful because they offer trading opportunities. Typically, if a short gets within 5% or 10% of that recessionary price, we'll start to cover it and then usually get out if it hits that recessionary price. In our experience, names can fall lower than that recessionary price in the short run based on momentum. But it's been a pretty good rule of thumb for where things will bottom out in downturns. And the seesaw prospects of interest rates, and people getting really excited about or worried about rate reductions or increases, has flowed through to markets being quite volatile. And so if we cover those shorts instead of riding them back up, we can have a nice opportunity to put them back on later, which has been helpful.

G&D: How does that contrast to the way that you think about exiting long positions?

JO: I do think about our position sizing being accordion-like: where there's greater upside, we'd be building our position and then trimming as we get closer to our price target. Typically, as we're nearing our target price, we are looking hard at that and thinking about whether there's any reason that we should be moving that up before we exit. If not, then we exit. Even with a great business, we have enough volatility within small and mid-cap that it makes sense to be relatively active. Given that, our dollar turnover is higher than our name turnover. So we're not statically holding, say a 5% position for those five plus years. Instead, it is typically moving around in position size over that period.

"We put all of our theses and risks in writing, and we always ask ourselves, 'Does each leg of our thesis still hold?' "

If a company is hitting our price target, we're better off exiting for now and often we can have an opportunity to rebuild it later. Other times though, to your point, there are names we exit for other reasons. We put all of our theses and risks in writing, and we always ask ourselves, "Does each leg of our thesis still hold?" If you realize that the margin improvement, for instance, that you expected to happen, is no longer going to materialize, then that could be a reason to exit. We had a salt mining company that was implementing continuous mining and then they had major labor relation issues and it became clear that they would never be able to realize the anticipated margin benefits. We exited upon realizing that our initial thesis was not going to materialize for the company.

G&D: You touched on some core tenets of your valuation philosophy, specifically going back 20 years on the historical model to study the cycles. What other valuation practices are fundamental to your approach and how do you think about valuation more broadly?

JO: We like looking at several different valuation metrics; P/E multiples, EV/EBITDA, and free cash flow yields are high on our list. The takeout valuations of similar companies in the industry can help frame the risk reward. We typically use a lot of scenario analysis, particularly right now when there's a bit of an uncertain macro environment. If a company has a major new product initiative or a major acquisition where there's a higher than usual degree of uncertainty about how that future might play out, scenario analysis helps us frame where we see the upside and where the downside could be if things don't play out as well as we would hope.

Our team discussions are very iterative. I prefer to hire an experienced team and I have been very fortunate to find analysts with a lot of experience. I love that because there can really be a sense of collective ownership on the team and a very active debate. I want everyone on our team to have input and we can collectively think through

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both the upside and downside. Not infrequently, you think that the signs point to things working out a certain way, but almost always there are also warning flags that things could go the other way. And so it's trying to balance those two signals. The fact is that we will be wrong sometimes in this business and we want to be intellectually honest about that and try to learn from those instances.

G&D: You mentioned being intellectually honest about the times when you're wrong. Can you tell us about the learning process that you've gone through during your career and lessons learned along the way?

JO: Adopting recessionary price targets has been our most helpful innovation in terms of refining our views on a given holdings risk/reward. In terms of continuous learning, we use both a pre-mortem and post-mortem in thinking through our investments. From a pre-mortem point of view, when you're excited about an idea, it is natural to buy into your own thesis, and brainstorming as a team to raise awareness of potential biases and risks. We like to think through, "If this ends up being a mistake and moving against us, what would be the likely reasons?" And of course, you could have things that come out of left field (nobody expected a pandemic, or that earthquake in New York five minutes ago), but actively brainstorming that process helps limit those surprises.

"When we exit positions, even positions that have worked for us, we're also asking ourselves, 'Did it work for the reasons that we thought or did it not?' It's nice to be right but also important to confront luck. "

And on the other end, when we exit positions, even positions that have worked for us, we're also asking ourselves, "Did it work for the reasons that we thought or did it not? Did we get lucky for some other reason?" It's nice to be right but also important to confront luck. Otherwise, it can be a self-reinforcing process of patting your back on a great investment when in reality it played out for different reasons. I think we'll all take that type of luck. But it goes against you often enough too. So you want to be aware of that, and often there are lessons there too that you can apply to other companies.

G&D: Let's shift to the most fun part: the individual position discussion. Perhaps we can kick off with Inter Parfums (IPAR)?

JO: This is my favorite part too. So Inter Parfums is a company that we found during COVID. We were looking for the proverbial "babies thrown out with the bathwater" in the spring of 2020 when the whole market sold off so quickly that it did so without a lot of discretion. Almost everything was highly correlated and there was not much difference in the sell-off between what we view as really high-quality companies and those of lesser quality. And so we were looking for companies that hadn't been on our radar, but that might fit our criteria. And we found Inter Parfums at that time. It had been growing at about a 12% organic CAGR prior to COVID, had really nice mid-teens operating margins, no debt, very strong free cashflow. They license fragrances, often from small luxury good brands, and then they outsource manufacturing and distribute them globally. And fragrances are a growing category. They do a really nice job partnering with small brands, which creates a positive flywheel where they are in turn better positioned to win new license relationships.

Going into COVID, almost 20% of their sales had been duty-free, and that channel had obviously shut down, as had most of their department stores and more typical retail channels. And so we decided to see if we

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could underwrite it without assuming a recovery of the duty-free channel. In our diligence process we wanted to better understand why a brand would pick a licensing partner, what made them attracted to each other, and how licensors competed for those licenses. Inter Parfums had lost a major license with Burberry back in 2013, when it was a 30% customer. We needed to thoroughly understand what had happened, and if in-housing of licenses presented an ongoing risk.

Inter Parfums does not have any customers of that concentration anymore, but still, losing a 10% customer, which they have a couple of, would hurt. It turned out that the dynamics were very specific to Burberry, where the brand itself had transformed from being a little bit of a sleepy raincoat company into a global powerhouse brand over the term of Inter Parfum's fragrance license. Burberry thought they could grow their fragrance business faster and more profitably in-house. But in fact they weren't able to do that. They relicensed the fragrances a couple of years later and we know from that press release that they actually shrank under their ownership, rather than growing as the rest of the industry had at the time. Ultimately, it ended up being a little bit more of a cautionary flag rather than a path that other companies are following with their fragrances.

We ended up initiating a small position in the fall of 2020 and built it up over time. An unusual element that added a little bit of complexity was the corporate structure, as the company is dual-listed in France. And because of that, they report both on the European calendar and the US calendar, and the US entity puts out an 8K when the French entity publishes results. Inter Parfums had only a $1 billion market cap at the time and it did not have a lot of Street coverage, so the stock was slow to react when there was news out of Europe. Fragrances recovered faster coming out of COVID than we or others had expected. They would post great results and the stock really wouldn't move here in the US, which we're like, "what's going on?" All of this was public information, but it was just a company that people weren't paying a lot of attention to. And sometimes you get that with little companies, particularly if there's an extra layer of complexity. So it gave us an opportunity to continue to build up our position as they continued to recover. And then they continued to win some great new licenses with Ferragamo and DKNY. And that was a really solid supplement to their revenue base that's continued to support their growth.

"Inter Parfums had only a $1 billion market cap at the time and it did not have a lot of Street coverage, so the stock was slow to react when there was news out of Europe."

To fast forward to right now, part of what continues to excite us about this business is a new license this year with Lacoste. That will do a nice job supplementing organic growth this year. Longer term, there's a unique opportunity in China, where historically consumers have not frequently used fragrances. Culturally, fragrance usage is not high in China, and so it's only about 5% of sales for Inter Parfums. But at many beauty companies, China can account for as much as 20% or 30% of sales, especially in skin care or cosmetics. Recently, younger consumers in China have been adopting fragrances and wearing them much more, however, and if this continues, there could be an interesting generational demographic shift in terms of fragrance penetration in China. That is a source of potential upside which isn't incorporated into our base case.

At times, Inter Parfums sells off on consumer discretionary spending concerns. I think it's been a little weak

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recently based on that. What's surprising is that organic sales were actually only down about 4% in 2009 during the financial crisis. Logically, fragrances seem like a very easy purchase to cut out. But in fact, it seems to be an affordable luxury that people do continue to buy for themselves. Over the past few years, we've had multiple periods where we've been able to upsize the position around those types of concerns. And then I think there is this potential longer term upside over the next three to five years if the Chinese market does take off.

G&D: You've been involved with the company for a while, so presumably some of these insights have been learned over time. When you were initially looking at the company, how did you go about constructing and then executing against a research plan?

JO: Some of the issues that we were trying to understand included, "Why does a brand select a licensing partner? Is it economics? Do they offer better royalty terms? Is it relationship-based? What does that licensing partner provide? How does one win or lose against another?" We had wanted to understand, as I mentioned, that whole Burberry issue. And of course, we were trying to think through the pace of recovery. This was in the midst of the pandemic. And so just thinking through the puts and takes of how recovery could look coming out of that as the retail environment slowly reopened. Our initial work took us a little over three months, three to four months.

Fortunately, we happened to have a number of business school friends and acquaintances who work in licensing at different luxury brands, but not always fragrances. Speaking with them was helpful to better understand licensing dynamics.

"Longer term, there's a unique opportunity in China, where historically consumers have not frequently used fragrances.... a source of potential upside which isn't incorporated into our base case. "

At the time, we wanted to understand why a brand would pick one versus the other. And it turns out that royalties are very standard in this industry based on brand size. And so it makes relationships really important, and brands deeply care about getting what they perceive as the attention of the top team and the best people, since they're relying on that partner to develop the fragrance and its marketing. They need it to tie into the overarching ethos of that brand and the customer set that they're going after. And so there has to be a lot of trust in that relationship.

We also spoke with Inter Parfums' competitors and continued to track them over time. Post-pandemic, Coty and L'Oréal have concentrated more on their larger brands, and that's left a little bit of an open playing field for Inter Parfums, which focuses more on smaller brands.

G&D: And in Q1 2023, the stock rallied quite a bit during the quarter, and you had the discipline from a portfolio construction perspective to trim the position despite being very excited about the long-term prospects of the company. Applying some of the concepts that we talked about with risk and position sizing earlier, can you just touch upon that particular decision?

JO: So you're right, Inter Parfums posted a great Q1 last year. They had an excellent holiday season and then a very strong quarter, and as it rallied it came very close to our estimated fair value, although not our upside case if China takes off. Given the rally it would have also been well over a 10% position if we had not trimmed it. And so from a portfolio management

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perspective, we needed to take some off. Also, from a valuation perspective it was close to our target price, and so, we took about 40% off of our position in the earlier part of 2023. Inter Parfums sold off later in the year, however, given macroeconomic uncertainties, we were able to rebuild it. By the end of the year, I think the position was more or less flat, maybe down a few percent in terms of the number of shares that we owned. But within that, we did have those shifts in our ownership that reflected the varying upside and risk-reward that we saw at different valuations throughout that year.

G&D: Great. Shifting to the next idea, HEICO Corporation (HEI), can you talk about the thesis there?

JO: So HEICO is a company that I've known for a really long time, actually started looking at it back in 2008, and that we've owned since Alpine Peaks' inception over six years ago. They're exceptional capital allocators and have made a number of great acquisitions over the years that have been really accretive to the business and their ability to grow. What has us particularly excited right now is that they bought a company, Wencor, which is their largest acquisition ever, that's right in the sweet spot of what their core business does. And they are doubling down on an area where they've really become the go-to provider.

Specifically, Heico makes what are called "PMA parts," which stands for Parts Manufacturing Authority. The acronym is given by the FAA. Essentially, Heico takes OEM parts and then reverse engineers them to create generic parts with the exact same technical capabilities. They need to prove that the parts can handle the same stress tolerances and are made out of the same materials and so forth. And then each of those parts has a two-step process where it needs to be approved first by the FAA and then by each individual airline. And that's actually the bigger threshold. You can have a skilled engineer coming out of Boeing or one of the tier one aviation suppliers who develops a good PMA, but United is not going to adopt that part across their fleet. You know, the cost of a part going wrong, if it grounds a plane, is much higher than anything they can save from a component purchasing perspective. HEICO built up trust and a reputation for excellent quality over time, helping make them the market leader in PMA parts. When the Mendelson family bought HEICO back in the early nineties, it only had a handful of PMAs and over the last 30 plus years they developed a library of almost 20,000 parts. Wencor solidifies their position as the dominant PMA provider.

If you think about the perspective of an airline, they have several choices for parts. Of course, they can buy a new part, they can buy a used part, which is called "used serviceable material," or they can buy a PMA part. And typically a PMA part would sell at roughly a 30% discount to the OEM part.

And so this was a long-winded way of saying that the Wencor acquisition, which is providing significant upside this year, is also positioning Heico to continue to be the dominant PMA provider. That is a reinforcing dynamic that is helping

"What has us particularly excited right now is that they bought a company, Wencor, which is their largest acquisition ever, that's right in the sweet spot of what their core business does. Wencor solidifies their position as the dominant PMA provider."

them continue to build market share. COVID was actually really favorable to them, because it created dynamics where airlines needed a dependable supplier, and HEICO was able to get them these parts on time. And they also had a need to save

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money. Airlines obviously went through a near-death financial experience, and it would've been in much worse shape if not for government support. And so coming out of that, they really cared about the economic bottom line. And HEICO's parts are one of the few ways that they can boost their thin profit margins without negatively impacting the customer experience.

G&D: This particular idea certainly calls to mind the philosophy that small companies can be big companies within their niches. Can you tell us more about their niche, how this acquisition strengthens their position, and why competitors wouldn't be interested or able to enter their market?

JO: That's a great point. This is a business model that multiple people have tried to follow. Within the aviation industry, most original equipment manufacturers sell the original part at very thin margins to the Boeings or Airbuses of the world. And then it's a "razor-razorblade" model where they make the vast majority of their money in the aftermarket, and typically price very aggressively too. 7% to 8% annual price increases were not unusual even prior to the inflation of the last few years.

Clearly, it is an attractive business, but it is difficult to create the scale and brand reputation for an airline to trust you. Heico partnered with Lufthansa very early on in its development in the '90s, who actually bought a 20% stake in what's called the Flight Support Division. And that was a big vote of confidence, because not only is Lufthansa a major airline, but Lufthansa Technik is a big service provider to other airlines

> ***"Airlines obviously went through a near-death financial experience [during COVID]... Coming out of that, they really care about the economic bottom line. And HEICO's parts are one of the few ways that they can boost their thin profit margins without negatively impacting the customer experience."***

as well. And so the fact that they thought that HEICO had sufficient quality was a major vote of confidence from somebody who was respected within the field. And that helped Heico build up their initial library. There is a threshold as in many markets, a tipping point where then you become the go-to person, because you have the big library of parts, because you have the customer relationships.

And so now, when HEICO is developing a new part, it's not their engineer looking at the plane and thinking about, "Where should we go next?" Instead they have customers actively asking, "Hey, we feel like our supplier's screwing us over on this part. They're gouging us on the price. Could you guys PMA this?" And when they get enough of those requests, they develop the new part, and already have a built-in customer base for it.

Private equity has seen the attractiveness of the business model and tried to emulate Heico's business. Wencor was owned by multiple private equity firms, including Warburg Pincus most recently, who sold it to Heico. Their smaller competitor Chromalloy was owned by Carlyle and then recently sold to Veritas Capital, another private equity firm. Generally though, the importance of scale and reputation in this business forms a formidable barrier that is difficult to overcome if someone is starting from scratch.

G&D: With acquisitions, sometimes it's hard to evaluate companies on traditional metrics like ROIC. How do you go about evaluating their acquisitions?

JO: Yeah, that's a great question. At a high level, we try to back out acquired revenues and assign some reasonable organic growth rate to

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that revenue over the years. We think about how that pool of acquired businesses has likely grown, and then try to back out how you think the organic business has done. And this is obviously "back of the envelope," but it's been a useful tool for us, particularly on the short side, where we've had some really good shorts from roll-ups that never integrate businesses. Sometimes, when you do that back of the envelope math, you realize that the business is really not growing organically.

But in HEICO's case, when you do that, you see that both sets of businesses are growing quite strongly. And they've been able to continue to improve margins over time, too. HEICO trades at a very premium multiple, and so whatever they acquired is almost certainly accretive to the business, because of that multiple step up.

How do you know if they're successful capital allocators? Did they pay an attractive price? Was it incremental to the company's economics? And it is hard to know honestly for any one deal when you're trying to do that analysis. But when you're looking over a ten-year period, or longer, I think that some of those more rudimentary methods can actually be helpful just to at least directionally understand if the company has been adding value or not through its acquisition program.

G&D: The Mendelson family has long been involved in this business, and the two brothers are now co-presidents. How do you view that, where there are two people running the organization, versus one individual leader? What are your general thoughts on succession planning?

JO: That is one of the primary risks that we see. CEO Larry Mendelson, who we think extremely highly of, is getting more senior and it wouldn't be unreasonable to expect him to retire at some point. Actually we think that both Eric and Victor, Mendelson's two sons who are the co-presidents, are both highly effective, thoughtful leaders. But generally, I haven't seen co-CEO structures work out particularly well in public markets. And What gives us comfort around this risk, is that we have spent a lot of time talking to the Mendelsons over the years. The decision making structure for major decisions involves a four-party group, including CFO Carlos Macau. And they need a consensus vote of all four of them to move forward with major decisions such as acquisitions.

Larry Mendelson has done a wonderful job as CEO, but it has not been one of those businesses with a sole person delegating down from the top. They've been making these decisions for years in a very collaborative way. The decision-making structure is frankly much more consensus-driven than it is at a lot of companies, which helps give us greater confidence in HEICO's ability to transition through the eventual succession.

We think very highly of Larry Mendelson and wish him all the best in his eventual retirement. But I think his retirement – when it comes – will raise questions in people's minds, and I wouldn't be shocked to see HEICO perhaps have some volatility in its stock price around that transition. But ultimately we do think that they'll be well-prepared to transition through it.

G&D: Great. Now to Trex. Can you begin by telling us the thesis there as a long?

JO: Trex was essentially the pioneer in composite decking. They essentially take a mix of recycled plastic and sawdust that they collect from furniture mills and lumber mills, mix it together at very high temperatures, and extrude it into boards and cap it. This creates an alternative to wood decks if you are thinking about building out your deck in your backyard. Composite decks are more expensive than basic lumber, anywhere from about 20% more to as much as double the price if you go for some of the really high-end composite decking. But a

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composite deck will typically have at least a 20-year warranty, whereas a wood deck on average lasts maybe ten years and needs to be treated and maintained over that time to keep it from rotting.

Trex has helped drive the shift toward composite decking with consumer and contractor education about the availability of composite decking and about the characteristics that make it more attractive. Directionally, there's been about a 1% market share shift from wood to composite decking a year, in terms of the linear feet sold of decking. Trex is the biggest company in the industry with approximately 50% market share.

We really like a lot of the financial characteristics of the company, which squarely fit the financial profile we like to see.

Trex has been growing organically at an attractive double-digit rate. It earns operating margins around 25-26%. So it's a very profitable business. It has no debt to speak of and generates significant free cash flows. So a really attractive financial profile. They've been steadily taking share within the industry. And we think that they're really well-poised to continue to do so. There are attractive environmental benefits too, since almost 100% of the inputs are recycled. Trex is one of the largest recyclers in the country, and their ability to handle heavily soiled recycled materials has helped profitability. This makes Trex's products a natural fit for consumers who want sustainable products.

G&D: You mentioned that they were a pioneer in this sub-sector of composite decking. Sometimes being the first mover can be a good thing but sometimes it can be a bad thing. Can you talk about the importance of the market structure for Trex, and whether in your view it has more to do with the cost structure or the existing customer relationships? And also, how does Trex defend their position and continue to add to the dominant position in this little oligopolistic sub-sector?

JO: Certainly. When you think about market share dynamics, there is a competitive advantage to locking in that position early on, but you made an interesting point that it can be hard to be the first mover, too. And actually the first couple of generations of composite decking had some quality issues that led to a number of lawsuits, and initially gave them somewhat of a bad reputation, because they had issues with warping under the sun.

There was a technical innovation where they started what's called capping the product. After the core board is extruded, they now wrap it with a clean layer of plastic. And that dealt with a lot of the quality issues that plagued the industry early on, and has led to much lower warranty costs and so forth in recent years. This was over 15 years ago, so this is in hindsight, but yes, there were certainly growing pains. There tend to be. Trex's market position benefits from a number of things, including distributor relationships, manufacturing scale, and brand recognition that results from its ability to spend on marketing and related education. Distributor relationships are quite important in this industry. These include Home Depot and Lowe's, as well as large lumber distributors. Many distributors only carry one composite decking brand. Perhaps they carry two, a premium one and then a lower-end option. Trex and AZEK, their biggest competitor, each now have a good / better / best offering, a three tier value offering to help fill the different price point, which a distributor would often look for. So at times they can fill the full range of product offerings themselves.

It's also important to have a contractor base that knows how to install your line of products. Since Trex was one of the innovators and first movers in this space, there are now a lot of decking contractors that know how to install their product. The contractors themselves tend to be brand-loyal because they know the ins and outs of working with a certain product. And so once you've built that

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familiarity, it actually takes quite a bit to get somebody to switch.

Being the largest player in the industry gives Trex attractive manufacturing scale, which is one of the things that enables it to have industry-leading margins.

And then finally, there's an advertising element where Trex is the biggest advertiser. Most of the advertisement isn't aimed at getting, say, a famous movie star to promote the product, but instead it is focused on continuing to educate people about what composite decking is and its benefits. Trex owns several of the decking websites, for instance, and there are different tools on those that can help consumers do price comparisons to see the difference in initial installation costs versus lifetime value. Those are really the avenues that they're focused on, and that helps build brand recognition, too, when a consumer does eventually make that call to a contractor.

G&D: I think something that popped out to us in reading your letters was the macro commentary, and I think we'd be remiss if we didn't touch upon that aspect of your investing style. In reading the way that you talk about Trex through different letters, it seems like the point in the demand cycle influenced your view on whether this was good or bad for the stock. Can you talk to us a little bit about how you formed the view that COVID demand was unsustainable, went initially short, and then how the changing macro environment caused you to determine that this would actually be a better long at the time?

JO: Back in Q3 2021, we heard both Trex and its competitor AZEK speak about the fact that they had another record quarter, with Trex growing 45% for instance. But what they both said in the commentary was that the growth was driven by channel replenishment rather than underlying demand. Essentially what happened was decking boomed during Covid, as people were home, it was a safe place to spend time outdoors with their friends and family, and a lot of people had money, they weren't spending it elsewhere, and the government stimulus programs were targeting consumers. Decking was so popular that at lumber yards and the Home Depots of the world, as soon as it came in the door from the suppliers, they called up the contractors on the waiting list who would pick it up. Most distributors had almost no inventory. And so this quarter happened to benefit from a really big inventory replenishment cycle. Hearing that always gets us intrigued, because that is not going to be sustainable next year, it creates a tough comparison. But an investor just looking at a financial screen or a model, will not realize that without digging into the company. So what happened was, we weren't sure how much COVID had pulled forward demand, but the revenue was up 18% in 2020 and then 36% in 2021. Clearly, this had created a particularly strong demand environment. Trex's 10-year average growth rate was 12%. This is a company with attractive growth, but this was above and beyond their typical growth.

"Trex's market position benefits from a number of things, including distributor relationships, manufacturing scale, and brand recognition that results from its ability to spend on marketing and related education."

What we were trying to think about, was "What is normalized growth? How will it return to that?" It's always a hard question. But we did think that there had likely been some element of decking build out that had been pulled forward by COVID. And then there was the fact that the Federal Reserve was likely raising interest rates. And frankly, that happened faster and more aggressively than we

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had expected when we began to build this as a short position.

We put on a small short really based on just the facts that the inventory channel refill dynamics created a tough comparison. And then as the Federal Reserve raised interest rates, it became more attractive from a short perspective. Decks can cost $20k to $40k or more. It is a big investment and a lot of people use home equity loans or another method of financing. And so that combination created a tough dynamic that led to revenue dropping 30-40% by mid-2022. The stock continued to drop to our estimated recessionary price and we covered it, but then it continued to drop, which intrigued us from a long perspective.

And as I'd said, this is a company that we really liked and admired. This was a unique set of circumstances where we recognized that there was a tough dynamic in their market, but we continued to be intrigued. And the stock fell to a point that we thought priced in a really difficult, really slow recovery coming out of COVID. Margins were also really depressed, but Trex has been an extremely good operator over the years. And so that combination intrigued us and we began to build a long position in Trex in early 2023. The company has continued to execute better, frankly, than we initially expected. And as they've done so, that's continued to raise our estimated target price and in turn made us more comfortable building up the position.

G&D: And beyond composite decking being a fundamentally better product due to less maintenance and therefore lower lifetime costs, you also mentioned that it has some positive ESG attributes. Can you tell us about your view on integrating ESG into your investing framework?

JO: It's become such a lightning rod, but for us ESG is one of the natural inputs to our process, like any other consideration that could impact a company's value. We look at it from a bottom line perspective and we think that environmental, social and governance issues can all be very meaningful to a company's ultimate value and demand for its products.

We don't give companies brownie points, so to speak, because they're doing something good for the environment or some social good. That's not the approach that we're taking. But I think if you're not considering these factors you can be ignoring important risk factors. Socially we've seen that if a company develops a culture where employees feel like there isn't security and that they're not valued, that tends to lead to elevated employee turnover that, in turn, frequently leads to elevated customer turnover. And that creates a really tough dynamic for a company to work their way out of and rebuild. And so that's something that is on our radar and not because it's a "societal good" to treat people the right way, but the fact is that building a workforce is challenging. Going back to HEICO, they have been exemplary about that. Although Larry Mendelson can't stand "ESG," it's ironic because I think he embodies a lot of the characteristics, especially when you think about the "S" of building a workforce that feels valued and that in turn is loyal to the company, that can have a lot of reciprocal benefits back and forth over the years. And so for us, they're all important from a bottom line perspective and I think help us make better informed investment decisions.

Matt Wind (MW): I actually don't see how investors can feel that they really understand and are being thoughtful about a company's outlook without taking into account those issues as well.

G&D: Moving to closing remarks, we all hope to emulate your success in our careers post-business school. What are some things that you've done to improve as an investor on a regular basis?

JO: I think that the pre-mortem and post-mortem that I mentioned earlier have been useful and I

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certainly applied that as an analyst just thinking through my own advice. Something that I did when I started out too was keeping a paper portfolio. A lot of firms don't allow you to actively trade your personal account when you're working for obvious reasons (i.e., they don't want you front running the investor). But I kept a paper portfolio and there are a number of tools online where you can do this. And so when I recommended a buy or a sell or a short or a cover, I did that in my paper portfolio as well. That was an interesting learning exercise because it's easy to look back with "rose-colored glasses" and think "I recommended this at just the right time" when actually the moment you did was maybe a month early or late.

It helps to be honest with yourself as you think about, "Did I make a good call? How was my timing? How was my sizing?" All of those decisions can set up a really useful learning cycle. It's even better if you're allowed to trade your personal account, but I think you can capture a lot of the same learnings with a paper portfolio as well.

G&D: When you were a young analyst, what qualities do you feel helped you stand out when you were starting out in your career?

JO: I feel like there is an evolution where a more junior analyst essentially is often a really good book reporter. And these are important skills, by the way, it's being very detail-oriented, it's really digging into a company, really understanding. You have to be willing to ask the basic questions, especially if you're a generalist or if you're new to being a sector specialist in a given area. I often find that if you're willing to ask those questions, and here I'm thinking of the context of group meetings, often it turns out that three or four other people at the table had no idea either. Some industries use a lot of technical acronyms and it's critical to push to understand, "Okay, what does that mean from a layman's perspective?" And having that back-and-forth until you really understand, and not being embarrassed to do that is enormous. Being willing to keep lightly pushing back to ensure that you really have that understanding of what's going on will help make you a good analyst.

"Pre-mortem and post-mortem [analyses] have been useful and I certainly applied that as an analyst just thinking through my own advice."

That first layer of being a good analyst also includes the basics of being willing to roll up your sleeves and dig into a company. Reading through the old 10Ks and 10Qs and digging into old presentations can be where you can find the best nuggets. Today a lot of funds move at a very fast pace, and some of them are spending, frankly, three or four hours on an idea and doing things at a pretty superficial level. If you can spend a lot more time on a company and dig into their history and understand why things have gone well, why that happened, conversely where they had issues, can really give you an advantage.

And then I pair that with, whenever possible in your career, having valuation discussions with the portfolio managers you work with or with other people you respect in the industry. Asking, "Why do you see this as a buy? Why do you see this as a sell? What are the risks you see? How do you think about sizing this up or down?" can help an analyst form a more refined view on valuation. And certainly, the more companies you cover, the more you develop a sense of how companies with similar financial characteristics often tend to trade at similar valuations.

The more you can have those conversations and practice that in your own recommendations and keep track of how those performed, the more that can create a positive cycle to help improve your recommendations as an analyst.

Finally, in my view the best analyst is the one

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who can take the excellent book report that a really solid junior analyst can do and then push it to the "What's next? What does this mean?" The "so what?" I think that's really the stepping stone to what makes somebody a great senior analyst and then a great portfolio manager.

G&D: That's really insightful. Shifting gears a bit, buy-side seats are becoming more limited; from a functional standpoint of breaking into the industry, can you talk about how to start forming those industry relationships and how to signify that we embody some of the attributes that you touched on that make a great analyst?

JO: I think that you're fortunate within Columbia's Value Investing Program. Personally, I have found the program to be a rich recruiting ground. It's a place that I always post for jobs on the alumni job board. You are fortunate to be in a program that has that legacy and is known for doing that type of deep work. At a broader level, this can be a hard industry for recruiting because there's no real central clearinghouse for jobs and it is more word of mouth. Unfortunately, there is definitely a higher networking element. I always enjoy the Berkshire Hathaway weekend, which is coming up and I think a number of you will be at.

Venues like that can be a great place to meet a number of investors. When you read an interesting article or hear an interesting talk, you can also reach out to that person with a follow-up question; that can be an interesting way to start building a relationship with somebody in the field. This is an industry with a little bit of a chicken-and-egg issue in that most people want somebody with experience, but how do you get that experience in the first place? And so doing internships was I think the most valuable element to school, at least for me; being able to try different things for a summer. No matter how many questions you ask somebody about what they do in their day-to-day job, it's hard to know until you actually walk in their shoes, whether that's something that you will personally enjoy doing.

Trying to do internships to the extent that your schedule allows is probably the most useful tool to see if a role is ultimately a good fit for your interests. And sometimes, too, you discover that something that's the sexy thing at the moment is not for you and that's a really valuable learning. That can be just as valuable, though a little disappointing, to find out that you don't care for working at a certain firm or their approach doesn't resonate with you. It is better to discover that in an internship, however, rather than spending perhaps three or four years in your career at a place that ultimately isn't a good fit. Banks and the sell-side also have great training programs, which can sometimes get overlooked. A lot of people do move back-and-forth between the buy-side and sell-side, and that can be a great stepping stone into an investing career.

G&D: Is there any off the beaten path advice that you would give aspiring investors that's been helpful in your own career?

JO: I've really benefited from people who have had an open door and been willing to talk to me both as an analyst when I was just developing my own sense of how I think about companies and then certainly when I was thinking about launching my own firm. People were enormously helpful and generous with their time, speaking to me about what went

"The more companies you cover, the more you develop a sense of how companies with similar financial characteristics often tend to trade at similar valuations."

right, what went wrong and just the practical kind of things about how you set up a firm. And since then, I have a peer group of portfolio

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managers who I turn to with questions. And I think it's always really helpful to have those people that you can bounce questions off of. The quid quo pro for me is I try to in turn keep my door open. The one caveat, and be aware of this if you email a busy person, is that just because they maybe don't get back to your first email, that doesn't necessarily mean that they have no interest in talking to you. Sometimes, if something falls out of the top page or two of your email, things can slip through the cracks inadvertently. It's perfectly fine to send a polite follow-up email just reiterating your interest in talking to that person.

It does help to be mindful that certain times, such as during earnings, for instance, are going to be tough times to reach out to somebody in our industry. And some people just won't have either the capacity or willingness to talk to you, but I think a lot of people will.

G&D: And how about outside of investing? What do you like to do for fun? Any interesting hobbies?

JO: Well, I love to ski, which probably will not surprise you since I named my firm Alpine Peaks. That's probably the big one. Otherwise, I enjoy tennis. I enjoy bike riding, and hiking. We were actually just visiting a few national parks last week, Zion and Bryce, which I hadn't been to since I was little. It was wonderful to be outdoors in such beautiful places.

G&D: Well, this has been extraordinarily helpful and really interesting and we're sure that our readers are really going to enjoy this one. So thanks so much for spending time with us. We really enjoyed it.

JO: Well, thank you all. I really appreciate you being so thoughtful with putting together these questions and spending so much time with me in what I know is an extremely busy period of your life with school. And congratulations on being part of a great program.

G&D: Thank you. It's hard to complain. I think we all feel very blessed.

The materials, information, statements (both oral and written) and documents provided by Jennifer Oppold and contained in this interview (collectively, the "Information") do not constitute or form any part of any offer or invitation to purchase any securities and the issuance of the Information shall not form the basis of, or be relied upon in connection with, any contract or commitment on the part of any person proceeding with any transaction.

Examples of specific discrete investments were selected for inclusion based on objective, non-performance based criteria for the purpose of describing the investment processes and analyses the Firm uses to evaluate such investments. The respective Fund's portfolio will contain a much larger number of positions; accordingly, the example is not intended to indicate overall portfolio performance that may be expected to be achieved by the Fund.

David Capital Partners

Adam Patinkin

Adam J. Patinkin, CFA, is the Managing Partner and Portfolio Manager of David Capital Partners, LLC ("David Capital"), a long-term oriented alternative investment firm headquartered in Chicago with offices in London. Adam oversees the firm's investment program and research process. Prior to founding David Capital, Adam was a member of the investment team at Chicago-based Sheffield Asset Management, L.L.C. ("Sheffield"), a $500M long/short equity hedge fund manager. At Sheffield, Adam was responsible for sourcing and evaluating investment opportunities in public securities and commodities markets on a global basis. Adam holds the Chartered Financial Analyst designation. He earned a B.A. from Dartmouth College with a double-major in History and Government in 2007.

Editor's Note: This interview took place on March 29, 2024.

Graham & Doddsville (G&D): Thank you for being here, Adam. We're really excited for this interview. To kick us off, please share an overview of David Capital Partners.

Adam Patinkin (AP): It's really nice to meet you, and I appreciate the invitation to be included in this issue of Graham & Doddsville.

I oversee David Capital Partners, a long-term oriented alternative investment firm based in Chicago with offices in London. Our flagship strategy is global long/short equity. We also manage significant co-investment assets. David Capital launched with just $2M – the classic "two guys in an office with a Bloomberg" – but since then we've built an institutional-quality firm with a great team and track record. We currently manage roughly $200M.

Our philosophy on the long side is "value plus a catalyst". Our philosophy on the short side is "supply side shorting". Our portfolio is relatively concentrated, with 15-20 longs and around 25 shorts. Our holding periods are measured in years, which is advantageous in a market that is increasingly short-term focused. We source investments from across global developed markets, and have significant expertise investing internationally as well as in the US.

"There is both a margin-of-safety from a low valuation and a likelihood of getting paid in a timely manner from some trigger event or business change. This is what we mean by 'value plus a catalyst'"

David Capital's portfolio is truly "best ideas". We meet with hundreds of companies each year, and review thousands of opportunities – only a few of the fattest pitches make it into our book. Every investment in our portfolio should whack you over the head with how compelling it is.

We look for high-quality businesses with healthy balance sheets, positive cash flow, and strong management teams – but where the stock price is materially misvalued for a reason we can understand, and a clear catalyst event path exists to correct the mispricing. There is both a margin-of-safety from a low valuation and a likelihood of getting paid in a timely manner from some trigger event or business change. This is what we mean by "value plus a catalyst".

Our bar is high and we don't cut corners. If a security is in our portfolio, it should be extraordinary. That's not to say we get every investment right – the real world is messy, and sometimes our thesis gets delayed or does not work out. But by being disciplined with our strategy and by doing deep fundamental research on each company we own, our batting average over

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time has been attractive. I look forward to sharing a few of our ideas in this interview.

G&D:
That's a great introduction. Please walk us through your background and how you first became interested in investing.

AP:
From the time I was little, I've seen the world through numbers.

Yesterday was the opening day of the baseball season, which makes this an appropriate moment for an interview. When I was in first grade, the boy who lived across the street from me was hooked on fantasy baseball and fantasy basketball, and I too was quickly captivated. I loved the strategy of it and I loved the statistics.

Each day, we would pour over box scores in the newspaper to track our teams – this was in the early-1990's, just barely pre-internet. We learned to calculate Ryne Sandberg's batting average if he went 2-for-5 (Sandberg was the star second baseman for the Chicago Cubs) or Michael Jordan's field goal percentage if he shot 16-for-24 (Jordan, of course, was the star shooting guard for the Chicago Bulls). We would play one-on-one baseball with a tennis ball against his garage door, with home runs hitting my family's house on a fly. We kept track of every at bat. Arithmetic became second nature to us.

I made my first investment in middle school. A great aunt had gifted me a $1,000 government bond when I was born, and it matured when I turned ten. On that birthday, my mom let me know about the investment. She works in private wealth management, so of course her advice was to invest my newfound riches into a stock of my choice.

She gave me a list of companies. One quickly stood out: Electronic Arts, the company behind the Madden NFL video game. It was a business I understood, and as a happy customer I was confident the company would do well. It made for a great first pick!

When I was in college, I majored in History and Government. But I knew that for my career, I wanted to do something more math-oriented and was drawn to the investment world.

About halfway through college, I sat down with a family friend who had known me since I was born. It turns out he worked in the hedge fund-of-funds industry. I asked him what he recommended I do after graduation. He said, "You should work for a hedge fund." I said, "What's a hedge fund?" He said, "Let me make a couple introductions for you."

One of the introductions was to Brian Feltzin, who runs a long/short equity investment firm in Chicago called Sheffield Asset Management. I went and sat down with Brian, we had a really nice conversation, and he gave me a list of books to read on investing. I came back to him a year later, and he said, "Hey Adam, did you read any of the books on that list?" I said, "Yeah, I read them all." He said, "All 30 of them?" I said, "Yeah, every single one." He said, "No one's ever done that before."

Brian and his partner at Sheffield, Craig Albert, gave me an investment project to work on. I still remember the company: TRW, an auto parts business.

I researched TRW and pulled together a 30-page write-up. At the end of the report, I needed to value the company and recommend whether it was a buy or a sell. I'd purchased a book on valuation published by McKinsey, which included a lengthy section on Discounted Cash Flow models, or DCF's. I tried to apply the DCF framework to TRW, but struggled to determine its fair value.

At the end of my report, I wrote in the conclusion: "I hate to say this, but I have no idea how to value this company. If I use this assumption in the DCF, it's undervalued. If I use this assumption in the DCF, it's fairly

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valued. If I use this assumption in the DCF, it's wildly overvalued. I'm not sure what to do."

I submitted the write-up to Brian and Craig. I figured they wouldn't like the conclusion, but to my surprise they loved it. Craig pointed out this was the problem with employing a DCF to value a public equity. "Using a DCF is like the Hubble Telescope," he told me. "If you turn the dial just a little, you're in an entirely different universe." They appreciated that when something didn't look right, I had the humility and independence of thought to say so.

Sheffield took me on as a consultant after I graduated. A week after I started, they hired me full-time.

I was certainly lucky to get that initial introduction to Brian. It changed my life. But demonstrating a work ethic and passion and a bit of independent thinking were what ultimately got me a seat on the buy side.

"In investing, there are lots of different ways to get to heaven. Each investor must figure out for himself or herself an approach that works."

G&D:
What drove you to launch David Capital in 2011?

AP:
I was at Sheffield for three and a half years. I couldn't have asked for a better experience. Brian and Craig were terrific mentors. The investment team was a talented group of folks who came at the world from different perspectives, but who loved to engage and think critically about markets and stocks and businesses. Pat Carlevato, Matt Klody, Evan Lorenz, Mark Hytros, Jon Hirschtritt – I was really blessed to be in that kind of environment with such wonderful people, and to have the opportunity to listen and learn. I remain friends to this day with all of them.

In investing, there are lots of different ways to get to heaven. Each investor must figure out for himself or herself an approach that works. For me, it is "value plus a catalyst". This philosophy, however, differed a bit from Sheffield's approach, which was more classically value investing. I had done well at Sheffield, and helped create a lot of value. But over time, it became increasingly clear we were not in perfect synch on investment philosophy.

Brian and Craig sat me down and encouraged me to launch a fund of my own – and offered to back me if I did. I was 25 years old. It was a big decision point in my life. I thought about it, and figured you don't get many times where people are willing to put their name and reputation behind you. I decided to go for it. I ended up raising a million dollars of working capital for the business, convinced a college buddy to join me, and we went live with $2.15 million in assets under management. You remember every penny when you start with $2.15 million!

G&D:
That's an amazing origin story. What has it been like building David Capital since then?

AP:
I made the strategic decision to create an institutional-quality firm from the start. We had a Big Four auditor, a real office, business cards, a name prime broker – all the things that demonstrate you're a serious firm.

This especially became the case after I hired our CFO Corey Vnoucek a couple years later, who is now my business partner. Corey had spent over seven years at Ernst & Young and then was controller of a $300 million fund manager. He accelerated our investment in infrastructure to make sure everything we did was in keeping with industry best practice.

We've also tried to set a strong culture. We work hard, value honesty and transparency, are detail-

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oriented, and have a passion for what we do. Importantly, we are committed to independent thinking – we strive to be data-driven and evidence-based, and to make decisions from first principles. This kind of approach can be very powerful. It's fun to come to work every day when your colleagues are so talented and thoughtful, and everyone is rowing in the same direction. I care deeply about my team, and I think it shows.

It's difficult to build a great investment firm. It's a grind to raise capital. But we've tried to do it the right way by putting up numbers, treating our capital partners well, building an A+ team, setting a good culture, and caring deeply about our reputation. We've come a long distance from that initial $2.15 million.

G&D:
Can you please speak to your investment philosophy. Let's start with your approach to short-selling.

AP:
Short-selling might be the most difficult skill in all of finance.

To do it well, you have to be committed. We devote significant time and resources to our short book, and treat short-selling as a craft. A lot of our reputation comes from our track record on the short side.

We call our approach "supply side shorting". We look for companies or industries that face a wave of new supply. No matter how good the company is, no matter how good the management team is, there's so much supply on the way that pricing is going down, which means profits are going down, which means the stock price is eventually going down too.

It's kind of the opposite of most short-sellers. We don't short frauds. Instead, we short boring, honest companies. When things are getting worse, we want management teams to actually tell the market about the challenges they face, so the stock price declines and reflects the business reality.

Our short positions generally fit into one of three buckets. The first is overbuilding of an asset class. If there are two hotels in town, and ten new hotels get built without a step-change to demand, that probably doesn't bode well for the owners of the original two hotels.

The second is overproduction of a commodity. There is always some commodity in deficit that is seeing a large supply response, which will eventually drive that commodity into surplus (and its price a lot lower). This can lead to declining profits (and share prices) for producers of that commodity.

The third is competition shorts. We are constantly searching for industries that are being disrupted, where barriers to entry have fallen and new competition has arrived to compete away profits.

"We don't short frauds. Instead, we short boring, honest companies. When things are getting worse, we want management teams to actually tell the market about the challenges they face, so the stock price declines and reflects the business reality."

We find these set-ups over and over again. It's a repeatable process. There's always an asset class being overbuilt. There's always a commodity cycle. There's always an industry being disrupted. These supply-driven industry changes are constantly happening. And we are out there continuously looking for them.

G&D:
One of your short positions is Brown-Forman Corporation. Can you please share why this fits your "supply side" approach to short-selling?

AP:
Brown-Forman Corporation ("Brown-

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Forman") is a spirits business that primarily focuses on the whiskey market. Its key brands are Jack Daniel's, Old Forester, and Woodford Reserve.

Over the decades, different spirits have gone through cycles of popularity. Here in the US, whiskey has been "on trend" for the better part of a decade. Whiskey has been hugely popular. But when you think about the timing of the supply response to meet that demand, it has been delayed in showing up.

The reason is structural: whiskey must be aged before it can be sold. At a minimum, bottom-shelf whiskeys are aged three-to-five years. Higher-end whiskeys, including brand-name scotches, are often aged for 12, 15, even 20 years or more. It takes a long time to see a supply response in the whiskey industry because of this delay.

The number of whiskey barrels in inventory, however, is a known figure. Historically, the inventory has averaged about five years of current consumption. But given the popularity of whiskey, manufacturers have rushed to boost production, leading to an explosion in whiskey inventories. Right now, whiskey inventory is equal to a staggering twelve years of consumption – and the number keeps going higher as production continues to outstrip demand.

It's hard to know when this tidal wave of supply is going to break in a big way. But we view it as inevitable. And in fact, we are seeing data points that the wave has already crested.

Whiskey companies, including Brown-Forman, have recently become more cautious when discussing their prospects. We think it's only going to get worse – we are in the first inning of this supply wave – and there's no way out. It could take a decade or more to clear the incredible amount of whiskey inventory. This will pose a significant challenge to Brown-Forman's business for years to come.

G&D:
How do you think about Brown-Forman's valuation?

AP:
Brown-Forman's stock is expensive. The company has a $26 billion market cap, and its enterprise value is a few billion above that. The company will do something like $1.4 billion of EBITDA this year. So it's a business trading for 20 times EBITDA or more. That kind of valuation implies a really valuable company where everything is going right with the business. Clearly Brown-Forman owns great brands. And I have nothing against the management team. Great brands, great business – but there's a cycle. The cycle is that whiskey production has gone crazy.

> ***"Historically, the inventory has averaged about five years of current consumption. ... Right now, whiskey inventory is equal to a staggering twelve years of consumption – and the number keeps going higher as production continues to outstrip demand."***

No matter what Brown-Forman does, I think there will be a significant deterioration in the company's growth, earnings power, and valuation multiple in the coming years. Why couldn't the EBITDA multiple compress to the low double-digits, on a reduced level of profits? That's not only possible, in my view it's probable. The stock price could be cut in half or worse.

This is what we look for – situations where a supply response controls the destiny of a company. Brown-Forman is a fairly boring company. I don't think the stock is going to triple on us – it's not an AI stock or a high-flying tech company. But its shares are undoubtedly expensive, especially relative to the business challenges ahead. We think it's a terrific risk/reward on the short side.

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Constructing a portfolio of attractive short positions like Brown-Forman, paired with a compelling portfolio of long positions, to me is a powerful way to compound capital at a high rate over time.

G&D:
That's a good transition to the long side. Can you please discuss your "value plus a catalyst" philosophy?

AP:
Most investors identify either as "value" investors or "catalyst-oriented" investors. Catalyst-oriented investors go by a variety of names – "event-driven", "growth", "momentum", etc. But fundamentally, value investors focus on whether a stock is cheap, and catalyst-oriented investors focus on whether a stock is likely to go up.

"Time is a vital ingredient to calculating IRR. A two-bagger in three years is not the same as a two-bagger in ten years."

I'm trained as a value investor, which is the reason I'm speaking with you. For me, every investment begins and ends with valuation. But I also acknowledge that value investing has a blind spot – value investors often get so focused on valuation, they fail to ask the next question: "When am I going to get paid?"

In other words, value investors tend not to focus on the time value of money. This is a problem, as a cheap stock can stay cheap for an awfully long time, or even forever (i.e., a "value trap"). Time is a vital ingredient to calculating IRR. A two-bagger in three years is not the same as a two-bagger in ten years. Not paying attention to the timeliness of an investment can and does have a profound negative effect on returns.

On the flip side, the problem with catalyst-oriented investors is when they're wrong. Because if they're wrong on the earnings power of the business – if they're wrong on the catalyst – and they haven't paid attention to valuation, they experience a double-whammy on the way down. It's not just earnings that come in lower, it's also the valuation multiple. The double-effect of reduced earnings and a compressed multiple can be incredibly painful.

Over time, the investment approach that resonated with me was to say "I want both". I want the best of both worlds. Every investment should be a value stock that is meaningfully undervalued relative to intrinsic value. But I also want there to be a clear, identifiable event path that I can point to and say, "This is how I'm going to get paid. This is my differentiated view from consensus. This is why an undervalued stock is going to return to fair value."

I think in many ways, my approach is borrowed from Michael Steinhardt. Steinhardt is an investing legend who returned +30% per year for decades. I have a quote of his on my office wall:

"Ideally, an analyst should be able to tell me in two minutes, four things: the idea; the consensus view; his variant perception; and a trigger event. No mean feat."

That's "value plus a catalyst" in a nutshell.

And don't get me wrong - it's hard to find these situations. It's difficult or impossible to employ a "value plus a catalyst" approach in a single-sector strategy, or a single-country strategy. But as a generalist with long-term capital, and a mandate to search out these rare and compelling set-ups across many sectors and countries, I think David Capital has every opportunity to construct an asymmetric portfolio of investments that matches our "value plus a catalyst" philosophy.

G&D:
We would love to dive into a few specific positions. Let's start with Vistry.

AP:

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Vistry Group plc is a £4 billion market cap housebuilder listed on the London Stock Exchange under the ticker VTY. The company's share price is currently around £12.

I think the best reference point for Vistry is a US housebuilder called NVR. In the 1990's, NVR figured out an asset-light approach to housebuilding based on pre-selling homes and using options for land purchases. This new strategy allowed NVR to grow while generating excess cash. That capital has been used to continually buy back shares.

In the 30 years since NVR adopted its asset-light strategy, the company's stock price has compounded at +30% per year. That blows away Apple, Microsoft, the S&P 500 Index, even Berkshire Hathaway. NVR is the second-best performing stock in America over that time period. And it's all because of this amazing model – an asset-light housebuilder, run by a competent management team, redeploying excess cash flow into buybacks.

We believe Vistry is poised to be "NVR on steroids". Since the middle of last year, Vistry has been transforming itself into a pure-play Partnerships company by exiting its traditional housebuilding business. The Partnerships model, which involves working with partners who pay upfront or provide land held on their own balance sheets, is an asset-light housebuilding model specific to the UK which can deliver returns on capital approaching 50%. Vistry's Partnerships business is the dominant #1 player, many times larger than any competitor.

Partnerships is a difficult business to execute with significant barriers-to-entry, and Vistry is the best-in-class operator. Given the structural shortage of housing in the UK, and especially of affordable housing, we believe Vistry has decades of growth ahead of it.

To sum up, we see a business that earns higher returns on capital than NVR, that is growing faster than NVR, and hat trades on a lower multiple than NVR did back in 1994. That's a heck of a set-up to compound capital at a high rate for many years to come.

"Partnerships is a difficult business to execute with significant barriers-to-entry, and Vistry is the best-in-class operator. Given the structural shortage of housing in the UK... we believe Vistry has decades of growth ahead of it."

One final point. Last year, Vistry added a new Director who previously served on the board of NVR for a decade. Not long after, Vistry announced a £1 billion share buyback program, which is now underway. Vistry fully understands the NVR playbook, and the potential value creation from executing on it.

G&D:
How do you think about Vistry's valuation?

AP:
Partnerships transactions in the past have happened at 12-13x EBIT. Vistry's Partnerships business is larger, growing faster, and earns higher returns on capital than any Partnerships business that has previously transacted. We think Vistry could easily command a 15-20x EBIT multiple.

Vistry has guided to £800M of EBIT over the medium term, which we take to mean three years from now. The exit of the housebuilding business will provide the firepower for the aforementioned £1 billion share buyback program, which implies a current enterprise value of less than £3 billion. Doing the math, we see upside to £50/share or more, which represents better than a 4x from current levels.

G&D:
Why do you think Vistry fits your "value plus a catalyst" approach?

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AP:
We see Vistry shares as materially undervalued, trading at less than 4x medium-term EBIT.

We also see a clear catalyst event path. The best catalyst of all, in our view, is a fundamental business change where a company transforms itself into an operation that is both more profitable and of higher-quality. This can lead to a lollapalooza effect where earnings grow and the valuation multiple rises at the same time.

Vistry's transition to a pure-play Partnerships business – which is faster-growing, less-cyclical, and earns higher returns on capital than a traditional housebuilder – certainly checks these boxes.

Then there are other factors. We look for great management – we think Vistry's CEO is the best in the sector. We look for a clean balance sheet – Vistry will have zero net debt by year-end. We look for strong cash flow – Vistry's operating profit this year should reach £550 million, with hundreds of millions of additional cash freed up by the exit of housebuilding.

Finally, we see several technical triggers that can drive a re-rating in the shares. The first and most imminent is potential inclusion in the FTSE100 Index. The next measurement date is at the beginning of June. We think Vistry is in a strong position to be added. Inclusion in the FTSE100 Index could quickly add a turn or two to the multiple.

Overall, we love the set-up. Vistry is a wonderful business, with capable management, a strong balance sheet, lots of cash flow, an undervalued stock, and a clear path to value creation via a fundamental change to the business. It's everything we look for in an investment.

G&D:
eDreams ODIGEO ("eDreams") is another name in your portfolio that interested us.

AP:
You will see a lot that rhymes with Vistry in our eDreams thesis. eDreams trades for well below peer multiples, is transforming its business to a higher-quality and more profitable business model, maintains a healthy balance sheet, has a great management team, and is buying back shares hand-over-fist. eDreams definitely fits our "value plus a catalyst" philosophy!

Taking a step back, eDreams is a €750 million market cap online travel agent ("OTA") listed on the Madrid Stock Exchange under the ticker EDR. The company's share price is currently just above €6.

eDreams is tied as the largest OTA in Europe with Booking.com. OTA's are wonderful businesses. They are asset-light, high margin, generate lots of cash flow, and are structurally growing. Booking.com's valuation reflects this as the company trades for 17x EBITDA.

eDreams has embarked on a transformation of its business from a transactional model to a subscription model. It's similar to the Costco approach, where customers pay an annual fee to get access to discounted pricing. eDreams charges around €60 per year, and the discounts more than cover the annual fee by a customer's second trip.

Travelers have flocked to eDreams's subscription model, and the company's subscriber count has exploded to nearly 6 million – up from just a couple hundred thousand pre-Covid, and well above our expectations when we first invested.

The subscription model is much more resilient and predictable than a transactional OTA model. Over time, we believe eDreams can re-rate to at least Booking.com's 17x EBITDA multiple, and perhaps to the 20-25x EBITDA multiples enjoyed by many B2C subscription software businesses.

Importantly, the subscription model has also provided a significant boost to profits. eDreams grew Cash EBITDA by +50% last year and is expected to grow Cash EBITDA by another +50% in the

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current fiscal year to a record €180M.

G&D:
What does this mean for eDreams's valuation and catalyst event path?

AP:
On FY2025 numbers, eDreams trades at just 5x EV/EBITDA. This is a significant discount to peer OTA's like Booking.com.

We see a number of catalysts that can drive the share price higher in the months and quarters ahead.

"eDreams trades for well below peer multiples, is transforming its business to a higher-quality and more profitable business model, maintains a healthy balance sheet, has a great management team, and is buying back shares hand-over-fist. eDreams definitely fits our 'value plus a catalyst' philosophy!"

First is the ongoing transition to a subscription business. A majority of the company's profits now come from the subscription business, but by FY2025 it will be an overwhelming percentage. It is becoming increasingly hard to deny eDreams is a true subscription software business. With every day that passes, eDreams's operation becomes of increasingly higher quality.

Second is the company's share buyback program. Just last month, eDreams announced a €50M share buyback and the company is now aggressively buying shares in the market every day at close to 25% of the volume. This is an excellent use of capital, and over time should support the share price.

Third is debt reduction. eDreams currently has just over €300M of fixed-rate net debt, which places the company at close to 3.0x Net Debt to Cash EBITDA on a trailing basis. However, with debt levels rapidly falling as eDreams generates prodigious free cash flow, and with Cash EBITDA expected to rise +50% in the year ahead, the company's Net Debt to EBITDA should fall to less than 1.5x within a few quarters. This could lead to further credit upgrades (S&P just upgraded the company's credit rating a few weeks ago) and rising interest from European investors, who tend to be more debt-averse than Americans.

Fourth is an up-listing or re-listing of the shares. eDreams is not far away from qualifying for the IBEX 35, Spain's main stock index. As eDreams's profits continue to grow, any re-rating could quickly propel the company into the index. In the event eDreams does not reach the IBEX 35, a re-listing to the NASDAQ is always possible.

G&D:
Let's turn a little closer to home and talk about Lifecore Biomedical ("Lifecore").

AP:
Lifecore Biomedical is a CDMO business based in Minnesota. The company is listed on the NASDAQ Stock Exchange under the ticker LFCR. The market cap is about $200M and the shares trade for just over $6.

A CDMO is a "Contract Development and Manufacturing Organization". A CDMO is an outsourced manufacturer that works closely with pharmaceutical companies to develop, formulate, and produce drugs.

CDMO's are wonderful businesses, as there is significant cost in time and treasure to shift production from one CDMO to another. As a result, CDMO's tend to have high-margin, recurring revenue customer relationships that last for years or decades. CDMO businesses regularly transact at premium or super-premium multiples of 15-20x EBITDA, all the way up to 30x EBITDA or higher.

In the US, CDMO assets

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are in tremendous demand. Following multiple takeovers announced earlier this year, just two CDMO businesses remain publicly listed, one of which is Lifecore. These are rare and valuable assets.

G&D:
What is your investment thesis for Lifecore?

AP:
Over the last few years, Lifecore has spent significantly to expand its footprint in a market desperately short on fill/finish CDMO capacity. As a result, Lifecore is currently manufacturing about 10M units per year, but its capacity will expand to 70M units per year by next summer.

Our investment thesis is simple: we strongly believe that over the coming quarters and years, Lifecore will successfully fill up its new capacity with high-margin production, leading to rapid profit growth and a significant increase in the company's share price.

Importantly, we think Lifecore operates in a particularly attractive vertical within the CDMO space. Lifecore specializes in complex injectables, operating fill/finish lines that transfer highly viscous liquids into syringes for patient delivery. Propelled by the tremendous demand for GLP-1 weight loss drugs like Ozempic and Wegovy, the market is now staggeringly short of fill/finish capacity. Due to regulatory constraints, it can take five to seven years for new fill/finish capacity to reach the market. Lifecore's new capacity is arriving at the perfect moment.

Given the supply/demand imbalance, we think it's just a matter of time before Lifecore fills up its manufacturing footprint. We already see momentum behind our thesis playing out, as Lifecore's revenues, profits, backlog, and customer pipeline are all at record-highs. But we think this is just the beginning, and that Lifecore's profitability could increase substantially in the years ahead.

G&D:
Are there any company-specific factors that make a Lifecore investment appealing?

AP:
Yes. Lifecore has dealt with several temporary challenges that should be resolved shortly, likely in the next 90 days. In our opinion, this provides a compelling entry point for the shares.

Four years ago, Lifecore's predecessor was a non-sensical combination of a crown jewel CDMO business in Minnesota and several low-margin and volatile salad, vegetable, and agricultural businesses in California. Under pressure from shareholders, Lifecore divested the non-core California businesses to focus exclusively on its high-quality CDMO business.

The exit of those businesses was messy, and led to delayed financial statements, a drop in Lifecore's share price, and Lifecore being kicked out of the Russell 2000 Index in 2023. Most of the restatement is now behind the company (the 10-K has been filed and the accounting adjustments proved immaterial). We expect Lifecore to become current on its financials and to be added back to the Russell 2000 Index by the end of Q2 2024. By Q3 2024, we think Lifecore will be an attractive, investable, pure-play CDMO business poised to capture the significant growth of GLP-1 drugs, trading at a fraction of its fair value.

As Lifecore puts these temporary issues in the rearview mirror, we see significant upside potential. The company could be doing more than $50M of EBITDA within 2-3 years. At peer multiples of 20x EBITDA, that would imply a market cap of $1 billion, which is 5x the current valuation.

Lifecore currently trades at $6 per share, but it's not unreasonable to see the stock reach $20-30/share or more as new customers are onboarded and turn on commercial production. Importantly, Lifecore's CEO is heavily aligned with shareholders and incentivized to boost the

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share price – he is due to receive tens of millions in compensation if the shares reach those price levels.

Finally, it's worth noting the CDMO industry is currently seeing a broad-based demand tailwind that is gaining steam. Beginning in early-2022, biotech funding was challenged as interest rates marched higher. This had a knock-on effect, hurting the entire ecosystem of drug research and manufacturing.

"Given the supply/demand imbalance, we think it's just a matter of time before Lifecore fills up its manufacturing footprint. We already see momentum behind our thesis playing out, as Lifecore's revenues, profits, backlog, and customer pipeline are all at record-highs. But we think this is just the beginning, and that Lifecore's profitability could increase substantially in the years ahead."

Starting late last year, as markets got comfortable that interest rates had peaked, biotech funding has come back in a really meaningful way. As research programs spin up, we anticipate a burst of new demand to reach CDMO's like Lifecore starting in the back-half of 2024 and into 2025.

G&D:
A portfolio with Vistry Group plc, eDreams ODIGEO SA, Lifecore Biomedical Inc., and Brown-Forman Corporation is certainly idiosyncratic and unique. How do you go about sourcing your ideas?

AP:
At David Capital, we generate ideas in three ways. Number one is we meet with companies. Each year, we meet with between 300 and 400 companies. If we sit down with a CEO, CFO, or COO for an hour, we should be able to come away with a strong understanding of what the business is worth and where it's headed.

Since David Capital started, we've now met with roughly 4,000 companies. That's an incredible amount of intellectual property. It's a fantastic knowledge base.

Remember too that we only have 15 to 20 longs in our portfolio, with an average holding period of three to five years. This means we only need to add a few new companies to our long portfolio each year. If even 1 out of 100 companies we meet with each year makes it into our book, we've just about filled up our portfolio requirement for the year.

So number one is companies we meet in the current year. Number two is companies we've met with in the past. Maybe it wasn't the right moment to invest with them when we originally met. But years later, the opportunity arrives. This is probably our most important source of new investments.

Number three is other smart investors. We have a great network of thoughtful, talented investors. And they know our philosophy. I can't tell you how many times another investor has come to me and said, "Hey Adam, I run a long-only portfolio, but there's this company over here and it looks like they're going through a supply cycle, and it's going to get really bad. You should probably have a look at it on the short side." Those are amazingly helpful calls to get.

My old boss at Sheffield, Craig Albert, used to tell me that "80% of the value in investing comes from sourcing." I think he's right. The best way to source new ideas is to know what you're looking for, and then to always be looking.

G&D:
One thing we want to touch on is management and activism. How would you describe your approach to engagement with management?

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What particular situations lend themselves to activism?

AP:
Our preference is not to go publicly activist. We prefer being engaged with companies and working closely with them behind the scenes in a positive way – by earning their trust and respect through our good counsel. We want to support competent management teams and help them solve the problems in front of them.

If we are invested in a company, there's some mispricing of the stock that needs to be fixed. We are happy to be involved in proposing solutions and helping make progress against those solutions. It could be better investor relations, capital allocation, maybe a re-listing of the shares, or some change to the strategy. We hope to win the trust of the management team through our track record and by proving we're a positive and thoughtful partner. And we've had a lot of success doing that.

There is one time we have gone public with our activism, and that was with a company called Countryside Properties plc in the UK, which we eventually helped merge into Vistry Group plc. For the full story, I suggest readers listen to our interview on the Yet Another Value Podcast from January 2024 with host Andrew Walker.

Even in that case, we were working closely with the company behind the scenes. Countryside operated two businesses – one extraordinary (Partnerships) and one mediocre (housebuilding). The sensible strategy was to focus exclusively on the high-quality Partnerships business. And that was the direction the company was headed, with our support.

Unfortunately, the CEO had to suddenly leave the company for personal reasons. It quickly became clear his successor was in over his head, as the replacement CEO decided to backtrack on the strategy and instead doubled down on the mediocre business.

We engaged at length to convince the new CEO this made no sense – to no avail. We ultimately determined to launch a public activist campaign, which led to his removal as CEO and eventually to the combination with Vistry.

Vistry is now in a terrific place. Vistry has top-notch management and is pursuing the strategy it should have followed all along: a pure-play Partnerships business alongside meaningful share buybacks. With the right strategy in place, it's now one of the best investment opportunities I've seen in my career.

So it's not something we sought out. But it is a tool in our toolbox if we need it. It's important to win your first public activist campaign, and we did. Our preference, however, is to be a positive and supportive shareholder behind-the-scenes.

"My old boss at Sheffield, Craig Albert, used to tell me that '80% of the value in investing comes from sourcing.' I think he's right. The best way to source new ideas is to know what you're looking for, and then to always be looking."

G&D:
What do you do to improve as an investor?

AP:
There are two things that come to mind, and they both involve trying to be as objective and data-driven as possible.

First, we are constantly self-assessing our performance and trying to figure out ways to improve. We run all kinds of data analytics on our portfolio, our returns, and our positions.

This is a humbling business. There are lots of unknowns. It's why investors should always build in a margin of safety – no one gets

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everything right. It's important to constantly be self-assessing and figuring out, "Hey, how can I do things just a little bit better?" And doing that in a data-driven way, I think, is powerful.

Second, it's so important to find people on the other side of your trades. Find people who disagree with you. Seek them out. Look around our country and world. Too often people get into their own echo chambers and only want to hear people who agree with them. That's not the right way to live life, and that's not the right way to invest.

You should actively seek out people who take the opposite position from you. I have generally found I get the most confidence and conviction when I hear the bear case from the most full-throated bear, and still can say, "Hey, I think the evidence supports me." That's how you get real conviction in an investment. So I would say to improve as an investor, be humble, do self-assessments, do it in a data-driven way, and always, always, always seek out counterpoints of view and test yourself and challenge yourself and your ideas. That's the best way to improve as an investor.

G&D:
Who are the investors, mentors, and/or books that have had the biggest impact on you as an investor?

AP:
Brian Feltzin had a reading list he gave me when I was in college. I've since expanded it. If any reader wants a copy, he or she can e-mail me at adam@davidpartners.com.

The investor who I most closely resemble in style is Michael Steinhardt.

In terms of mentors, it's clearly Brian Feltzin, Craig Albert, and the entire Sheffield team, as well as the group of inner-circle advisors I have here at David Capital. I owe them all a debt of gratitude.

I have also learned a great deal from friends and colleagues in the investment community. There are so many talented fund managers who are genuinely good people. It's a joy to call them my friends and to collaborate with them from time-to-time when researching investment ideas.

In addition, I learn something every day from my colleagues at David Capital. I've been working with Corey and my colleague on the investment team Hicham Talebali for years, and continually benefit from their insights and perspectives. It's great to empower a team where you really value their opinions and they feel like they can speak up when they disagree. I think that's a phenomenal way to learn and get better.

"This is a humbling business. There are lots of unknowns. It's why investors should always build in a margin of safety – no one gets everything right."

G&D:
Do you have any advice for undergraduate or MBA students looking to break into the investment management industry? If you were to hire an analyst, what qualities would you look for?

AP:
About a year and a half ago, we conducted a search for a junior analyst. We had one hundred applicants for one seat. We ended up hiring Maheen out of Johns Hopkins, and we're training her up in our investment approach. She just passed Level III of the CFA and she is getting better every day.

In our search there were five qualities we looked for: work ethic, passion, values, independent thinking, and intellectual horsepower. These are things any fund manager would look for in a new hire.

So I think you need to ask yourself – how do you demonstrate these qualities? I was able to show my work ethic by reading all the books Brian gave me. I was able to demonstrate

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independent thinking through my work on TRW. But somehow you will need to convey that you have these qualities in the interview process.

Julian Robertson, the investment legend who ran the Tiger Funds, talked a lot about values. He believed that in the investing business, finding people with good character really matters. This business will test you. There will be moments of challenge and difficulty. Being a good person, treating people well, being ethical and moral in your decision-making – I think it all matters a great deal. Protect your reputation at all costs, even if you have to make sacrifices to do so.

Finally, one small piece of advice. Once you're on an investment team, do everything you can to make your portfolio manager's life easier. I am confident it will be noticed.

G&D:
What do you like to do for fun outside of investing?

AP:
I still love baseball statistics and sports statistics more generally. I'm a diehard Chicago Cubs fan and a diehard Chicago Bears fan. My first job as a teenager was working at Wrigley Field, walking up and down the aisles selling peanuts and hot dogs. I still try to attend as many games as I can.

From a numbers perspective, the richness of the data in baseball is just incredible. And the strategy in building a professional football team with the salary cap, it's endlessly fascinating. So the first grader in me has never really left.

My family has a small operating farm out in Northwest Illinois. We raise cattle, and grow corn and soybeans as cash crops. My dad oversees it, but I help him out. It's nice to leave the city every now and again to stomp around some cornfields and pastures. As with most things in life, having a balance – in this case, between urban and rural living – is a good thing.

When I was little, my grandfather used to brag about how many newspapers he read each day. I think he really was trying to impart to his grandchildren the importance of staying knowledgeable about the world. There's so many dots to connect between politics and economics and war and peace and business and history. I'm fascinated by all of it. And there's just no better seat than to be at a fund manager. My job is to connect all these dots, and then to use that knowledge to help make the best capital allocation decisions possible. It certainly comes with a lot of responsibility. But I love it.

G&D:
Adam, thanks so much for the conversation. This has been fantastic.

AP:
Really appreciate you inviting me to join you. It's been my pleasure.

Muddy Waters Capital

Freddy Brick

Freddy Brick is a partner at Muddy Waters Capital LLC ("Muddy Waters"). Mr. Brick began at Muddy Waters in 2014 and has led Muddy Waters' investments in resource-related issuers since 2017. Prior to joining Muddy Waters, Mr. Brick was an Asian equity analyst at Oasis Investments Ltd., an event-driven fund based in Hong Kong. Mr. Brick holds a Bachelor of Arts in Finance, Accounting and Management from the University of Nottingham.

Editor's Note: This interview took place on February 23rd, 2024.

Graham & Doddsville (G&D): Freddy, thank you for joining us today. To start off, we'd like to get to know you. Who is Freddy Brick? And how did you become an activist short seller?

Freddy Brick (FB): I ended up becoming an activist short seller, and this is probably going to go against the name of your newsletter. I wasn't one of these kids reading Warren Buffet. I wasn't interested in the stock market or investing. My dad ran a clothing business, and I was fascinated by business growing up. When I was around 15, I'd done little bits of work experience in summer holidays at stockbrokers. And this is going to sound crass, but the guys, and unfortunately at the time it was mostly guys, the guys that worked at these firms all they drove nice cars. And what they were doing sounded interesting that they went out and had a good time. And I was like, "Cool, I want to do something like this. This is pretty cool."

So, I was interested in markets, and I liked the fast-paced nature. I thought markets sort of interacted with business, but you could see that it kind of didn't really.

And so, when I went to university, I studied finance accounting at the University of Nottingham, which I think is mostly known for producing rogue traders. If I remember correctly. Kweku Adoboli, the UBS rogue trader, went there.

When I left university, the financial crisis just happened. I was really starting to learn about accounting and markets and at the same time, the only people who came out of the financial crisis looking smart were short sellers. So, as I was really learning about the nuts and bolts of finance, you have all these short sellers that look really smart. And I thought what a lot of them did was really interesting, specifically that "big short" housing bubble and the asymmetry in that trade was super interesting to me.

I think it also had a very visceral impact on the way I thought about risk. Because I saw friends of mine where their parents had to massively downsize their houses, or they had businesses that were contingent upon short-term financing. And it really was life-changing for these people that the parents who were in their 50s lost a lot of money. Or people who thought they were very, very smart, I knew a number of real estate developers that went bust.

And so, for me, I think it really did shape the way I looked at things a little bit, in addition to seeing like, "Oh, wow, well, these short sellers made dynastic amounts of money." So, I think for me, that was somewhat formative. And I think what was equally formative was that I was on the bottom tier of people trying to get into banking. I went to an okay school. My grades were good enough to get through some of the rounds of applications, but I wasn't a straight A's, no-brainer hire for Goldman. But as banks were cutting back sales and trading, I knew I didn't want to be a banker. I could see that accounting was really important. I'd done an internship at PWC in corporate tax, and this is somewhat interesting in terms of taking risk, understanding what the client's trying to do, really move things around. I thought that was pretty interesting, but I thought working in a corporate environment wasn't going to be a great fit for my personality so I knew I didn't want to do that. I started a small business at university helping kids

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with all these numerical tests and other things you need to do to get into banks.

I started a small business in 2009, and China was really taking off. So, I think it was in the summer of '09, I was like, "I'm going to go to China. I'm going to defer this job at PWC as a backup. And I'm going to go out to China and see if there's a way to make a buck."

And I had this small business that I was running at night in China, and I was studying Mandarin during the day. Pretty quickly I realized a lot of people had this idea a long time before me. It felt like the kind of low hanging fruit of taking some US concept to Asia. At the same time, I was still interested in getting into finance, so I pinged a bunch of people and said, "Look, I'm in Asia. This is what I'm doing. I'll work for free." So, I worked for free for two or three months at a hedge fund. I then went to work for Seth Fisher at a fund called Oasis for a few years and sat on the desk doing equity long short, short-term, event-driven stuff. At the same time there were people trading converts, there were two other guys doing India. It was really commercial place to work, really interesting. Seth had all these wonderful sayings. He was one of the guys to tell me "An investment is a trade gone wrong."

It was an amazing place to work for two, three years. It was just the rawest essence of trying to find ways to make money. What was great is that they were willing to be entrepreneurial. For example going into Japan activism. People at the time thought "Oh, you can't do Japan activism because they won't listen." And it was like, "Well works elsewhere, why wouldn't it work there?"

And Seth became one of the early pioneers of this wave of Japan activism, which was super impressive. It was like drinking through a fire hose in that I came in knowing nothing.

After two and a half, three years, I met Carson [Block] and I joined Muddy Waters early '14.

"We realized the same dysfunctions that are apparent in China are actually everywhere. The same behaviors, the same lack of diligence from investors, and the same poor incentives exist in many other markets. They take slightly different forms, but really this is not something that's unique to China."

G&D: When did Muddy Waters launch?

FB: Muddy Waters started in 2010 in terms of publishing, but we actually only started managing outside capital in 2015. For the first few years it was proprietary capital. I joined Carson [Block] and we had an initial investor structured as a fund of one in late 2015, and then we launched a commingled vehicle in 2016. The firm through 2015 was more China-focused and from 2015 on we realized the same dysfunctions that are apparent in China are actually everywhere. It's not just that China has a monopoly on stock fraud. The same behaviors, the same lack of diligence from investors, and the same poor incentives exist in many other markets. They take slightly different forms, but really this is not something that's unique to China.

G&D: Since we're on the topic of Japan, any views or thoughts today about activism in Japan? Long or short?

FB: We've done a couple of things in Japan. We had a company called PeptiDream (4587 JP), which worked pretty well. We went after NIDEC (6594 JP), which didn't go so well. People just didn't care what we said. It's a very interesting place potentially for short activism because there is fraud in Japan. I would differentiate that I believe it's sort of altruistic fraud typically.

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It is not like fraud in the US that is, "Cool, I'm going to jam the stock, I'm going to promote this, I'm going to set out to deceive because financially I have a huge incentive to do so."

I actually think it's often more like, "Look, things have been covered up." Like the Olympus type fraud where Michael Woodford turns up and they open the books up and they're like, "Oh, by the way, we have a multi-billion-dollar hole. And the previous guy was covering it up and now as CEO, it's your job to cover it up. Because otherwise 20,000 people could lose their jobs."

Corporate managers are not paid that well in Japan, and there's a much more formulaic way that your career progresses in Japan. I think it is a very interesting place for short activism but It's a very hard place to research because culturally it's difficult to penetrate. I think communicating there is harder in terms of understanding the drivers of what long investors really care about in the stock than in the US or Europe. But I do think it's a big liquid market and I think there are probably some very interesting opportunities there but the barriers to entry are probably higher.

Long side activism is working there. There are the reforms driven by Shinzo Abe. There's a lot of money that is repositioning from China to Japan, Asia-based money. Obviously with the yen being so weak as well, that's great for exporters.

G&D: To bring it back to Muddy Waters, we read the following statement on the website, "Muddy Waters produces three types of research product. Business fraud, accounting fraud, and fundamental fraud." Could you provide a breakdown of how you go about identifying each and how each is different in your process?

FB: If you look at things in the $1 to $2 billion-dollar market cap range, you are more likely to find what would universally be considered fraud. Behaviors that are not really debatable.

As you get up in market cap size, I think you find a lot more intellectual fraud. And this is the kind of stuff that was going on at GE back in the day, the kind of stuff that for the most part was going on at Enron. I know there were some things that were over the line. It's the heavily driven financial engineering. It's the stuff that by the letter of the law is kosher, but by the spirit of law, is a total violation. It's the stuff that smart finance people and lawyers and accountants spend hours thinking through and contorting . We focus a lot more on the latter. And just because of the size of the companies we typically go after, we spend a little bit less time nowadays focusing on the former. Even if you find a hand in the cookie jar type fraud, it's often just smaller relative to the size of the total company. So, it can more easily be dismissed.

In terms of our process for identifying things. We're not thematic investors, but oftentimes we accidentally find ourselves following themes. And the reason for that is that capital is attracted to whatever the new bright shiny object is. Over the years that's been China, it's been periods of emerging markets, 3D printing, EVs, and ESG. What we find is usually the first couple of movers in that space are pretty real. I mean, whatever anyone feels about Elon Musk, he gets the cars to drive, the rockets to fly. Even if he might not be the nicest person to work for.

> ***"As you get up in market cap size, I think you find a lot more intellectual fraud.... the heavily driven financial engineering. It's the stuff that by the letter of the law is kosher, but by the spirit of law, is a total violation."***

Lots of short sellers focused on his by hook or by crook means to get there. But he got there,

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and he built the cars and people liked them. But that tends to spawn a whole group of people who are like, "Well, my thing's kind of like that, right?" Everyone's looking for the next Tesla. So, you've got all this money that feels validated by owning Tesla or people who missed out on it, so they want to buy the next Tesla.

When you combine people looking for the next Tesla with the EV-type boom that we got during SPAC-mania, you get a high zone, you get an XL Fleet Corp, you get 15 other kind of EV SPACs that go public in a short period of time. So, we often end up focusing on what the new hot, exciting thing is. Not because we have a view on the technology per se, and not because we're trying to work out what the future of that is, but because we tend to find that is where the grift, the capital and the grifters attach themselves. We often find that's quite a good way for us to screen for ideas, as opposed to using really quantitative screening.

Not that we're working on anything in AI, but obviously AI is a place where there's lots of companies now rushing out press releases and there's lots of capital being attracted to it. That's likely to be a place where thematically there's probably lots to do for short sellers in one variation or the other. And again, that's not a view on AI, that's a view on capital being attracted to that segment of the market.

G&D: Would say that the way you would come across ideas is just by simply following the capital? Given the platform and the brand you have, do you also get inbound ideas from others?

FB: We do get inbound ideas. It can be a varying degree of development. It could be as innocuous as someone saying, "Hey, I was at a conference the other week, I spoke to CEO and CFO was there and I asked a couple of basic questions. The CFO was really squirrely. And I followed up a couple times and they just wouldn't give me the answers. And this is a very straightforward question."

And sometimes people will present to us what they think is a pretty developed thesis. I'd assume it's a fund that's already short. And I think what's interesting about that process is the level of diligence required for something internal versus external. The level of work and surety you need if you are going to publish something is just a whole other level. A huge part of that is also really trying to make sure there are no unknown unknowns

And so, something that looks directionally right and is probably directionally correct as a short, there might be nuances in the thesis that are not quite correct or not quite buttoned up. And it's obvious why that's the case. It's not a lack of diligence, it's just like we can spend hundreds of hours with several people working on a single idea. If you're a small team of analysts and you work on several ideas, it doesn't make sense to spend the extra 20 hours to run down the smallest detail of something because it's not probably material to the overall thesis.

> ***"We often end up focusing on what the new hot, exciting thing is. Not because we have a view on the technology per se, but because we tend to find that is where the grift, the capital and the grifters attach themselves."***

But if you're going to publish, you need such a level of certainty because every time we publish, we effectively create a liability. We assume that we could one day be sitting down in front of a regulator to explain this. We've gone through a regulatory process in France and Germany and so we expect things like, "Hey, if we need to sit there in civil court or in front of a regulator and explain where we got the filing, how we reach the conclusion, and what supports that?" We

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chase every absolute smallest minutia down, that's the level we have to go to. For us to get the level of conviction is just slower and more methodical than probably what is done inside of a traditional long/short hedge fund if we are presented with an idea.

G&D: With that being said, because you have to be more thorough, how many ideas do you say you go through?

FB: In a given year, in real detail, we probably find ourselves looking somewhere between ten and twenty names. Five to ten we look at a reasonable level of detail. And we find that for whatever reason, maybe the thesis isn't as profound, maybe a stock falls apart by the time we can get there. Maybe some other activists beat us to the punch or something.

G&D: Have you come across ideas where you said, "This is actually pretty good business, or this is a good long idea?"

FB: Good question. The inverse of a good short isn't necessarily a good long. Usually the businesses we look at do have problems. The reasons we don't get there is maybe we think it's not particularly profound for activism. Or maybe the problems are in a small part of the business, which doesn't really speak to the thesis as to why people own the stock.

A good example of a stock where there was actually good activism, but it wasn't core to why people owned the stock, was Penumbra (NYSE: PEN). It was a thesis both Roddy Boyd and Gabriel Grego wrote on, and they got a horrible medical device that was dangerous off the market. We think that's amazing activism and people should really care about that. But it was becoming a smaller part of the business and the longs were able to say, "Well, I don't really care about that and we're happy to ignore it."

There've been things over the years where there's been lots of smoke but no fire. You might find yourself going really deep in the research and not proving it’s a fraud, but we don't find ourselves saying, "We're going to go long on this because we can't prove it's a fraud” because it might be."

G&D: That's interesting. So, can you distinguish between a good commercial short and a good short in theory? Is there a difference?

FB: I would say it's the difference between the melting ice cube shorts and the activist shorts. The melting ice cube shorts are in structural decline. Maybe there's leverage, there's technology change. The vanilla kind of larger cap, not super volatile, things like that but there's no particular management malfeasance. They're not covering something up. It's just a business that's in structural decline. It's maybe poorly managed, over-levered, weak end-markets, poor drivers, maybe some bad decision-making. There are plenty of good examples of retailers and shopping malls and some of these large commercial real estate businesses.

“But if you're going to publish, you need such a level of certainty because every time we publish, we effectively create a liability. We assume that we could one day be sitting down in front of a regulator to explain this.”

I think those are kind of the candidates over the last few years that have played out well. They're large, they're liquid, unlikely you're going to get some 100% premium takeout kind of thing. Those are typically I think what people are focused on it, at larger funds on short side.

Yeah, for us and a lot of activist short sellers, our process tends to be actually pretty backward looking. So, we're not trying to predict the future of whether a product is going to work, or an industry is going to decline faster or be

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worse. We're trying to say, "You have already published this information. You have told the market that this is the truth. We're actually trying to prove whether you've disclosed the whole truth. Or did you just tell us about a little fragment like, you bought this business for $100 million but didn't tell us you bought the shell from the chairman's brother-in-law four weeks ago for $10 million. So, we peeled another layer back and really showed the true substance of the transaction.

So that's I think a really big difference between the more traditional shorts and the activist shorts. The traditional shorts tend to be more forward-looking, and the activist short selling tends to be somewhat backward looking in terms of the analysis.

G&D: How have you viewed the short selling business changing over the last five years? Has there been a trend of retail trading coming in and trying to find a short squeeze? Or on the professional side, are investors being more cautious when they're thinking about how they want to go against a company?

FB: I feel anecdotally people are generally less interested in single name shorting and if they're long/short and they spend less time on the short side. But that's purely anecdotal because I have a sample size of people I speak to. I don't know if the data would or wouldn't support that.

"Our process tends to be actually pretty backward looking. So, we're not trying to predict the future of whether a product is going to work, or an industry is going to decline faster or be worse. We're trying to say, 'You have already published this information. You have told the market that this is the truth. We're actually trying to prove whether you've disclosed the whole truth.'"

Certainly, market structure is important on the long side as well. But for short selling, the passive phenomena have had an impact on the kind of companies we go after. Because if you go after a company that's a fraud, but 70% of the float is owned by passive and ETFs and management and it's a $5 billion market cap, it doesn't matter what you say about the company, there is no structural buyer or seller there. So that I think has a very distortive effect on markets. We've been aware of that for quite some time. That certainly I think has been the biggest change in terms of ability to select targets and across markets in general. I think that's had a really distortive effect on the way stocks react to things.

G&D: Historically, Muddy Waters has generated attractive returns, and even after premium fees. Given investors don't have too much of an appetite now for single short name selling, how is the fundraising, if you are still fundraising?

FB: I can't speak directly about our fundraising, but my view is if you have something that's not scalable, that's niche, and you can deliver on what you promise, you should charge a higher fee for that. If it's very true alpha, and really you can deliver, the only way to do that is with a premium fee structure. But you have to remain intellectually honest and can't all of the sudden be like, "Oh, we just worked out actually, it's scalable to a $1 billion." And you really must remain true to that. We have returned capital previously because our AUM outgrew our strategy.

Higher fees in general put some people off. I would always say focus on the net returns. Why do you care about the gross? There are all these amazing businesses like the platform businesses with

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the pass throughs and the fees-on-fees. No one complains about that because Citadel deliver amazing results. So, what do you care what Ken Griffin takes home? It's irrelevant if he delivers the product you want.

I think certainly post GameStop, people worry more about short squeezes. I think the kind of short selling as an insurance type product hadn't delivered for the last 15 years because of rates at zero. It just made short selling quite ineffective. I think that's possibly made some allocators shy away from being interested in short selling.

I wish I was raising a private credit fund. That seems to be the allocators' choice du jour.

G&D: On the back of that, it's a higher rate environment, which means you could collect a higher rebate in a higher rate environment, but also means maybe some stocks become harder to borrow. What is the net effect for your positions?

FB: For our market neutral strategy, we run long baskets against shorts So, we're paying on the financing, we're borrowing. Net-net, it's probably a wash. A high-rate environment means you're getting paid on your cash, as opposed to in a low-rate environment where you receive nothing on your cash. But I think market participants understand that and they obviously price that into the expected return.

G&D: Got it. We've covered the ideation, the sourcing, the framework. Once you've come up with the idea, you've done your diligence, how do you think about timing a position from when you publicize your research to time in a position, if that makes sense?

FB: We view risk as a function of time you have a position on. Obviously the longer you extend that runway of the time you're in the stock, the more random variables you introduce. Now we do hedge out macro and factor risk to the best of our ability. We tend to not want to publish things over earnings because these are all things we don't control and that we have as good, bad, or indifferent a view on as anyone else. The longer you have the position on, the more chance you have to have something taken out. Or just be very unlucky with an announcement of some sort. Or a peer announces some good news and people look at that as a read through. We view risk both in terms of size of position relative to capital, but also very much in terms of time that we have the exposure on.

G&D: And once you publish, what are the tools at your disposal that you use? We know you're active on social media, we actually enjoyed watching your YouTube videos, especially the Burford holiday party. What tools are you using and how do you think about those?

FB: What's very important for us is to get long-term wins. I think where short activism can get a bad name is if people feel like long term there isn't structural alpha there. It's really important for people to look at our track and say, "If I'd have shorted this at some point on the day that the report was published, would I have made money or generated alpha?" And we think that's very, very important. Because if you're a short activist and it'd be no different to the long side, you wouldn't have credibility on the long side of every single call you got up on CNBC. I think it's important for short activists' credibility, when you look at their long-term track record, that they've certainly got more right than wrong.

We look at businesses like Sunrun (NASDAQ: RUN), which is destroying capital by anyone's imagination. Well, if rates go back to zero next week and then Powell says they're going to stay there for 10 years, Sunrun stock will go up, and that will bail them out of horrific financial decisions they've made. And if Biden says, "Look, I'm going to subsidize every

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single solar panel on every roof and car for the next 25 years," the stock's going to go up. Not for reasons that have anything to do with the management, but for pure luck. We've seen this sometimes in biotech where short sellers are correct. The drug gets taken out by big pharma and then fails. And it's like, "Great, you're correct, you didn't make money."

We think it's really important as short sellers to get long-term wins. And it always amazes me that after we and other short sellers put out reports, the sell side rushes out to defend people who own the stocks. When it would be easy to just say, "Well, okay, let's look at Muddy Waters or any of these guys long-term track record."

"On the balance. If they're pretty right, I should probably take what they're saying into account." And for whatever reason it appears people just tend not to do that, which statistically is pretty unusual. But that's what I would do. I would just say, "Okay, look, let's look at the long-term track and if it's garbage, we can ignore this." And if it's pretty good, 60, 70, 80% batting average of the stock being down, we should probably pay attention to this.

G&D: What about in implementation? We saw an interview of Carson Block on CNBC from 2019. He expressed his view on Tesla, not through shorting the stock, but through put options. How do you think about the implementation of what tools to use for that?

FB: We spend a lot of time thinking about trade structuring and we want to find the most asymmetric way to express it, whether that's straight equity, options, or credit. We think a lot about downside risk. We actually spend more time thinking about how might this go wrong and how did we lose money than how are we going to profit maximize. We're very, very focused on risk management. We spend a lot more time really thinking about trade construction from the perspective of how do we not lose money versus how do we really dial up the risk and make money?

G&D: We could dive into the ideas and could go into your two most recent shorts. We can start with Fairfax (TSE: FFH). Do you want to walk us through your thesis on that one?

FB: Ah Fairfax. Everything I’m saying here is just my opinion. We believe Fairfax based on my review of the data is incredibly aggressive with respect to marking its book. And much of this is allowed, which we never said it wasn't. We just see a great deal of intellectual dishonesty. In Fairfax, what we see is significant areas where there's subjectivity. So, while the company would like to say, "Oh, well value is where something ends up and it's not about where it's marked today. And we have this wonderful way of determining intrinsic value and it's completely devoid from a market price." If that were the case, I would think the intellectual honest thing to do is marking very conservatively. And when lo and behold you reach that tangible, whether it's a takeout or crystallization, you take the markup then. What we see in many cases is actually the inverse. Where there's significant subjectivity, which is deviated from an observable price, which to my mind is always a better mark.

In my opinion, many of their investments haven't perform as well And that's a pattern over 10 plus years. I think the sell side would like to characterize this as Muddy Waters cherry-picked a few examples and that's really not what we did. We actually identified a pattern of behavior.

We believe there are a lot of things that are dressed up as sales, which are financing transactions. And again, we think this is probably done to benefit leverage metrics.

But when you see tons of aggression all over the book from the publicly observable financials, you really must question what else is going on. And we didn't really touch on the insurance operations,

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which we're also looking into.

G&D: The research report is very specific that it's targeting the holding company, not the subsidiary-level businesses. Do you have a view on the subsidiary-level businesses?

FB: Yes, we do. There are good investments and bad investments. For example, we can all intellectually debate about Digit's value. The issue we take is with the approach to marking it. With successive higher VC rounds Digit was marked up. And then lo and behold, we have a pretty significant financial crash in terms of multiples of VC-backed companies. We have a number of IPOs in India that massively underperformed and then they're very slow to take the mark-down. And so intellectually, again, if the approach wasn't, "Well, we really care about the marks," why didn't you take the marks down as fast as you take the marks up?

Our gripe is more with the intellectual approach. And not, as characterized by the sell side that, "Oh, Muddy Water has said that Fairfax made some bad investments." Everyone has bad investments. If you take for example, Exco [Resources]. Exco is an example of throwing bad money after good for over a decade. They first invested in equity, then they did some debt. They went through a bankruptcy process, which we believe for a long time the debt was aggressively marked during that bankruptcy process.

There's an observable price where the shares are trading in the OTC market, and they choose to market at a higher price because of their own fair value metrics. Why are you doing this if you're not fussed about day-to-day profitability in the business? Why wouldn't you just take the most conservative approach every time?

Then we get to the board, two of his children sit on the board. I believe John Templeton's niece sits on the board. Prem is very open about John Templeton being a great mentor of his. Three other members of the board are I think over the age of 80 or have been on the board for 15 to 20 years. And this is important in the context of these being the people that are supposed to hold this accountable. People think of Fairfax as this big company, it's got a $35 billion market cap. It's very small in terms of people.. And I think that's important in the context of how these things were allowed to happen because there's no real accountability at the board level, in my opinion.

G&D: Turning to the Blackstone Mortgage Trust (NYSE: BXMT). Going back to the three labels, would you consider this one a fundamental problem?

"Blackstone, of all the mortgage REITs, is the most levered and has the most exposure to office. Blackstone, because of its leverage position and the fact that it has CLOs which have peculiarities with respect to remaining in compliance and how that affects the cash flows to support the dividend, are in a place where it's very difficult for them to [divest office exposure]. Because they have a bunch of covenants that would actually be much more restrictive and problematic for them."

FB: This is unlike most things we look at. I actually don't think this was initially a case of significant management malfeasance. I think this was billions of dollars being thrown at commercial real estate funds and people had to put it to work. And none of them foresaw rates going up as fast as they did. And none of them saw the change to the

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world that the way we were going to go back to work and the relevance of office. Unlike most things, I don't think these are “bad people”. This was a fundamental thing that stimulated what's now become a problem. What is really interesting about Blackstone is we've actually seen it behaviorally morph. I think this recent quarter is extremely interesting because Blackstone, of all the mortgage REITs, is the most levered and has the most exposure to office.

What you saw previously was pretty much everyone, whether it was the KKRs or Ares, had some office exposure. They were kind of in the subjective gray area. You've actually had a number of those REITs come clean, mark things more accurately, cut their dividends. Really hunker down and true things up. Blackstone, because of its leverage position and the fact that it has CLOs which have peculiarities with respect to remaining in compliance and how that affects the cash flows to support the dividend, are in a place where it's very difficult for them to do that. Because they have a bunch of covenants that would actually be much more restrictive and problematic for them.

Now, when your peers are pretending that the marks are the marks, it's quite easy for you to say, "Well, we're no better or worse than anyone else." But now you have Blackstone that's very clearly significantly deviating from its peers. So that to me is a really interesting thing. I would say this quarter, Blackstone probably went from being the kind of business that was in the gray area of valuation aggressiveness, into probably a much more clearly delineated, "We're going to depart from our peer group," and be problematically aggressive here.

G&D: In terms of leverage their 10K published about, their LTV was about 63%. Where did you see its peers’ LTV compare to theirs?

FB: What is important to understand is Blackstone has tiers of leverage because you have the loans at the top of the structure. Then you have some holding company debt and convertibles. So, you have tiering of leverage. The cap structure is more leveraged.

LTV is highly misleading. The “V” is based on the loan at the time it was given. If you think a class B or C office is worth what it was three years ago, I've got some other stuff I could sell you. So that is just to me a laughable metric. And then my understanding is they don't have to really address the “V” until they do modifications.

And I think an area that is highly subjective and problematic within investing is these valuation firms. It's completely unregulated. Yes, there are best practices and principles, but it is completely unregulated. So, you can shop around, and you can find who you want. And all they're often doing is checking assumptions. For you to get a “V” fudged is not very difficult. And if you're a large platform who's across hundreds of billions of dollars of real estate and you apply pressure to the person who's generating the “V”, my assumption is that you would probably be able to extract a decent amount of malleability out of the counterparty there. We found single cases where we think the V is overstated by hundreds of millions of dollars on assets that are marked at $300 to $400 million currently. So, we think it's just egregious.

They can go through all kinds of steps and back flips with sponsors to hold things where they are and extending maturities and increasing occupancy optically. But if you actually look at the shadow vacancy, it's significantly higher, which includes basically subleasing. But like I said, the LTV is a highly gamed metric.

G&D: Can you walk us through the dynamic of borrowers capping their interest rate via rate caps? Is that part of the catalyst in your thesis?

FB: Blackstone talks

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about borrowers having put new rate caps in and that's fine, but the rate caps are higher on average than they previously were. So that impacts the cash flows to Blackstone. It's not that they can't get rate caps, it's just buying the same rate cap would be more expensive, which reduces cashflow to Blackstone.

In terms of borrowers, there are obviously going to be some borrowers that are able to put more equity in and there are going to be some borrowers that are going to walk away. And I think if Blackstone didn't have the dividend, they would be in a much better position to true things up. But because a lot of the stock is probably owned by retail and they have a dividend, and that's why people own it, if they cut the dividend, the stock goes down massively. Ultimately, they're just between a rock and a hard place. Between preserving long term value and supporting the dividend.

G&D: As part of your research, does Muddy Waters conduct a pre-mortem? As in, how can this go wrong for us?

FB: Yes, we spend a lot of time thinking, "If I was management, what would I do?" And what can change at a macro level that can make this thesis totally irrelevant? Again, we hedge rates so it isn't about, "We think the 10-year is going to do this and therefore this will happen." We try to hedge that variable out. But there are obviously macro factors that are going to be more or less supportive of their ability to continue to keep this game up.

G&D: And to your point, it does have a high retail ownership. That dividend yields attractive. I think it's about 12.5%. The price to book value, has been over 1x. Now it's at below one, around 0.8x. How do you convince the retail investors, it's not some just good attractive value investing?

FB: If I was good at convincing retail investors of anything, I'd be a much better short seller! I think where the rubber meets the road here is the dividend cut, which we believe is coming in the next few quarters. So that's usually the moment that retail gets religion.

G&D: We're arriving at the end of our interview. Do you have any advice for other graduates or MBA students looking to become short sellers?

FB: Don't become one! You will be much happier. That's my true, honest opinion, it's a tough business. I would say if you're very interested, I think one of the best ways to get into short selling is to start researching and working on companies. And if you're interested in getting into a fund that specializes, or short selling is a big component of their book, I think the best way to get people's attention is to say, "I did this write up," and try and send it to people.

I found people always receptive where they can see people have spent time and effort and work. And even if it's the worst thesis they've ever seen, I think they'll typically be receptive to give you pointers and want to engage. I think if you can engage with people, that's a good way to further your ability to get somewhere. And even if they don't have a seat, they might know a friend that has one they are looking to hire for.

G&D: And outside of investing and short selling, what do you like to do for fun? Any unique hobbies?

FB: I used to be an avid surfer but since we moved from San Francisco to Texas, as everyone commented on the way as I was moving my surfboards. They're like, "There ain't a lot of surf in Texas, buddy." So no, that's really curtailed my favorite hobby, sadly.

Enstar Group (NASDAQ: ESGR) - Long
2024 Artisan International Growth Stock Pitch Challenge (1st Place)

Business Overview

Enstar is a run-off reinsurance business that acquires portfolios of policies from insurance companies that are exiting specific lines of business. These policies will not see incremental premiums but may still see claims for many years and are said to be "running off" and thus represent a liability. Insurance companies pay Enstar a premium to take responsibility for these liabilities. Enstar manages the claims and invests the funds while opportunistically closing policies below book value. In terms of cash flow, they gain a large upfront sum and experience smaller outflows (claims) over a decade, profiting from interest despite total outflows surpassing the initial lump sum.

Investment Thesis

This is an attractive opportunity to acquire a stake in an excellent business which has delivered excess returns and that I believe is worth between US$400 to US$500 per share (versus the current price of US$267 per share). This opportunity exists for three key reasons.

1) Enstar falls in the "too hard to understand" or "black-box" bucket for most investors

- It is an unfollowed, obscure re-insurer with lumpy accounting and lumpier cash flows. There is no sell-side coverage, it operates in a niche industry, and is the only listed company of its type. As Enstar does not collect ongoing premiums, it has very small revenue (its main earnings come from a contra-expense), and traditional insurance metrics (loss ratio, core operating ratio) are not meaningful. Its cash flows are incredibly lumpy; it receives a large premium upfront, which it slowly pays down over time. Changes in observed performance can cause large swings in estimates of the loss reserves.
- It is a very long duration business that is not suitable for investors with short horizons. The liabilities are repaid slowly over more than a decade (the weighted average life is ~5 years), and its earnings accrue slowly over that time. Given the acquisition-driven nature of the business, it is difficult to predict with great accuracy the exact losses that will occur in a given quarter, and so it is not possible to trade around the expectations of next quarter's or even next year's earnings.

2) Its liabilities are worth substantially less than reported

- US GAAP doesn't take the time value of money into account. It requires most property and casualty claims to be held in nominal terms, i.e., you cannot present value them except where there is an agreed settlement.
- Present value is 30% to 40% lower than BV, even if the future is far worse than the past. Enstar presents the historical loss development in their accounts by line of business. On average, if they have acquired $100 of reserves, they have had to pay out between $101 to $108 ~10 years later (looking at the cohorts prior to 2013 and excluding Asbestos). The annual effective cost of those liabilities is 1-2%. Recent cohorts have shown a similar historical development pattern. Even assuming that they will have to pay back ~$130 for every $100 of reserves they have acquired, at a 5% discount rate, the present value of those liabilities should be ~30% lower than the book (nominal) value.
- In addition to this, US GAAP requires them to record their fixed maturity assets at market value in spite of the fact that the majority of those assets will be held to maturity (weighted average duration of ~5 years).

3) The management team is capable and aligned to shareholders

- They have Compounded BV / share at ~15-20% CAGR over 20 years in spite of record low interest rates.
- Dominic Silvester owns ~4.5%. He invested US$ ~10 Mn (at US$ 227 / share) in November 2023.

Valuation

In valuing the equity in Enstar I assumed;

- A 10% decline in the fixed income portfolio, equivalent to a further 1% rise in interest rates (including those held by counterparties).
- A 30% haircut in the equities and illiquid book (hedge funds, private equity, etc). I also assumed that the benefits it would have to pay to its policy holders would be 10% higher than the actuaries estimate.
- Fair / Market value of Enstar's liabilities. I estimated this by forecasting a range of loss developments and total ultimate developments that were more pessimistic than the worst historical experience. I estimate that the NPV of the loss reserves is 20 to 30% lower than BV.

Note: I define Margin of Safety as Value / Price - 1.

In this article, I have presented the valuation as I had originally prepared it in January 2024, please contact me via email (akashyap24@gsb.columbia.edu) if you would like a valuation that is more up-to-date.

Enstar Group | Latest Quarter Valuation

Figures in US$ Mn	Reported	Adjusted		Low	Base	High
Summary Balance Sheet	Sep'23	Sep'23	per share			
Assets	**21,031**	**18,284**	**$1,182**			
Investments	**14,430**	**12,090**	**$781**			
Fixed Maturity	9,849	8,864	$573	(10%)	(10%)	(10%)
Other Investments	3,637	2,546	$165	(30%)	(30%)	(30%)
Equities	881	617	$40	(30%)	(30%)	(30%)
Short-Term Trading	63	63	$4			
Cash	884	884	$57			
Receivables	4,067	3,660	$237	(10%)	(10%)	(10%)
Other Assets	1,650	1,650	$107			
Liabilities	**15,961**	**12,782**	***$826***			
Losses	**12,944**	**9,708**	**$627**	**(20%)**	**(25%)**	**(30%)**
Policy Benefits	572	629	$41	10%	10%	10%
Debt	1,831	1,831	$118			
Other Payables	614	614	$40			
Equity	**5,070**	**5,502**	**$356**	**$314**	**$356**	**$397**
Margin of Safety	**23%**			**18%**	**33%**	**49%**
Market Capitalisation	**4,129**					
Price / Share	$267					
Shares Outstanding	15.5					

Enstar Group (NASDAQ: ESGR) - Long

Further Upside and Sensitivity Analysis

The current price offers investors the potential benefit of large amounts of upside that they receive for free. I classify these as being of two varieties – being a "Hold-To-Maturity Investor" and being an "Exceptional Business".

1) The benefit of Enstar being a Hold-to-Maturity Investor: the reported values of the Fixed Maturity assets used in the valuation have been (in accordance with US GAAP) measured at fair value / market value. During 2022, interest rates rose and so the values of those assets fell. However, as Enstar holds that investment grade debt to maturity, the unrealized losses will be slowly unwound as those assets mature. Adding back the unrealized gains and losses increases the book value by US$ ~1 Bn (approx. US$ 100 / share). Recall that the fixed maturity assets are all in investment grade (A- to AAA) assets.

2) The benefit of being an Exceptional Business: The valuation assumes that profits will either be distributed to shareholders or reinvested at the cost of capital, i.e., that the business does not have durable competitive advantages. However, there are strong reasons to believe that this business can continue to deliver excess returns:

- Regardless of any reinsurance they purchase, insurance companies remain ultimately liable for the claims of their policyholders. They therefore face an element of counterparty risk if their reinsurers go bust and hence they prefer and accept higher prices from reinsurers who are less likely to go bankrupt. As the chart below shows, over the past 25 years, reinsurers with lower leverage have experienced higher growth than those with higher leverage.
- As one of the best capitalized players in the industry, Enstar should be able to continue to attract premium pricing from it's customers over the next 10 years. This allows them to be more selective in their underwriting and only pick off the "cream of the crop", underwriting risks that they wish to. This has allowed the to compound the book value of equity / share at a ~20% CAGR for 20 years. Being better capitalized is a durable competitive advantage, because it is not easy for reinsurance companies to refinance it's liabilities or change its capital structure. Unlike other businesses, reinsurance companies cannot easily prematurely settle their obligations with new capital. They would have to negotiate with many individual policy holders to commute their policies (none of whom are obligated to do so), which would be a tremendous operational challenge, not to mention expensive.

Sensitivity Analysis	Value / Share			Margin of Safety		
	Low	Base	High	Low	Base	High
Price / Share		$267				
Reported		$328			23%	
Fair-Value	**$314**	**$356**	**$397**	**18%**	**33%**	**49%**
Upside Cases						
Mark-to-Market	$404	$445	$487	51%	67%	83%
Hold-to-Maturity	**$494**	**$535**	**$577**	**85%**	**101%**	**116%**
Exceptional Business	$600	$700	$800	125%	162%	200%

NB: I only adjust the value of the fixed maturity assets

Risks and Mitigants

1) Deterioration in Returns, Underwriting Quality or Capital Allocation; Enstar's profits take many years to accrue and cannot be distributed to shareholders until losses develop in a favourable manner. The final use of that capital, as well as the pursuit of additional transactions, can have a large impact on the results experienced by shareholders. While Enstar has had a good run over the last twenty years, it is not certain that they will continue to be able to do so. As with many franchise businesses and investing, it becomes difficult to continue to earn excess returns as businesses scale and reach the limit of their competitive domain. Enstar was born in a softer market than today with a lot of transactions.

- The dynamics of run-off insurance, being that reinsurers have more information than the original underwriters and can often commute risks when more attractive opportunities arise, should give Enstar an advantage.
- While it does get harder to find attractive deals as one scales, Enstar is still only ~1% of the US$ 1 Tn global non-life run-off reserves.
- Enstar's management has a large amount of their personal wealth at stake.

2) Liquidity; Future claims are uncertain and could see increases due to regulatory or legal developments. Long duration, high severity claims like Asbestos may lead to unexpected balance sheet stress. Despite several mitigating factors (discussed below), large unexpected claims can have a material and adverse impact on Enstar's future performance if it is forced to liquidate investments at inopportune times.

- Enstar holds 2x the required amount of capital. As Enstar operates in multiple countries, it is required by each regional regulator to meet the solvency requirement of each geography with assets in that country and, to some extent, cannot easily get the capital benefit that diversification would offer them – *"at the entity level where the capital gets trapped, it doesn't matter that overall Enstar is very diversified because the local regulators really only look to their regime and their company."* (Former COO and Co-Founder of Enstar)
- Enstar can be a hold-to-maturity investor and has done a reasonable job of aligning duration on both sides of its balance sheet; the weighted average duration of it's claims (~5 years) is very close to that of it's investment book (~4.5 years).
- Enstar has entered into certain reinsurance contracts that mitigate the impact of large adverse developments that reduce their exposure by US$ ~1 Bn (vs its gross exposure of US$ 13 Bn). Even under pessimistic claim development assumptions (total claims of ~120% of reserves), the cash and investment book is >7.5x any single year's forecast claims.
- Post-1986, insurance policies stopped covering asbestos related injuries (because of previous high claims). Asbestos Mesothelioma typically arises 15-40 years post exposure and so we are likely closer to the tail end of claims (it has been 37+ years) supported by the fact that *"the rate of mesotheliomas in the United States increased from the 1970s to the early 1990s, but since then it has levelled off and even gone down slightly"* (American Cancer Society). Enstar holds US$ >1.5 Bn of asbestos liabilities.

Bio: Amar Kashyap is a second-year MBA student at Columbia Business School. He previously worked at True North, a leading Indian private equity fund where he primarily covered financial services companies. He would like to hear your thoughts on this article, especially if you disagree with him or are familiar with insurance businesses (akashyap24@gsb.columbia.edu).

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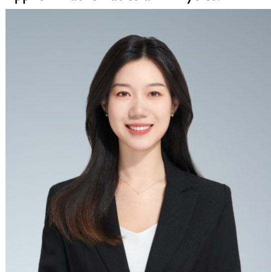
Joe is a first-year MBA student at Columbia Business School. He started his career as a consultant at PwC, developing statistical models for financial institutions. During his time at Columbia, Joe interned at Brizo Capital, a long-short global equities fund. He graduated from Vanderbilt University with a Bachelors in Applied Mathematics and Physics.



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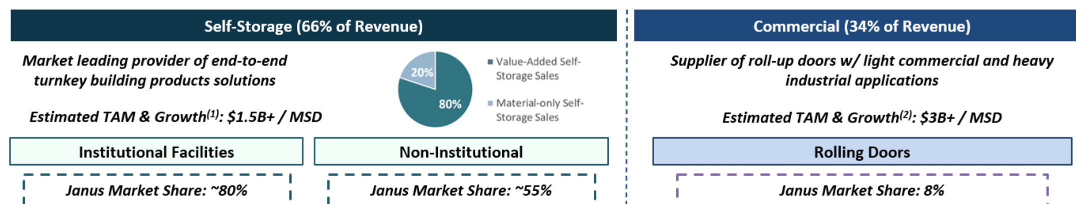
Janus International Group, Inc. (NYSE: JBI) - Long
2023 UNC Alpha Challenge (1st Place)

($mm, unless otherwise stated)					
Current Price ($)	$10.43	EV/'24 EBITDA (x)	6.9x	'24E Revenue	$1,133
Market Cap	$1,533	'24 P/E (x)	9.8x	'23-'25 CAGR (%)	4.4%
Enterprise Value	$2,039	ND / '23 EBITDA (x)	1.9x	'24E GM (%)	41.7%
52W High / Low ($)	$12.45 / $8.66	LTM Q3'23 ROA	11.8%	'24E EBITDA	$301
Avg. Volume (mm)	1.55	Short Interest (%)	1.8%	EBITDA Margin (%)	26.6%
Float (%)	76.3%	Dividend Yield (%)	0%	2024E EPS ($)	$1.06

Recommendation: Long JBI with a 1-year target price of **$13.77**, representing an upside and IRR of **32%**. Established in 2002, JBI is the market leading provider of products and services in the institutional (~80% market share) and sub-institutional (55% market share) self-storage markets. JBI's current valuation is not reflective of its true value: (I) Its SPAC origins and ownership dynamics have masked its true value; (II) Janus has significant competitive advantages to capitalize on the REIT cycle; (III) Mix shift will drive improved unit economics, and recent corporate actions will drive cost improvements and productivity.

Business Description: Janus International Group is the leading provider of turnkey building products & services for the self-storage and commercial markets. Janus manufactures and supplies roll up and swing doors, hallway systems, relocatable storage units, and facility and door automation technologies, serving both self-storage and the broader commercial industrial markets. They have 11 domestic and 3 international manufacturing facilities and ~2,300 employees. LTM Revenue was $1,082M, and their revenue is broken down as follows:



Investment Thesis:

I. Misunderstood business, trading like a commodity:

- Shaking off stigma: De-SPAC'd in June 2021, JBI has been grouped with other underperformers from the SPAC bubble. Moreover, JBI has dealt with a PE overhang until recently. In 3Q23, Clearlake materially unwound its position and now owns ~15%, which should remove fears of sustained large share selling.
- The baby thrown out with the bath water: Despite being an asset-lite market leader, with capital deploying end markets and significant cash flow generation, JBI is trading in correlation with commodity business product businesses (e.g., Acuity Brands, Atkore), a significant discount to its premium business product peers (e.g., Trex, AZEK, Graco), and where it was trading pre-September 2022.
- What the market is missing: JBI's revenues are related to Self-Storage REIT spend, which is expected to decrease in the near term; however, only a portion of JBI's revenues are expected to be cyclical to the Self-Storage REIT Cycle.
- JBI's synergistic businesses with distinct drivers: JBI's Greenfield (New Development) business provides materials, technology & services for construction of new self-store facilities and is driven primarily by real estate development and favorable market conditions, similar to REIT revenue growth. JBI's R3 business focuses on renovating and upgrading existing self-storage facilities and is driven by REITs CapEx spend, looking to increase customer willingness to pay.
- REIT CapEx spend for revenue enhancements are not well understood: While the market does not expect REITs to do new acquisitions and construction, hampering Greenfield development, renovation CapEx is the next highest ROI spend for REITs; however, the market has less insight into REIT Cap-Ex spend, the main driver of R3:

	Type of CapEx Disclosed		
Ticker	Maintenance	Deferred Maintenance	Revenue-Enhancing
CUBE	Yes	No	No
EXR	No	No	No
LSI	Yes	No	No
NSA	Yes	Yes	Yes
PSA	Yes	No	Yes (as of 2Q23)

II. Significant competitive advantages to take advantage of the current REIT cycle:

- Current situation for storage center operators: Falling rental rates, stubborn valuations, and higher debt

Janus International Group, Inc. (NYSE: JBI) - Long

- costs have neutralized the operator's price hike and greenfield development levers.
- REITs need to shift to sustain growth: REITs can't pool capital; however, self-storage operators generate significant cash, which requires continuous evaluation of highest ROI capital allocation. Per the Extra Space CEO, "The best returns on capital continues to be redevelopment of existing stores…high-single, low-double digit returns."
- Impact of reinvestment: While ~60% of Self Storage Center install base is >20 years old, enhancements can drive a rental premium of +25-30%, and enhancements are fully depreciable in 1 year time, and 100% tax deductible.
- JBI has the geographic footprint to deliver: Janus is the go-to partner for products and services in the Institutional (~80% market share) and Sub-Institutional (~55% market share) Self-Storage market. Per an expert call, "First of all, we bought everybody and there's not much else in terms of competition. So, I've always said there probably is clear monopoly as I've ever seen anywhere, right? They got like 90% of the market."
- Differentiated products that enhance Storage center value: JBI offers the Nokē Smart Entry System, a key-less entry control system that forms the core of JBI's "Security-as-a-Service" offering. It provides seamless access, sophisticated usage analytics, and enhanced security, directly increasing the perceived value of operators' properties. It constitutes a SaaS model with a strong value proposition. President of National Self Storage stated, "we're getting 30% premiums over our competitors at our facility in Marana, Arizona. That facility is in a retirement community, and our tenants loved the technology so much that we replaced PTI with the Nokē system at our 6 properties in Texas and Utah." Moreover, their comprehensive Restore, Rebuild, Replace (R3) service replaces storage unit doors, optimizes unit mix and idle land, helping operators double their ROI per month.

III. Mix shift will drive improved unit economics, and recent corporate actions will drive cost improvements on an already impressive base:

- Historically stable margins: JBI has proven its ability to maintain strong margins despite supply chain issues, making it a more durable business than the market is giving credit for. Over the past 5 years, JBI gross profit margins have averaged 36.2%, while premium business products peers have averaged 39.5%, and commodity business product companies have averaged 28.7%.
- Strong and steady FCF conversion: JBI is an asset-lite business model, with Net PP&E-to-Sales of 8%, allowing for significant FCF generation even during periods of growth. Further, FCF Generation of 95% affords flexibility and provides material downside protection in both growth and no-growth scenarios.
- Shift to R3 accelerates unit economics: Because Janus can provide more services when refurbishing and remixing an existing storage center, R3 can provide a higher dollar content per square foot. For instance, conversions are 2.5x dollar content per square. As a result, R3 provides greater revenue per contract, and with refurbishing contract volumes growing, this means accelerated revenue growth from mix shift.
- Cost Improvements & Productivity: JBI has redesigned contracts and corporate actions have lowered and streamlined cost pass through. In addition, JBI is increasing capacity, with two factories in development expected to drive further efficiencies.

Valuation

- In the base case, we assume that revenue growth will grow at 6.2% CAGR, primarily driven by the R3 segment outpacing growth in New Construction and Commercial. P/E and EBITDA multiples are based on historical values.
- Our base case assumptions translate to a 1-year target price of $13.77, with an upside of 32%.

Valuation Summary: 2024 Target Price

		Base	Bull	Bear
P/E Multiple	2025 EPS	$1.26	$1.30	$0.87
	Forward P/E	*11.0x*	*13.0x*	*9.0x*
	Target Price	**$13.88**	**$16.94**	**$7.84**
EV/EBITDA Multiple	2025 EBITDA	295	303	243
	Forward EV/EBITDA	*8.0x*	*9.0x*	*7.0x*
	Enterprise Value	2,359	2,727	1,699
	Debt	(508)	(508)	(708)
	Cash	156	163	331
	Equity	2,006	2,381	1,322
	Shares O/S	147	147	147
	Target Price	**$13.65**	**$16.20**	**$8.99**
	Avg. Target Price	**$13.77**	**$16.57**	**$8.42**
	Upside/(Downside)	*32%*	*59%*	*(19%)*

Forecast vs. Consensus (Base Case)

	2023			2024		
	Forecast	Consensus	*% Diff.*	Forecast	Consensus	*% Diff.*
Revenue	1,091	1,087	0.4%	1,167	1,133	3.0%
% growth	*7.0%*	*6.6%*		*7.0%*	*4.2%*	
Gross Profit	451	454	(0.7%)	491	476	3.1%
% margin	*41.3%*	*41.8%*		*42.0%*	*42.0%*	
EBITDA	286	286	(0.1%)	314	301	4.3%
% margin	*26.2%*	*26.3%*		*26.9%*	*26.6%*	
EPS	$0.92	$0.95	(2.9%)	$1.12	$1.05	6.3%

Forecast Assumptions

	Base	Bull	Bear
'23-27 Rev. CAGR	6.2%	7.0%	0.9%
'23-27 avg. GM %	41.9%	42.1%	41.2%
'23-27 avg. EBITDA %	23.7%	24.1%	22.7%

Key Risks and Mitigants

I. Volatile Input Prices: Janus faces volatility in steel coil and other commodity-linked product prices, which may lead to unstable results for part of its business due to global supply and demand factors. *Assessment:* With its high market share and differentiated products, Janus has been and should be able to continue passing on prices to customers, shielding its current margins.

II. Dependence on Self Storage Market: Janus's significant leverage to the domestic self-storage market makes it susceptible to industry shifts and changes in the creditworthiness of storage operators. *Assessment:* The trends in the self-storage market, particularly as it relates to the renovation of existing units provide market tailwinds in the near-term.

III. Competition and Market Share: The threat of new entrants and competitors in Janus's primary end markets, especially within the self-storage space, could erode its market share. *Assessment:* Janus holds robust market share in a fragmented market that is consolidating. Its competitive products and network defend its competitive position.

The full pitch can be accessed online at www.kenan-flagler.unc.edu/alpha-challenge/archives

Snöboll Capital

Noah Snyder

Noah started his career in 2007 as an analyst for the family office of the Continental Grain Company. Next, he attended Columbia for his MBA where he participated in the Value Investing Program and was President of the Investment Ideas Club.

In 2012, Noah helped to launch Incline Global, an equity hedge fund that was backed by some of the world's most influential investors. Serving as its MD, Incline Global was a Barron's Top 100 hedge fund, and Noah was selected by Institutional Investor as one of its Hedge Fund Rising Stars.

From 2019-2023, Noah was a Sr Analyst at American Century Investments, a >$225 billion manager, on its International Small Cap team and he focused on the Nordics, W. Europe and Australia.

Noah actively contributes as a mentor and guest lecturer in Columbia's Value Investing Program.

Editor's Note: This interview took place on March 29th, 2024.

Graham & Doddsville (G&D):

Hello, Noah. Thank you so much for being with us today. Could you please walk us through your investment background and how you first got interested in investing?

Noah Snyder (NS):

Yes, definitely. I was born and raised in Chicago, where my family was in the scrap metals business for four generations. Yet, it was my father who taught me that the stock market was like a casino, but you could put the odds in your favor. From a young age, I started managing my own money and I was obsessed with trying to do just that. I started my career on the buy side at the family office hedge fund of the Continental Grain Companies called Arlon Group.

This was a phenomenal place to start because the firm had the benefit of permanent capital. This allowed me to focus on long-term fundamentals, rather than short-term factors. My stocks beat the market and I was already eager to launch my own fund. However, I still felt like there was much to learn and I followed in the footsteps of some greats, like Buffett and Graham. I attended Columbia Business School for my MBA, and I was selected to take part in its Value Investing Program. Columbia was a great opportunity as I worked with and learned from some of the best in the industry and I was elected President of the Investment Ideas Club. As a way to pay it forward, I helped mentor classes in Columbia's Value Investing Program for several years.

After business school, I felt that the best way to prepare myself to launch and run my own fund, would be to help someone else build one from scratch. In 2012, I joined Incline Global just as the fund launched. It was led by Jeff Lignelli, an accomplished PM, and it was backed by some of the highest quality investors in the industry.

> ***"I believe that Frameworks, or mental models were key to the fund's success in its formative years and it was a Barron's top 100 hedge fund globally based on its performance."***

As Incline's Managing Director, I helped lead in the development of its unique frameworks and its strategy, which allowed the firm to achieve outstanding results. I also learned a tremendous amount about building a best-in-class fund.

I believe that Frameworks, or mental models were key to the fund's success in its

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formative years and it was a Barron's top 100 hedge fund globally based on its performance. The fund grew to $1 billion in AUM, and I was recognized by Institutional Investor as one of the 20 Rising Stars in the hedge fund industry. Yet I yearned for increased specialization. My investments in frameworks tied to great CEOs and programmatic acquirers were some of my best investments, but I felt that these frameworks could be even more powerful in less efficient markets.

In 2019, I joined American Century Investment's international small cap team where they had some of the most knowledgeable international investors in the world. I led the team's investment efforts in the Nordics, Germany, and Australia and it quickly became apparent that my frameworks tied to great CEOs and programmatic acquirers, were even more impactful in these niche markets. As rates started to rise in 2021, small cap and international stocks saw pronounced declines, and I realized the opportunity at hand. In 2023 I resigned from American Century to pursue my dream of building my own fund.

G&D:

That's an incredible background, Noah. Could you talk a little bit about how Warren Buffett and Charlie Munger have shaped your investment philosophy?

NS:

Absolutely. First, Snöboll Capital's name was actually inspired by Warren Buffett. Buffett said investing in compounding businesses, "was like rolling a snowball down a hill: what starts as a small handful eventually grows bigger and bigger." Achieving this effect is the intent at Snöboll Capital. From Buffett, I have had some powerful takeaways. Focus on intrinsic value as the true north, stick to a circle of competence, make concentrated bets when odds are in your favor, and use size to your advantage. Lastly, the principle of treating investors like partners and carrying yourself with high integrity is also important to me. At the same time, I wouldn't call myself a "value investor" in the traditional sense. Stylistically we have gained more inspiration from Munger, who got Buffett to move beyond the cigar butt approach towards a focus on quality compounders.

Charlie Munger also inspired mental models and frameworks which are key to Snöboll's investment strategy. Munger said, "if the facts don't hang together on a latticework of theory, you don't have them in a usable form." Snöboll uses frameworks that we've developed over thousands of hours of case studies and over a decade of continuous improvement to develop our variant perceptions. So, I'd say Munger has been more inspirational for Snöboll Capital.

"Charlie Munger also inspired mental models and frameworks which are key to Snöboll's investment strategy. Munger said, 'if the facts don't hang together on a latticework of theory, you don't have them in a usable form.' "

G&D:

Turning to Snöboll Capital, which was founded in 2023, it's a global long/short fund that invests in small and mid-cap stocks that are considered acquisition platforms. Could you tell us more about your investment strategy and the Snöboll Compounder Roll-Up framework?

NS:

Sure. I'm convinced that good process leads to good outcomes and Snöboll's investment strategy is like a "lollapalooza" where several small things combine to have a larger impact. First, Snöboll has a clear vision and a circle of competence. We're not a generalist

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long/short equity fund. Instead, we own a long-biased, concentrated portfolio of 10-15 long investments, consisting of the best small, mid-cap CEOs and programmatic acquirers globally, which are complemented by idiosyncratic shorts. We own companies that we think could be worth multiples of their current value in a few years, with a moderate level of risk, and we work closely with our CEOs in a constructive manner. We target outsized profits by concentrating our bets, rather than trying to replicate the indices. Good opportunities come infrequently, so our top five long positions are >50% of capital and they are very influential in terms of the fund's performance. Next, by using frameworks we exploit structural inefficiencies through a repeatable pattern recognition strategy. Also, we're big advocates of game selection. We focus on playing the games that are easiest to win. Why face major league fastballs when you can play rec league softball? By leveraging our frameworks in the small, mid-cap space, we see fewer skilled competitors which allows us to gain larger informational advantages and increase our odds of generating alpha.

On top of this, smaller companies have traditionally outperformed the market, and it has been the best spot for finding hundred baggers. We're also global and there is even less research and liquidity abroad. Outside of the US we concentrate on Sweden, the UK and Australia. These markets have some of the best capital allocators in the world and we have built institutional knowledge and relationships that are extremely difficult to replicate. With index concentration in the US and Europe at their highest levels in decades, we think this is a key differentiator for Snöboll. There's not another fund on Wall Street with a similar strategy focused on these markets. If it helps, I can elaborate on our circle of competence and our relevant frameworks?

G&D:

Absolutely, that would be great.

NS:

Some dated studies concluded that most acquisitions don't create value and they lead to complexity. As a result, many investors are averse to acquisitive companies. But they say to become an expert in something, it takes 10,000 hours. At this point I believe I've spent >20,000 hours on publicly traded acquisition companies over the last 10+ years. Moreover, I strongly believe that investing in high quality programmatic acquirers allows Snöboll to achieve the holy grail, low business risk and high return potential.

Our attraction to programmatic acquirers rests upon the premise that they have twin engines of value creation: strong organic growth and acquisitions. The best ones have developed expertise throughout the entire acquisition process. They tend to focus on smaller companies and avoid large deals. Ultimately, we think the alpha from this strategy stems from a private/public multiples arbitrage, a higher likelihood of consensus beating results, sustained high returns on invested capital, and long runways for capital deployment. The last two features bolster the compounding nature of these companies.

"Our attraction to programmatic acquirers rests upon the premise that they have twin engines of value creation: strong organic growth and acquisitions. The best ones have developed expertise throughout the entire acquisition process. They tend to focus on smaller companies and avoid large deals. "

Also, well-known successful acquisition platforms can trade at higher valuations. This is

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precisely why we developed the Snöboll Compounder Roll-Up framework, which leads to the most asymmetric risk rewards across all our frameworks.

We commonly see that valuations correlate with daily trading liquidity and institutional ownership. This framework allows us to identify promising companies before the institutional masses when growth, M&A expectations and valuations are low. This provides us an even larger margin of safety. As these companies succeed and grow, they attract more sell-side research and more liquidity. As a result, our Snöboll Compounder Roll Up companies see their returns amplified by a snowball effect including more virtuous growth, and a third engine: valuation expansion.

G&D:

Could you also talk about the outsider CEOs that you are looking to invest with?

NS:

Sure. I have met William Thorndike, author of The Outsiders, a few times, and I found his book to be inspirational for Snöboll's strategy. In fact, Snöboll's goal is to find the CEOs that could be in the sequel of this book. First off, we are drawn to owner/operators where their skin is in the game. This is always superior to hired help.

Next, the best outsiders are flexible and rational, and their allocation of capital is always tied to incremental returns. The ideal ones are operators, not financial engineers, and they focus on improving businesses they've acquired. They typically have a very decentralized corporate structure. These CEOs are often quiet, humble, and like to stay under the radar. They avoid providing short-term guidance, and they let their results speak for themselves. We sleep better at night knowing that our companies are run by "maniacs" with decades of experience and heavily aligned interests.

G&D:

What is the investment time horizon for Snöboll's long and short investments? And then how do you think about valuation catalysts?

NS:

The goal at Snöboll is to own a concentrated portfolio of stocks that could be worth multiples of their current value in a few years, with a prudent level of risk. So, our investment underwriting is long-term, and we like to focus on the sustainability of growth as well as competitive advantages. However, we tend to value our stocks on multiples of cash flows two to three years out. Ideally, we'd like to own stocks for many years, but we tier, and force curve our positions, so our holding period is not only driven by the underlying risk/reward of a security but also how it compares to existing positions and watchlist names. As the share price and our risk/reward changes, our time horizon can be truncated, especially if the realization of the value happens quickly. Regarding catalysts, I think the hedge fund industry in general focuses too much on them and often overpays. In fact, investors appear to be biased against boring, high return companies, which don't offer the opportunity for an immediate strong share price appreciation. In turn, the steady compounders that we like to own don't really excite most investors.

For shorts, we have a bit of a shorter time horizon, which is six or twelve months, and we are more opportunistic.

> ***"The goal at Snöboll is to own a concentrated portfolio of stocks that could be worth multiples of their current value in a few years, with a prudent level of risk."***

G&D:

Could you tell us a little bit more about Snöboll's shorting strategy and investment criteria?

NS:

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Sure. So, I'll start by saying, I was profoundly lucky to start my career in 2007 on the verge of the great financial crisis. During this time, I saw firsthand how those that couldn't make money on the short side struggled, and I learned the importance of being a good short seller. It has been a priority throughout my career to be a proficient short seller and I have taken leadership roles on the short side at my previous firms.

For individual shorts, we have a very high bar. If there is not a path to a 50% downside, we typically pass. We mainly use three frameworks which have been the most successful for us over time and have resulted in the highest return on our capital and our time: the Commodity/Cyclical Peak, the Spinoff Short, and the Competition Short. Once again, our frameworks which us to repeatedly look at the world through a unique lens and to identify compelling shorts.

G&D:

That's great. Could you tell us more about Snöboll's geographic exposure? Where have you found a lot of investments that fit your roll up framework?

NS:

Great question. When we launched Snöboll Capital, my goal was to be 50% US and 50% international, but right now we are >90% international on the long side. Just like our Outsider CEOs, we tend to be flexible and pragmatic about how we allocate our own capital. Currently, international equities are trading at their lowest valuation relative to US stocks in almost 50 years. This allows us to buy companies with stronger growth, higher margins, and better returns on capital at lower valuations abroad right now. Moreover, 70% of our long portfolio is actually listed in Sweden. Sweden is a very rich, productive economy and it has extremely well-run businesses. In these markets we also have competitive advantages. At American Century, I had one of the few seats in the world that provided me full access to this stock market and its network, and this allowed me to build unique knowledge and expertise over many years.

Also, believe it or not, Sweden was the best performing stock market in the last century. Despite this fact, I'll attend SEB's conferences where there are hundreds of investors and there are only a few from the US. Not only is this a great place for stocks in general, but it's a great place for programmatic acquirers. In Sweden, there have been decades of historically successful decentralized acquirers, and the market has a strong appreciation for this model. While most investors are familiar with Constellation Software, Danaher, Transdigm, Roper, which have represented some of my most successful investments, Snöboll Capital owns four peers in Sweden which have grown faster, performed better (almost ~2x returns over the last five years), and trade at lower valuations. I think this highlights the opportunity set.

Moreover, the Nordic markets are well insulated from large institutional investors which ensures that this advantage is sustainable. Companies in this geography trade at much lower volumes than other developed markets, especially compared to the US. This stems from the disproportionate share of companies with >20% stakes that are held by quasi-permanent shareholders and there are significantly fewer passive flows. In the US, passive flows account for 40% of trades on some days. In Sweden it's immaterial. This market structure allows us to acquire well-performing businesses that are oftentimes too illiquid for larger institutional investors at steep discounts. While most Americans aren't willing to wake up at 2 AM for earnings, Snöboll's sacrifice is rewarded. They say, "the early bird gets the worm" – in our case it's the profit.

Finally, what makes Sweden so interesting is that they have been one of the economies that has been hit the hardest by higher rates. Most of their residential

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mortgages and their corporate debt have floating rates. So, as rates have risen its GDP has declined for nearly two years, home prices corrected by ~15% from their peak, and the economic challenges due to higher interest rates have been acute. Therefore, Sweden is a good place for long-term investments, a great place for programmatic acquirers, and a place where there's a cyclical trough that's quite compelling.

G&D:

To dig a little deeper on the macro piece, could you talk about the impact of higher rates on your portfolio of programmatic acquirers? Have you seen any impact?

NS:

Yes. The impact of higher rates has been profound in many regards. First, higher rates were, in many ways, the impetus for me resigning from American Century to launch my own fund. As we saw over the last two years, higher rates have been depressing growth expectations and valuations, and this impact has been most severe for smaller cap companies and those that are listed abroad. Moreover, companies that depend on access to capital markets for growth were hit very hard. At this point, we think this has created more of an opportunity than a headwind. We have found that higher rates have an immaterial impact on the returns of a typical acquisition for our portfolio companies. Our companies typically have low leverage and it's not low rates or their use of debt that leads to value creation. Their success is instead tied to a structural public/private market valuation arbitrage where our serial acquirers can buy private companies at ~5-7x EV/EBITDA and use their systematic processes to improve them, which results in significantly higher earnings at their acquired businesses over time.

Also, while we aren't macro investors, we think that the current interest rate and stock market dynamics are similar to the emergence from COVID, when even after the vaccine was created, there were several flare-ups and repeated market pullbacks before the system had rid itself of this fear. We think inflation has sustainably turned a corner, and Snöboll is well-positioned to capitalize on this once-in-a-decade buying opportunity that has presented itself in smaller companies, international equities, and acquisitive companies. Moreover, we would argue that Sweden is the largest beneficiary of a peak in interest rates.

G&D:

Moving on to individual positions, we would love to hear about Vitec Software Group (VITB SS) and your thesis on this name.

NS:

Vitec Software is around $2 billion of market cap. It represents the largest vertical market software (VMS) company in the Nordics. This is a smaller and potentially higher quality version of Constellation Software.

> ***"We think inflation has sustainably turned a corner, and Snöboll is well-positioned to capitalize on this once-in-a-decade buying opportunity that has presented itself in smaller companies, international equities, and acquisitive companies."***

Over the last five years, they have been able to grow revenues at >20% CAGRs and EBITDA at >30% CAGRs. It has generated a >40% CAGR in terms of total shareholder returns over the last 10 years and despite Constellation Software earning cult-like status, investors in Vitec did even better over this time.

What makes the stock interesting right now is that they have been operating in relative obscurity for ~35 years

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and they only had research coverage from three local banks. However, we think Vitec is poised to become a more well-known entity that could be owned by more US and global institutions as the shares continue to outperform and garner increased attention. For instance, they just hosted their first quarterly call, and research coverage was just launched at their first non-Nordic bank. Moreover, Constellation Software's revenue is over 30x larger than Vitec's, which highlights the sizeable opportunity ahead.

For starters, vertical market software is an optimal type of business for executing our Snöboll Compounder Roll-Up Framework. Vitec has >85% recurring revenue, is capital light, and they consistently have high incremental returns on capital. Next, we believe that its organic growth will remain higher than its publicly traded peers' and consensus expectations. They have historically put up mid-high single organic growth, which is 2-3x its public peers, and this is due to their industrial approach. They call themselves geeks and they invest heavily in R&D. Also, they have annual CPI pricing adjustments in their contracts, which alone should add mid-single digit organic growth this year.

The company also recently put in place a corporate structure where they now have six VPs which each oversee a group of six-to-eight decentralized companies. This has been a key driver behind Vitec's significant margin expansion. For EBIT margins, they target >20% and they've surpassed this level, so its target could be revised higher. Moreover, they now routinely acquire businesses with >30% EBIT margins vs 10-15% margins previously. Another thing that highlights Vitec's business quality, its durability, and its scalability is that their labor costs as a percentage of recurring revenue is around ~60%, vs. mid-70% for its other public VMS peers.

Combining this with the recent acceleration that we are seeing in capital allocation, and this opportunity gets us very excited. Just recently, their corporate M&A team expanded from one to three. They announced the largest two deals in the company's history in the last year-and-a-half, and they announced their first acquisition in the Netherlands, which doubles the size of their TAM. Shares are trading at ~18x our forward EBITDA, while their peers unjustly trade at 20-30% premiums. We believe that Vitec will realize higher than expected growth, and that the closing of this knowledge gap will lead to a higher valuation over time.

"We would argue that Sweden is the largest beneficiary of a peak in interest rates."

G&D:

Could you explain what allows Vitec to acquire companies at lower valuation multiples relative to its current valuation? And how do you think about Vitec's competitive advantage in M&A?

NS:

The reason they're able to acquire businesses at low valuations is that they focus on small, privately owned businesses that are <$5 million revenue deals. These are too small for most institutional investors, so they don't see a lot of competition. Secondly, the owners of these businesses do not have many routes to realize value, and they are oftentimes subscale and undiversified, so on a standalone basis they are worth much lower valuations.

Why do I think this is sustainable? Well, it's a massive total addressable market. There are over 10,000 software companies in Europe for them to look at. And case in point, Constellation Software, has been doing a hundred VMS deals a year. Vitec is doing six to eight, which allows

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them to remain highly selective and it doesn't require them to pay much higher valuations over time.

G&D:

That's great. Maybe we can move on to the second idea, Kelly Partners Group (KPG AU), which is based in Australia. We would love to hear more about the company.

" Kelly Partners has enjoyed annual revenue growth of >30%, and revenues have doubled every three to four years, for the last 18 years, while its stock is also up >400% since its IPO in 2017."

NS:

Sure. Kelly Partners is even small for our standards. It is a $200 million market cap company in Australia, which represents around 90 decentralized accounting and taxation partnerships. Its uber ambitious CEO, Brett Kelly, owns half of the company, and he aspires to build what he calls the Berkshire Hathaway of accounting. Moreover, he has taken best practices from Constellation Software, Danaher and McDonald's and used them to help build his company. Kelly Partners has enjoyed annual revenue growth of >30%, and revenues have doubled every three-to-four years, for the last 18 years, while its stock is also up >400% since its IPO in 2017.

What attracts us to Kelly Partners is that they have the key ingredients to be a successful Snöboll Compounder Roll-Up: a high-quality, organically growing core business, a strong management team, a well-oiled acquisition playbook, and they focus on a fragmented industry with sustainably low acquisition multiples. Moreover, currently there is no sell-side research coverage and very limited trading volume, which leads to a lower valuation. Through mid-single digit organic growth and a programmatic acquisition strategy, Kelly Partners has been consolidating the accounting industry for SMEs in Australia. They are now looking to replicate this strategy in the US and eventually in the UK. Brett Kelly believes that they have built a repeatable franchise model like McDonald's which can be rolled out globally.

The company has enjoyed almost 35% EBITDA margins and 20% returns on capital in a very predictable non-cyclical industry. Moreover, they have a unique structure for their deals. They provide a permanent home to the owner/operator who are contractually required to stay on after the acquisition. The deals are structured in the Partner-Owner-Driver model that they patented, where Kelly Partners acquires 51% of the business, the existing management team retains 49%. The acquired entity must then pay Kelly Partners a 9% royalty on its revenues in return for KPG's shared services and its robust operational playbooks.

Ultimately, Kelly Partners can double the profits of the companies that they acquire and save 40% of the manager's time. So, they have built this terrific flywheel. Second, we believe that Kelly Partners provides a unique opportunity to invest with the "Warren Buffett of accounting" at a reasonable valuation. It trades at ~15x forward EV/EBITDA, which we think is a mispricing given its quality and its expected growth rates.

However, what catalyzes this stock is that like what Mark Leonard and Constellation Software did in 2011, Kelly initiated a strategic review last year. Brett Kelly felt that the company's valuation was extraordinarily low, and this review led to a presentation in October 2023 where KPG suggested that a US-listing would support their acquisition strategy in this market and result in a higher valuation. At the time, the stock price was close to $5, but Brett Kelly believed it was worth $10. Kelly recently acquired two businesses in California, which now make up 5% of KPG's total revenue

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and we believe that a KPG stock listing in the US could happen in the second half of this year. They have already stepped their toe in the water by creating a US OTC listing.

Moreover, recently there have been many non-US companies which have relisted in the US, and it has led to increased institutional interest, higher volumes, and higher valuations for the early movers. Kelly Partners currently trades at a 20% discount to its best US comp, CBIZ (NYSE: CBZ), despite having two times the growth, margins and ROICs. So, as we see it, this is another early-stage acquirer led by a potential outsider CEO that has proven to have a unique and powerful business model and acquisition strategy. We think that the knowledge gap will close over time leading to a higher share price.

G&D:

Could you talk about how KPG is able to acquire companies at lower multiples and then also the competitive advantage that a KPG partnership provides these firms?

NS:

Yes. Before building Kelly Partners, Mr. Kelly was an accountant himself, and he struggled with the issue that these are often good businesses that are poorly run. Another big issue he recognized was in that of succession planning. Most accounting firms are partnerships and to accomplish succession planning their senior members are typically required to sell down their equity to junior partners, who oftentimes don't have sufficient capital. In turn, senior partners are usually forced to sell their business. Brett saw this as a massive opportunity for KPG to exploit as accountants are getting older and grayer and there hasn't been a clean way to solve this succession issue. As a result, Kelly Partners has become the de facto solution.

On top of this, the takeout valuations they pay are lower and it's sustainable because they are advantaged acquirers. Owners prefer to sell to KPG for less, instead of selling to private equity because they can stay in place and continue to share in the growth of their company.

Its competitive advantages also stem from Brett Kelly's approach to process. He developed Kelly Business System, similar to Danaher's DBS, where they have a detailed operational and integration playbook that includes now >800 modules. This highly repeatable playbook creates key advantages.

G&D:

If you're an accounting partnership, what are the key operational advantages that a Kelly Partners partnership provides you?

NS:

Time is the biggest benefit. Most accountants or partners should be out generating business, not managing their back office. Also, KPG is very focused on pricing. The combo of those two things along with its Kelly Business System lead to strong earnings growth. On top of that, one of the lowest hanging fruits is the receivables. Brett Kelly typically finds that receivables are 40% higher than they should be, and this goes back to the fact that their targets are good businesses that are not run as efficiently as they could be.

G&D:

Brett Kelly owns half the company, but he is selling down his position. Should investors be concerned about that?

NS:

Kelly Partners is unique in that they previously paid monthly dividends. Brett did this because he wanted to prove that the model worked. If people saw that he did 50 plus acquisitions and the cash was coming out the bottom, then they would be more eager to sell to Brett Kelly. In addition, Brett Kelly depended upon this dividend because he took a very low salary. In addition, dividends are tax-advantaged in Australia. However, the company's review concluded they KPG could do ~50% more M&A without its dividend, and Brett is

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focused on listing in the US, where dividends don't share in the same tax benefits, so KPG just canceled its dividends.

As a result, Brett needs access to cash to live his life. He sold some stock in lieu of not getting dividends, and he may continue to sell some in the future, but he wants to remain a >35% shareholder even after a US IPO. Another inspiration for a US-listing is the dual-class share structure, which isn't permitted in Australia. This would allow Brett to maintain control despite owning <50% of the company. So, the recent stock sales have been the result of corporate actions, which we think make the company more valuable as they now have even more dry powder for highly accretive M&A.

G&D:

For our readers, could you discuss the biggest investment lesson that you've learned?

NS:

Yes. First of all, I have made many mistakes, and you learn the most from your mistakes. However, one really stands out. In 2015, my team was involved with Valiant Pharmaceuticals and Endo Pharmaceuticals, and at the time, these stocks were going up a lot. They were actively doing M&A and oftentimes the deals were large. Unexpectedly, what ultimately happened was that these companies both collapsed and nearly went to bankruptcy. I believe Endo actually did file for bankruptcy.

This allowed me to appreciate that the best acquisition platforms are the ones that don't neglect organic growth. The great platforms really focus on improving the businesses once they've acquired them. So, although we focus on acquisition-driven companies, organic growth is often the most important thing when assessing the quality of our platform businesses. This experience taught me that it's operational excellence that leads to success, not the acquisitions.

> ***"This experience taught me that it's operational excellence that leads to success, not the acquisitions."***

G&D:

Great. And then, as a former Golden Gloves boxer, has boxing influenced you as an investor?

NS:

Definitely. I think the grit, discipline, and strong work ethic that I picked up from boxing are all things that have allowed me to continuously improve as an investor. Early on in boxing, it was a humbling and painful experience to get better over time. This is similar to the process of getting better at investing, where if you don't put the work in, the markets will beat you up. But one of the most important takeaways from boxing is that you learn it's not the big knockout punch that wins most of the time. Instead, it's the boxers with the best fundamentals, the best one-two punch that end up winning fights. Just like in investing, I think people are overly focused on hitting home runs, when it's actually those that focus on the one-two punch and do it very well that end up being the most successful investors.

G&D:

For advice for students, what makes a great analyst?

NS:

The most important thing is to focus on continuous improvement and to be a "learning machine", as Buffett and Munger like to say. Also, you should do your own work and have confidence in your conclusions. What made Michael Jordan the greatest basketball player of all time, to make a Chicago reference, is that not only did he practice and prepare very hard, but he also wanted to take the big shot. When it

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mattered most, he had the courage and the bravery to try and be a big difference maker. If you're going to do the hard work, and you have conviction, you must have bravery and the desire to take the "big shot."

G&D:

To wrap it up, what do you like to do for fun outside of investing? Any fun or unique hobbies that you have?

NS:

I have three young children, so they take up the vast majority of my free time, but I really enjoy spending time with them. In turn, they do help provide a nice balance to my life. Also, when my wife and I can get away, we love to travel.

G&D:

What's your favorite country you've been to recently?

NS:

We recently went to Costa Rica, which was just great. It's a wonderful combination of good weather, a nice laid-back culture, and great geological stuff to see and do. It really has a good mix of what we are looking for when we want to get away.

G&D:

Thanks for all of your insights, Noah.

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Finding your Edge and Sharing it with the World: A conversation with Shayan Mozaffar

By: Richard Lalane

I came to Columbia Business School (CBS) to learn from the best investors, take something from each and make it my own. One of the classes I was fortunate to take was *The Analyst's Edge* during the Fall of 2023, taught by Shayan Mozaffar and Adam Birnbaum. I worked with Adam the prior summer and he introduced me to Shayan one summer night on his rooftop when he gathered the incoming Analyst's Edge class to get to know one another. When I met Shayan, I knew I had to give 100%. He expects nothing less. After three months of conducting primary research, learning how to evaluate management teams, filtering what matters most for my companies, developing conviction in my ideas, and learning bits of Shayan's story, I thought his story and insights through my lens would be valuable to our G&D readers. Shayan would be the first to tell you that any insights should be taken with a grain of salt – everyone's cards are different and as such what works for one person might not work for another. Herein you'll find the quotes and stories that resonated most with me along with my takeaways. I hope it inspires you as much as it has inspired me.

What is an Edge? From an investing perspective, most investors view an edge as the ability to develop non-consensus views, or variant perceptions, that turn out to be accurate. Not all investors can have non-consensus views because collectively they are the consensus. In a business where everyone is trying to gain an edge, how does one achieve superior insight that stands out? Shayan offers a deeper perspective:

"Your edge comes from an alignment between who you are, what you were built to do in life, what brings you meaning and fulfillment, and what you're doing. Then committing to becoming the best you can be and developing your skills to the highest level—Your edge is the outcome of that journey. The byproduct is your ability to execute better than other people, and more consistently, in your area of expertise. Your edge is something you discover and cultivate… It is not something out in the world… It's actually within you."

Finding your Edge

One of my key takeaways from my time at CBS is that the best investors remain authentic in how they approach investing. Your genetic predisposition and investing philosophy have to align in order to have long-term success.

"All musicians know how to play instruments. All guitarists play the same strings. All of them are trying to make music. Many copy other musicians and can do a good cover. So why does Jimi Hendrix sound so different? Why are certain musicians more successful than others? If you go through that you realize there's something about authenticity. It's their interpretation of their life and experiences through their music. I feel the same about investing. There is not much difference between the basics in what we all do. What makes it interesting and unique is how we connect it to who we are and how we view the world, and how authentically we're able to do that."

Shayan was raised in Pakistan. He grew up in a single bedroom with his parents and siblings. Shayan knew at an early age that he had to make it out on his own, so he became entrepreneurial at an early age and left home on his 18th birthday. Shayan bought a one-way ticket to the U.S. and arrived in

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Massachusetts with $1,000. He began working multiple full-time jobs at grocery stores and fast-food chains. He saved money so he could attend UMass Amherst. During his undergrad, he continued working 40-50 hours a week to pay for tuition, often working from 11 at night to 7 in the morning so he could attend classes during the day.

"When I look back at my life, I have found that I persisted more than most. It came from my mindset, my ability to function well in uncertainty, and my higher threshold for pain and discomfort… and this came through practice… from having a tough journey from very early on in my life."

At Amherst, Shayan had a great advisor who shared the essays of Warren Buffett and recommended that if Shayan wanted to understand and own businesses he should learn accounting. Shayan followed suit and completed his Undergraduate and Master's in Accounting, got his CPA and started working at Ernst & Young (E&Y). Shayan's relentless work ethic continued at Ernst & Young (E&Y). Not only did he excel there, but he would spend his free time researching stocks to the tune of 20-30 hours a week.

"One of the things I realized very early is that I was good at seeing opportunities, I enjoyed solving problems and coming up with creative solutions, and I found partnering with other people to bring compelling opportunities to life – fun. When I thought about investing, I liked the idea that I'm not going to be an expert in every industry, but if I can find an expert – a founder, manager or team – who is really good to work with then I can partner with them or invest in them… Investing as such was a natural outset of finding and recognizing compelling opportunities."

Shayan spent 6 years at E&Y working on audits, bankruptcies, fraud investigations, and ultimately leading due diligence efforts on mergers and acquisitions for private equity, venture capital and strategic investors. In late 2007, he got an opportunity to join an investment firm. Unfortunately, the month after he received his offer, the investment firm faced $2bn in redemptions and was forced to rescind his offer. The world was entering a recession, so Shayan pivoted towards pursuing his MBA at Columbia Business School.

"There is no shortage of setbacks in life. It is part of the journey. I never wanted to look back and complain, blame or make excuses. I wanted to be able to say that whatever the cards I was dealt, I gave everything I had. I found a way. I left nothing in the tank. This has been a mantra for much of my life."

Being at CBS during the aftermath of the global financial crisis simplified Shayan's priorities. It gave him the opportunity to further develop his skills, cultivate new and meaningful relationships, and provided the time needed to find opportunities that were right for him.

"I took nothing for granted. I knew I was only going to be in business school once, so I wanted to make the most of the opportunity. I competed in stock picking competitions, took every class that interested me and every trip possible with my friends at Columbia. In my final semester, I applied and was accepted into the Analyst's Edge class taught by David Greenspan. I wrote about wanting to take this class in my admission essay. When it became a reality, I cleared my calendar and devoted 95% of my final semester to the class. When I look back at my time at CBS the most valuable thing I left with was the relationships with my classmates and my professors… and that came from the time and focus I had devoted while there."

Given his focus on making the most of the opportunities at CBS, Shayan did not begin recruiting for full-time opportunities until May of his final semester.

"When I got to business school, jobwise, I felt that if I continued to work on my craft, then somebody would hire me… You only have control of the present. If you have an opportunity like business school, for example, you want to give it 100%. Focusing on the past or future only takes away from the present, which is more relevant to how your future develops than you think."

"Starting in May of my final semester, I fully committed to recruiting. In July, I came across

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an opportunity where two of my friends had interned and received offers but declined to take them. It was an opportunity at a start-up fund. My friends saw risk. And there was. But, I also saw opportunity. I wanted something entrepreneurial where I could work with cool people to build something special."

Shayan joined Tyrian Investments in 2011. Tyrian was seeded by Julian Robertson's Tiger Management. He worked with Orlando Muyshondt and Mike Baron. Over the next three years, Tyrian delivered exceptional risk-adjusted returns, and assets under management (AUM) grew from $30 million to over $1 billion by the end of 2013.

"Business-building is essentially finding compelling people to solve problems with… I wanted to find a place where I was excited to spend my time, where I could do something that I thought was meaningful, where I could learn a ton, and at Tyrian I found these great people, Orlando [Muyshondt] and Mike [Baron]. Tyrian had $30 million in AUM at the time, not much in returns, and was burning cash. I felt I would enjoy spending time with Orlando and Mike doing something that was difficult, but something that I also thought was possible…"

I asked Shayan about his investment philosophy. How and when did it develop?

"I needed to be independent and support myself, so I was thinking about businesses and making money from a young age. When I first began investing, I did what came naturally to me. Business and investing seemed similar – it's partnering with people to build stuff or do things that are compelling and create value. If you create value for the customer, you're going to create value for yourself… What I realized over time is I have a proclivity towards higher quality businesses and people… and my ability to recognize good people and opportunities naturally lent itself well towards finding and investing in earlier stage growth companies."

Developing your Edge

To become great at anything requires testing, iteration, and high-quality repetitions across a range of skills, situations and environments.

Some of Shayan's initial successful long investments at Tyrian were in Kate Spade (part of Liz Claiborne at the time) that was undergoing a turnaround under a new management team, and TripAdvisor when it spun off from Expedia. Shayan's most contentious idea, however, was Tesla. The stock was highly shorted when he began to look into the business in early 2012 with an intern class he built at Tyrian. While the research began with evaluating the merits of the prevailing short thesis, it ended with the view that if the Model S adoption was successful, the market would price in the success of future models to come. The idea was so contentious that no one was willing to bet on the pitch, so Shayan decided to invest 10% of his personal account into Tesla in April 2013 when they first reported improving profitability and Model S deliveries far ahead of consensus expectations.

"My development took another meaningful step up after business school when I started at Tyrian. Orlando [Muyshondt] is one of the best people I have worked with. He created an environment with autonomy and ownership that allowed us to discover and pursue what we enjoyed most. I realized that my ability to identify compelling people and opportunities enabled me to identify founders and management teams that investors often misunderstood or didn't empathize with. My best [long] investments were ones where I invested in people who overcame significant odds against them. It was a meaningful goal for them to bring their businesses to life."

"People who overcome really tough things tend to have a lot of empathy because they know how difficult it is. For me, one of the things I get great joy from is betting on people when others are not betting on them… where I came from, there was no shortage of people telling me why things weren't possible. There's no reason, logically, to think that where I grew up that I should end up here where I am today. Experiencing that journey, and understanding it, has helped me empathize with others pursuing similar paths."

John Griffin, founder of Blue Ridge Capital, once came to speak at CBS and said, "There is only one

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reason you short, and that is to make money." Shayan developed his interest and expertise in short selling at Tyrian. The commodity markets were peaking at the time which created many cyclical short opportunities. He devised a shorting style attuned to him. He didn't try to copy anyone else.

"Orlando [Muyshondt] was a great short seller and liked shorting, so he created an environment at Tyrian that allowed me to discover that I could be good at shorting too... With shorting, I also followed what came naturally to me. I naturally focused on what could go wrong in investments or how a thesis breaks down… and this seemed to work well when identifying and evaluating short opportunities… and it also worked well at identifying bad shorts which ended up becoming some of my best longs."

"In 2011 and early 2012 the commodity markets were peaking and pricing was breaking down indicating that supply was now in excess of demand. This created many short opportunities across commodity markets. While many investors were focused on the commodities themselves and the major producers and miners, I felt that more compelling and underappreciated opportunities lay in the service providers. While the direction of commodity prices was uncertain in the short run, what we could be more certain of was that the producers and miners would cut capex budgets, and hence I found opportunities to short oil servicers in the U.S. and iron ore mining servicers in Australia. Many of these companies eventually went bankrupt."

"If you really want to make a lot of money in investing, you have to size up. The difficulty, especially with shorting, lies in how you put on a 10% or 20% short position given the meaningful risk of short squeezes. And this is where my natural inclination towards shorting entire sub-sectors helped us express large short positions."

Shayan left Tyrian in 2013. He wanted to further refine his research process. David Greenspan, the founder of Slate Path Capital, was Shayan's professor in *The Analyst's Edge* course at CBS and a mentor since. He created an opportunity for Shayan to work with him and his team.

"When I think about development, you want range, and you want to play with the best players. That allows you to develop a diversity of skillsets and elevates your game. David [Greenspan] has the best temperament I have seen, especially when it comes to investing in volatile investment opportunities, and the team at Slate Path is exceptionally talented and has the best investment research process I have seen. I learned a lot and it helped me evolve and improve."

After Slate Path, Shayan started his own fund, Solomon Global Management. He was, however, forced to close the fund not long after. He was quite open about the experience. His strengths were in investing, and not in operations and marketing at the time. It was a great learning experience, but he was unable to achieve the necessary scale. When I read Phil Tetlock's book *Superforecasting*, one of the ideas that stuck with me was "The Leader's Dilemma". One must act with relentless conviction, until you don't anymore. A leader must possess unwavering determination to overcome obstacles and accomplish his goals—while remaining open to the possibility that he may have to throw out the plan and try something else.

"Building a business is continuous problem solving. Sometimes you get to a point where solving the problems in front of you gets you to a place you don't want to be. That's where the toughest decisions are made. You have to know when to hold them, and when to fold them…You want to be around to play your next hand. Under no circumstance should you extend yourself to such an extent, where you don't have the ability to stay in the game…I had a very difficult decision to make to stay in the game for the long term."

"When I did my little businesses as a kid, I had no money, so the business had to be profitable at the get-go. That's a lesson I was reminded of with Solomon. I needed longevity to build the business I wanted to build. If you don't have revenues coming in sufficient to cover costs, it limits your time. I basically went back and re-analyzed the situation and decided to shut the business down. The positive was I now knew a lot more about operations.

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I have gone through many investor meetings. I understood what worked and what didn't. I knew all the mistakes I had made. I could see all the areas I could have executed better. This knowledge greatly increased my odds of success in the future."

In 2017, Shayan joined Woodson Capital Management, a long/short fund also seeded by Julian Robertson's Tiger Management. Woodson was founded by Jim Davis and had $120 million in AUM when Shayan joined.

"I remember a recruiter had called me when I was considering the opportunity at Woodson. He was trying to place me in another opportunity and had recently placed the previous analyst at Woodson at a new opportunity as well. He said Woodson was going nowhere. It had been 6 years since the firm's founding. The returns were not great thus far, and it had only reached a little over $100 million in AUM. He was like, 'Why the hell would you want to go there?'"

"Jim was really transparent before I joined which engendered trust. He had shared all his investor letters up to that point, his returns and their composition. When I looked through the data I could see incremental improvements over time. The underlying hit rates were good, and the returns would have been much better had Woodson been running greater exposure and had the positions been more concentrated. This is part of the natural development and evolution of an investor. You have to find your way, what works for you, and the best way to express it. And it comes through experimentation, iteration and experience over time."

"In the end you have to make a bet on whether you and the team you are working with can make the future better than the past. I trusted my instincts and it worked out better than any of us could have imagined. Jim is one of the most intuitively talented investors I have met, especially when it comes to recognizing new products that are experiencing explosive adoption. When things get hard, he persists. He also has a way of doing things that is uniquely attuned to him. I admire that and learn a lot from him."

Woodson grew to over $1 billion in AUM by 2020 putting up some of the best returns in the firm's history during that period. Shayan left the firm in 2020 wanting to take some time off before starting his own investment firm again.

Sharing it with the world

Being in service of a mission or goal bigger than and beyond yourself brings greater and more enduring fulfillment, meaning, and purpose.

"Life involves suffering no matter what one pursues. The question is what's worth suffering for. We all have something special within us. Something we are willing to suffer for more than most. Something we just do better than other people because it comes naturally to us. The journey towards becoming a better human being, a better leader, and a better investor is to discover this while submitting to the feedback and pressures that come with your job and life. To see what surfaces from within – what's holding you back from becoming the best version of yourself. As you go through that journey, and if you persist, you will come out on the other side a much more refined and effective human being – and investor. In the end, what you're trying to do is serve other people whether it be your family, your friends, your teams, your colleagues or your clients. You're taking all the skills that you possess, who you are and what you're meant to do in life, and you're trying to help other people with it. If you keep improving the quality and breath of what you offer, and you do that consistently, you will build a life, a career and a business that you can be proud of. This is the underlying philosophy I have lived my life by."

"What I have realized in hindsight is that often just by being you, you can raise the level of performance of the people around you. You set the bar so high for yourself. You try to live up to the expectations of what you believe is possible for you. You just try to do the maximum you can. And, without realizing, you start impacting those around you and you can inspire

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them to elevate their beliefs, their performance and their expectations for themselves. When you think about it, the biggest thing you share with the world is your energy and enthusiasm."

Shayan launched 10x10y in 2021. I asked him about his motivation to launch 10x10y and its mission.

"I really wanted to be in a position where I could do the thing I love, pursue my desire to be the best at it, and do it for people I care about. It was that simple. And I knew there was a need."

"I had been managing money for my parents and some family for almost 20 years. They are simple hardworking people. They built their wealth the old-fashioned way. They worked 50-60 hours a week, invested with a long-term mindset and lived below their means. In recent years more family and friends kept coming to me to help them manage their savings as well. When I was working at my prior hedge funds, I couldn't help them directly due to my fiduciary responsibility to our clients. I tried to find them alternative solutions but was really disappointed in the quality of the offerings serving this segment of the market. So, when I left Woodson, I knew I wanted to find a solution and build something where I could help people I care about and those who needed it regardless of their net worth. None of the investment firms I was aware of had a high-quality egalitarian solution to manage all of a client's assets – a solution where for example my sister, a social worker, can invest alongside a high net worth individual or institution and have it managed the same way. That's a problem I wanted to solve. It's the solution I built at 10x10y."

"The mission at 10x10y is simple: Build the highest quality money management solution for our clients and improve and expand its quality and accessibility over time."

10x10y manages money for individuals, families, and institutions globally. It has five strategies: Growth, Quality, Roll-ups, Index and Yield that work seamlessly together to allocate capital bottoms-up to the best ideas at any given time. Shayan manages money the same way across all clients, and it's attuned to what he sees and does best.

"What we do is not that different from what any investor is trying to do. We are trying to buy things that will go up in value and sell things that will go down. Why we do it, how we do it, and how its attuned to what we see and execute best is what makes it unique."

"At its core, we are looking to bet on compelling people, businesses, and products during periods of uncertainty. And, we are looking to short industries experiencing cyclical or structural headwinds. We view cash as a strategic asset that gives us optionality. While we wait for these opportunities we make money through fixed income. Our aim is to be concentrated on our best performing opportunities. While these opportunities surface, we keep our losses small, and we take at least partial profits when we have them. This helps limit drawdowns and maintains a positive skew between our wins and losses. We operate with the understanding that no matter how much work we do, and how certain we might be, the world in which we operate is uncertain and offers limited control, so we aim to live within this reality."

I liked the firm's name, 10x10y, so I asked Shayan what's behind the name?

"When water meets stone, the stone usually wins in the short run. But over longer periods of time, water reshapes the stone. Our aim is to be water in how we approach what we do and how we operate. We have little control over what happens in the short run. But over decades, doing the right things consistently greatly increases the odds in our favor and that of our clients. 10x10y means to 10x in 10 years. It's a mantra – a journey. I named the firm 10x10y, so it inspires and aligns everyone involved in helping us realize our ambitions."

I loved this. I asked Shayan how this mantra impacted how he is building 10x10y.

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"In investing, and in life, when you look back, often a few opportunities, a few people, and a few relationships make all the difference. This is the nature of things. To find these opportunities, and these people, however, you have to be on the field—of investing and of life. And, to increase the odds of finding them you have to bring your best every day, know what you're looking for, be selective, and prioritize them when you do. Even then, as it happens, would-be opportunities will often turn out to be mundane, and sometimes even disappointing. So, you need to let go and move on. Not letting these experiences leave you jaded. Understanding that you don't control the sequence of outcomes. What you control is showing up, bringing your best, and refining what you're looking for. Believing that any day could be the day where you find the few opportunities and people that really matter. At 10x10y, this is our practice. Our aim is to deliver our best for clients with whom we have enduring and enriching relationships over a lifetime. To achieve this, the firm is anchored by a core group of families led by mine aligned in this long-term journey, and in our vision of building the highest quality money management firm for families like ours."

Shayan teaches *The Analyst's Edge* at CBS with his friend, Adam Birnbaum. Both Shayan and Adam also took the class when they were at Columbia. You have to apply to the class and only a handful get in. I asked Shayan why he taught the class and how he and Adam decide who gets in?

"It's a privilege to teach this class and with it comes responsibility. For me, when I take responsibility for something, I want to leave it better than I found it. That's part of who I am. In addition, I get to do this with a friend, Adam [Birnbaum] who I deeply admire and respect. Doing cool things with friends is one of the great joys of life."

"Adam [Birnbaum] and I know how difficult this journey is and how messy it can be. We have both experienced highs and lows. The situations where someone could have helped but didn't. With that comes empathy. So, our way of giving back is in part through teaching the Edge class where we can find 'diamonds in the rough', students where we feel we can increase their odds of success."

"In terms of what we look for in our students: When you look back at the best performing investors in history whether it be more recently or the market wizards of the past century, very few came from conventional backgrounds. Quite the contrary, the common elements were non-traditional backgrounds, a comfort with taking the road less traveled, a willingness to take risks, the resilience to get up from setbacks and succeed despite the odds, and a willingness to stick to something difficult for long periods of time. When Adam and I see evidence of this in a student's life, we get pretty excited."

To reach the pinnacle of your profession requires enduring hardship. Even in a profession meant to make you laugh, Jerry Seinfeld once said in an interview that, "Your blessing in life is when you find the torture that you're comfortable with." Jerry is in a profession where he needs to find jokes in everyday life. Even in a light-hearted profession, there will be hardships and those that frankly enjoy it can endure the longest.

Shayan has an intensity about him. His way of caring about you is telling you the truth – what you need to hear—even if you don't want to hear it. You feel the pressure to live up to his high expectations. But, and perhaps because of it, you end up doing your best work. I did, and so did many of my classmates. Today, you can learn about investing through books and YouTube videos, but what the *Analyst's Edge* offers is the opportunity to be mentored by Shayan and Adam who are perceptive thinkers with a deep understanding of the investment process. I feel fortunate to have had this opportunity. Shayan is quite private, but I got him to relent for this article. I wanted his advice, and I felt our readers would benefit from his thoughts as well. I hope you did.

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To hire a Columbia MBA student for an internship or a full-time position, please contact Dan Gabriel, Director, Employer Relations, in the Office of MBA Career Services at (212) 854-6057 or valueinvesting@gsb.columbia.edu.

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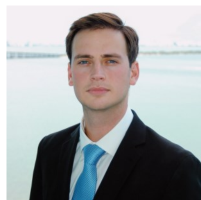

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