# The Blue Chips Investor Letter

## Fall 2020

"Opportunity comes to the prepared mind."

**Charlie Munger**

## Statement from the Chair

Chair of the Investment Committee: Ricardo Mestre

As a history major, I cannot help but feel that in writing these letters The Blue Chips is contributing our voice to the larger narrative of the world in documenting the life of a college investment club during a pandemic. I am certain that in several decades if anyone goes back to read this letter it will be to better understand the pandemic and its "firsthand" impacts on the social lives of college students. It is odd to feel as though you are writing a primary source, capturing a strange and difficult moment in history as I live it, yet that is the position that I find myself in today. I will write accordingly…

The Fall of 2020 represents the second quarter that The Blue Chips has been run over Zoom. As the country and world continue to be deeply affected by COVID-19, I am particularly grateful for this group and the sense of community it has provided. In that spirit, we have tried to return to some sense of normalcy, exchanging the weekly newsletter for the normal presentation format, albeit virtual. Conducting a club remotely has continued to present unpredictable challenges—technological issues, lack of the normal banter before and after the meeting, and the nostalgia of being in Stuart 105. However, no challenge has been greater than that of member engagement. Zoom fatigue is very real and has impacted almost every individual that I have spoken to in the club. Simply put, limiting your social interactions to a screen is not sustainable over the long-term. I have no doubt that Zoom or something like it will be a permanent fixture in our lives after the pandemic, yet I am equally certain that people will value their face-to-face interactions all the more. While Zoom may be a supplement for some of our social interactions within an organization, it is not a complete substitute for all the interactions that make this group successful. Our 50 new members this quarter do not know a world where TBC was in person and I look forward to the day when they can see the club return to "normal" even though my time as Investment Committee Chair will likely have come to an end.

Even as I speak about the limitations of Zoom, I must admit that it has come with some advantages. At the beginning of this quarter, we were able to speak with Joel Greenblatt, author of two of my favorite investing books, The Little Book that Beats the Market and You Can Be a Stock Market Genius. I am very thankful to have had the opportunity to hear from such a thoughtful investor and learn from his stories about his career. I am also pleased to report that this event was open to the entire undergraduate community, providing students with valuable access to investment education whether they are in TBC or not. On behalf of TBC, I would like to thank Joel Greenblatt for his time, and Andrew James and Chris Rosemeyer from the University of Chicago Office of Investments for making the event possible.

Finally, I have not forgotten that this is an investment letter and luckily there is plenty to talk about in the investing world. Since my last letter, stocks have continued their climb upwards, with the total return in 2020 for the S&P 500 at 18.4% and the total return of the Russell 2000 at 34.6% after having trailed the S&P 500 for much of the year. One of the advantages of having procrastinated this investor letter until now is that I got to read the year-end letters by many renowned investors. Many of them focus on the irrational exuberance of the market and seemingly nonsensical story driven valuations for companies. Anecdotally, friends of mine have boasted about their miraculous returns on stocks ranging from Tesla to marijuana stocks to SPACs to Cryptocurrencies to trading cards, often day trading or using margin to achieve such high returns. Stories that begin this way tend to have a bad ending and they serve as valuable examples of the degree to which speculative activity has taken over the market. Many of these anecdotes harken back to the days of the dotcom boom where investors reacted to FOMO (fear of missing out) and piled into expensive stocks about which they knew little.

I do not have the confidence of other investors to claim that I think a bubble has formed, much less to posture as though I know when that bubble (if it exists) will burst. Nor do I think it is possible or useful to speculate where the market will go in the near future. What I do know is that investing is the act of understanding a business, exercising intellectual honesty to price that business accurately, and ultimately purchasing companies that offer the highest possible risk-adjusted return. When this process is not followed and securities are purchased based on outright gutfeel, general speculation, or on what you suspect others may be willing to pay at some point in the future regardless of intrinsic value, it is gambling — not investing. As we know, just because something is purchased in a brokerage account and not at a casino table does not fundamentally change the inherent risk of the action. It worries me to see people risk their hard-earned money on companies that they do

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

not understand with return expectations that are unlikely to be met over the long-term. I hope that they can avoid the inevitable crash that many of these companies will face, but ultimately someone will be left holding the bag.

While I do not know the direction the market or most individual securities will go, I am confident that many securities in the market remain undervalued and finding those opportunities for value remains an ongoing effort. Furthermore, it is in moments when we are coming across the fewest deals that it is most important to not get discouraged and continue to learn and become an expert about businesses. When deals inevitably pop up, you will be well-positioned to take advantage of the price decline. When markets fall there may be only several weeks, months, or years where the market is severely underpriced — not nearly enough time to effectively research many companies or industries. As Charlie Munger says, "Opportunity comes to the prepared mind" and I believe that this could not be truer in the case of a downturn. Having an existing rolodex of industries and companies that you are comfortable analyzing and pricing is invaluable when the market is in crisis and volatility increases. A prepared investor will be able to quickly determine the price movements that are and are not justified, therefore ensuring that they are able to buy high quality investments, making volatility their friend, while others abandon the ride, fearful of volatile price movements because of their lack of conviction in an underlying thesis behind a particular investment.

Preparation creates opportunity and learning about industries and companies is a never-ending process for investors. I believe that devoting too much time to thinking about the relative expensiveness of the market only detracts from the time that an investor has to research companies and gain access to knowledge with a long half-life (as Pat Dorsey would put it). Meanwhile, predicting what the market will do in any particular year is not only impossible, it is information that will only last precisely one year. Meanwhile, learning about a business's supply chain, competitive positioning, or growth opportunities is information that could be useful for years or decades, enabling investment success for many years to come.
I hope that everyone who reads this letter will join me in being as thoughtful as possible about the investments we make this year. It may not guarantee success, but it will certainly increase our chances. Although it is often challenging, buying companies significantly below their intrinsic value after careful analysis will always be the most effective investment strategy. Whether you are reading this letter in 2021 or happened to have stumbled back upon it in 2041 wishing to learn more about TBC during the pandemic, I am confident that this philosophical understanding of investing will always be essential for investment success.

In this letter, you will find the sector leaders' summaries of their pitches this quarter, the Investment Committee's decisions on those pitches, and explanations behind exited positions. If you have any questions, please feel free to contact me at rpmestre@uchicago.edu. Thank you for the great quarter and your dedication to TBC throughout a difficult year. I hope you've had a healthy and happy start to the New Year, and I look forward to seeing you all soon.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Table of Contents

**Fall Pitches** 5

American Campus Communities (NYSE: ACC) 6

Ormat Technologies, Inc. (NYSE: ORA) 9

Hanger (NYSE: HNGR) 12

Lamar Advertising Company (NASDAQ: LAMR) 14

National Cash Register Corporation (NYSE: NCR) 16

WEX Inc. (NYSE: WEX) 18

Mercadolibre Inc. (NASDAQ: MELI) 21

Madison Square Garden Entertainment (NYSE: MSGE) 23

**Exited Positions** 26

MTS Systems (NASDAQ: MTSC) & Slack Technologies (NYSE: WORK) 27

**Portfolio Weightings** 28

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Fall Pitches

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# American Campus Communities (NYSE: ACC)

Consumer Sector Leader: Will Noddings

**Company Overview**

American Campus Communities (ACC) is a REIT owning and operating 166 residential properties on and around college campuses in the United States. These properties total to 111,900 beds as of September 2020. This includes 126 fully owned off-campus properties near colleges and universities, 34 properties which are operated under facility leases within the American Campus Equity (ACE) program, and six on-campus participating properties. ACC is the largest dedicated student housing firm in the industry by a notable margin but faces significant competition in developing new capital deployment opportunities from other similar firms.

**Investment Thesis**

The Consumer Sector recommended a BUY in ACC at $38.75 for the following reasons:

1. Student Demand Countercyclicality and COVID Resilience: Residential real estate tends to be cyclical, as vacancy rates across rental asset classes tend to increase as incomes stagnate and households consolidate during recession. However, student housing experiences the opposite trend, as people see education as a path forward. During 2008 and 2009, post-secondary enrollment rates saw significant increases, and student housing industry-wide capitalization rates saw local maximums compared to surrounding years. Taken together, this implies strong resiliency to recession, an attractive trait relative to other residential assets.
   Student housing has also shown more resiliency to COVID-related setbacks than initially anticipated. Q3 occupancy rates were only 4% lower than one year ago, and ACC rents were actually 1.1% higher than a year ago, compared to expected declines of 6% and 5%, respectively. With these points in mind, student housing seems to have favorable short-term demand resiliency when compared with the rest of the residential real estate market.
2. Long-term Consistency of College Demand: Over the long run, higher education has provided a large and growing wage premium to those who attend, underlying strong demand for college housing. Large, public universities, like those where ACC focuses, make up the majority of this undergraduate enrollment, a share that has been fairly consistent for the last 20 years. Lastly, college is a cultural norm in the U.S. that does not seem likely to change soon. 94% of parents want their parents to attend college, despite many (57%) believing that it does not provide a good value for money. This implies extreme demand inelasticity, a theory supported by continued price increases above the cost of inflation over the past several decades. Combining these factors with the cultural relevance of college and the college experience, it seems likely that long-term demand for college housing will continue to be strong.
3. Favorable Comparison to REIT Indices: The price of ACC's stock has almost exactly tracked the price movements of several highly correlated REIT indices, such as the iShares Residential & Multisector ETF, the Dow Jones Equity All REIT TR Index, and the Bluerock Residential Growth Index. However, we can see the significant advantages that college properties have compared to typical residential housing. Through COVID, they have seen less decline in rent, higher occupancy rates, and higher collection rates than the overall residential market. They also face more long-term stability than traditional residential real estate. With these favorable characteristics in mind, it seems that ACC should not be punished in line with their REIT index peers, but the market has pushed ACC down with the indices, presenting an opportunity for mispricing.

**Key Risks and Considerations**

1. College Financial Problems: Especially through COVID, many colleges and universities have seen severe financial pressures as a result of the shift to virtual learning and potential drops in enrollment. If colleges where ACC holds property close, then this would present a severe challenge to maintaining rent and occupancy levels. However, taking a closer look at the specific colleges where ACC holds property, this is a very manageable risk. An academic report on college financial stress identified four key risk factors for many colleges. Nationwide, over 500 out of 2,662 colleges show warning signs in two or more metrics, while only one college with which ACC associates shows two

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

warning signs (Bethany College). ACC appears to be fairly well-removed from the risk of associated colleges closing down, as the types of colleges where they own property are not the types of schools facing significant trouble.

2. Colleges Pushing Students On-Campus: Even pre-COVID, colleges and universities have been moving towards more stringent on-campus residency requirements for students. Dorms and meal plans can represent a significant source of revenue for these colleges. However, ACC is also insulated from this potential risk. Freshmen residency requirements are much more common at schools with acceptance rates under 50%, which only describes 16 of the schools were ACC operates. Also, many public universities (majority of ACC schools) face legal restrictions from enacting such rules, as they are "agents of the state" and are required to not infringe on state-level constitutionally protected liberties to engage with agents of the state. While it is a possible negative factor, it appears unlikely that ACC will see significant consequences from colleges increasing on-campus requirements.
3. Prolonged COVID Caseload: ACC has obviously seen significant impact on their results from COVID in recent quarters as occupancy rates have fallen and summer camp revenue did not materialize. They have also paid out increased expenses related to rent relief and resident hardship programs. Prolonging the pandemic could keep occupancy rates low and result in more bad debt/rent relief expenses for ACC. However, ACC has demonstrated significant resiliency as already discussed, and it is unlikely that the pandemic would be prolonged so long as to be disastrous for ACC.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

## Decision: MONITOR

Consumer Investment Committee Representative: Joshua Soong

The Consumer Sector pitched American Campus Communities (NYSE: ACC) in Autumn 2020 as a buy. The Investment Committee decided to monitor ACC. Our reasons are as follows:

**FIRST**: We are attracted to the stable and consistent cash flows generated by this industry. The industry, which is counter cyclical in nature, also benefits from some degree of geographic monopolization in the form of limited residential land and dormitory space surrounding college campuses. However, while we see the strong moat that surrounds the student housing industry as a whole, it is difficult to quantify American Campus Communities' competitive advantage over its peers. Specifically, all major players are well-established and well-entrenched as each is well-capitalized, has extensive collegiate relationships, and maintains a large portfolio of stabilized and up-and-coming student housing developments.

**SECOND:** The Company's flagship project, its 1,600 bed Disney campus, seems promising but also detracts from the Company's core focus on college housing. At $615 million, this is the Company's most ambitious development and, while its partnership with Disney provides some comfort, we are cautious about a) initial occupancy during the pandemic — especially as the Disney interns the campus was designed for remain virtual — and b) whether this undertaking suggests college housing economics are no longer as attractive as they once were. Management's downward revision of the expected cap rate also gives cause for concern about the value of this project.

**THIRD:** In the Sector's model, a significant amount of cash flows is derived from the difference between recorded D&A and CapEx. This is especially true of terminal year cash flows and stems to some degree from the aforementioned Disney project. The Investment Committee feels that a more detailed breakdown of D&A and analysis of the Company's pipeline is required to better understand the stock's value drivers before a conclusive "buy" or "no buy" decision can be made.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Ormat Technologies, Inc. (NYSE: ORA)

Natural Resources Sector Leader: Frank Li

**Company Overview**

Ormat Technologies, Inc. is the world's only vertically integrated geothermal company with unique expertise in binary cycle technology. It is also expanding into the Solar Photovoltaic and Energy Storage and Management services. The company is split into three segments—Electricity, Product, and Energy Storage and Management Services—accounting for 72.4%, 25.6%, and 2.0% of its total revenues, respectively. It currently owns and operates 914 MW of generating capacity in its 25 geothermal, recovered energy generation (REG), and solar sites globally.

**Investment Thesis**

The Natural Resources Sector recommends a BUY in ORA for the following reasons:

1. Favorable industry trends for binary cycle power plants: There are three types of geothermal power plants: Dry Steam Power Plants, Flash Steam Power Plants, and Binary Cycle Power Plants, with differences in their dependence on the state of the geothermal fluid and its temperature. While Dry Steam and Flash Steam plants may be more efficient, they require higher temperature fluids which makes it difficult to find future sites for these plants. On the other hand, as most geothermal resources in the world are at lower temperatures (below 300°F), it is likely that the majority of geothermal energy will come from binary cycle power plants in the future. While other major competitors all focused on different technologies, ORA has specialized in binary cycle power plants for over 50 years, with its proprietary system protected by over 70 US patents, which would best position ORA to benefit from the favorable future trends in the industry.
2. Fundamentally strong business with competitive advantages and barriers to entry: Firstly, Ormat has unique advantages in Geothermal, especially in binary cycle technologies, with its long-term experience and over 70 patents. It further shields itself from competition with its dominant scale in the Product Segment, as it produced the same amount as the next three largest players—Fuji, Toshiba, and Mitsubishi—combined in the past 5 years. Secondly, Ormat enjoys a favorable contract structure with long-term contracts with public and private utility companies (~17 years on average) and a healthy backlog of $66 million in the Product Segment alone. Moreover, ORA has the scale and flexibility to adjust their strategy to adapt to various domestic and international government regulations, including changing rules in PTC and other tax incentives. Furthermore, Ormat has been successfully securing financing for all projects with non-recourse debt and lease financing with relatively low interest rates around 5%, which provides it with a strong competitive advantage in this capital-intensive industry. Lastly, as the only vertically integrated geothermal company, ORA benefits from its capabilities both in owning and running power plants and in producing equipment for other operators, thus it is able to serve its customers in all steps of the value chain.
3. Market Mispricing due to underestimation of growth: The unique growth potential of Ormat with its expertise in binary cycle technologies is not correctly priced in, as many analysts mistakenly considered more mature geothermal companies as its comps. As geothermal accounts for only 2% of US energy generation, the industry is less understood by the market, and many analysts overreacted to short-term events, such as recovery from COVID-19, the temporary shutdown of ORA's Puna plant, and changes with the PTC.

**Key Risks and Considerations**

1. Customer Concentration: 51% of ORA's 2019 revenues came from three large utilities: SCPPA, NV Energy, and KPLC. However, all three companies are rated stable by Moody's and S&P, and revenues from them are covered under long-term PPAs. SCPPA and NV Energy have never been late on payments, and ORA's insurance covers riots and political upheaval in Kenya, which mitigates its risk exposure to KPLC.
2. PTC Expirations: The expiration of Production Tax Credit, which benefits ORA both directly and indirectly from the sale of tax credits, could imply less profitability in its US operations. However, ORA has been diversifying to international projects, which have 90% higher margins than domestic ones, even with PTC. ORA is also focusing on

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

strategically scheduling US developments to take advantage of the last wave of PTC. State RPS's will also continue to drive up domestic demands and prices.

3. Puna Power Plant: ORA's Puna plant became non-operational in 2018 when lava filled geothermal wells, and Management originally projected it to be operational by Q1 2020. Although resumption of operation was delayed by risks associated with COVID-19, ORA was able to claim business interruption income of $30.6M and would-be receiving insurance payments for as long as Puna is offline. ORA's insurance policies are very comprehensive, with Puna insurance specifying lava flow and Kenyan insurance specifying political unrest, for example.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

## Decision: MONITOR

Natural Resources Investment Committee Representative: Parth Patel

The Natural Resources Sector pitched Ormat Technologies (NYSE: ORA) on Sunday, November 8th, 2020 as a buy. The Investment Committee (ICOMM) decided to monitor ORA. Our reasons are as follows:

**FIRST:** ORA is well positioned within the growing geothermal energy industry as the preeminent binary cycle technology provider. The sector convincingly argued that the rapid growth in binary cycle power plant demand, which ramped up in the past few years, will continue and act as a tailwind for the company's growth. Binary cycle is the least efficient of the three kinds of geothermal power plants because it utilizes low-to-moderate temperature geothermal resources, but as new high temperature resources grow scarce demand is steadily shifting toward binary cycle. The company has clear reinvestment opportunities, including the development of new plants and funding international growth as renewable energy becomes more in favor around the globe.

**SECOND:** ORA has steady, contracted sources of revenue through its power purchasing agreements with utility companies that provide transparency into its topline and pipeline. Additionally, ORA's product backlog presents a clear picture of its success in winning business internationally to grow its presence in tandem with renewable energy demand. The general stability of the business is attractive, which mirrors the appeal of geothermal energy to utility companies, explained in the next point.

**THIRD:** As utility companies incorporate renewable energy into their portfolios, geothermal energy is differentiated from solar and wind by filling the baseload generator duty. Like coal and natural gas, geothermal can be relied upon as a consistent source of energy, so utility companies would desire it separately than competing renewable energy sources. This distinction has allowed geothermal energy to become dominant in areas where coal and natural gas are expensive to transport or out of favor due to government incentives without having to compete as much with the two other renewable sources of energy.

**FOURTH:** Despite the strong business model and growth runway, ICOMM decided to monitor ORA due to its valuation. As per the discussion with the sector and their model it seemed as though much of the value of ORA's growth was captured in its price, perhaps due to the transparency of its pipeline and the salience of the secular trend toward renewable energy.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Hanger (NYSE: HNGR)

Healthcare Sector Leader: Austin Wang

**Company Overview**

Hanger is the U.S.'s leading provider of orthotics and prosthetics (O&P) services, providing roughly 21% of all O&P services in the U.S. Hanger owns and operates a prosthetics supply and distribution subsidiary, 700 clinics, custom prosthetic fabrication centers, and an O&P insurance management business. In 2014, an accounting scandal caused Hanger to be temporarily delisted from the NYSE and subsequently lose 80% of its market cap. Since then, Hanger has revamped their upper management and built out internal documentation services to regain investor trust.

**Investment Thesis**

The Healthcare Sector recommends a BUY in HNGR for the following reasons:

1. Recession Resilience: O&P is a naturally recession resilient industry. Prosthetics replacements are necessary every 3-5 years and provide Hanger with a consistent revenue stream. Furthermore, Hanger's largest costs stem from employee wages which tend to decrease during recessions. In the 2008 recession, Hanger's revenue grew at the same rate while their margins improved. Despite Hanger's historical resilience, Hanger's stock price has not recovered from pre COVID-19 levels.
2. Scale Advantages and Barriers to Entry: Hanger's massive vertically integrated network of fabrication centers and clinics provides them with a sustainable cost advantage over competitors. Furthermore, Hanger owns Linkia, the U.S.'s largest O&P insurance network management agency, which helps almost all major U.S. insurance companies match their customers to local O&P clinics. Linkia has helped Hanger clinics gain significantly better commercial coverage rates than their competitors.
3. Growth and Cost-Cutting Opportunities:
    a. Margin Improvements: Hanger's clinics have consistently grown organic revenue by 1-2% every year, and we believe they will be able to continue this growth **without incurring additional employee wage costs.** Hanger has made considerable investments in 3D scanning technology and dedicated fabrication centers in order to reduce clinician-patient interaction time. As a result, we believe wage costs will remain relatively stagnant or even decrease in the future. Hanger's personal costs per clinic have already been decreasing year over year since 2016, and we expect this trend to continue. The resulting margin improvements are the main value driver for Hanger.
    b. The COVID-19 crisis has created an opportunity for Hanger to acquire O&P clinics. Prior to the 2014 accounting scandal, making accretive acquisitions was a core tenant of Hanger's growth strategy, and we believe Hanger will be able to quickly scale up given the abundance of available low-cost acquisitions in the industry.

**Key Risks and Considerations**

1. Ossur's market entrance: Ossur, an Icelandic supplier of prosthetics parts, is vertically integrating and entering the U.S. clinic market as Hanger's competitor. Although Ossur has significant financial resources, we believe they will have significant difficulties in replicating Hanger's national distribution, payor, and fabrication networks.
2. Poor Customer Service: Recently, Hanger has received backlash from customers due to poor customer service and billing complaints. However, we believe these problems are temporary as Hanger chose to reduce all employee wages by 30-40% rather than fire employees, likely causing customer service agents to become disgruntled. Additionally, Hanger's billing and revenue management systems were only recently implemented and are still experiencing some friction. Despite customer complaints, many patients' insurance only covers Hanger, so many patients have no choice but to use Hanger for their O&P needs.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

## Decision: NO PURCHASE

Healthcare Investment Committee Representative: Neha Kavi

The Healthcare Sector pitched Hanger Inc. (NYSE: HNGR) on Wednesday, November 11th, 2020 in General Meeting as a buy. The Investment Committee (ICOMM) decided to not purchase HNGR. Our reasons are as follows:

**FIRST:** We are not convinced there is a sufficient margin of safety. Realization of value from an investment in HNGR is dependent on significant cost reduction and clinic growth, which does not seem like a safe bet in the current circumstances. Reductions in costs in 2020 have largely been due to the reduction in personnel, which would only remain reduced if technological advancement played out as management hopes for. This, combined with the necessity of clinic growth, creates concern that many goals need to be achieved in order for HNGR to realize value as an investment.

**SECOND:** For the same reasons, the sector argues that the market does not fully understand HNGR and analysts overlook it, it is likely that even if the sector's thesis plays out successfully, it may not be a sufficient catalyst for our investment to realize value. Unless HNGR grows significantly, which is beyond the foreseeable scope of an investment, it is likely to be overlooked and misunderstood for a while, and it is unclear if there is a significant catalyst in the near future to change its course.

**THIRD:** In general, much of the potential upside is dependent on HNGR changing and improving upon its existing operations, rather than HNGR being a good quality company that has been overlooked. Given the number of contingencies and lack of significant catalyst, it did not make sense to purchase at this time.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Lamar Advertising Company (NASDAQ: LAMR)

Communications Sector Leader: Will Reid

**Company Overview**

Lamar Advertising Company (NASDAQ: LAMR) is a U.S. based REIT that operates as an outdoor advertising company, mainly leasing out ad space onto billboards. They operate across 3 segments: a $1.5B billboard segment, a $130M logo advertising segment, and a $85M transit advertising segment. The business model for their main business, billboards, is simple: they rent (or sometimes own) small patches of land next to highways on which they build either a digital or analog billboard and lease it out to advertisers based out of local offices for periods ranging from 4-52 weeks at a time. The billboard industry is largely consolidated with 60%+ of the market being controlled by Lamar and 2 other companies and is subject to heavy state and national regulations surrounding the construction of new billboards – therefore, the majority of the large competitor's growth comes from either M&A or digitization.

**Investment Thesis**

The Communications Sector recommends a BUY of LAMR for the following reasons:

1. Favorable Local Scale: Lamar operates with a unique focus on small to mid-sized markets in which they tend to have an even stronger market share than they do nationally – in virtually all of their markets they are the largest or second largest option. Partially due to this, 76% of Lamar's advertising revenue comes from local advertising. This focus on local advertising and small markets has resulted in favorable pricing power when compared to their competitors; Lamar's gross margins are 15-21% in excess of their two large competitors. We further believe this advantage is sustainable in the long-run due to extreme regulatory hurdles around the construction of new billboards like the Highway Beautification Act and Lamar's ownership of legally nonconforming billboards.
2. Strong Digital Unit Economics: With limited opportunities to expand analog billboard presence organically, Lamar has turned to digitizing their billboards as a growth runway. We believe that the compelling unit economics of digital boards will allow Lamar to increase profitability and continue to compete with substitute advertising mediums. Digital billboards allow Lamar to lease out higher-quality more personalized ads in 6-8 second increments, leading to each digital billboard outperforming analog billboards by about 7x in revenue terms and carrying on average a 15% higher operating margin.
3. Market Mispricing: The investor sentiment through much of 2020 was that Lamar was struggling under a heavy debt load and concerns about what decreased road traffic might mean for the advertisers, leading to Lamar trading at all-time low multiples relative to its past (even lower than 2009, where they were in a much worse financial position). We believe, however, that their focus on local advertising will play out to be more resilient to decreased outdoor advertising spend and their refinanced balance sheet will actually allow them to remain competitive and aggressive where both of their two competitors continue to struggle to meet covenants and stay liquid under their pandemic-induced operational distress.

**Key Risks and Considerations**

1. Substitutions: Analog advertising is destined to compete with newer and more personalized digital advertisements through the internet, which can command much higher prices from advertisers. We believe, however, that while billboards are less targeted than other ads, the value proposition of any extremely cheap per-impression and physically local advertising source will continue to increase over time – especially for Lamar's local-advertising small-market focus group.
2. Opportunities for Digital Expansion: The unit economics of digital billboards are clearly compelling – but if that expansion is slower than expected, that would take away a key part of the investment thesis. Lamar is capitalized well enough to afford an expansion in excess of the ~500 boards a year they are doing now, so the fact that they are not could imply the opportunities and spaces for digital boards are not as widespread as we would hope. To account for this, we made very modest digital expansion assumptions – which left potential for significant upside if they manage to increase the rate of their rollout in the coming years.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

## Decision: MONITOR

Communications Investment Committee Representative: Jacob Tucker

The Communications Sector remotely pitched Lamar Advertising Company (NASDAQ: LAMR) as a BUY on November 12th, 2020. The Investment Committee (ICOMM) decided to monitor LAMR, and ultimately decided against a purchase. Our reasons are as follows:

**FIRST:** We see limited ROI upside from switch to digitalization. Management has frequently touted the benefits of an increased shift to digitalization. Digitalized ads benefit from far more attractive unit economics and make billboards a more robust platform from which to advertise. However, we do not trust management's evaluation of the situation given that they have not seized more opportunities to convert their existing properties. Without the upside represented by a switch to digital, the investment's upside is quickly outpaced by the increased risk.

**SECOND:** We are a somewhat wary on the value of the CPM statistic, given the potentially limited effectiveness of certain billboard ads. While it is true that the economics of billboard ads may make sense for certain businesses, we believe that the limited targetability of billboard ads in addition to the narrow viewing window relative to television ads places billboards in a difficult competitive scenario.

**THIRD:** If this pitch had been made a bit earlier, the ultimate decision made might have been different. However, at the time the pitch was made, we believe that investor sentiment has been reflected in the recent price appreciation to a degree that leaves us with limited upside. While the business may be fairly valued, its fundamentals do not communicate that it is a trusty compounder that represents a worthwhile allocation of club capital.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# National Cash Register Corporation (NYSE: NCR)

Technology Sector Leader: Emily Ballinger

**Company Overview**

NCR was founded in 1879 and specializes in money transferring technology including ATMs, payments processing, and POS software and hardware for restaurants, banks, and retail locations. Currently they control over a third of the global ATM market and hold the leading market share in global self-checkout.

**Investment Thesis**

The Technology Sector recommends a BUY in NCR for the following reasons:

1. Solid Core Business: NCR is one of the largest players in the ATM and POS markets holding a long-term competitive advantage due to the economies of scale and switching costs present in the industry.
2. Transition to services: NCR is transforming its product services into a SaaS structure ensuring stronger forms of recurring revenue and a more streamlined product for end customers. This will expand margins and generate a higher level of value for customers.
3. COVID mispricing: The current pricing of NCR ignores the fact that operating environment difficulties are a temporary result of covid. Further long-term changes in business operations as a result of covid are likely to favor NCRs operations in self-checkout and ATM services that limit in person exposure.

**Key Risks and Considerations**

1. Weak Transition: Despite the advantages of a SaaS model NCR still faces a great deal of costs driven by the need to continually invest in technology to keep up with competitors such as Square.
2. Lack of pricing power: NCR may lack significant room to up or cross sell its products given most legacy customers already pay a significant cost to NCR and may be unwilling to increase their costs. Further NCR is not a technological leader in its restaurants or hospitality segments and may increasingly see customers use a hybrid model where new spend goes to competitors and NCR sees only stable or declining revenues.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Decision: NO PURCHASE

## Technology Investment Committee Representative: Chris Sun

The Technology Sector pitched NCR Corporation (NYSE: NCR) as a buy. The Investment Committee decided not to purchase NCR. Our reasons are as follows:

**FIRST**: At the time of investment, we believed that the margin of safety was not sufficient. NCR is currently trading at premium multiples comparable to other similar competitors in the ATM, POS, and payments processing segments. Changing model inputs for revenue and margins quickly diminishes an already narrow margin of safety, following the stock's performance YTD since mid-March. With most Covid mispricing gone, this is no longer an attractive entry point for the stock.

**SECOND**: The company's growth opportunities remain limited, as its core target demographic is largely mature companies with a national footprint. These customers likely possess downstream pricing pressure on NCR, hindering NCR's ability to hike prices when volume growth prospects might decline.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# WEX Inc. (NYSE: WEX)

Industrials Sector Leader: Darius Hong

**Company Overview**

WEX Inc., founded in 1983 and headquartered in Portland, ME, is a major provider of corporate card payment solutions operating across three segments: Fleet Solutions, Travel and Corporate Solutions, and Health and Employee Benefit Solutions. Fleet Solutions (~60% of 2019 revenue) generates revenue from payment processing and account servicing fees, and it primarily serves commercial and government fleets, as well as fuel providers. WEX's network is extensive, covering ~90% of fuel locations in the U.S. and Australia. Travel and Corporate Solutions (~21%) provides corporate cards to track employee spending and prevent fraud while streamlining the procure-to-pay process with a single integrated card. Health and Employee Benefit Solutions (~18%) provides a SaaS product supporting payments for healthcare benefit programs, as well as other programs related to employee benefits.

**Investment Thesis**

The Industrials Sector recommends a BUY in WEX for the following reasons:

1. Strong Business Model with Two-Sided Network Effects and Switching Costs: WEX's business model in their Fleet Solutions segment (serving as a card provider for fleets and as a payment method for fuel providers) generates a two-sided network effect; an increase in the number of fleets who use WEX increases the addressable market for fuel providers, while an increase in the number of fuel providers increases the number of fueling options for fleets. These network effects, in addition to this industry being heavily relationship-based, create substantial barriers to entry. Also, there are high switching costs for WEX's mission-critical products, which are closely entwined with their customers' technology and HR stacks.
2. Industry Trends Favor WEX's Superior Closed-Loop Solutions: WEX operates on a proprietary closed-loop payment network, which provides data that allows fleet managers to effectively reduce fraud and card misuse, a growing issue. As open-loop payment networks offer an inferior quality of data and customers are becoming increasingly concerned about commercial loss from card fraud, WEX's closed-loop payment network is set to capture an increasingly large proportion of customers entering this market.
3. FTC Investigation into Rival, FleetCor (FLT), Serves as Catalyst: WEX's only pure-play competitor, FLT, is under investigation by the FTC for their supposed predatory pricing practices. As a result, we believe that a portion of FLT's existing customers will switch to WEX, and importantly, there will be a long-lasting negative impact on FLT's ability to capture customers, which should serve as a catalyst for WEX.
4. Market Misconception Surrounding WEX: The optically higher margins which drive FLT's trading premium are misleading because of FLT's different revenue recognition practices and their aforementioned predatory fees. Furthermore, current market concerns regarding WEX's exposure to fuel prices and the economy as a whole may be overdone, as fuel prices are currently in a trough, travel is unlikely to depress further, and elective surgeries and other healthcare-related spend is still rebounding. Relatedly, while customer spending has dropped during the pandemic, adversely affecting 2020 revenue, the number of vehicles serviced and the number of SaaS accounts have both increased during this time, suggesting that a return to pre-COVID unit economics should result in solid increases to revenue.

**Key Risks and Considerations**

1. Exposure to Fuel Price Volatility: WEX's Fleet Solutions segment generates a portion of its revenue as a take rate on total fuel-related transaction value, which is a function of the gallons of fuel purchased and the price per gallon, indicating an exposure to fuel prices. However, there are multiple mitigating factors at play. Firstly, through diversification, the company only has ~20% direct exposure to fuel prices, while the market seems to believe that the exposure is much more outsized. Additionally, WEX's pricing model incorporates a hedge against fuel price drops through fixed fees in most fuel-related transactions. Finally, and very importantly, fuel prices are currently in a trough, limiting the downside risk here.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

2. Adoption of Electric Vehicles in the Trucking Industry: The mainstream introduction of electric vehicles in the trucking industry could potentially erode WEX's network advantages with fueling stations and reduce the demand for fuel, decreasing fuel prices. However, new vehicles still have some runway to prove economic viability and should not significantly impact fuel prices within the investment horizon.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

## Decision: BUY

Industrials Investment Committee Representative: James Young

The Industrials Sector pitched WEX Inc. (NYSE: WEX) on Wednesday, November 18th, 2020 in General Meeting as a buy. The Investment Committee (ICOMM) decided to buy WEX. Our reasons are as follows:

**FIRST:** We believe that the Fleet Solutions business segment has significant competitive advantages from its network effects and switching costs which result in stickiness and pricing power. Network effects stem from WEX serving as both a card provider for fleets and a payment method for fuel providers. The more fuel providers that join the network, the greater the value proposition is to fleets, and the more fleets that join the network, the greater the value proposition is to fuel providers. Further, WEX's large existing user base allows for significant data aggregation that has led to the creation of various services such as ClearView Advanced, a concrete example of a value-add service for fleets. WEX's services are highly integrated with cardholders' systems which creates high switching costs and leads to customer stickiness. Finally, fleets tend to prioritize anti-fraud over minimizing costs which makes WEX's primarily closed-loop systems particularly attractive and ultimately leads to pricing power in the form of take rate expansion.

**SECOND:** WEX is operating in a duopoly and has staying power – they are poised to capitalize on positive trends in end-markets. Gas prices are currently in a trough and travel is unlikely to depress further. Further, elective surgeries and other non-healthcare spend continues to rebound. General e-commerce and B2B payments growth will benefit both the Fleet Solutions and Health and Employee Benefits business lines.

**THIRD:** Market misperception on sensitivity to commodity prices has created an investment opportunity. Additionally, the FTC investigation into FLT, WEX's main competitor, may serve as a catalyst for WEX's growth in the future as customers switch services to avoid predatory fees.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Mercadolibre Inc. (NASDAQ: MELI)

Financials Sector Leader: Adam Keller

**Company Overview**

MercadoLibre (NASDAQ: MELI) operates market-leading ecommerce and payments platforms in Latin America. We recommend a buy at the current price of $1,522.86 because MELI's high prospective returns on capital and phenomenal reinvestment opportunities have not been fully recognized by the market. In our base case DCF analysis, we estimate an intrinsic value for MELI of $2,400. We assume that one decade from now, MELI will achieve an 18% NOPAT margin and trade for 3.8x EV/Revenue (vs current EV/Revenue of 13.1x).

**Investment Thesis**

The Financials Sector recommends a BUY in MELI for the following reasons:

1. Cross-selling opportunities: MercadoLibre controls hundreds of millions of relationships across its MercadoLibre (ecommerce marketplace), MercadoPago (payment processing), MercadoCredito (lending to SMEs), and MercadoEnvios (logistics). Rapid consumer adoption of MercadoLibre and MercadoPago drive the scale and durability of MELI's business. Lending and logistics services attract and retain SMEs, which increases the quality of the marketplace.
2. Pandemic-driven demand acceleration: Covid-19 has caused a rapid acceleration in user growth for ecommerce and digital payments companies. MELI has witnessed enormous demand for mobile POS systems, online shopping, and electronic payment apps. Latin America represents a particularly attractive market given that large segments of the population lack access to traditional banking infrastructure.
3. Dominant competitive position: MELI leads Amazon significantly in market share. Outside of Brazil and Mexico (where Amazon has concentrated its investment in the region), few competitors rival MELI's market share. Over the next decade, we expect the ecommerce markets to become highly duopolistic in the larger and more developed countries, with even less competition in smaller and less established markets. The payment processing market is more oligopolistic in nature, but nonetheless remains an attractive industry with high returns on capital. MELI's platforms are currently under-monetized due to the firm's growth focus. The firm will generate high and sustainable returns on capital due to 1) returns to scale driven by increasing adoption of ecommerce and digital payments technology, 2) pricing power once market leadership has been cemented.

**Key Risks and Considerations**

1. The primary risks are country-specific, including currency devaluation, macroeconomic weakness, and political instability. We are comfortable bearing these FX and geopolitical risks given that MELI's operations are diversified across 16 countries.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

**Decision: MONITOR**

Financials Investment Committee Representative: Nathan Nangia

The Financials Sector pitched MercadoLibre, Inc (NYSE: MELI) on Wednesday, December 2nd, 2020 in General Meeting as a buy. The Investment Committee (ICOMM) decided to monitor MELI. Our reasons are as follows:

**FIRST:** We see MELI as a strong business in potentially lucrative markets. However, we are not convinced of their ability to capture market share in undifferentiated, competitive markets and the long-term stability of the growth in the business.

**SECOND:** We view there to be significant execution risk on cross-selling and successful new market entry. As a result, we do not agree with the sector's assessment that there is a margin of safety.

However, in the event of a dramatic sell-off and more evidence of a competitive advantage, we believe that MELI could be an attractive investment. Further, given the attractive upside, we believe it could hold a significant weight in our portfolio.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Madison Square Garden Entertainment (NYSE: MSGE)

Special Situations Senior Analyst: Roger Shen

**Company Overview**

Madison Square Garden Entertainment Corp. (NYSE: MSGE) is the result of the Madison Square Garden Sports Corp's (NYSE: MSGS) spinoff of its non-sports assets. The spinoff took place in April 2020. MSGE owns Madison Square Garden, the Hulu Theater, and the Chicago Theatre. It additionally operates Radio City Music Hall and Beacon Theatre. Through these performance venues, MSGE engages in the entertainment business by producing, presenting, and hosting various live entertainment events. MSGE has Arena License Agreements with the Knicks and Rangers to host all Knicks and Rangers home games. Furthermore, MSGE operates entertainment dining and nightlife venues in New York City, Las Vegas, Los Angeles, Chicago, Singapore, and Australia under the Tao, Marquee, Lavo, Avenue, Beauty & Essex, and Cathédrale brands. MSGE is currently in the midst of constructing the MSG Sphere, a $1.6bn state-of-the-art performance venue located in Las Vegas.

**Investment Thesis**

The Special Situations Group recommends a BUY in MSGE for the following reasons:

1. Deceptively Unattractive Performance Venues: The pandemic's timing could not have been more unfortunate for MSGE. Not only did Covid cause the performance venues to cease operations for the foreseeable future, but it did so *while* MSGE was in the middle of constructing the MSG Sphere. The operational shut down, in combination with heightened fixed SG&A expenses from the Sphere's construction, resulted in tremendous operating losses in 2020. However, the recent setbacks are quite deceptive. The underlying economics of these performance venues are quite attractive. MSGE has a near-monopoly on large performance venue space in NYC and Chicago. Additionally, these performance venues boast strong positive feedback loops between audience attendance, artist line ups, brand name, and sponsorship. These advantages give MSGE considerable pricing power within the live entertainment industry. Consequentially, when adjusting for pre-Covid levels of operations and subtracting out the temporarily artificially high SG&A expenses from construction, we arrive at a steady state level of NOI that is considerably more attractive.
2. Brand value and global platform in TAO: Although the global nightlife and entertainment industry is still facing an existential crisis, Tao Group's brand image and associated celebrity status will be key catalysts for a quick and full recovery back to 2019 levels once the pandemic ends. We believe the market is currently pricing in a depressed multiple due to high recent operating expenses as a result of investments in new locations and lack of visibility over venue reopening. Tao's significant performer-customer network effects, economies of scale in branding and marketing, and synergies with MSGE's other assets represent considerable growth potential at a high ROIIC well into the next decade. Moreover, its unique competitive positioning in the global nightlife industry warrants a higher multiple reflecting its brand image and management quality.
3. The MSG Sphere is a Valuable Form of Reinvestment: There remains an expected $1.039bn of future capital expenditure before the Sphere is completed. Taking into consideration that MSGE has burned through roughly $275mm since it ceased most of its operations in March, the MSG Sphere appears to be a dangerous and bottomless pit of future capital expenditure. However, MSGE even now has nearly $1bn of cash and short-term investments which it can use to fund the Sphere's construction in the future. More importantly, featuring the most modern entertainment technology, a seating capacity of over 23,000 people, and an expected 525 annual events by 2023-2024, the MSG Sphere has the potential to rival Madison Square Garden's unit economics. The Sphere's projected steady state NOI (of roughly $180mm annually) will likely account for nearly 50% of MSGE's future NOI.
4. An ugly special situation: The timing of MSGE's spin-off during the global Covid-19 pandemic leaves substantial uncertainty around the fair value of MSGE's assets. Investors are shying away from owning an almost singular asset business with ceased operations, reported operating losses, and enormous expected future capital expenditure. And one can hardly blame them for doing so—the near future of the business certainly appears grim. That said, we believe the underlying economics of the MSGE business to be quite attractive. We also feel strongly that MSGE's operating performance will recover to significantly more profitable steady-state levels once the Covid vaccine is

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

sufficiently distributed. This gives us an opportunity for time arbitrage by buying the business when it is ugly and waiting for the market correction once its operations recover.

**Key Risks and Considerations**

1. Considerable potential for continued cash burn: MSGE has ceased its operations for the foreseeable future. And until America is sufficiently vaccinated, MSGE will remain inoperative. We expect a large portion of America to be vaccinated by end of year 2021, and thus expect to see some recovery to normalcy by year-end. But it is important to note that for each quarter it remains inoperative, MSGE burns $163mm of cash. Thus, we are already expecting anywhere between $163 - $491mm of additional cash burn. If America is not properly vaccinated by year-end, or if the pandemic persists for any reason, MSGE is at risk of burning through its entire cash reserve. This is particularly unacceptable because MSGE's current cash reserves are intended to fund the construction of the Sphere. Thus, MSGE is at considerable risk of needing to raise additional debt to finance the Sphere.
2. Future popularity of the Sphere: The design of the Sphere sounds incredible right now. The Sphere boasts a central Las Vegas location, 3.5 acres of LED panels, 157,000 new ultra-directional speakers, haptic vibrant floors, and German Holopot speakers. MSGE has plans to make it a hub for concerts, performances, and even gaming tournaments. We are currently forecasting the future performance of the Sphere by benchmarking it to the unit economics of Madison Square Garden. However, it is entirely possible that the Sphere's true realized performance in the future is not as glamorous and lucrative as it is expected to be. In such a case, the magnitude of the failed investment is detrimental to the company's value. There is a great deal of uncertainty regarding whether the Sphere will meet its high expectations.
3. Uncertain Taoism: Our projections for Tao's future growth levels we projected are ambitious (~3 new venues per year in line with historicals) but still well within reason. Management has an excellent track record of scouting, developing and operating locations profitably. However, Tao's strategy of international expansion might entail added risk since its brand power has been only proven in North America. It is still unclear if Tao can replicate its American successes in untapped markets such as Western Europe and Asia.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Decision: NO PURCHASE

Investment Committee Chair: Ricardo Mestre

The Special Situations Sector pitched Madison Square Garden Entertainment Corp. (NYSE: MSGE) on Wednesday, December 2nd, 2020 in General Meeting as a buy. The Investment Committee decided not to purchase MSGE. Our reasons are as follows:

**FIRST**: The economics on the new Sphere facility that is being built in Las Vegas and others like it that may be built around the world are unclear. We believe that a substantial amount of the value of MSGE is based on these new developments in which the company has already panned to invest over $1.5 Billion and in which it may invest significantly more in the future if it were to build out the London location. While this new innovative facility represents a significant opportunity for value creation and continued reinvestment, there is no facility like it around the world and it is unclear how much cash the facility will produce in the long-term. We believe that this project caries a significant amount of risk and we are not comfortable attributing a value to the property higher than book value. It appears that the market is not so conservative.

**SECOND**: The company seems to have a high cost of capital. MSGE issued $650 million in senior secured term loans at a rate of 7%. This loan was secured by the company's safest assets—the subsidiary that owns and operates all of the core live entertainment venues excluding MSG Sphere and the TAO Group—thus, we believe that the overall enterprise level discount for the company's safest assets may be near 10% while the new developments and other assets may have costs of capital well above the 10% range. The reality is that the company is risky with its main business being directly impacted by COVID and much of the value of the company coming from a development with uncertain economics. We believe that the risk of this company demands a high rate of return in order to justify an investment, a criterion that was not met given our reasonable operating projections and valuation methods.

**THIRD**: The company has a high rate of cash burn and if COVID shutdowns were to last longer than expected this could have a material impact on the company. As explained above, the company has a high cost of capital and any attempt to go back to the capital markets will likely be met with even higher rates. Cash burn beyond the expected time horizon may force the company to delay developments and have a material impact on our investment's success. We believe there is a relatively small chance that any delays would have a material impact on enterprise value, however, with the uncertainty surrounding COVID it is certainly not impossible. We take any risk of permanent capital impairment extremely seriously.

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Exited Positions

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

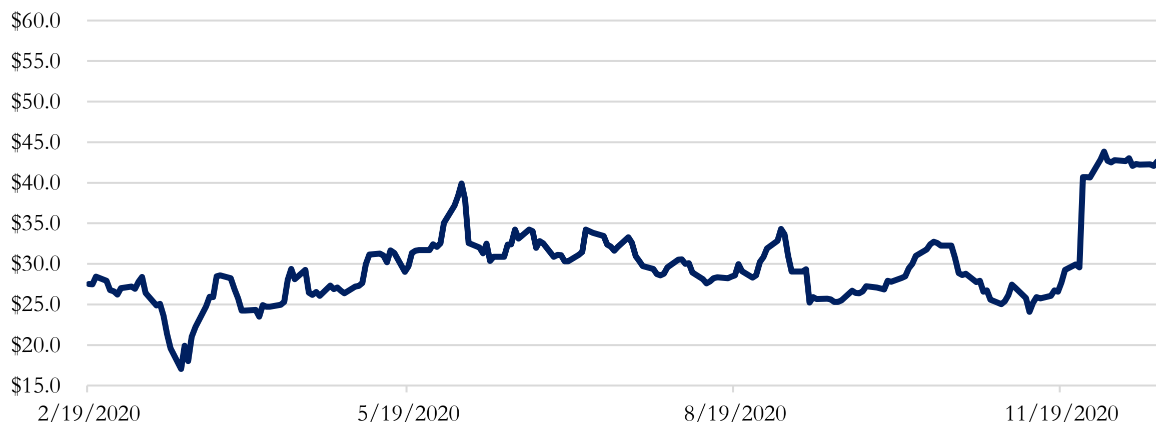
# MTS Systems (NASDAQ: MTSC) & Slack Technologies (NYSE: WORK)

Investment Committee Chair: Ricardo Mestre

The technology sector had an outstanding period last quarter with two of the companies they pitched in the past year getting bought out!

MTS Systems was purchased at $23.71 in early-June and achieved an IRR of over 300% with its acquisition by Amphenol. Amphenol will keep MTS sensors business while selling the MTS Testing and Simulation business is being sold to Illinois Tool Works. We are currently holding the investment waiting for the closing of the sale. These results are impressive, and I did not expect they would be achieved within such a short time period. With that being said, good things tend to happen when you purchase a business below its intrinsic value!

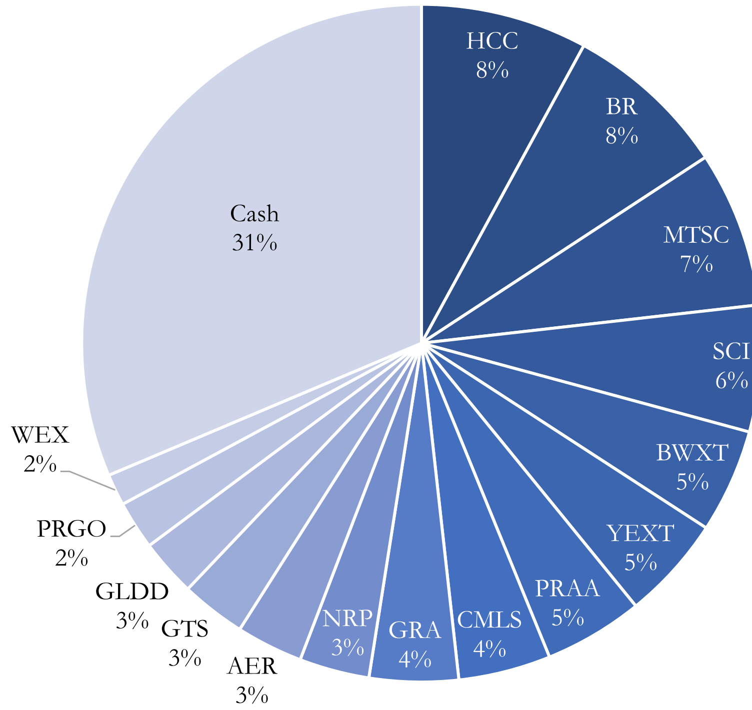
We were also the beneficiaries of the blockbuster deal between Slack and Salesforce which led to a ~70% IRR on our investment. Salesforce stock sunk on news of the acquisition, with many worried about the high purchase multiple (26x forward sales) and strong competition from Microsoft Teams. I am happy the investment ended positively and relieved that TBC no longer holds the stock which was purchased before my time as Investment Committee Chair.

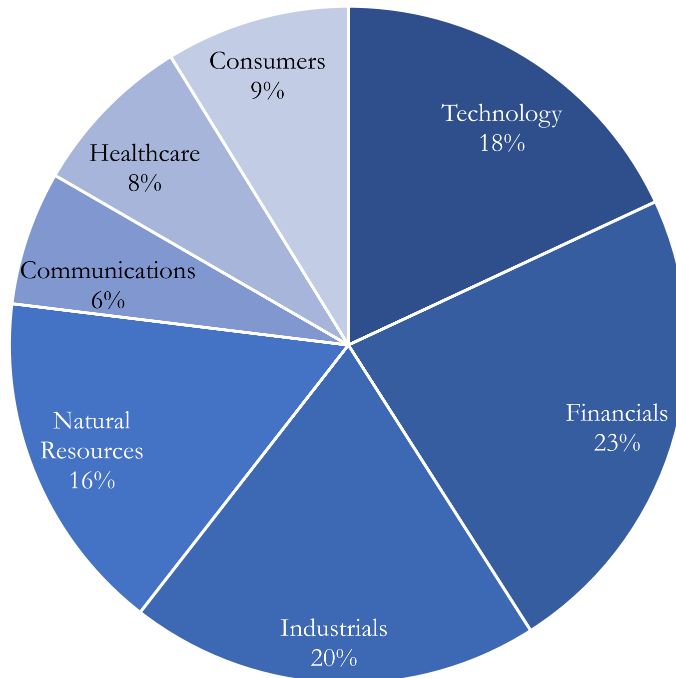



©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.

# Portfolio Weightings

©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.




©2021 The Blue Chips. All rights reserved. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security. Redistribution is prohibited without written permission.