"The trick in investing is just to sit there and watch pitch after pitch go by and wait for the one right in your sweet spot."

Warren Buffet

Statement from the Chair

Chair of the Investment Committee: Austin Wang

Our intro quote described our approach to investing in yet another tumultuous quarter where investors had to navigate rising valuations, supply chain breakdowns, and the threat of interest rate hikes. ICOMM chose to not purchase any stocks this quarter and instead flagged multiple high-quality businesses for future monitoring.

For example, we believed Anaplan to be an excellent business with a best-in-class planning software product. The combination of upselling opportunities and a shift towards their partner system for sales and marketing provided compelling opportunities for bottom line growth. Despite the attractiveness of the business itself, we were unable to justify a margin of safety for the high-flying tech stock. At the time of the pitch Anaplan traded at an 11x revenue multiple. Based on the sector's model, justifying such a high revenue multiple required one to believe Anaplan would rapidly cut margins down while maintaining similar revenue growth rates despite already penetrating most of the Fortune 500. Without having a full understanding of how much of the "low hanging fruit" – in terms of customers and upselling opportunities – was realized, we had little confidence in Anaplan's aggressive growth and margin assumptions.

In other cases, we found companies, like Rent-A-Center's newly acquired Acima, that seemed incredibly cheap from a revenue-multiple perspective but had unproven business models and paths to profitability. In 2020, Rent-A-Center acquired Acima – an 80%+ revenue growth digital rent-to-own payment business with nearly as much revenue as Rent-A-Center itself– for under a 2x revenue multiple, making the company seem incredibly undervalued. Rent-A-Center's unit economics were also vastly superior to its other rent-to-own furniture competitors, having significantly better margins and lower delinquency rates than its peers. However, Rent-A-Center's post-acquisition valuation could only be justified if the Acima business became more profitable and drove a more favorable margin mix for Rent-A-Center. ICOMM worried Acima would see higher-than-expected delinquency rates especially given the high delinquency rates seen by many digital buy-now-pay-later businesses. Furthermore, Acima was under fire for multiple lawsuits and customers complained that Acima employed predatory and unscrupulous tactics to delay pay-backs and generate late fees. In this case, we decided against investing in Rent-A-Center due to legal risks and Acima's unproven ability to reach profitability.

As valuations continue to swell, our investment committee has decided to remain disciplined and avoid succumbing to the fear of missing out on the newly invigorated technology-bull-run. We believe such a decision aligns with our primary objective of achieving high risk-adjusted returns and preserving capital for future generations of the club to use.

The Blue Chips is also motivated by the opportunity to invest in its future generations and become a long-lasting place of learning for the University of Chicago community. To that end, our club once again redoubled our efforts to recruit a diverse class of underclassmen and expanded our educational program. Our leadership team recognizes that not every member feels ready to dive into pitch-work at the end of a nine week training period, especially if they have had no exposure to business or finance. Thus, we introduced an "Enriched New Member Education Program" for students who needed more time to fully grasp investing fundamentals. After the initial ten-week education program, we decided to offer additional discussion sections, assignments, and exams for students who needed additional support in developing their technical acumen. Our hope is that, through offering additional resources, we will be able to reduce barriers to entry for actively engaging with the investment teams and promote greater inclusiveness.

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Spring Pitches

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Rent-A-Center (NYSE: RCII)

Industrials Sector Leader: Jesse Weinstein

Company Overview

Rent-A-Center (RCII) is a Lease-to-Own (LTO) business that primarily provides household goods to credit-constrained customers. RCII leases furniture, consumer electronics, and household appliances to consumers, and payments are made on a weekly, semi-monthly, or monthly basis (77% of lease agreements employ weekly payments). They generate revenue through four segments: Core Business (42% of revenue), Acima (53% of revenue), Franchising (4% of revenue), and Mexico (1% of revenue). The Core segment includes sales generated directly from RCII's brick & mortar stores and online website. The Acima Virtual Lease-to-Own (VLTO) segment earns revenues on leases derived from point-of-sale systems and browser extensions on partnered retailers' websites. Acima was acquired by RCII in December 2020 and works by purchasing e-commerce products on behalf of consumers and leasing it back to them with options for full ownership.

Investment Thesis

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

1. Smaller multiples discount to Buy Now, Pay Later (BNPL) competitors: With the acquisition of Acima, RCII has expanded its point-of-sale partnerships enabling its VLTO segment to serve similar functions as BNPLs. BNPL competitors Affirm and Afterpay are trading at EV/Revenue multiples of 44.48x and 40.95x respectively, while RCII is trading at 1.24x. The VLTO model is not as weak as is implied by these trading multiples. VLTOs have better repossession capabilities compared to the BNPLs who must sell their defaulted agreements at huge discounts to third parties. RCII can instead repossess the leased item, having earned LTO rates on an effectively rented item. While we do not expect close to complete multiple convergence, the market is severely underappreciating the relative value of RCII.
2. Acquisition of Acima driving growth: Acima's partnership with Mastercard to roll out the LeasePay Card, the industry's first LTO payment card, drastically expands RCII's customer base and exposure. RCII customers are now able to enter into lease agreements through the 2.2 million merchants acceptMastercard. Furthermore, the integration of a VLTO and LTO business is structurally attractive due to the cost synergies involved in returned merchandise to Acima. RCII can more easily monetize returned products from their virtual segment in their brick & mortar stores, whereas other VLTO players must hold returned merchandise on their balance sheets at a loss. Lastly, the inclusion of Acima's proprietary decision engine decreases the average transaction time from 45 to 10 minutes and is expected to reduce fraudulent lease agreements.
3. Dominant positioning in LTO and VLTO Industries: The LTO industry is effectively a duopoly between RCII and Aaron's (AAN). AAN was forced to spin-off their VLTO segment, Progressive Leasing, due to poor performance in their brick & mortar LTO stores dragging down valuations for their more profitable VLTO segment. Comparing same store sales growth between the two players, RCII has seen 15 consecutive quarters of positive growth whereas AAN has seen negative or barely positive same store sales growth prior to the spin-off. RCII has a far faster cash conversion cycle and superior inventory turnover ratio. AAN's forced spin-off of their profitable VLTO segment enables RCII to compete as the only player with both a LTO and VLTO segment. Consequently, RCII can achieve scale and cost synergies that will be difficult to replicate by other players in the space.

Key Risks and Considerations

1. Increasing adoption of BNPLs represents a risk to the VLTO segment: BNPL competitors have had difficulty penetrating Acima's niche in credit-constrained consumers but nonetheless remain a potential threat. Many BNPLs such as Zip and OpenPay have installed minimum credit requirements due to the large losses incurred from low-credit consumers. As a result, BNPLs do not directly compete with the credit-constrained customers that drive RCII's core business. BNPLs also typically service lower ticket items, whereas LTO businesses such as RCII specialize in higher ticket items like furniture.
2. Integration of Acima: AAN's spin-off of their VLTO segment could be seen as a sign VLTO and LTO segments are poorly compatible. However, AAN's management noted their VLTO segment was not as beneficial as originally anticipated in part because they operated the two segments independently. RCII management will integrate the two segments, and RCII can monetize returned products to Acima and provide last-mile capabilities.

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3. Growth driven by stimulus is not sustainable: While results may be partially inflated due to stimulus payments, RCII has had a steady history of positive same store sales growth and their acquisition of Acima will propel them further into the digital world. The Acima LeasePay card will increase the value proposition for customers to enter into lease agreements with RCII instead of other competitors.

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Decision: NO PURCHASE

Industrials Investment Committee Representative: Darius Hong

The Industrials Sector pitched Rent-A-Center (NASDAQ: RCII) on Wednesday, October 27, 2021, in General Meeting as a buy. The Investment Committee (ICOMM) decided not to purchase RCII. Our reasons are as follows:

FIRST: There is significant uncertainty surrounding the competitive environment. The sector has described Buy Now Pay Later (BNPL) as a major competitor for digital Lease To Own (LTO) businesses like Acima. While there are important differences between BNPL and LTO, we are afraid of Acima's competitive prospects. Businesses like Affirm, Afterpay, Klarna, and many others are willing to spend enormous amounts of capital with atrocious unit economics; delinquency rates at major BNPLs are at least an order of magnitude worse than at typical banks and rising quickly. We think it will be difficult for Acima to build a strong digital LTO franchise while competing with an ocean of capital that seems content to earn negative returns for a long period of time. Beyond BNPL, leasing/lending is an inherently cyclical and capital-intensive industry, and digitization has not changed those characteristics.

SECOND: The current valuation implies that a radical transformation of RCII's business is needed to make the stock attractive. The sector's base case calls for an 8.7% FCF margin in 2025, compared to 3.9% in the first three months of 2021. In addition to assuming rapid growth and yet to be demonstrated profitability at Acima, the model also assumes that growth for the franchise segment will significantly exceed past rates. The sector also chose to straight-line "rental merchandise" (the largest asset category on the balance sheet) over the next 5 years; this is unrealistic as the model does not properly account for large cash outflows needed to purchase rental merchandise as the business expands. With less heroic assumptions in terms of margins and capital efficiency, the business does not seem undervalued.

However, a minority of ICOMM indicated a potential buying opportunity in RCII for the following reasons:

FIRST: Given rising retailer support, customer loyalty, and user adoption, it is evident that BNPL and LTO business models are likely to endure and proliferate for some time to come. Currently, BNPLs trade at much higher multiples than LTOs, largely as a function of the former arriving earlier to the digital market, having larger scale generally, and seemingly serving a less risky portion of the market. However, the market is not appreciating that RCII is quickly digitizing and that based on allowances for credit losses, BNPLs possess no significant advantages over RCII in the risks they manage. Furthermore, we doubt the viability of the BNPL business model in contractionary economic conditions, but our research suggests that LTOs like RCII can thrive across the full economic cycle. Inflation borne by rising shipping costs and commodities prices suggests a potential slowdown or reversal in economic growth in the near future, straining consumer finances and opportunities to seek credit. In this [likely] scenario, RCII will outperform large BNPLs given the former's ability to upcharge (and adapt to increased default rates) and their niche in providing financing options for consumers with low creditworthiness. Furthermore, in the event that consumers default on their lease payments, RCII has the right to repossess leased items from those consumers and lease those items out to new consumers, resulting in pure gain on original consumers' previously made payments and ensuring complete inventory deployment.

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MillerKnoll Inc (NASDAQ: MLKN)
Consumers Sector Leader: Aarsh Kak

Company Overview
MillerKnoll (formerly known as Herman Miller) is a designer, manufacturer, and distributor of high-end office equipment. They specialize in ergonomic seating products and modular office furniture. The company was founded in 1905 and includes a variety of brands including Herman Miller, Maharam, and HAY as well as the retailer Design Within Reach. Primary customers include corporate offices, healthcare settings, higher education institutions, and residential settings. In July 2021, MLKN acquired Knoll, an American designer and manufacturer of luxury home and office furniture, for $1.8B. Workplace furnishing (excl. chairs), performance seating, and lifestyle products account for 34%, 32%, and 28% of sales respectively.

Investment Thesis
The Consumers Sector recommended a BUY in MLKN for the following reasons

1. **MLKN will benefit from the Hybrid Business Model and WFM**

Based on employers and employee preference data, we believe that a hybrid business model is here to stay. We also see companies recently giving stipends to employees to spend on home office equipment and furniture. This trend has allowed MLKN to increase direct-to-consumer sales which have higher margins than large office contracts. We believe this trend will continue as employers and employees accept a hybrid model as a permeant change to how business is conducted rather than a model that will vanish in a 'post-covid' world. We believe the increase in DTC sales to outweigh the harms of fewer people in offices. Wealthy individuals (who are more likely to work in hybrid model jobs) now have the potential to have two office chairs, one in the office and one in their home. A decrease in utilization of the chair in the office will lead to a longer replacement cycle, but we believe the net effect of having some individuals use an MLKN chair in the office and the home will outweigh this effect.

2. **Brand Name Moat**

MLKN has established its Herman Miller brand as the go-to brand for office furniture. Over the past 100 years, the company has established its brand as synonymous with high-end modern furniture. They maintain this through innovations in ergonomics that can be seen through their track record of awards and loyal customer base. Through online customer reviews, we can see Herman Miller products rate higher than their closest public competitor, Steelcase. We see potential to widen this moat as the company expands internationally. International sales and orders are both up 45%+ YoY (adjusted for currency translation). These sales have primarily come from offices and institutions. Word of mouth recommendations between office managers was the primary way MLKN established such a strong brand name in the US, and we expect their brand name to grow internationally in the coming years.

3. **MLKN is poised to capture Developing Health & Consumer Trends**

The sudden shift to WFM due to covid caused chronic back pain to increase significantly based on both medical studies and consumer interest data based on online search popularity. We also see based on Google Trends data that "Ergonomic Chair" internet searches experienced an increase due to covid and are still at highly elevated levels compared to pre-covid. MLKN's brands are not just associated with luxury but are rather known for their advanced ergonomics based on Chair Marketing Survey data. Increased need for specifically ergonomic chairs as well as general trends of increased focused health and wellness put MLKN in a position to use its existing strengths to capture more of the market. Potential buyers who experienced chronic back pain for the first time will be much more likely to splurge on a chair if it comes with the best ergonomics.

Key Risks and Considerations

4. Uncertainty caused by Knoll Acquisition

MLKN's debt has grown from the Knoll acquisition giving MLKN a debt/equity ratio of 86.3% Additionally, there is uncertainty on short-term restructuring costs. Debt is not well covered by operating cash flows, but interest payments are well covered by EBIT. MLKN management believes they can achieve a significant $120M of cost synergies in the next 3

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years which should offset the immediate restructuring costs. Nonetheless, the high levels of debt from the acquisition make MLKN a riskier company.

5. Supply Chain Pressure

As a manufacturer, MLKN is exposed to rising input and labor costs. Steel price volatility (prices are near a 6-yr high) as well as increased labor costs associated with general inflation add an element of uncertainty in margins. While MLKN is a premium product and has shown historical pricing power, sudden changes in input costs will still hurt margins.

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Decision: NO PURCHASE

Consumers Investment Committee Representative: Niralee Shah

The Consumers Sector pitched MillerKnoll Inc. (NASDAQ: MLKN) on Wednesday, November 4th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided not to buy MLKN. Our reasons are as follows:

FIRST: The sector's investment thesis relies very heavily on the shift towards the retail segment as a source of future growth and profitability. We are not convinced by MLKN's goals to shift to end consumers rather than focusing on their core competencies of offices and business spaces due to 1) a lack of customer retention and recurring revenue in the retails segment, 2) that return to office will likely cannibalize future work from home retail sales 3) and lack of differentiation from high quality chairs of other competitor brands.

SECOND: There is significant uncertainty associated with the Knoll acquisition, and enough information is not available to alleviate concerns. Particularly, MLKN's **debt position** has grown significantly from the costly acquisition. At the time of the pitch, MLKN had around $500M of debt due in 5 years, and another $600M of debt due in 7 years. If we use a general interest rate of between 2-4%, it suggests that MLKN is barely able to meet debt requirements even before dividends are considered. Their debt is not well covered by their operating cash flow. But dividends must be considered as their high payout ratio (118%, as cited by the sector), suggests that their dividend payments are not well covered by earnings.

THIRD: At the time of the pitch, the margin of safety was insufficient. Over half of the company's market capitalization was attributed to an acquisition it had paid a 45% premium for. Management had claimed $100MM in cost synergies, but there was no evidence to the realization of these synergies. Thus, we see no argument that there was a fundamental mispricing. The sectors valuation assumptions seem aggressive, particularly regarding their extremely low cost of capital, given what has been mentioned earlier about MLKN's debt levels.

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Anaplan (NYSE: PLAN)
Technology Sector Leader: Charlotte Donnelly

Company Overview
Founded in 2006, Anaplan is a cloud-based enterprise planning company that allows businesses to seamlessly combine disjointed planning tools on a single platform. Anaplan offers basic, professional, and enterprise subscription plans, with additional add-ons like training. Although Anaplan competes with systems giants like IBM Planning Analytics and Oracle Hyperion, Anaplan offers a variety of integrations and extensions that make it more convenient and agile for large departments with large amounts of data. Anaplan experienced rapid revenue growth of 43%, 45%, and 29% in 2019, 2020, and 2021 respectively. Although revenue growth has been substantial, Anaplan is punished widely for its Sales & Marketing expenditures, which accounted for between 60%-73% of revenue in the past several years. Sales & Marketing represent Anaplan's largest barrier to profitability. We believe that market overreaction to unprofitability coupled with strong switching costs, network effects, and mitigants to S&M overspending offer an opportunity to realize value.

Investment Thesis
The Technology Sector recommends a BUY in PLAN for the following reasons:

1. Switching Costs: Adopting enterprise planning software requires a significant amount of time, cost, and sensitive data. As a result, enterprise software planning companies experience high switching costs, with Anaplan benefitting from its connected planning platform and integration across HR, supply chain management, and finance. Initially, a single division in a corporation may identify a planning problem and adopt Anaplan, making an investment in time, cost, and training. Next, company data is integrated into Anaplan, and employees are trained to rely on Anaplan for daily processes, during which time large sets of sensitive data are integrated. From this point, Anaplan expands within a single corporation, with employees investing in an enterprise solution that they will likely rely on for the foreseeable future. Anaplan's data integration features and APIs increase these switching costs, as corporations can continue using some of their existing planning tools within Anaplan.
2. High S&M Costs & Profit Potential: Anaplan has spent ~70% of revenues on Sales & Marketing over the past 3 years, and has yet to turn a profit. Furthermore, for every dollar spent on S&M, Anaplan generates 60 cents of revenue. These metrics, and subsequent market overreaction, fail to consider Anaplan's upselling sales model. Like many enterprise planning businesses, Anaplan needs to invest heavily in enterprise sales teams to onboard new clients. However, once they land a new customer, Anaplan skillfully upsells: Anaplan's top 25 customers in 2020 had an average annual recurring revenue of ~4.2M, which was 10.5x the size of their initial contract values. Furthermore, Anaplan's partner program will likely lower future consumer acquisition costs and S&M expenditures. Partners account for ~50% of Anaplan sales, and extend Anaplan's direct sales force by referring Anaplan to their customers. Sample partners include Accenture, Deloitte, EY, and PWC. Anaplan already has over 180 partners and as this network continues to grow, consumer acquisition costs will likely decrease.
3. Network Effects: Anaplan benefits from network effects within and between organizations. Within a corporation, a single department often adopts Anaplan and a few key employees become Anaplan "experts." Anaplan is slowly adopted by other departments, gaining employee loyalty and increasing Anaplan's contract size within a single company. Between organizations, Anaplan's robust developer community creates network effects as more committed Anaplan experts join the community and make the planning software easier to use, therefore attracting new customers. Anaplan offers certifications and recognition to experts who share their expertise, and hosts annual conventions to increase engagement. These efforts ease adoption for new users, allowing Anaplan to become more useful as more loyal developers join.

Key Risks and Considerations

6. Product Concentration: All of Anaplan's revenue comes from a single product, and Anaplan's profitability depends on maintaining a cutting-edge and helpful enterprise planning software platform. Since adoption costs for enterprise planning are quite high (generally about ~$30-50k for the first year), Anaplan's software must be significantly better than existing, cheaper tools like Excel.

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7. Interest Rate Risk: The tech sector may be particularly exposed to interest rate hikes. Given Anaplan's aggressive growth expectations and current unprofitability, our margin of safety could be partially or completely eroded within the next few years by an anticipated ~7x rate hike (from 0.25% to 1.75%) by the close of 2023.

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Decision: No Purchase

Technology Investment Committee Representative: Emily Ballinger

The Technology Sector pitched Anaplan (NYSE: PLAN) on Wednesday, November 3 in General Meeting as a buy. The Investment Committee (ICOMM) decided to monitor the company. The company was reevaluated on January 16 after further declines in the share price but ICOMM voted to not buy. Our reasons are as follows:

FIRST: Uncertainty regarding the timeline to profitability. Although the quality of the firm is high and profitably can reasonably be achieved in the foreseeable future it is unclear exactly when this will take place. The resulting imposes a higher degree of uncertainty on our valuation as near term cashflows are either small in magnitudes or negative. The terminal years in our cash flow are then responsible for nearly all the Free cash flows adding a second layer of difficulty to estimation as small changes to the terminal growth rate or the multiple change the upside. Even when best case scenarios were taken the resulting IRR was well below what could be earned just investing in a diversified basket of stocks. In short, this led to a valuation where the required risks obscured the potential upside and did not justify purchase.

SECOND: Complicated and opaque nature of growth. Anaplan's software addresses a real need for connected planning across various parts of the firm. Further the solutions strong network effects have and likely will continue to provide cheap growth as various departments evangelize the software to other parts of the company. This will likely continue to provide revenue growth in the low twenties to mid-teens for some time. At the firms current EV/Revenue of roughly 11x we believe that this growth is already priced in, and investors are appropriately compensated for the risk they are taking on. Furthermore, the wide range of possibilities for future growth and the speed at which it will slow from its current levels also justifies the current pricing.

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Copart, Inc. (NYSE: CPRT)

Financials Sector Leader: Victor Liu

Company Overview

Copart, Inc. (NYSE: CPRT) is an online two-sided salvage vehicle auction platform that serves as the intermediary step that connects various players in the auto value chain, with significant market presences in the United States, the United Kingdom, Canada, and Germany. CPRT primarily operates two business segments: service revenues, in which CPRT collects a commission fee (around 10%) on all transactions conducted on its platform, and vehicle sale revenues, in which the company purchases and sells vehicles itself. Service revenues account for roughly 85% of total revenue, while vehicle sales account for the other 15%.

Investment Thesis

The Financials Sector recommends a BUY of CPRT for the following reasons:

1. Durable Market Positioning in a Duopolistic Industry: CPRT leads the auto salvage industry, controlling around half of the current market; more importantly, high barriers to entry into the auto salvage industry allow CPRT to comfortably defend its position. It is extremely difficult to obtain the necessary capital, land, and licenses to operate salvage lots at scale, making it hard for newcomers to break into the industry and tricky for some incumbents to expand. Fortunately, CPRT already owns 200 lots that span over 9,500 acres, which lower transportation costs while bolstering convenience and liquidity for both buyers and sellers. Moreover, CPRT further entrenches is leading market position through the relationships it has forged with insurance companies. Specifically, insurance companies are critical in increasing the supply of cars to be sold to buyers, and CPRT's long-lasting relationships not only give it access to more favorable deals from insurers, but also prevent competitors from entering strategic agreements with the same partners. Higher supply attracts more buyers to CPRT, and materially, this has resulted in average selling prices on its platform to increase by 48% YoY, outpacing the global average increase of 35%.
2. Differentiated Product Offering: When compared to the second-leading player in the auto salvage industry, IAA, Inc. (NYSE: IAA), CPRT has advantages in being both a B2B and B2C platform (IAA offers B2B only). CPRT's fully digitized platform supports both automated and real-time bidding alongside mobile check-ins and scheduled pickups that reduce friction for buyers. Its proprietary VB3 software also creates predictive analytics to create a tailored experience for buyers based on past views and purchases. In operating a tech-enabled platform, CPRT has not only been able to thrive despite COVID-related limitations, but also create inroads to international expansion. Notably, 75% of all US-based auctions receive a bid from an international buyer, and CPRT's position as the leading salvage vehicle auction platform allows it to more easily access a global clientele base. Digital auction processes also boost liquidity for both sides of the marketplace, making CPRT's platform more attractive and incentivizes buyers and sellers to join.
3. Fundamentally Resilient Business Model: CPRT's two key revenue indicators are vehicle prices and total losses, and the inverse relationship between the two factors minimize revenue downside and margin compression. Higher vehicle prices increase CPRT's revenue per transaction, while total losses increase the frequency in which cars are sent to salvage. Vehicles are becoming more expensive due to their various electronic component requirements (sensors, cameras, radars etc.), driving up prices; at the same time, increased vehicle accident frequency and older cars (around 12 years old in the U.S. on average) lead to greater total losses. For these reasons, CPRT's revenues are inherently insensitive to broader macroeconomic trends. To illustrate, while used car prices decreased by 10% during the 2008-09 Recession, CPRT's revenues shrank by less than 1% because higher salvage frequencies counteracted the impacts of the recession.

Key Risks and Considerations

1. Rise of Driver Assistance: New driving technologies that seek to reduce traffic accident rates might lead to fewer totaled cars in CPRT's supply. However, these same technologies increase the complexity of cars, which makes them more difficult to repair and more likely to be considered totaled, and therefore sent off to CPRT's lots.

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2. Supply Chain Risks: International expansion is key to CPRT's growth strategy, since it allows CPRT to tap into new markets and sell salvage vehicles in comparatively lower income markets. However, this additionally exposes CPRT to towing and shipping container costs.

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Decision: NO PURCHASE

Financials Investment Committee Representative: Adam Keller

The Financials pitched Copart (NASDAQ:CPRT) on Wednesday, November 10 in General Meeting as a buy. The Investment Committee (ICOMM) decided not to buy the company. Our reasons are as follows:

FIRST: High valuation leaves little to no margin of safety: In the sector's base case, Copart's WACC is 6.0% and its intrinsic value is 13% above current prices. This implies a prospective return in the 6-7% range – far too low to justify an investment. Copart is an excellent business with a durable moat, but the sector's perception of the company does not seem to vary much from the market's expectations.

SECOND: Operating projections require excessive optimism: We feel that the sector may be giving Copart too much credit for its ability to improve certain drivers of operating performance. Specifically, the sector expects a 9% increase in fixed asset turnover over the next 3 years, as well as a 990bp improvement in EBITDA margins over the projection period. While Copart has historically been able to drive higher free cash flow margins and higher invested capital turnover, we do not have confidence that such a mature business will be able to substantially increase its ROIC over the next 15 years. Copart's two-sided network effect may protect the firm from competition for the foreseeable future, but we do not see this moat becoming much stronger than it already is.

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iHeartMedia, Inc. (NASDAQ: IHRT)

Communications Sector Leader: Cody Tracey

Company Overview

iHeartMedia, Inc. is the number one audio media company in the U.S. based on consumer reach. IHRT operates primarily within the companionship sector of the audio industry and uses its large scale and national reach in broadcast radio to build additional complementary platforms. IHRT is now the only major multi-platform audio company, with each additional platform building and extending the relationship with its consumers. IHRT's reach extends across more than 250 platforms and over 2,000 different connected devices, reaching 228 million fans on its social media platforms. IHRT operates across five leading platforms: Broadcast Radio, Digital, Podcasts, Social Media, and Events. IHRT's podcast platform is the largest podcast publisher with 30M+ MAU and 281M monthly downloads.

Investment Thesis

The Communications Sector recommends a BUY in IHRT for the following reasons:

1. Rise in Popularity of Podcasts: The Global Podcasting market is expected to reach $94.88B by 2028, representing a CAGR of 31.1% from 2021 to 2028. Podcasts are increasing as a platform for companies and content creators to engage with their audiences, increasing ad spend on podcasting. IHRT is currently the number one podcast publisher with 281M global monthly downloads and 29M monthly active users. Furthermore, IHRT recently acquired two advertising technology companies (Jelli, Inc., and Voxnest) to improve monetization on its podcast platform. IHRT's market dominance in podcast publishing combined with its ability to leverage its user base to increase ad spend and monetization represents a significant competitive advantage for IHRT.
2. IHRT's Emergence from Restructuring: In 2006, IHRT was taken private by Thomas H. Lee Partners and Bain Capital through an LBO. This LBO placed crippling debt on IHRT's balance sheet and forced it into Chapter 11 bankruptcy in 2018. Through the restructuring process, IHRT was able to discharge all of its debt, shore up its balance sheet to improve financial flexibility, and spin-off Clear Channel Outdoor Holdings to focus more on digital strategies. Since the May 2019 restructuring, IHRT has been able to pay down $250M of debt early and repurchase all preferred stock from the restructuring, resulting in a 100 bps improvement in the borrowing rate. IHRT has also improved its D/EBITDA from 19.39x to 6.87x and increased adjusted EBITDA margin from 21% to 25%.
3. Strength of Brand and Assets: IHRT has high brand awareness across its business segments, especially within its events business, where it hosts eight major tentpole events, including the iHeartRadio Music Festival, iHeartRadio Jingle Ball Tour, and the iHeartRadio Music Awards. Additionally, within its platform portfolio, IHRT is able to leverage advertising technologies to improve monetization and ROI for clients, especially within its podcast network. Podcasts represent a significant opportunity in this space as typical podcast listeners are young, educated, and wealthier and use ad blocking services for other digital content, whereas podcast advertisements are built into the show similar to broadcast radio. These factors have resulted in YoY podcasting revenue growth of 90.9% for IHRT's podcast business.

Key Risks and Considerations

1. Bankruptcy and Restructuring: IHRT's Chapter 11 Bankruptcy allowed it to discharge all debt from the LBO, but it still maintains a relatively large debt load. While management has been aggressively paying down debt, there is still a risk of IHRT not being able to service all debt obligations and falling into bankruptcy again. Furthermore, even if IHRT can pay down all debt, debt servicing will result in significant use of FCF, preventing management from reinvesting into the business.
2. Broadcast Radio Trends: IHRT's Broadcast Radio business is currently the largest component of the firm by revenue. There has been a secular decline in Broadcast Radio ad spend, which could continue into the future and reduce revenue in IHRT's largest segment.
3. Increased Competition: While Apple and Spotify currently operate primarily as podcast distributors, there is potential for a Netflix case to occur where Apple and Spotify begin to produce more original content. If this were to occur, both companies would own content and distribution on their podcast platforms and create a more fragmented and competitive

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space for IHRT to operate in. This could have the effect of competing away IHRT's current margins, or reducing MAU below current levels, either of which would be a significant headwind to IHRT.

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Decision: NO PURCHASE

Communications Investment Committee Representative: Will Reid

The Communications Sector pitched iHeartMedia, Inc. (NYSE: IHRT) on Wednesday, November 10 in General Meeting as a buy. The Investment Committee (ICOMM) decided not to buy the company. Our reasons are as follows:

FIRST: While we admit that IHRT currently holds a strong position in the podcast production market, we believe that their acquisitions of talent and current podcast production are not enough to constitute a durable competitive advantage in a space with relatively low barriers to entry and healthy competition. Anyone with a microphone and a laptop can make a podcast, and the most successful stories are often no more than that (see Joe Rogan). We believe it will be exceedingly difficult to stand out in the podcast production market without a significantly larger cash pile or an advantage in distribution, which leads into the second point:

SECOND: Though IHRT is currently the largest podcast publisher, there is reason to believe that the distribution platform has the true bargaining power in the industry, and the majority of IHRT's podcasts are also listed on outside platforms like Spotify. Further, the majority of IHRT's podcasts are lower rated, with only 1 of the top 20 podcasts being produced by IHRT. Given this, we don't see why Spotify and Apple can continue to use their orders of magnitude larger investments to take more share of distribution and continue to vertically integrate into production and acquisition. While we don't claim this is *likely*, there are potentially parallels with the streaming industry, and Spotify/Apple have the cash to be the "Netflix," spending aggressively to simultaneously increase production, acquisitions, and distribution.

THIRD: We are not confident in the sector's prediction that broadcast radio will continue its very slow decline barring further evidence. There have been several cases in the past where outdated technologies exhibit slow attrition for the first 10 years or so after they lose their prominence followed by a much sharper decline. This could be driven by factors like the radio population aging out and cars coming equipped with radio less frequently. Again, there is too much uncertainty here either way.

FOURTH: The sector modeled an expected return of 7.5% a year, which was lowered even further when we took more conservative assumptions with respect to capital expenditures. We do not believe this presents an attractive enough return profile or a large enough margin of safety even ignoring the above points.

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SolarEdge Technologies, Inc. (NASDAQ: SEDG)

Natural Resources Sector Leader: Karol Mukhamediyeva

Company Overview

SolarEdge Technologies, Inc. is a global leader in engineering, manufacturing, and providing module-level electronics for solar power harvesting. SEDG's main products include power optimizers, photovoltaic inverters, battery banks, and EV charging inverters, and their solutions include software monitoring systems. Their revenues can be broken down by product where the sale of inverters, optimizers, and all other products respectively comprise 43.98%, 42.86%, and 13.16% of total revenue. They provide their services to residential, commercial, and utility-scale photovoltaic installers. Currently, SEDG holds over 350 patents, has over 70% market share in the power optimizer space, and they are the #1 solar inverter company in terms of revenue.

Investment Thesis

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

4. Strong overall industry growth resulting from political and market forces, and expansion of universe of solar products: Global solar capacity has grown over 325x in the past 10 years, and looking forward, the global solar energy market is projected to reach $223.3B by 2026 growing at a CAGR of 20.5%. Solar is the fastest growing form of renewable energy, outpacing both hydro and wind power, with 139 GW of energy being installed in 2020. Increasing solar panel efficiency is a driver of industry growth, as viable models have approximately 18-22% efficiency but prototypes are exhibiting 44.5% efficiency. In addition, the US Solar Investment Tax Credit, started in 2006 and meant to end in 2020, was extended through the end of 2031 as part of the newly passed infrastructure bill. On the state level, 14 states pledge to increase their total energy consumption to 100% renewable energy by as early as 2040. Also, with solar installations increasing at a drastic rate, demand for supplemental solar products such as storage solutions is growing in tandem. Since SEDG has strong relationships with distributors and has superior optimizer and invertor technology, they are well-equipped to take advantage of and benefit from the favorable future industry growth.
5. Industry leader positioning protected by network effects, switching costs, and intangible assets: SEDG provides software to their end-users for free through their cloud-based monitoring platform and mySolarEdge app. These platforms collect power, voltage, current, and system data which customers can view and analyze, and SEDG can utilize to improve their platforms and offer additional solutions to clients. The platform provides tremendous network effects to SEDG, as more customers translates into more data and an improving platform which in turn increases the value of the system and attracts more customers. Furthermore, SEDG has significant procedural and financial switching costs. More specifically, distributors acquainted with SolarEdge products would need to educate and train their team if they were to switch to another company's products, and it is very costly for end users to swap out one part of their inverter/optimizer system since the combination of SolarEdge products form a complete solution. Finally, SEDG has noteworthy intangible assets. In particular, they have a strong reputation in the inverter supplier space, many patents, and licenses/government permits that allow them to maintain presence in 31 countries.
6. Advantaged market position in growing utility-scale solar market: Currently, utility-scale solar is the key driver of worldwide solar power capacity growth. More than 61 GW in utility-scale solar projects are currently under construction, and the US Department of Energy predicts a 50% reduction in the levelized cost of energy (LCOE) for utility-scale solar by 2030. Compared to their competitors such as Enphase Energy, SEDG's inverter and optimizer technology is superior in almost every category. Most notably, they have a market-leading efficiency at a weighted efficiency level of 98.8%, and their power-optimizer technology is easily adaptable to utility-scale projects which cannot be said about many of their competitors. Since SEDG has announced their plans to expand their utility-scale solar segment, they can capitalize on the rapid development in utility-scale solar to expand their business.

Key Risks and Considerations

3. Customer Concentration: Given the nature of SEDG's operations as a firm that operates as a supplier to distributors rather than to end users, a considerable 31% of their revenues in 2020 came from their top 3

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distributors. However, the SolarEdge Preferred Partner Program provides rewards and benefits to customers registered in the program which incentivizes distributers to continue their close relationships with SEDG. Also, SEDG's customer relations have strengthened over the years. For example, Sunrun selected SolarEdge as their preferred supplier of MLPE's in 2015, and in early 2021, SolarEdge announced an expanded supply agreement with Sunrun.

4. Impact of Q4 Product Backlog: Production at SolarEdge's Vietnam factory had to be halted for 6 weeks due to a regionwide shutdown resulting from a COVID-19 outbreak. While the factory has since been reopened, this setback will impact 2021 Q4 revenues and could create a slight surface-level misunderstanding among investors of the current state of operations. Despite these challenges, SEDG now has an order backlog which management anticipates will be resolved in Q1 of 2022 without any long-term impact on operations.
5. Lawsuit and Patent Infringement Threats: Over the course of SEDG's history, there have been reasonable patent infringement issues that the company has been forced to address, and in recent years, a few of their patents have been revoked. However, past patent issues have not had any considerable impacts on core operations, and the rapid evolution of the technology in the industry makes most lawsuits and patent infringement threats trivial due to the lengthy trial process.

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Decision: Monitor

Natural Resources Investment Committee Representative: Frank Li

The Natural Resources Sector pitched SolarEdge Technologies (NASDAQ: SEDG) on Wednesday, November 17th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided to monitor SEDG. Our reasons are as follows:

FIRST: We recognize that SolarEdge offers technologically superior products in a market that will likely observe strong overall growths in the coming years. Protected by high switching costs and its portfolio of intangible assets, SEDG will continue to benefit from its industry-leading market position in module-level electronics in both residential and utility-scale solar markets.

However, we believe that the growth opportunities in the industry outlined by the sector driven by continued federal tax incentives and state-level clean energy programs are well understood and appreciated by the broader market. As a result, we would need to have a drastically different view on the company's potential growth rates in the next five to ten years to conclude that it is currently undervalued. We are not certain that there is sufficient evidence to support the existence of such mispricing and the margin of safety that we typically look for in our investments.

SECOND: While we agree that SolarEdge has a dominant market position in the Americas and Europe and has been successfully competing against other market players within these regions, we are concerned about the recent entries made by other larger players such as Tesla in the solar inverter market. Although TSLA currently only sells products that are unable to match the efficiency levels of SEDG's offerings, given their brand name and R&D capabilities, we should not discount the potential competitive threats they pose to SEDG. We concur that TSLA may not commit to prioritize solar inverters as a key part of their product offerings, but we do want to highlight the potential risks associated with new entries.

THIRD: Based on our discussions with the sector and the valuation model presented, when we realistically project out SEDG's revenue growths in the next decade, it seems that much of its value is currently captured by the market valuation. As discussed above, at the current price, any additional implied upside would require more aggressive assumptions in the long-term growth rates of the market as well as SEDG's ability to fend off competition and capture larger market shares, which we currently lack. Nevertheless, future declines in SEDG's share price could present attractive entry opportunities given the solid fundamentals of its business. Therefore, we are of the opinion that we should continue to monitor the stock performance of SolarEdge and the competitive dynamics of the market and re-evaluate once we can have a greater conviction in this investment.

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Boston Scientific (NYSE: BSX)

Healthcare Sector Leader: Alexander Prakash

Company Overview

Founded in 1979, Boston Scientific is an American company that develops, manufactures, and markets medical devices. It sells mostly single-use, minimally-invasive items; the firm is particularly known for, and weighted towards, cardiovascular solutions. It is diversified across hundreds of products and earns half its revenues from outside the U.S. With $11.5B in LTM sales, BSX is one of the largest players in the markets where it competes. These industries are characterized by complex, expensive regulations, patent moats reinforced by billions in annual R&D spend, and substantial scale benefits in distribution and marketing. Thus, Boston Scientific enjoys a stable oligopoly. Importantly, the firm gets many of its new products through acquisitions; however, these are mainly small, early-stage purchases, so most (around three quarters) of BSX's revenue growth is organic. Although sales fell 8% YoY due to Covid, the firm has since recovered.

Investment Thesis

In mid-2021, BSX's multiple fell about 25% in response to several high-profile product recalls. We argued this created an investment opportunity because the business' underlying strength had not changed, and these individual recalls did not affect the firm's long-term earnings power as much as the price action implied.

1. <u>Strong fundamentals.</u> Bostin Scientific enjoys secular tailwinds. As the global population ages, it will consume more healthcare, especially the minimally-invasive products that BSX makes, since older people have more comorbidities and thus are less suitable for surgery. Moreover, the growing sophistication and wealth of emerging markets push the firm's product mix towards higher-margin offerings. Boston Scientific can capture this growth potential, partly due to industrywide barriers to entry, but also for firm-specific reasons. It has a strong balance sheet for future acquisitions, thanks to an equity raise during Covid, favorable debt maturity schedule, and doable deleveraging plan. To illustrate, pre-Covid, management estimated that 2020/21 M&A would unlock $20B of TAM.

   Additionally, the firm has strong leadership: CEO Mike Mahoney drove substantial margin expansion while pivoting from legacy assets towards new growth areas and maintaining stable R&D reinvestment, helping the stock outperform its benchmarks over his ten-year tenure. In recent years, analysts' biggest source of worry was capital discipline, particularly in response to the acquisition of an unusually mature and diverse drug portfolio from BTG. However, Boston Scientific quickly divested the BTG assets that did not synergize with the rest of its portfolio and successfully integrated the remaining assets. Other historical evidence also speaks to management's wisdom. In 2018, BSX favorably resolved a tax overhang, freeing considerable capital for M&A. The ensuing dealmaking yielded several promising new products as the firm expanded into areas adjacent to its traditional strengths. Indeed, a detailed survey of every product category reveals that BSX has a strong presence in diverse and rapidly-growing markets.

2. <u>Overreaction to high-profile recalls.</u> In mid-2021, three high-profile recalls of cardiovascular products drove down Boston Scientific's multiple substantially. However, these three assets together represented under 5% of BSX's sales and a small fraction of its growth potential. Additionally, the firm's previous (albeit rare) experiences with high-profile recalls suggest that the market's level of pessimism to these headwinds is unwarranted. BSX can iterate on the defective machines and regain market share. The product recalls dominated analyses of the Cardiovascular segment's performance, obscuring two positive factors: first, the substantial contributions of other, higher-growth products; second, the trend of customers transitioning away from stents – a legacy, low-margin asset – towards higher-margin alternatives. More broadly, while the market continues to see Boston Scientific primarily as a cardiovascular-focused business, the firm has diversified in recent years to the point where only 40% of sales come from this segment. The other segments have several industry-leading, high-growth offerings which have received less attention.

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3. Free option value in Rhythm & Neuro. Thanks to recent advances, machine learning ("ML") can now be deployed in commercial medical devices. ML may revolutionize some of the markets which Boston Scientistic competes for, for instance by finding tiny irregularities and patterns in a heartbeat to predict cardiac issues. BSX recently introduced an ML-enabled implantable cardiac monitor which not only collects data, like its "dumb" competitors, but also uses ML to predict major heart events. BSX trains its algorithm by pooling and then analyzing data from its entire installed base of smart devices. Notably, An ML algorithm's effectiveness depends on the size of its training dataset, which creates a flywheel: a firm with a bigger dataset than competitors can train better algorithms and thus make a better product, thereby taking market share, which widens its data advantage. BSX can build an unusually large dataset because it enjoys a bigger installed base than most competitors; the firm also gained an early-mover advantage by buying Prentice, a leading medical-device ML firm.

   Importantly, equity research does not recognize that BSX may gain a moat from ML's winner-take-most dynamics, which suggests that the market has not priced-in the possibility. Perhaps this inattention is because Cardiac Rhythm Management ("CRM"), the area where Boston Scientific is innovating with ML, is a slow-growing market. Moreover, the few ML-enabled products which the firm currently offers have low-TAM use cases, and this seems to limit their upside. However, BSX could use data collected by CRM devices to train ML algorithms with applications in several other, high-TAM markets where it already operates. In sum, ML represents substantial, free option value.

Key Risks and Considerations

1. Product recalls. Boston Scientific's several recent product recalls made the news and were very poorly received by Wall Street. In addition to zeroing-out revenues from a few portfolio, these recalls may herald a litigation liability. Moreover, they could be symptomatic of deeper cultural issues at the firm, or management's poor M&A strategy, both of which would manifest themselves in further recalls and write-downs. This risk is mitigated by BSX's long and successful track record under the unbroken tenure of current management, against which the 2021 recalls are an outlier. Moreover, our analysis suggests these issues will have a relatively small impact on overall earnings.

2. Political risks. Jurisdictions around the globe face political pressure to contain medical costs. These forces are especially strong in the United States, which, unfortunately for Boson Scientific, is also the firm's best market – American customers are the least price-sensitive and generate half of BSX's revenues. The risk of new regulations hurting the company's pricing power is mitigated by the fact that most of the energy for medical cost-control is directed towards pharmaceuticals, particularly those with niche applications, and recurring treatments like dialysis. BSX is not heavily exposed to either of these businesses since it mostly sells single-use, minimally-invasive medical devices.

3. Corporate efficiency. Although management repeatedly touted its goals to cut Opex margins, they have not realized meaningful efficiencies. Corporate efficiency has not increased even though BSX has grown revenues, and thus increased in scale, substantially since Mr. Mahoney took over in 2011. This risk is mitigated by the fact that gross margins have consistently, albeit slowly, ticked up over time, especially after adjusting for currency effects. Moreover, margin expansion is not necessary to make BSX an attractive investment: our model shows attractive returns under very conservative margin assumptions.

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Decision: Monitor

Investment Committee Chair: Austin Wang

The Healthcare Sector pitched Boston Scientific (Nasdaq: BSX) on Wednesday, November 17, in General Meeting as a buy. The Investment Committee (ICOMM) decided to monitor Boston Scientific. Our reasons are as follows:

FIRST: Although we viewed BSX as an attractive business, we did not believe the sector had a significant differentiated view on the business that would explain a mispricing. While there was a decline in stock price after product recalls, we did not believe that the decline was unjustified by the expected loss of cash flows from the recall. Furthermore, given the overall multiple compression of the medical device industry, it does not seem like BSX is being unfairly punished.

SECOND: We did not believe the valuation was attractive enough to warrant a buy without a strong differentiated view. While the returns analysis does seem promising, it was unclear whether a 22.0x EV/EBITDA multiple in 2025 was warranted given. BSX had already seen significant multiple expansion over the past five years (although multiples did recently contract) and the projected mid-single digit growth rates past 2025 did not seem high enough to warrant such a high EV/EBITDA multiple. The intrinsic valuation also did not provide a sufficient margin of safety as we saw only 20% upside in the base case despite significant expansion in FCF margins and an 11% effective tax rate into perpetuity. Furthermore, it seemed bullish to assume that BSX's FCF would grow consistently every year despite the high historical volatility in FCF over the past decade. The rise of disruptive technologies in some of BSX's core segments may also threatens the 20-year FCF growth forecast in the extended DCF and the 3.7% terminal growth in the APV.

THIRD: We did not have conviction in BSX's machine learning medical devices serving as a significant value driver. Although sell-side reports are not mentioning their machine learning capabilities, we do not find evidence that BSX is uniquely well positioned in this area. Most large medical device companies are planning to incorporate machine learning into their products, and it is unclear whether a large dataset truly constitutes an additional economic moat.

We believe BSX is a fundamentally strong business but given the lack of a highly defensible differentiated view, we require a larger margin of safety for a purchase.

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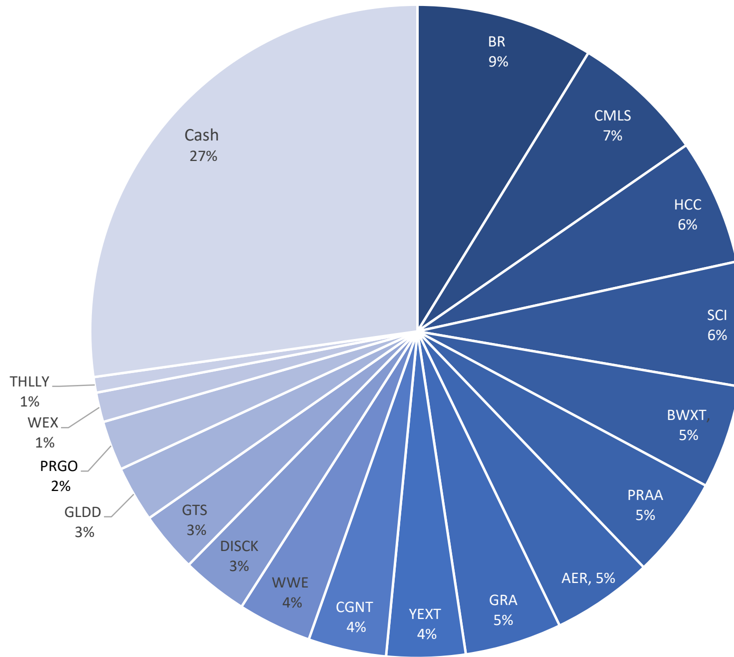
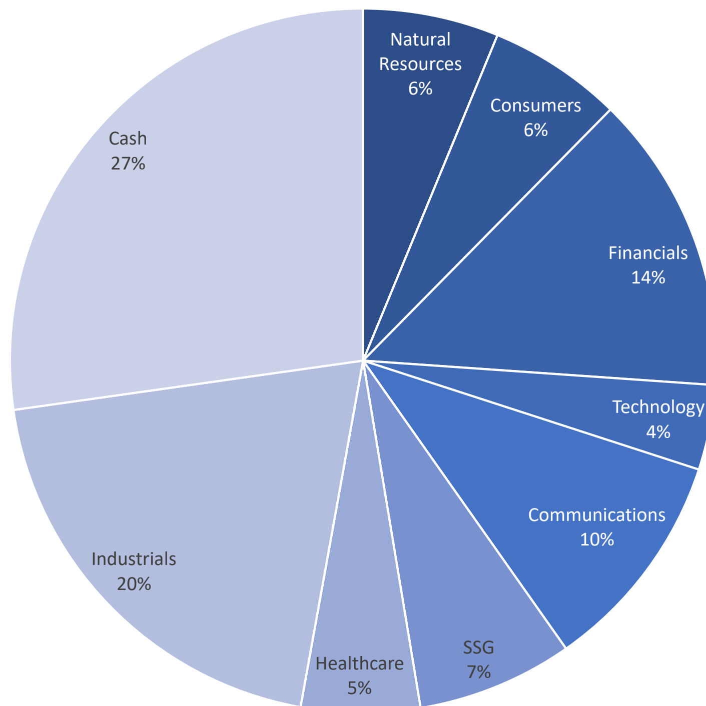
Portfolio Weightings





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