Tapasya

Creating Generational Wealth

APRIL 21, 2023

TAPASYA INVESTMENT FUND I

GLOBAL INVESTMENT REVIEW - IV

INTRODUCTION

Welcome to the **4th edition** of the "**Global Investment Review**".

As mentioned in the previous letters, the intent of this document is to detail the thesis of the companies the fund has made investments in. Besides articulating the thesis of the investment, it would also help to look back at the assumptions made to understand which ones were true and the ones that did not work out. It would help me become a better investor and help overall returns for the fund. It's a practice I have been following before starting this fund.

So far the past 3 editions we have focused on investments in the US, Europe and China. This time around we will bring the focus back to domestic companies. One of the companies being discussed operates globally while the other operates in the US market only.

As you may have read in the annual letter I talked about the portfolio composition and sizing. I used the analogy of soccer to describe the portfolio broken up into Defense, Mid-Field and Offense.

As a quick refresher, **Defense** companies are expected to outperform the market during market downturns e.g. 2022 but at par or at times below par when the markets are in a euphoric state. **MidFielder** companies are expected to be steady compounders (not linear) that make up the bulk of our portfolio (>70%). **Offense** companies have potential for asymmetric returns but carry higher risk. These make up about 10%-15% of the portfolio.

I have also defined what risk in my previous letters. At a high level, I look at Risk as permanent loss of capital compared to volatility which is movement of price in either direction. The street often talks about volatility as risk. In my view volatility is our friend and to be taken advantage of should we have the stomach to do so.

DOCUMENT CONSTRUCT

Wanted to write about how I think about the thesis both in terms of being a relatively easy read for my investors, and also making sure I focus on the key aspects of the business that matter.

I would typically start with an overview of the company, followed by a brief financial history. In general during this time I am looking at many financial metrics. For the purposes of this document and also the ones I hone in on, are Revenues, Gross Margin, Cash Flow, ROCE (Return on Capital Employed), ROE (Return on Equity), Quality of Earnings , etc.

I do not make investments unless I have read the annual report — typically at least a few years, not just the company I have invested in but also its competitors. The reason I am stating this part is because one of the companies I am going to describe below was bought due to competitor's research. I was researching Boise Cascade Company (BCC) and while I was looking at its competitors I came across Builder FirstSource Corp. (BLDR) and post analysis thought it was a better buy and is part of our portfolio.

Document Construct

1) Company Overview

2) Financial History

3) How the company makes money

4) Reasons to buy the company

5) Risks

BUILDER FIRSTSOURCE (BLDR)

Builders FirstSource, Inc., together with its subsidiaries, manufactures and supplies building materials, manufactured components, and construction services to professional homebuilders, sub-contractors, remodelers, and consumers in the United States. It offers lumber and lumber sheet goods, manufactured products, windows, and interior and exterior door units, as well as interior trims and custom products.

The company also offers gypsum, roofing, and insulation products, including wallboards, ceilings, joint treatments, and finishes; and siding, metal, and concrete products, such as vinyl, composite, and wood siding products, as well as exterior trims, other exteriors, metal studs, and cement products. In addition, it provides other building products and services, such as cabinets and hardware, as well as turn-key framing, shell construction, design assistance, and professional installation services.

The company was formerly known as BSL Holdings, Inc. and changed its name to Builders FirstSource, Inc. in October 1999. Builders FirstSource, Inc. was founded in 1998 and is based in Dallas, Texas.

Let's start with some financial history.

Income Statement | TIKR.com	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	LTM
Revenues	6,367.28	7,034.21	7,724.77	7,280.43	8,558.87	19,893.86	22,726.42	22,726.42
Total Revenues	**6,367.28**	**7,034.21**	**7,724.77**	**7,280.43**	**8,558.87**	**19,893.86**	**22,726.42**	**22,726.42**
% Change YoY	*78.6%*	*10.5%*	*9.8%*	*(5.8%)*	*17.6%*	*132.4%*	*14.2%*	
Cost of Goods Sold	(4,770.54)	(5,306.82)	(5,801.83)	(5,303.60)	(6,336.29)	(14,042.90)	(14,982.04)	(14,982.04)
Gross Profit	**1,596.75**	**1,727.39**	**1,922.94**	**1,976.83**	**2,222.58**	**5,850.96**	**7,744.38**	**7,744.38**
% Change YoY	*77.1%*	*8.2%*	*11.3%*	*2.8%*	*12.4%*	*163.3%*	*32.4%*	
% Gross Margins	*25.1%*	*24.6%*	*24.9%*	*27.2%*	*26.0%*	*29.4%*	*34.1%*	*34.1%*

As you would see here, the revenues have grown significantly over the years, organically as well as acquisitions. Along with the revenue growth the margin profile of the company has improved. It has moved from approx. 25% gross margin to about 34%, about a 900 bps improvement while increasing its revenues. This helps tremendously in terms of earnings and cash flows.

Cash Flow Statement | TIKR.com	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	LTM
Net Income	**144.34**	**38.78**	**205.19**	**221.81**	**313.54**	**1,725.42**	**2,749.37**	**2,749.37**
Free Cash Flow	**115.57**	**116.12**	**181.42**	**391.18**	**147.99**	**1,515.66**	**3,259.08**	**3,259.08**
% Change YoY	***(13.3%)***	***0.5%***	***56.2%***	***115.6%***	***(62.2%)***	***924.2%***	***115.0%***	
% Free Cash Flow Margins	***1.8%***	***1.7%***	***2.3%***	***5.4%***	***1.7%***	***7.6%***	***14.3%***	***14.3%***

Both net income and free cash flow have been increasing at a rapid clip as seen above. Along with that the company is what I would call a ***cannibalizer*** in a good way. It continues its significant buy-back program. In my view buybacks are one of the best ways to return capital to shareholders, second only to reinvesting in the business at high rates of return. I always prefer buybacks over dividends given how tax efficient that is. As a part owner of the company, we own more of it when the company is buying back its own stock.

In the case of BLDR, in 2020 they had about ~206M shares outstanding and at the end of 2022, it was ~138M. Hence about a 33% reduction, in other terms those shareholders who held onto their stock instead of selling it in the open market/to the company were well rewarded.

One of the other metrics I look at is ROCE, or Return of capital employed. Typically I prefer this metric to be above 20% or on the way there. Some of this is driven by increased pricing power during post pandemic supply chain issues we faced and would normalize over time.

Ratios | TIKR.com	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	LTM
Return Ratios:								
Return on Assets %	5.0%	6.0%	7.8%	7.9%	9.5%	20.2%	22.1%	22.1%
Return on Capital %	11.0%	13.2%	17.1%	16.0%	18.2%	28.1%	43.2%	43.2%
Return On Equity %	62.9%	11.3%	42.2%	31.2%	31.7%	57.9%	56.3%	56.3%
Return on Common Equity %	62.9%	11.3%	42.2%	31.2%	31.7%	57.9%	56.3%	56.3%

How does it make money?

The company can be looked at as 4 lines of business, their 2022 revenue distribution as % of total revenues is mentioned alongside.

1) Specialized Products (18.3%)

2) Lumber (35.6%)

3) Manufactured Products (25.0%)

4) Windows, Doors & Millwork (21.1%)

Value Added Products as the management looks at it is a sum of #3 and #4 above hence makes up 46.1% of total revenues.

Key reasons to Buy

1) Business that I can understand

2) Growing Revenues

3) Growing Cash Flows and High returns on invested capital

4) Strong Management Team with a great track record

5) Available at a reasonable price relative to its intrinsic value

Now let's understand how BLDR meets these criteria. BLDR serves the residential home market e.g. single family home business. I believe there is a secular growth trend in this business. The housing sector is currently underserved in the US. Looking at data since 2000 this sector has seen just a few downturns. It's a sector we all take part in during our lifetime and is usually our biggest spend category.

Real Estate is also a sector that has proven to be more resilient and one of the sources of wealth creation for most individuals. It's a ***business we can understand*** since we partake in it and also as I look at its financial statements (income statement, Cash Flow and Balance sheet) it's a business that I have confidence in getting a grip on future cash flows. This does not mean that the business has no risks and has been mentioned later in this document. All businesses have risks.

In regard to ***growing revenues***, historically the company has been able to grow revenues organically and through acquisitions. Besides being a growing market, this business is growing in a fragmented market. It has about 10% market share and is growing at about twice the market growth rates. The combination of how well its acquired business in the past (about 60 in total adding acquisitions made by the companies it has acquired); and the high positive cash flow allows them to strategically deploy capital towards future acquisitions.

The company continues to grow its **cash flows.** With some of the capital it has bought back its own stock and retired about 33% of its outstanding stock in the past 3 years. If nothing else, all else being equal, this buyback could be the single biggest wealth generator in this company.

Also, with the increases in labor costs, demand for BLDR Value Added services should continue to grow. The reason being it makes home building more efficient.

In regard to the **management team**, I look for a team that has grown market share, revenues and cash flows over time which BLDR certainly has. One of the red flags is when there is significant attrition in senior management and more importantly replaced by external talent or most of it. BLDR has had a change in CEO, but they hired Dave Rush into the role who has been with the company for 27 years. This change was not accompanied by any further attrition in the management at least thus far. There is not a whole lot of diversity within the management team outside the token D&I (Diversity & Inclusion) position all companies do these days.

As far as buying at a **reasonable price** is concerned, for cash flow positive companies I look at it as FCF/Market-cap or FCF/Enterprise Value and prefer this to be higher than Fed Funds rate. We bought this company well above the Fed funds rate. For those who prefer to use the P/E metric at the time we purchased it was about 4.

Risks

1) Higher Interest Rate

2) Seamless integration of acquired companies

3) Lumber Pricing

There are certainly risks for this business like for every business. Some of the very near terms ones are **interest rate risks** and associated impact on housing starts. In my view these are more short term in nature. Having a depressed housing market for a long time leads to a slow/recessionary growth environment given how big the housing market is. Single Family New homes are over $400Bn and Repairs about $160Bn. Generally actions are taken to address slowness in the housing market.

In regard to **integration of acquired companies**, in general most companies fail to do a good job. Either they pay more or the expected benefits from the acquisition are not realized. The one thing that gives me more confidence here, they have had ~60 acquisitions. So that should give them a lot of experience. This one will be watched closely.

Given volatility in the commodity market and recent downtrend in pricing, **lumber is a key** part of BLDR business. It represents about 35% of the total business. During Covid these prices were about 4x of current prices. At the time of writing this document the price is $430 / 1000 board feet. This is expected to fall to about $337 / 1000 board feet. Any further declines in pricing could lead to impacts to revenues and profitability.

Overall this company has been bought with a long term horizon i.e. ideally not to sell. Hence unless there are significant changes to the business i.e. several quarters of declining revenue and associated market share losses, bad acquisitions resulting in significant increase in debt etc. we will hold onto our position.

AIRBNB (ABNB)

Let me make a **confession** before I start, I ***love*** ABNB and may have paid more than I typically would have liked (approx. 10% or so).

Airbnb is a **global online marketplace for short-term rentals**, connecting people who want to rent out their homes or apartments with those who are looking for a place to stay. The company was founded in 2008 by Brian Chesky, Nathan Blecharczyk, and Joe Gebbia, and has since grown to become one of the most popular travel websites in the world.

Airbnb offers a wide variety of properties to choose from, including apartments, houses, villas, and even castles. Guests can find properties in over 100,000 cities and towns in over 220 countries and territories. Airbnb also offers a variety of features to make it easy for guests to find the perfect property, including user reviews, photos, and maps.

In addition to its short-term rentals, Airbnb also **offers a variety of experiences**, such as cooking classes, tours, and activities. These experiences are led by local experts and offer guests a unique way to learn about the culture of the place they are visiting.

Airbnb has been credited with revolutionizing the travel industry. The company has made it possible for people to travel more affordably and experience different cultures in a more authentic way. Airbnb has also helped to create a new economy, with millions of people around the world earning money by renting out their homes or apartments.

Let's start with some financial history.

Income Statement | TIKR.com	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	LTM
Revenues	2,561.72	3,651.99	4,805.24	3,378.00	5,992.00	8,399.00	8,399.00
Total Revenues	**2,561.72**	**3,651.99**	**4,805.24**	**3,378.00**	**5,992.00**	**8,399.00**	**8,399.00**
% Change YoY		***42.6%***	***31.6%***	***(29.7%)***	***77.4%***	***40.2%***	
Cost of Goods Sold	(647.69)	(864.03)	(1,196.31)	(876.00)	(1,156.00)	(1,499.00)	(1,499.00)
Gross Profit	**1,914.03**	**2,787.95**	**3,608.93**	**2,502.00**	**4,836.00**	**6,900.00**	**6,900.00**
% Change YoY		***45.7%***	***29.4%***	***(30.7%)***	***93.3%***	***42.7%***	
% Gross Margins	***74.7%***	***76.3%***	***75.1%***	***74.1%***	***80.7%***	***82.2%***	***82.2%***

Over the past 6 years the **revenues have grown almost 3x** from **$2.5Bn to $8+Bn**. It has a great **gross margin profile standing at 80%+** with improvement coming since Covid pandemic. The company had its first profitable full year in 2022 on a GAAP basis.

Cash Flow Statement | TIKR.com	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	LTM
Net Income	**(70.05)**	**(16.86)**	**(674.34)**	**(4,585.00)**	**(352.00)**	**1,893.00**	**1,893.00**
Free Cash Flow	**151.02**	**504.93**	**97.28**	**(777.00)**	**2,288.00**	**3,405.00**	**3,405.00**
% Change YoY		***234.3%***	***(80.7%)***	***(898.8%)***	***394.5%***	***48.8%***	
% Free Cash Flow Margins	***5.9%***	***13.8%***	***2.0%***	***(23.0%)***	***38.2%***	***40.5%***	***40.5%***

Looking at cash flows, the company is becoming a cash machine and I would expect it to continue in the foreseeable future barring any unforeseen black swan events.

The company demonstrated significant resilience to survive and eventually thrive to what can be described as a near death experience during Covid-19.

With the change in work environment to some extent permanent, at least in consumer preferences ABNB should continue to have a tailwind to its business for the next few years. To some extent this would be offset by management across companies wanting to bring workers back to office.

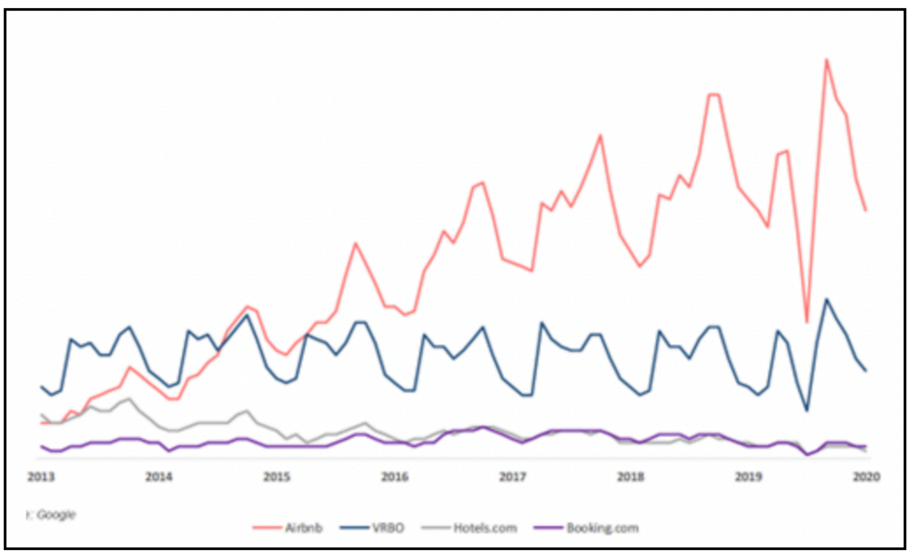
How does it make money?

The business is quite easy to understand, where the rentals and selling of experiences are driving revenues. Hence won't spend much time in this section and instead focus on the reasons to buy.

Reasons to buy

ABNB is a relatively **easy business to understand**, not just being users of the platform but also a business that typically grows its moat the larger it grows. What I mean by that, the more users it has on its platform, attracts more hosts which attracts more users due to the optionality available.

This becomes a **significant competitive advantage** for the company as it becomes harder for competitors to create the ecosystem once left behind. Actually ABNB was not the pioneer in this space. It was VRBO which is now owned by Expedia. Google search clearly shows ABNB has left the competition behind



77% of traffic to ABNB is organic or unpaid, which is great since it requires no direct marketing dollar spend unlike VRBO and Booking.com which is closer to 50%. ABNB continues to gain market share based on YoY (year over year) revenue growth, hence continuing to strengthen its position in the market.

Tourism is the 5th biggest industry in the world, contributing about 10% of global GDP. This industry will continue to grow as disposable incomes grow across the developing world which should work as a tailwind for growth. Also, I expect ABNB to be able to grow its revenues not only on rentals but also other experiences that customers book via the website/app.

Businesses that have **operational leverage** are wonderful businesses. Basically these are businesses that can accommodate growth in revenues without a corresponding growth in Costs. Let's look at ABNB and understand its cost structure.

The major component of COGS (**Cost of goods sold**) is payment processing, merchant fees, chargebacks (fraud etc), AWS for hosting the website, and amortization of technology. This is about 22% and would grow more or less in line with revenues.

Product development is another key spend for ABNB. As its platform matures and revenues grow, I would expect the spend here to reduce as '%' of total revenues.

The other costs, **Marketing & Sales**, ABNB is unique here with most of its traffic being organic/unpaid. This was the reason ABNB was able to reduce its Marketing dollars by 65% during the pandemic. This clearly creates a significant competitive advantage for ABNB and also gives it operational leverage.

G&A (General & Administrative) expenses are also expected to continue to come down as % of total revenues. As an example in 2015 this was 36% of revenues which came down to 14% in 2021.

Overall, this clearly shows that ABNB has a strong path to profitability which it demonstrated in 2022 as its first full profitable year. I expect its profitability along with growth in revenues (10%+) to be a catalyst for the coming years for its stock price.

RISKS

One of the **biggest risks is regulation**. Airbnb has been criticized by governments around the world for not paying taxes and for driving up the cost of housing. In some cities, Airbnb has been banned outright.

Another risk is **competition**. Airbnb faces competition from a number of other companies, including traditional hotels, homestay websites , etc. These companies are all vying for the same customers, and Airbnb could lose market share if it is not able to keep up.

Airbnb also faces the risk of **changing consumer preferences**. If people start to prefer to stay in hotels or other types of accommodations, Airbnb could see its business decline. The company is constantly trying to stay ahead of the curve by offering new features and services.

Finally, Airbnb faces the risk of its own success. As the company grows, it becomes more difficult to manage and control. This could lead to problems with **quality control**, **customer service, and fraud**. Airbnb is constantly working to improve its operations, but it is always possible that it will make mistakes.

Despite these risks, Airbnb is a well-positioned company with a bright future. The company has a strong brand, a loyal customer base, and a talented management team. If Airbnb can continue to innovate and grow, it will be well-positioned to succeed in the years to come.

CONCLUSION

I expect both these **companies to be long-term compounders** and multi-baggers. One of these is a cannibalizer i.e. buying back a significant amount of its own stock (BLDR) along with growing revenues and market share organically and through acquisitions. The other ABNB is a disruptor and becoming a verb in the travel industry for those who chose to have a differing experience to what hotels have to offer.

Both these investments have been made with a multi-year horizon. Unless something significantly changes I would not be selling. At times when there is high volatility and market prices are depressed I could look at adding onto my position.

I would welcome any feedback you may have on this document and as always feel free to reach out to me by email or phone if you have any questions.

We are in this journey together, **our biggest advantage is going to be our collective focus on the long term** along with my skills on capital allocation.

If you have managed to read this document in its entirety itself is one measure of success for me, as unless I receive feedback I will assume it was a reasonably good read.

My next Global Investment Review will be published in September. In the interim, I will be sending across the bi-annual letter in July.

APPENDIX

In regard to the investment thesis document, I want to mention some references that I have used for ideas on writing this document.

Firstly, Nick Sleep and Qais Zakaria (Nomad Investment Partnership), used to provide such documentation to their investors. You would see a common thread across my investment philosophy and how I manage the fund, similar to Nomad's which closed in early 2014 (thankfully, else they would be the best game in town - I would still compete though!!).

Other Tools and websites used-

1) TIKR - Analytical tool to analyze financial metrics

2) Value Investor Club (VIC) - Website for some great analysis

3) BARD - To see how it writes analysis and summarizes information

Thank you for taking the time to read this and as always, if there are any questions please do not hesitate to reach out to me.

Sincerely,

Pratik Kodial