November 2021 - Investor Update

Dear Friends & Partners,

Our investment returns are summarized in the table below:

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Month</th>
<th>YTD</th>
<th>12 Months</th>
<th>24 Months</th>
<th>Inception</th>
</tr>
</thead>
<tbody>
<tr>
<td>LRT Economic Moat</td>
<td>-3.11%</td>
<td>+22.46%</td>
<td>+27.81%</td>
<td>+1.44%</td>
<td>+26.50%</td>
</tr>
</tbody>
</table>

Results as of 11/30/2021. Periods longer than one year are annualized. All results are net of all fees and expenses. Past returns are no guarantee of future results. Please contact us if you would like to receive a full performance tearsheet. Please see the end of this letter for additional disclosures.

In the LRT Economic Moat strategy, as of December 1st, 2021, our net exposure was 98.27% and our net beta-adjusted exposure was 63.6%. We currently have 43 long positions and our top 10 positions account for 46.6% of our total long exposure. As of December 1st, 2021, firm assets under management stood at approximately $129 million.

The last several months have felt like sailing up wind – full of frustrations. Market momentum, investor flows and positioning have determined returns for many stocks over the past few months much more than the financial results reported by individual companies. The current market environment remains frustrating for investors, such as us, who believe that stock prices follow company fundamentals over the long term. Significant performance detractors from last month’s results include StoneCo Ltd. (STNE), Asbury Automotive Group, Inc. (ABG), Roku, Inc. (ROKU), TFI International Inc. (TFII) and Hexcel Corp. (HXL).

Through December 1st, the S&P500 index is down only -4.07% from its all-time high, while the small-cap index, Russell 2000, is down -12.08%. However, these numbers do not give the full picture of the market decline that has occurred over the past several weeks. A small group of stocks, primarily mega-cap tech shares have supported the market, while most stocks have been declining for...
several weeks now. The disproportionately large impact that mega-cap companies can have on market capitalization weighted indexes has effectively hidden this fact, so while the S&P500 has only declined approximately 4%, the average stock in the index is down -15.5% through December 1st.

To put some numbers around this phenomenon, we looked at all the stocks in the S&P500 – there actually 505 stocks today in the index – and here is what we found:

**Decline from 52 week high of at least:**

<table>
<thead>
<tr>
<th>Decline %</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>317</td>
</tr>
<tr>
<td>15%</td>
<td>205</td>
</tr>
<tr>
<td>20%</td>
<td>130</td>
</tr>
<tr>
<td>25%</td>
<td>78</td>
</tr>
<tr>
<td>30%</td>
<td>43</td>
</tr>
<tr>
<td>50%</td>
<td>6</td>
</tr>
</tbody>
</table>

Average decline: \(-15.5\%\)

More than half of all stocks in the S&P500 are down more than double the decline of the index itself. In addition, the percentage of S&P 500 stocks at one-year lows is at its highest level since April 2020. Despite the overall index having risen this year, there are, paradoxically, many more investment opportunities now than at the beginning of the year.

To name just a few:

- **StoneCo Ltd. (STNE)** – this Brazilian merchant acquirer is dealing with short term problems in its lending operation and a recession that is hitting the Brazilian economy. Yet, despite this, the company remains profitable and continues to grow. It is a potential multi-bagger from where it trades today. We are similarly bullish on **PagSeguro Digital Ltd. (PAGS)**, and similar company, that also operating in Brazil.

- **Global Payments Inc. (GPN)** – another credit processing / merchant acquirer that is currently trading at a depressed valuation. **Fiserv, Inc. (FISV)**, is in a similar spot. Both companies are trading at their lowest forward earnings multiples since 2013 and represent good opportunities. We expect payment companies to be particularly good inflation hedges as their revenues rise with the nominal spending that flows through their networks while most costs are fixed.

- **Roku, Inc. (ROKU)** – the streaming TV company is currently trading at the lowest valuation it has been in many years, despite reporting 50% revenue growth, and over 80% growth in its most important and profitable “Platform” segment. Ostensibly the risk of increased competition is weighting on the stock, in practice we believe Roku’s recent underperformance has more to do with it being the 4th largest holding in Cathy Wood’s ARKK ETF, which has been hammered by outflows in recent weeks. We wrote about Roku in our July Investor Letter.¹

- **Mercadolibre, Inc. (MELI)** – the LatAm eCommerce, shipping, and payments company, is now trading at a very attractive valuation – its lowest P/S ratio ever. The concerns here have to do with the recession in Brazil and slowing economic growth throughout the region.

We could list many others, but we think you get the picture. Our current investment opportunity set is the greatest it has been in many months. We are excited and expect strong returns in the months ahead.

The Twilight Zone

In the hit TV series “Silicon Valley” fictitious character Russ Hanneman tells Richard, the young software entrepreneur who is trying to figure out how to make money at his new company: “No. If you go after revenue people will ask how much and it will never be enough. The company that was the 100x’er, 1,000x’er becomes the 2x dog. But if you have no revenue, you can say you are pre-revenue. You’re a potential pure play. It’s not about how much you earn. It’s about what you’re worth. And who’s worth most? Companies that lose money.”

Russ was right. Rivian (RIVN) is a budding new electric car company that earlier this month was valued at $150 billion dollars. The company has generated $0 from selling electric vehicles (EV) over its lifetime.

Compare Rivian to Applied Materials (AMAT), a semiconductor equipment supply company that specializes in the “frontend” (primarily patterning) of the semiconductor manufacturing process. The company makes products that are critical to making modern computer chips. It has a market cap of approximately $145 billion dollars. It, also, generated $0 from selling EVs over its lifetime. However, Applied Materials generated $21 billion in revenue and $5.1 billion in net income over the past twelve months alone in its semiconductor equipment business. Since a company that sells no EVs is worth $150 billion, then Applied Materials semiconductor business is being valued at a negative $5 billion dollars.

We are being only slight facetious here. Clearly the market is forward looking and pricing Rivian on the expectation that the company will generate huge revenues in the future. But are these expectations realistic? Or are investors playing a dangerous game of the greater fool?

George Soros, one of the world’s most success financial speculators, posited a theory he calls “reflexivity” in which market fundamentals and sentiment can both reinforce and influence each other. Soros describes his theory as follows: “Every bubble has two components: an underlying trend that prevails in reality and a misconception relating to that trend. A boom–bust process is set in motion when a trend and a misconception positively reinforce each other. The process is liable to be tested by negative feedback along the way, giving rise to climaxes which may or may not turn out to be genuine. If a trend is strong enough to survive the test, both the trend and the misconception will be further reinforced. Eventually, market expectations become so far removed from reality that people are forced to recognize that a misconception is involved. A twilight period ensues during which doubts grow and more people lose faith, but the prevailing trend is sustained by inertia.”

We believe that the market has reached the twilight period, especially with respect to high growth technology companies that are going to “change the world”. The rise of growth-at-any-price investing, #neversell, meme stocks and the overall total disconnect between fundamentals and stock prices is just one of the many signs. Investors and traders alike are buying stocks based purely on momentum, without regard to the fundamentals of the companies and in some cases without even knowing what the companies do. Don’t believe me? Watch as trader Mark Minervini recommends Upstart Holdings, Inc. (UPST) in a recent interview with CNBC and struggles to answer the simple questions “what does Upstart do?” The interview is a beauty.

Going back to Rivian and its smaller cousin Lucid Group, Inc. (LCID) (another EV company that will “electrify” and “revolutionize” the world; market capitalization $72 billion as of this writing), most investors we speak to understand that the valuations of the companies have no basis in the company’s

---

2 https://www.youtube.com/watch?v=BzAdXyPYKQo
3 Source: Sentieo.
4 Credit for this clever analogy goes to Ian Bezek.
6 https://www.youtube.com/watch?v=m1GIbs0NULg
financial statements. Yet these same investors continue to play the momentum game to generate short term performance. This reminds us of Chuck Price, the former CEO of Citibank, who when speaking about subprime mortgages said: “as long as the music is playing, you’ve got to get up and dance. We’re still dancing.”

This is a terribly risky game to play, because as soon as the trend reverses investors will be dealt heavy losses. Speculators of course understand this dynamic, yet each seems to believe they can get out of their positions just in time. Naturally, someone must be left holding the bag, as for each seller the must be a buyer in the marketplace. One does not have to search far to see this play out. Upstart Holdings, Inc. (UPST), the stock recommended by Mark Minervini, is down more than 50% in less than two months since the interview took place.

Companies such as Snowflake Inc. (SNOW), Zscaler, Inc. (ZS), Datadog, Inc. (DDOG), and NVIDIA Corporation (NVDA) continue to report good financial results, but they trade at astronomical valuations – a reflection of their popularity. And yet, with every earnings report, the stocks zoom ever higher, as if nothing is ever reflected in their share prices and no price appears too high to pay. When does the momentum in these stocks turn? When does Zscaler become Fastly, Inc. (FSLY)? When does Snowflake turn to Alteryx, Inc. (AYX), and Datadog, Inc. (DDOG) to Splunk, Inc. (SPLK)? When we ask these questions of other investors, we are often told that the companies in question are “very special” – a truly remarkable admittance of ignorance. Of course, FSLY, SPLK, AYX and countless other companies were also once thought of as “very special”.

Lastly, let’s consider the case of Ginkgo Bioworks Holdings, Inc. (DNA), a company that has been brought to our attention by a friend and frequent reader of these letters. The company operates in the synthetic biology space, genetically engineering cells to achieve desired properties. There is no doubt that synthetic biology is amongst the most exciting and promising fields of human endeavor today. We believe that its applications are wide ranging (more efficient enzymes, biofuels, and immune compatible human transplant tissues – just to name a few), and that tremendous value will be created in this space. But consider the valuation of the company. Annualizing last quarter’s revenues, DNA generated sales of approximately $310 million, giving the company a valuation of approximately 50x sales today. For DNA to justify its valuation, the company must growth exponentially from here and become highly profitable. Should DNA today trade at 100x sales or 5x sales? Both could be “fair” prices depending on what story one tells. We can’t predict if this will be the next Tesla or the next Zymergen Inc. (ZY), but we believe it will be market sentiment that will determine most of the stock price performance over the next several years, not the company’s fundamentals – to us this is the very definition of speculation.

We can’t say when the trends in some of these highfliers will turn, but we continue to avoid most “hot” companies due to their excessive valuations. Tech and SaaS companies, in particular, are hot and “popular” stock investments at the moment. We believe that the best investments of the next 10 years will almost certainly not be the companies that are most admired and most highly valued today.

---

7 Paradoxically, the music had already stopped when Mr. Prince spoke these words in July 2007. Citibank shares would go on to lose over 90% of their value over the coming eighteen months.
8 Down over 80% since its IPO.
Executive Summary

At LRT Capital Management we are continuously searching the market for great investment opportunities. Our favorite finds are companies with moats and growth opportunities that justify a higher price than what the stock is trading for. One of our holdings (approximately 1.5% of our long exposure) is Dollar General (DG), so today, we wanted to tell you a bit about this great company.

Company Overview

Dollar General is a discount retailer with the largest brick-and-mortar presence in the United States by store count. The company’s largest concentration of stores can be found in the southern, southwestern, midwestern, and eastern parts of the United States. Dollar General was founded in 1939 by J.L. Turner, who originally named the company “J.L. Turner and Son, Wholesale”. As the name suggests, the company began its life as a wholesaler, but quickly turned to a retailer of general store goods. By the early 1950s, the company had annual sales of $2 million per year, which is the equivalent of $22.95 million in 2021 dollars when adjusted for inflation.

The first Dollar General store opened on June 1st, 1955 in Springfield Kentucky. The simple concept was that no item in the store would cost more than one dollar. The company changed its name to Dollar General Corporation in 1968 when Dollar General became publicly traded. At the time of its initial public offering, the business generated more than $40 million in annual sales. The company’s common stock was publicly traded from 1968 until July 2007, when it was taken private by KKR. The company went public again in November 2009, under the ticker DG.

Today, Dollar General is an evolved, and phenomenal business with more room for growth. Annual sales reached a record $33.7 billion in fiscal year 2021 after consecutively growing the top line for many years. The company’s main products are every-day necessities and consumables purchased by lower income consumers on tight budgets.

Dollar General has the following reportable segments illustrated in the table below.

<table>
<thead>
<tr>
<th>Classes of similar products:</th>
<th>13 Weeks Ended</th>
<th>26 Weeks Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>July 30, 2021</td>
<td>July 31, 2020</td>
</tr>
<tr>
<td></td>
<td>July 30, 2021</td>
<td>July 31, 2020</td>
</tr>
<tr>
<td>Consumables</td>
<td>$6,612,950</td>
<td>$6,496,350</td>
</tr>
<tr>
<td></td>
<td>$12,991,085</td>
<td>$13,199,799</td>
</tr>
<tr>
<td>Seasonal</td>
<td>1,090,311</td>
<td>1,161,611</td>
</tr>
<tr>
<td></td>
<td>2,140,693</td>
<td>2,079,523</td>
</tr>
<tr>
<td>Home products</td>
<td>561,190</td>
<td>586,021</td>
</tr>
<tr>
<td></td>
<td>1,132,505</td>
<td>1,084,303</td>
</tr>
<tr>
<td>Apparel</td>
<td>385,747</td>
<td>440,259</td>
</tr>
<tr>
<td></td>
<td>786,879</td>
<td>769,065</td>
</tr>
<tr>
<td>Net sales</td>
<td>8,650,198</td>
<td>8,684,241</td>
</tr>
<tr>
<td></td>
<td>17,051,162</td>
<td>17,132,690</td>
</tr>
</tbody>
</table>

---

9 Seeking Alpha, Dollar General’s Unrivaled Store Footprint Drives Upside Potential, https://seekingalpha.com/article/4461141-
dollar-generals-unrivaled-store-footprint-drives-upside-potential
10 SEC filing, DG 10-K FY 2020
11 Ibid.
13 Ibid.
14 SEC filing, DG 10-K FY 2020
Dollar General’s most important segment, by far, is consumables which consist of items such as: food, beverage, cleaning supplies, personal care, and household products. While the company’s consumables segment is the main source of revenues, at 77% of fiscal year 2020 sales,\(^{15}\) the company also offers seasonal items, home products, apparel, and more.\(^{16}\) These products range from well-known national brands, to the company’s own private label product lines.

Dollar General’s strategic placement of 17,683 stores\(^ {17}\) across the country has created strong brand recognition, with the company’s locations conveniently placed within 5 miles of 75% of the United States’ population.\(^ {18}\) The company’s stores range from 3,500 square feet in more urban areas, to roughly 16,000 square feet in rural areas. To give you a sense of scale, the typical Walmart Supercenter is 179,000 square feet,\(^ {19}\) while an average Kroger boasts 165,000 square feet of space.\(^ {20}\) Dollar General’s strategy is to locate its stores in areas which are underserved by competitors. As a direct result, about 75% of DG’s stores are located in towns with populations of less than 20,000 residents.\(^ {21}\)

Dollar General’s customers have an average household income of about $40,000 per year.\(^ {22}\) The average basket size for a Dollar General customer typically contains five items or less, and costs about $12 on average.\(^ {23}\) Lower income consumers are **total cost sensitive**, whereas higher income demographics are willing to purchase items in larger package sizes at a higher total cost, but lower cost per unit. For this reason, most other retail stores offer larger package sizes, which lower the cost per unit for its customers. Dollar General’s strategy is to offer its economically limited customers products in their preferred smaller package sizes, to lower the customer’s absolute cost for the products they need. To Dollar General’s benefit, smaller package sizes carry higher margins than the bulk sized packages of the exact same products in other stores. This allows the company to meet its customer’s needs, while benefiting overall margins.\(^ {24}\)

We believe that Dollar General’s competitive advantages are enduring. Due to Dollar General’s scale, the company has greater leverage over its suppliers than its smaller competitors, creating a cost advantage.\(^ {25}\) The company also benefits from scale-based advantages in advertising and efficiencies in distribution due to local store density. The company has also shown itself to be largely “Amazon proof” as evidenced by the company’s strong same store sales growth over the past decade (more about this in the next section).

Dollar General’s simple, yet highly profitable business model of *“providing a broad base of customers with their basic everyday, and household needs, supplemented by a variety of general merchandise at everyday low prices, in a conveniently located small-box store”*\(^ {26}\) has paid off well for the business over many years. Dollar General has traditionally targeted lower income customers, but the company’s most recent initiatives are aimed at expanding its product offerings.

---

\(^ {15}\) Morning Star, *Sales Normalization Does Not Alter Dollar General’s Long-Term Competitive Strength*, [https://www.morningstar.com/stocks/xnys/dg/quote](https://www.morningstar.com/stocks/xnys/dg/quote)

\(^ {16}\) SEC filing, *DG 10-K FY 2020*

\(^ {17}\) As of 2Q2022, 10-Q filing.


\(^ {19}\) 24/7 Wall Street, *Walmart Now Has Six Types of Stores*, [https://247wall.com/retail/2014/03/22/walmart-now-has-six-types-of-stores/](https://247wall.com/retail/2014/03/22/walmart-now-has-six-types-of-stores/)


\(^ {22}\) Ibid.


\(^ {24}\) Ibid.

\(^ {25}\) Ibid.

\(^ {26}\) SEC filing, *DG 10-K FY 2020*
Dollar General seeks to capture more business from suburban and middle-class customers by targeting families with household incomes of $50,000-$125,000 per year. To achieve this objective, the retailer is expanding its product selection, and branding to include “Treasure Hunt” type stores that offer products at $5 or less, across a broad variety of non-consumables. These new stores are called pOpshelf stores, and the company expects to have a total of 50 pOpshelf locations by year end 2021. pOpshelf stores are a new brand under the Dollar General umbrella, and are part of what management is calling its “Non-Consumable Initiative” (NCI). pOpshelf stores are also referred to as “hybrid stores” where pOpshelf is combined with Dollar General Market locations, or standalone locations branded as pOpshelf. Dollar General Market locations are more grocery store-like in layout, and some locations offer fresh food options such as meats, veggies, and fruits. This format of Dollar General’s retail store provided the perfect testing ground for the pOpshelf concept, as the Dollar General Market locations are also geared to attract a higher income demographic with its product selection.

So far, the results from pOpshelf have been positive. Management noted that the most recent quarter’s total sales benefitted from a 41% year over year increase of non-consumable products sales. NCI stores also reported a “meaningful improvement” to gross margins as compared to stores without NCI. Sales and gross margins have improved as a result of NCI, which has been rolled out in a total of 8,800 stores to date, with the goal of offering NCI products in a total of 11,000 stores by calendar year-end 2021. It is evident from these results that the NCI initiative, and pOpshelf locations alike are causing a positive impact on the top and bottom lines for Dollar General.

NCI is not the only set of innovations that Dollar General is rolling out. The company’s “DG Fresh” is an initiative by the company to offer fresh groceries to its customers. Phase one of the strategic decision has been completed as of August of this year, where Dollar General offers refrigerated, and frozen goods in a wider variety. This initiative also shifted distribution of these frozen/refrigerated goods to a self-distribution model, and Dollar General plans to expand upon these product offerings to eventually offer fresh groceries. Management reported that DG Fresh is now serving 17,500 stores, from 12 distribution facilities. DG Fresh is now the single largest contributor to the company’s gross margins, through realized benefits from higher inventory markups.

More recently, Dollar General began an initiative to serve the health needs of its customers. Dollar General intends to offer access to affordable healthcare products and services, with a particular concentration on rural communities. Todd Vasos, Dollar General’s CEO, explained that the company is pursuing healthcare products and services because about 65% of the company’s stores (roughly 10,000 locations) are located in

---

27 Listen Notes-Bloomberg Intelligence: Dollar General's Upscale Popshelf Path to $1.9 Billion (Podcast), https://www.listennotes.com/podcasts/bloomberg/dollar-generals-upscale-90PsLogu6
32 YouTube, Introducing Dollar General Market, Introducing Dollar General Market
35 Ibid.
36 Ibid.
37 Jeff Owen, Q2 FY2022 Earnings Call,
38 Insider, Dollar General says it completed the first phase of its DG Fresh overhaul, and the program could be a game-changer for its fresh grocery dreams, https://www.businessinsider.com/dollar-general-dg-fresh-overhaul-complete-cost-savings-2021-8
39 Jeff Owen, Q2 FY2022 Earnings Call.
40 Todd Vasos, Q2 FY2022 Earnings Call.
what was referred to as “health deserts”. These “health deserts” apply mostly to a large portion of the company’s rural stores, where alternatives are limited. Other than simply noting that Dollar General will offer a wider selection of medication on the shelf, the company has not yet specified its exact offerings. We are continuing to monitor the company’s announcements regarding this initiative.

Finally, while we view Dollar General as primarily a brick & mortar retailer, the company does have a robust online presence. The COVID-19 Pandemic increased the utilization of curbside, and in-store pickup as lockdowns hindered customer’s abilities to shop in retail stores. As a result, online shopping has become more frequently used through the company’s online services. Dollar General is well positioned for digital growth. Dollar General’s digital ecosystem offers digital coupons, a shopping list feature, a cart calculator, budgeting tool, and an e-commerce site. The DG Go mobile app has 4 million active users and allows customers to order online for pick up in the store, or curbside.

**Inflation Pressures**

Inflation in the United States has reached a 31-year high, with the most commonly used measure, the CPI, registering 6.2% in the month of October. Consumers are feeling the pain, as inflation erodes their purchasing power, and are increasingly turning to discount retailers and dollar stores for their shopping needs. Rising inflation in the United States has created price pressures across the board. Inflation-pinned shoppers increased spending at discount stores in the first week of November, with figures showing a 65% increase over 2019 measures. This data confirms that consumers are looking for deals wherever they can be found.

In addition to inflation, customer service has also suffered virtually everywhere, and consumers are getting less value for their money. Meanwhile prices for goods and services have remained unchanged. As an example, customer service at restaurants has suffered greatly in quality, as has customer service at places such as Disney World due to the rising cost of labor, and therefore understaffing to protect margins. This concept is being referred to as *skimpflation*. However, Dollar General has consistently held steady in its value to customers by providing low-cost everyday needs, protecting the business from inflation, and skimpflation.

**Growth & Capital Allocation**

Dollar General has consistently grown both its store count and Same Store Sales (SSS). Dollar General’s SSS have been positive in each of the last 31 years, before skyrocketing just north of 16% for the abnormal

---

46 Npr, Meet skimpflation: A reason inflation is worse than the government says it is, [https://www.npr.org/sections/money/2021/10/26/1048892388/meet-skimpflation-a-reason-inflation-is-worse-than-the-government-says-it-is](https://www.npr.org/sections/money/2021/10/26/1048892388/meet-skimpflation-a-reason-inflation-is-worse-than-the-government-says-it-is)
48 Dollar General’s fiscal year is one year ahead of the current calendar year.
year of 2021.\textsuperscript{49} We feel that this metric speaks to Dollar General’s effectiveness in retail operations and shows the strength of the retailer’s brand and the value that it brings to consumers.

Currently, management only expects same store sales (SSS) to decline by 3%-5% from the highly abnormal increase of FY 2021. However, this decline would still represent an 11%-13% growth on a two-year stacked basis.\textsuperscript{50} This would mean that the majority of the gains realized during the pandemic will be retained, leading to more profitable stores. We believe that this growth, along with its footprint, and the addition of pOpshelf stores, as well as other initiatives is likely to fuel Dollar General’s top line going forward.

Additionally, returns on invested capital (ROIC) have remained consistent and high. In Dollar General’s case, the company does not spend money acquiring businesses, or buying growth. Instead, the company spends its money on capital expenditures to continue organically by way of new stores, and most recently the addition of the pOpshelf, DG Fresh, and the upcoming healthcare services to their stores.

We believe that a company’s ability to grow and reinvest capital at attractive rates of return is key to generating high returns for shareholders over the long term. To quote Warren Buffett: “Leaving the question of price aside, the best business to own is one that over an extended period can employ large amounts of incremental capital at very high rates of return”.\textsuperscript{51}

\textsuperscript{50} John Garratt, Q2 FY2022 Earnings Call, https://seekingalpha.com/article/4452040-dollargenerals-ceo-todd-vasos-on-q2-2021-results-earnings-call-transcript
\textsuperscript{51} Berkshire Hathaway, Letter to shareholders, 1992
Returns on incremental invested capital (ROIIC) measures the returns based on each incremental dollar invested. We think that DG’s incremental capital investments have produced excellent returns, particularly in the past 10 years. The chart below shows the ROIIC for one- and two-year periods since 2012. Although ROIIC was historically volatile until 2011 (not shown), the returns for each incremental amount have been exceptional since, and often pushing against or exceeding the 100% marker. The ten-year average for the one-year measure was 78.5%, and the two year measure at 67.8%. High returns on incremental invested capital are an extremely important measure when assessing the strength of our investment candidates. In our opinion, for a company as large as Dollar General to consistently reinvest at a high rate of return makes for a very attractive investment candidate.
Dollar General’s margins have increased over time and the company remained profitable during the 2008-2009 recession, demonstrating its economic resilience. Management has ably navigated the challenging macro environment as well. For example, the impact of tariffs on goods made in China affected margins, but the company renegotiated with vendors, and mitigated the costs to its customers which meant product substitutions in some cases.52

The graph below shows the evolution of the company’s margins over time.

---

52 John Garratt, Q1 FY2019 Earnings Call
Over the past ten years, Dollar General’s total revenues have grown from $14.8 billion at year end 2012, to $33.7 billion for the company’s fiscal year 2021 - a 9.98% compounded annual growth rate (CAGR) in revenue, with fiscal year 2021 representing an abnormally high year due mostly to government stimulus transfer payments increasing disposable income disproportionately amongst DG low-income shoppers.53

Although Dollar General has experienced fantastic growth in revenues, and steady margins, the company’s valuation has remained relatively unchanged in the same time period. We should note that the valuation of the US stock market overall has doubled over this time period. We believe that DG represents a relative bargain in today’s overvalued stock market.

53 Todd Vasos, Q1 FY2022 Earnings Call
Over the past decade, Dollar General has generated $17.8 billion in cash from operations. Of this amount, the company has spent $6.7 billion on capital expenditures, $1.8 billion on cash dividends, and $9.8 billion on share repurchases - shrinking share count by approximately 32%.

Historically, management has reinvested approximately 35% of its capital for a 7%-10% annual return in revenue growth, 11%-15% ROIC. The company spent the majority of its cash repurchasing shares at
opportune times. The remaining 10% of cash has been paid out to shareholders in the form of dividends. Capital Expenditures help expand Dollar General’s footprint, as well as finance DG’s new NCI initiatives in both their legacy stores, and pOpshelf hybrids or standalones.

Looking forward, Dollar General intends to double its current footprint of stores, as identified by management at the end of 2020.²⁴ As part of this plan, Dollar General is set to open 1,050 new stores by the end of 2021. We feel that this is a somewhat aggressive goal, but one that is rational as long as returns on incremental invested capital stay strong and same store sales continue to be positive.

**Dollar General vs. Dollar Tree**

Dollar General’s (DG) closest competitor in the United States is Dollar Tree (DLTR), which a few years ago acquired Family Dollar (FD), bringing competition down from three to two national dollar stores. Family Dollar had historically been the worst managed of the three large dollar stores as evident by the company’s weak margins. We believe Dollar General is superior to Dollar Tree in many ways, and we believe that the differences in profitability between DG and DLTR are likely to persist into the future.

As aforementioned, Dollar General has the largest brick-and-mortar store count of any retailer in the U.S., with a close contender being the Dollar Tree/Family Dollar combined business. After Dollar Tree purchased Family Dollar, and Deals stores, the company’s store count has remained relatively flat. In addition, margins, and returns on invested capital have also suffered significantly since the acquisition. When DLTR acquired FD, the rationale was that superior management would improve margins quickly to DLTR levels. Reality turned out differently, with the margins of the combined entity having been stuck at lower levels for several years now – although recent trends show some improvement. Overall, we think that the FD acquisition has been a poor use of shareholder capital by Dollar Tree and the company continues to struggle with the integration of the legacy Family Dollar stores.

Meanwhile, Dollar General’s organic growth model has continued to lead to a higher store count, greater ROIC, and greater same store sales growth when compared to Dollar Tree.

---

Dollar General’s Same Store Sales growth has outperformed that of Dollar Tree since 2018, and recently skyrocketed amid the pandemic induced increase in consumer spending. We believe that the growth in same store sales is a clear sign of the company’s ability to grow organically while outpacing its largest competitor.

Over the past 10 years, Dollar General has generated $220.2 billion in revenues, compared to Dollar Tree’s $141.3 billion, and this is including the sizable acquisition of Family Dollar stores. Excluding the impact
of the Family Dollar acquisition Dollar General has also consistently grown revenues at a faster rate than Dollar Tree.

With fiscal year 2021 representing an unusual year for retailers in general, both Dollar General and Dollar Tree benefited greatly from increased consumer spending, and increased margins. However, Dollar General continued its streak of outperforming Dollar Tree in regard to financial metrics such as returns on invested capital and EBITDA margins.

Dollar General has a more efficient distribution system than DLTR, a likely result of the company’s organic vs. acquired growth in Dollar Tree’s case.\(^55\) This translates to lower margins for Dollar Tree. Additionally, Dollar General has wider margins, and more “wiggle room” than that of Dollar Tree in general due to lower cost of procurement.\(^56\) Once again, the acquisition of Family Dollar plays a key role in this factor. Prior to the acquisition of Family Dollar, Dollar Tree had industry leading margins.\(^57\) At the time, Dollar Tree was solely dedicated to the $1 price point. Unlike Dollar General’s margins, Dollar Tree has eroded away its advantages through a large, and in our view, failed acquisition.

---

56 Ibid.
57 Ibid.
As for many businesses, larger scale typically leads to lower costs, which Dollar Tree attempted to buy, but has failed to gain benefit from. Family Dollar’s operating margin was only 4% and 6.6% in the two years leading up to the acquisition. Although the companies are nearly the same size in store count, Dollar General is clearly a more efficient operation than Dollar Tree.

Returns on invested capital have historically favored Dollar Tree. The company’s returns were above the 35% mark until the acquisition of Family Dollar. We believe that the drastic drop, and short-term stagnation of Dollar Tree’s ROIC is due to the acquisition turning out to be a bad move for Dollar Tree, damaging the financial performance metrics from 2015 onward.

On the other hand, Dollar General’s ROIC has remained steady, while slowly growing its store count. Dollar General's most recent ROICs are north of 15%, while Dollar Tree’s ROIC has reduced by more than half over the past decade. Clearly Dollar General’s management invests its capital more intelligently than its closest competitor.
The single largest driving factor making Dollar General superior to Dollar Tree is the Asset Turnover Ratio.\textsuperscript{58} Since 2002, Dollar General has averaged a strong 300% Asset Turnover Ratio, as opposed to Dollar Tree’s 238.5% average in the same time period. To come to our conclusion of asset turnover, we adjusted total assets by subtracting Goodwill and Intangible Assets, as not doing so would penalize Dollar Tree even further due to the nature of acquisition accounting. Dollar General exhibited better operational efficiencies with higher profit margins, and a lower average equity multiplier\textsuperscript{59} which indicates that Dollar General has achieved superior results with less leverage over time. The average equity multipliers since 2002 for Dollar General, and Dollar Tree are 1.46x and 1.60x respectively.

Combined, all these factors explain why Dollar General has grown earnings per share at a much faster rate than Dollar Tree over the past decade. DG achieved an EPS CAGR of 17.74\% as of the most recently reported quarter vs only 12.18\% for Dollar Tree.

\textsuperscript{58} Asset Turnover Ratio = Total Sales divided by Total Assets.
\textsuperscript{59} Equity Multiplier = Total Assets/Total Equity.
We believe that Dollar General is superior in virtually every measure to Dollar Tree, and we are not tempted by the siren song of DLTR’s “turnaround story”, especially since both companies trade at roughly the same valuations. Dollar General’s high profitability, and growth model has endured the test of time, and we believe that it is set to continue moving forward. We believe that Dollar General’s management has intelligently operated the business, driving the company forward to be the greatest dollar store brand in the United States, and perhaps the world.

Conclusion
Dollar General’s strong core business, the DG GO app, DG Fresh, healthcare initiative, NCI, and pOpshelf initiatives provide excellent growth opportunities for the business going forward. Dollar General’s competitive advantages will continue to help insulate the company from competition in its legacy business. Dollar General has a history of opening stores consistently, regardless of the macro view of the economy. As an example, Dollar General opened nearly one thousand stores during a global pandemic in the calendar year 2020. Furthermore, Dollar General has committed to building upon the success of the Dollar General Plus store format, which offers a larger selling space. The company is increasing its store size for smaller formatted stores from about 7,300 square feet to 8,500 square feet to accommodate future growth. We feel that Dollar General is well positioned for its future growth initiatives.

It is not often that a retailer decides to open an entirely new retail brand under its umbrella, but Dollar General has the customer base, experience, and the resources to continue to do this successfully. We commend Dollar General’s bold move aimed at expanding into the sub-urban markets and targeting higher income shoppers. If the company’s pOpshelf brand can replicate just some of the success that Five Below has enjoyed, we believe it could have a material impact on the company’s financials.

60 Listen Notes, Bloomberg Intelligence, https://www.listennotes.com/podcasts/bloomberg/dollar-generals-upsacle-9OPsLogxulp/
61 Todd Vasos, Q4 2020 Earnings Call.
The executive staff’s capital allocation, and business management skills are excellent in our opinion. The company has consistently invested incremental capital at high returns, intelligently spent on capital expenditures, grown shareholder values through repurchases of shares, and returned excess cash to the shareholders in the form of a dividend. Per management’s most recent comments: “We also remain committed to returning excess cash to shareholders through anticipated share repurchases in quarterly dividend payments, all while maintaining our current investment-grade credit rating and managing to a leverage ratio of about three times adjusted debt to EBITDA”\(^{62}\)

The business is conservatively financed. Total Debt to EBITDA sits at a reasonable 0.85x multiple, with net debt to EBITDA (debt minus cash and equivalents) of only 0.66x. EBITDA/Interest Expense shows 27.46x, indicating that the interest expense is covered 27.46 times over by the company’s EBITDA. From a historical perspective, these are the lowest leverage ratios the company has had over the past decade, which suggests to us that a more aggressive capital return program may soon materialize.

Management has guided to a sales decline of 1% next year due to the unusually high sales in FY 2021.\(^{63}\) Same store sales (SSS) are expected to decline by 3%-5% but would still represent 11%-13% growth on a two-year stacked basis.\(^{64}\)

In our investment process we always look for three characteristics: a strong competitive advantage, the ability to grow and reinvest capital at attractive rates of return, and a management team that has demonstrated astute capital allocation skills. We feel that Dollar General checks all the boxes, and its shares are available for purchase at a reasonable valuation. For these reasons, we are long term holders of Dollar General’s stock and expect strong returns in the years to come.

\(^{62}\) John Garratt, Q2 FY2022 Earnings Call.
\(^{63}\) Ibid.
\(^{64}\) John Garratt, Q2 FY2022 Earnings Call.
Our Portfolio

The top ten investments in our portfolio as of 12/1/2021, in order of position size, are presented on the following pages. All valuation metrics and returns are as of 12/1/2021 unless otherwise stated. For a relative valuation context, the S&P500 is currently trading at 28.81x trailing and 22.45x forward earnings, respectively – valuations that are at the upper end of the historical spectrum.65 The Russell 2000 trades at a forward PE ratio of over 32.62x – also an extremely high number. We believe our portfolio will generate far superior returns than the S&P500 going forward.

The table below gives additional insight into our portfolio exposure. We are dramatically underexposed in technology, communication, financials, utilities, and basic materials, while being overexposed in industrials, consumer cyclicals, and real estate. These sector weightings are an outcome of where we currently see opportunities, and not a top-down decision based on macro predictions. We will happily own many technology companies if their valuations become more attractive.

<table>
<thead>
<tr>
<th>S&amp;P 500 Sector</th>
<th>Portfolio</th>
<th>S&amp;P 500</th>
<th>Delta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrials</td>
<td>29.70</td>
<td>8.37</td>
<td>21.33</td>
</tr>
<tr>
<td>Consumer Cyclical</td>
<td>22.18</td>
<td>12.54</td>
<td>9.64</td>
</tr>
<tr>
<td>Healthcare</td>
<td>12.95</td>
<td>13.11</td>
<td>(0.16)</td>
</tr>
<tr>
<td>Financial Services</td>
<td>7.81</td>
<td>13.77</td>
<td>(5.96)</td>
</tr>
<tr>
<td>Consumer Defensive</td>
<td>7.57</td>
<td>6.06</td>
<td>1.51</td>
</tr>
<tr>
<td>Communication Services</td>
<td>5.35</td>
<td>10.83</td>
<td>(5.48)</td>
</tr>
<tr>
<td>Technology</td>
<td>5.12</td>
<td>25.28</td>
<td>(20.16)</td>
</tr>
<tr>
<td>Real Estate</td>
<td>5.12</td>
<td>2.63</td>
<td>2.49</td>
</tr>
<tr>
<td>Energy</td>
<td>4.20</td>
<td>2.85</td>
<td>1.35</td>
</tr>
<tr>
<td>Utilities</td>
<td>-</td>
<td>2.38</td>
<td>(2.38)</td>
</tr>
<tr>
<td>Basic Materials</td>
<td>-</td>
<td>2.18</td>
<td>(2.18)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market Cap Allocations (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
</tr>
<tr>
<td>Mid</td>
</tr>
<tr>
<td>Small</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country Allocations (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
</tr>
<tr>
<td>Canada</td>
</tr>
<tr>
<td>Denmark</td>
</tr>
<tr>
<td>Singapore</td>
</tr>
</tbody>
</table>

65 https://www.wsj.com/market-data/stocks/peyields
66 Source: Morningstar, Sentieo.
Domino’s Pizza is the world’s largest franchisor of pizza restaurants with over 13,800 locations in 85 countries. As for any restaurant operator, the key metric to consider for Domino’s Pizza is same-store-sales (SSS) growth. Growing same-store-sales are ultimately how a restaurant business increases earnings from its existing assets. The company continues to impress in this criterion with SSS having grown in the U.S. for 40 consecutive quarters, and an astounding 109 straight quarters internationally.

Two-thirds of the company’s stores are currently abroad, and the international segment remains the company’s largest growth opportunity, as the penetration of convenient fast food remains lower abroad than in the United States. Pizza is a product with exceptionally high gross margins, one that “translates” well across different cultures, and one that literally “travels well”, not losing much of its appeal when delivered in a cardboard box. The rise of 3rd party delivery platforms such as Uber Eats, DoorDash and Grubhub is challenging the pizza category as it has expanded the number of choices consumers have for convenient takeout. However, the economics of food delivery remain challenging for most restaurants and platforms alike, while pizza delivery continues to be highly profitable. Regardless of how the “delivery wars” currently playing out end, Domino’s financial results show little impact of this increased competition, and the company continues to deliver exceptional financial performance.

Domino’s Pizza stock is not optically cheap based on forward earnings, however, the company has routinely reported earnings growth of over 20% in almost all quarters since 2009. Given the company’s high growth rate, international growth opportunities, and capital light business model, which allows for returns on invested capital of over 40%, we are happy to continue to hold the shares.

Shares are +34.31% year-to-date and +31.73% over the past twelve months.

---

67 DoorDash lost $312 million in Q4, 2020. Source: DoorDash, 8-K Earnings, Update, 25-Feb-21
Watsco Inc. (WSO)

Watsco is a long time holding of our fund that recently made it into the top ten. The company distributes Heating Ventilation and Air Conditioning equipment (HVAC). The HVAC distribution business is approximately 80% replacement / 20% new construction. This is a great business due to the fragmented supplier base (seven major HVAC manufacturers) and fragmented buyers (thousands of HVAC contractors). This limits the bargaining power of both buyers and suppliers. Furthermore, while homeowners ultimately pay the bill, in most cases it is the contractor that makes the purchasing decision. Parts availability, speed of delivery and ease of installation play a major role in the purchasing decision with price being only a secondary consideration. Most HVAC equipment is bulky and difficult to ship – limiting competition from online players. Simply put, when your HVAC unit breaks on a hot summer weekend you don’t spend time shopping around for the lowest price – fixing the AC unit becomes a priority no matter the cost. The company’s earnings are also extremely predictable given that the majority of sales are tied to replacement demand which itself is a function of the installed base.

Watsco is the largest player in a very fragmented industry. The company earns mid-teens returns on invested capital and pays out most earnings in the form of dividends. The company also expands through acquisitions over time, buying up smaller independent HVAC distributors. Most recently they have acquired Temperature Equipment, a Chicago based distributor. Watsco also has the most unique long-term compensation policy for senior executives we have ever come across in corporate America – all stock grants vest at retirement or after 10 years, whichever comes later. This makes managers extremely long-term focused, something we believe is a real benefit for a company that grows primarily through acquisitions. We believe the shares are attractive at current valuations given the extremely predictable earnings the company enjoys, recession proof nature of the product and long growth runway. GAAP earnings are understated due to the amortization of intangible assets related to prior acquisitions.

Select Financial Metrics - Trailing Twelve Months

Shares are +31.83% year-to-date and +32.02% over the past twelve months.

Marriott is the world’s largest hotel company followed closely by Hilton (HLT) and Intercontinental Hotels Group plc (IHG). The company owns a portfolio of brands from the low end (Courtyard, SpringHill Suites, Aloft), through the mid-tier (Marriott, Sheraton, Westin, Renaissance Hotels), to the luxury high end (JW Marriott, Ritz-Carlton, St. Regis). In total the company had 7,642 properties with over 1.4 million rooms as of the end of Q1 2021.69

The majority (85%) of Marriott’s revenue comes from hotels in the United States, with the rest almost evenly split between Asia Pacific and Europe. Like it’s smaller peer, Hilton, the company today is almost exclusively a manager and franchisor of hotels, not a hotel owner. The company owns 66 hotels, manages 2,083 and franchises 5,493. Like all franchise-based businesses Marriott requires very little capital to grow as it utilizes the investment capital of its hotel-owners/partners to expand. Marriott currently faces a difficult operating environment due to the Covid-19 pandemic and uncertainty about the future of business travel. However, the company is an excellent operator with a somewhat leveraged capital structure (the company acquired Starwood Properties in late 2016) – if pent-up demand for travel materializes post-Covid, as we expect it will, the company will quickly go from losing money to raking in profits.

Shares are +8.02% year-to-date and +10.88% over the past twelve months.

---

69 Source: Marriott, 10-K/A, 02-Apr-21
Novo Nordisk is the global leader in insulin, which is, sadly, a growing business as more and more people around the world suffer from diabetes. Millions of people need daily injections of insulin to stay alive\(^70\), a number that, unfortunately, is likely to continue to grow by millions more in the coming decade. It may seem at first glance that insulin should be a commoditized business, after all, it was discovered and synthesized over a hundred years ago, but nothing could be further from the truth. There are many types of insulin and Novo Nordisk has spent billions on R&D over the years to develop new products. On February 11\(^{th}\), the company reported favorable results from a phase-3 trial of Semaglutide, a drug that is currently used for Type 2 diabetes treatment. The study evaluated the use of Semaglutide for weight loss treatment in non-diabetic patients and found a significant impact on weight loss for patients receiving Semaglutide vs. the placebo control group. If Semaglutide is approved for weight loss treatment, we expect it will be meaningfully accretive to the company’s bottom line.

The company’s proprietary product line supports returns on invested capital of over 40%, and while sales growth is relatively slow (+6% annualized CAGR over the past decade), the company’s shares trade at a reasonable valuation of only 22x forward earnings. For a company with an extremely predictable business, high returns on capital, and an easily forecastable future, we believe this to be highly attractive.

Shares are +56.63% year-to-date and +62.06% over the past twelve months.

\(^{70}\) According to the WHO there are 422 million diabetics worldwide. This is estimated to increase to over 570 million by 2030.
Hexcel manufactures carbon fiber composite materials with the primary end markets being aerospace and defense. The company’s stock price was hit heavily last year due to the decline in the aerospace market, but the stock is making an impressive comeback this year as the outlook for travel and aerospace demand improves. The near-term demand for lightweight, high-performance carbon fiber composites is still uncertain, but the longer-term trend is clearly very strong. As airplane manufacturers look to improve the fuel efficiency and performance of their planes, the primary way of doing this is to reduce weight. The 787, 777X and A350 are just the most recent examples of planes from Boeing and Airbus that utilize an increasing amount of carbon fiber materials in their construction.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Share of revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Aerospace</td>
<td>47.60%</td>
</tr>
<tr>
<td>Space &amp; Defense</td>
<td>36.00%</td>
</tr>
<tr>
<td>Industrial</td>
<td>16.40%</td>
</tr>
</tbody>
</table>

Just as is the case with Marriott, we do not view recent results as meaningful or indicative of a long-term trend, but rather a once in a century aberration due to the Covid-19 pandemic. Once Covid-19 recedes, we expect the demand for more fuel-efficient planes to return rather quickly, powering the demand for the company’s light weight carbon composites.

Select Financial Metrics - Trailing Twelve Months

Shares are +1.13% year-to-date and -3.45% over the past twelve months.
#6 - Repligen Corporation (RGEN)

Based in Waltham, MA, Repligen makes equipment for the biologic drug manufacturing industry. The company’s main products are focus on filtration (48% of revenue), chromatography\(^{71}\) (20% of revenue), process analytics products (9% of revenue), as well as select proteins used in the manufacturing of biological drugs (22%). We believe that biological drugs represent the most exciting frontier of medicine today, with monoclonal antibodies and gene therapy amongst the most promising approaches to tackling rare diseases.

The manufacturing of biological drugs is very different from that of traditional, “small molecule” drugs. Whereas the construction of a traditional line for a traditional small molecule drug might cost as little as $5 million dollars, the development and scaling of a biological manufacturing line can cost well over $100 million. Every biological manufacturing process is different, but their common feature is that the active ingredient in the drug is created by living cells and usually consists of a complex protein that is administered to the patient by injection. In the most general of terms the manufacturing of a biological drugs has the following stages:

- Creation and selection of cell culture to produce desired protein.
- Growth and amplification of selected cells – usually in a bioreactor.
- Filtration, purification, and isolation of active ingredient.
- Testing, quality assurance and packaging.

Under CEO Tony Hunt, Repligen has successfully reoriented itself away from selling commoditized inputs to the biological manufacturing process, towards selling specialized proprietary equipment – largely accomplished through M&A. Revenue grew at a CAGR of 22% before Tony joined the company and at 41% since then. Importantly, this growth has not come at the expense of margins or ROIC, which have remained very strong throughout the period.

![Select Financial Metrics - Trailing Twelve Months](chart)

Shares are +44.47% year-to-date and +42.8% over the past twelve months.

\(^{71}\) [https://www.nist.gov/video/what-chromatography-all-about]
#7 - Texas Pacific Land Trust (TPL)

Long time readers will know that we rarely invest in commodity businesses. However, there are periods in the market where commodity-based businesses outperform the broad indexes by a wide margin. Therefore, in order to have balance in the portfolio, we have long searched for a competitively advantaged company in the commodity space. We believe that Texas Pacific Land Trust (TPL), meets that criteria. Formed out of assets of formerly bankrupt railroads, TPL controls the largest acreage of land in the Permian basin – the center of the US shale oil industry. The company has two main sources of income: 1) royalties from oil & gas extracted on its properties – essentially a free call option on future oil prices and production; and 2) a water business which develops water resources and sells services to the fracking industry. We see TPL as an effective way to diversify the portfolio into a commodity exposed business that has a history of smart capital allocation and low risk of financial distress during periods of low oil prices. The company has no debt, and $281 million in cash.  

The company uses most of its cash flows to pay dividends and repurchase shares.

![Select Financial Metrics - Trailing Twelve Months](chart)

Shares are +63.41% year-to-date and +96.35% over the past twelve months.

---

72 Source: TPL, Investor Presentation March 2021, 02-Mar-21
Colliers International Group Inc. (CIGI)

Colliers International Group is a commercial real estate brokerage and investment management company founded by Jay S. Hennick in 1976 in Toronto, Canada. From humble beginnings the company has grown, primarily through acquisitions, to become one of the five largest commercial real estate brokerages in the world (the others being CBRE, Jones Lang LaSalle, Cushman & Wakefield, and Savills). The company today offers a full range of services and reports in the following segments: Outsourcing & Advisory (45% of revenue; this includes Engineering & Design services, Valuation services and Property Management), Capital Markets (25% of revenue), Commercial Real Estate Leasing (24% of revenue), and Investment Management (6% of revenue). The company believes that about half of its revenue is recurring in nature. The Investment Management segment deserves special attention, as it is the result of an acquisition of the real estate investment management company Harrison Street in 2018. While the segment contributes the smallest part of revenues, it has a very high margin, contributing over 17% of the company’s EBITDA.

Colliers has historically grown by acquisition and we expect it to continue to do so. The real estate services market is highly fragmented outside of North America presenting ample opportunities for Colliers to continue its growth strategy. The company has been a good steward of shareholder capital and spun out FirstService Residential (FSV) in 2014 to maximize the value of that business. This spinout accounts for the drop in revenue in 2014 seen in the chart below.

Shares are +51.01% year-to-date and +51.61% over the past twelve months.
A.O. Smith is the largest US manufacturer of residential and commercial water heaters, boilers and water treatment products. The company generates close to $3 billion in annual sales. The majority of the company’s business (73%) is done in North America, with the balance coming from China and India. Approximately 80% of demand is replacing existing heaters and 20% is tied to new construction. The company continues to benefit from a shift towards higher efficiency, but more expensive, tankless heaters.

A.O. Smith generates returns on invested capital in the high teens. The company uses its earnings to consistently grow its dividends and share repurchases. Over the past three years the company’s performance has been hurt by its exposure to China as its business there suffered due to the US-China trade war and poor execution. We believe the China business is back on track and the all-important US business is doing better than ever as housing demand heats up in the US. The company beat earnings estimates over the past several quarters and is currently enjoying very good performance as the hot U.S housing market continues to be strong. A.O. Smith also recently increased its share repurchase authorization.

![Select Financial Metrics - Trailing Twelve Months](#)

Shares are +47.42% year-to-date and +46.78% over the past twelve months.

---

Asbury Automotive Group is one of the largest automotive retailers in the United States. It operates 90 dealerships consisting of 112 franchises and 25 collision repair centers. The company’s stores offer new and used vehicles, parts and service, as well as finance and insurance (F&I) products. Franchise agreements controlled by automotive manufactures and state laws create an environment of tightly controlled market entry and restricted competition.

The dealership industry is highly fragmented with 93.5% of dealers having only between 1-5 locations according to data from 2020. In fact, dealers with over 50 locations account for only 0.1% of the industry – a testament to the huge opportunity for consolidation that lies ahead. Industry dynamics, including the rising complexity of automobiles and the need for omnichannel distribution are favoring better capitalized and larger dealer groups. We believe Asbury Automotive Group has several distinct advantages, particularly its highly profitable parts and service business, its overexposure to the luxury vehicle business, which carries the best margins, and its Clicklane omnichannel strategy. Asbury’s management has also been acting in the best interests of its shareholders by allocating capital towards acquiring dealerships to aggressively expand its business, and occasionally repurchasing stock when attractive acquisitions targets could not be found.

ABG is not a fast-growing SaaS business, but when paying a valuation of ¼ of the overall stock market, one does not need to make heroic assumptions about the future to enjoy strong returns as shareholders. We believe that over the next several years, Asbury will continue to acquire dealerships, occasionally buyback stock and invest to improve its digital shopping experience. We wrote about Asbury in detail in our August 2021 Investor Letter.

Shares are +10.35% year-to-date and +36.57% over the past twelve months.

74 https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474861098
During the month we completely exited our position in Stepan Company, Inc. (SCL), and reduced our position in TFI International Inc. (TFII).

As always, I look forward to hearing from you and answering any questions you might have. Thank you for your continued interest and support.

Wishing you a happy and safe holiday,

\[Signature\]

**Lukasz Tomicki**
Portfolio Manager
LRT Capital
### Appendix I: Attributions and Holdings as of 11/1/2021

<table>
<thead>
<tr>
<th>LRT Economic Moat</th>
<th>Portfolio Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top Holdings (%)</strong></td>
<td><strong>Sector Allocations (Long Exposure)</strong></td>
</tr>
<tr>
<td>Domino's Pizza, Inc. (DPZ)</td>
<td>7.46</td>
</tr>
<tr>
<td>Stepan Company (SCL)</td>
<td>7.07</td>
</tr>
<tr>
<td>Novo Nordisk A/S (NVO)</td>
<td>6.21</td>
</tr>
<tr>
<td>Marriott International, Inc. (MAR)</td>
<td>5.69</td>
</tr>
<tr>
<td>Hexcel Corp. (HXL)</td>
<td>4.95</td>
</tr>
<tr>
<td>Texas Pacific Land Trust (TPL)</td>
<td>4.53</td>
</tr>
<tr>
<td>Colliers International Group Inc. (CIGI)</td>
<td>4.51</td>
</tr>
<tr>
<td>Watsco Inc. (WSO)</td>
<td>4.51</td>
</tr>
<tr>
<td>TFI International Inc. (TFII)</td>
<td>4.25</td>
</tr>
<tr>
<td>Repligen Corporation (RGEN)</td>
<td>4.19</td>
</tr>
<tr>
<td><strong>Top Holdings Total</strong></td>
<td><strong>53.36</strong></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market Cap Allocations (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vanguard Mid-Cap ETF (VO)</td>
</tr>
<tr>
<td>Vanguard Small-Cap ETF (VB)</td>
</tr>
<tr>
<td>iShares Core S&amp;P Mid-Cap (IJH)</td>
</tr>
<tr>
<td>SPDR S&amp;P MidCap 400 ETF (MDY)</td>
</tr>
<tr>
<td>iShares Russell 2000 (IWM)</td>
</tr>
<tr>
<td>iShares Core S&amp;P Small-Cap (IJR)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Return Attribution (%)</th>
<th>Country Allocations (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Equity</td>
<td>-5.33</td>
</tr>
<tr>
<td>Hedges</td>
<td>1.82</td>
</tr>
<tr>
<td>Unlevered Gross Return</td>
<td>-3.51</td>
</tr>
<tr>
<td>Leveraged Gross Return</td>
<td>-7.89</td>
</tr>
</tbody>
</table>

| Net Return | -6.71 |

Source: Morningstar, Sentieo.

Net returns are net of a hypothetical 1% annual management fee (charged quarterly) and 20% annual performance fee. Individual account results may vary due to the timing of investments and fee structure. Please consult your statements for exact results. Please see the end of this letter for additional disclosures.
Appendix II: Investment Philosophy

Over the past 36 months, we saw a large increase in the number of LRT Capital partners (the term we use to describe our clients). With so many newcomers, it is important that we write about our investment philosophy again.

Here are the key points:

- Exceptional stock returns come from exceptional business returns on a **per-share** basis.
- We seek to invest in high-quality companies, i.e., those possessing sustainable competitive advantages (moats), the ability to grow and reinvest capital over time, and management that excels at capital allocation.
- We only purchase companies whose shares trade at a discount to our assessment of their intrinsic value.
- It is futile to predict short-term market movements. We seek to hold our investments for as long as possible.
- The financial markets are dominated by short-term traders who see stocks as casino chips. This occasionally allows us to purchase shares in great companies at large discounts to their true worth.
- If we are right about the trajectory of the businesses we invest in, over time, we will be right on the trajectory of their stock prices.

We view stock market volatility as a source of opportunity. Volatility allows us to profit by acquiring shares in superb businesses at attractive prices. The more that markets (the “other” participants) are irrational, the more likely we are to reach our ambitious performance objectives.

In the long run, stocks are the best investment asset class, but our experience has taught us that our investment process will not generate linear returns. In some years, our portfolio will outperform, and in others, it will generate a below average return. This is a certainty that we must accept. We are long-term investors and we do not try to dance in and out of the market.

In summary, our investment strategy can be summed up in three steps:

- Only seek out high-quality companies.
- Do not overpay.
- Do nothing – patience and discipline are the keystones to success.
Appendix III: Portfolio Construction Software Overview

LRT separates the discretionary and qualitative process of selecting the equity holdings from the portfolio construction process which is systematic and quantitative.

Our quantitative process considers each position’s contribution to portfolio volatility, contribution of idiosyncratic vs. systematic risk and portfolio factor (size, value, quality, momentum, vol, etc.) exposures.

The system outputs target portfolio weights for each position. We trade mechanically to rebalance the portfolio each month to the targeted exposures. This eliminates emotions, human biases and overconfidence risk.

Example system output:

Rebalancing dates, and current date target allocation (7/14/2021 in this example).
Disclaimer and Contact Information

LRT Capital Management, LLC is an Exempt Reporting Adviser with the Texas State Securities Board, CRD #290260. Past returns are no guarantee of future results. Results are net of a hypothetical 1% annual management fee (charged quarterly) and 20% annual performance fee. Individual account returns may vary based on the timing of investments and individual fee structure.

This memorandum and the information included herein is confidential and is intended solely for the information and exclusive use of the person to whom it has been provided. It is not to be reproduced or transmitted, in whole or in part, to any other person. Each recipient of this memorandum agrees to treat the memorandum and the information included herein as confidential and further agrees not to transmit, reproduce, or make available to anyone, in whole or in part, any of the information included herein. Each person who receives a copy of this memorandum is deemed to have agreed to return this memorandum to the General Partner upon request.

Investment in the Fund involves significant risks, including but not limited to the risks that the indices within the Fund perform unfavorably, there are disruption of the orderly markets of the securities traded in the Fund, trading errors occur, and the computer software and hardware on which the General Partner relies experiences technical issues. All investing involves risk of loss, including the possible loss of all amounts invested. Past performance may not be indicative of any future results. No current or prospective client should assume that the future performance of any investment or investment strategy referenced directly or indirectly herein will perform in the same manner in the future. Different types of investments and investment strategies involve varying degrees of risk—all investing involves risk—and may experience positive or negative growth. Nothing herein should be construed as guaranteeing any investment performance. We do not provide tax, accounting, or legal advice to our clients, and all investors are advised to consult with their tax, accounting, or legal advisers regarding any potential investment. For a more detailed explanation of risks relating to an investment, please review the Fund’s Private Placement Memorandum, Limited Partnership Agreement, and Subscription Documents (Offering Documents).

This report is for informational purposes only and does not constitute an offer to sell, solicitation to buy, or a recommendation for any security, or as an offer to provide advisory or other services in any jurisdiction in which such offer, solicitation, purchase, or sale would be unlawful under the securities laws of such jurisdiction. Any offer to sell is done exclusively through the Fund’s Private Placement Memorandum. All persons interested in subscribing to the Fund should first review the Fund’s Offering Documents, copies of which are available upon request. The information contained herein has been prepared by the General Partner and is current as of the date of transmission. Such information is subject to change. Any statements or facts contained herein derived from third-party sources are believed to be reliable but are not guaranteed as to their accuracy or completeness. Investment in the Fund is permitted only by "accredited investors" as defined in the Securities Act of 1933, as amended. These requirements are set forth in detail in the Offering Documents.

LRT Capital Management, LLC
108 Wild Basin Road, Suite 250
Austin, TX 78746
Office: +1 512 320 9085
www.lrtcapital.com