ValueInvestor INSIGHT
The Leading Authority on Value Investing
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# After the Fall

Legion Partners' Chris Kiper, Sagar Gupta, Ted White and Susan Xu describe the multiple layers of their activist engagements, the key indicators that they've overstayed their welcome, their advice for management when an activist comes calling, and why they see unrecognized value in Primo Water, Garrett Motion, DigitalBridge, Nutanix and Clear Channel.

**INVESTOR INSIGHT**

**Chris Kiper**
Legion Partners

It's fair to say there's not a lot of nuance in Chris Kiper's investing approach: "We're stockpickers first, looking to find undervalued securities we think will go up," says Legion Partners' chief investment officer, "but if we can use activism to accelerate and magnify those returns, all the better."

Directness has thus far proven to be a virtue. Legion's composite portfolio – including commingled funds as well as single co-investments – has since the firm's founding in 2011 earned a net annualized 14.1%, vs. 10.9% for the Russell 2000 index.

Targeting fallen-from-grace companies with multiple levers to pull in order to get back on track, Kiper sees particular upside today in such areas as enterprise software, digital infrastructure, advertising billboards, turbochargers and water.

**There's a line of thought in investing that an activist approach is a bit like pushing a rock up a hill, so if you're unhappy with what's going on at a company just move on or don't get involved in the first place. Explain why you disagree with that.**

**Chris Kiper:** We'd love to find deeply undervalued companies where everything looks great and we can buy the stock and watch it go up. But that doesn't line up with our view of reality. We generally look for companies whose stocks have gone down a lot and the market has a very pessimistic view about negative aspects of the business we believe are transitory or short term. Very often things need to change at the company for it to deliver on its long-term potential and we think our activist involvement can increase the likelihood that change happens. While we focus on undervalued stocks like other investors – we're only interested if we believe we can at least double our money in a reasonable period of time – we don't think hoping things get better is the greatest investment strategy.

**To jump right into a representative example of a company and situation that attracts you, describe the impetus for your establishing a stake in the fourth quarter of last year in Twilio [TWLO].**

**CK:** The company is the category leader in communications platform as a service (CPaaS) software, which basically enables real-time communications in any app. A simple example of its technology in use would be your ability to call or message your Uber driver in Uber's app without either of you knowing the other's phone number. Another example would be the text messaging system it set up for VA hospitals to communicate about appointments, which the VA system says has saved it over $100 million in administering that part of its medical program. Twilio's technology is considered second to none, and we say this as former happy shareholders of Vonage, their direct U.S. competitor.

Twilio was one of the highest flyers as tech stocks took off in the pandemic. Having gone public in 2016 at $15 per share, even with a "growth at all costs" strategy that effectively kept a lid on operating leverage, the stock hit an all-time high of $457 in February of 2021. The company and its founder, Jeff Lawson, were featured on the cover of *Forbes* under the headline "The World's Sexiest Stock."

As you might imagine given our interest in the shares, the narrative has changed. We established our position in the fourth quarter of last year after the company's Investor Day in which management, on the heels of reporting a trailing-twelve-month GAAP operating loss of $1 billion, said it was shooting for GAAP breakeven over an undefined "long-term" timeframe. Excuse me, maybe you missed the memo about companies needing to make money, but that's the goal? Not surprisingly, the market was not impressed and the stock fell into the $40s. Our initial cost basis in the stock was around $48, but has since declined further given option premiums we've earned.

Encouraged by the fact that the dual-class share structure put in place at the IPO was expiring in June of this year, we immediately began engaging with management and the board on several topics including cost cutting, balance sheet productivity, financial disclosures, corporate governance, management accountability and strategic alternatives. In mid-February they announced a number of changes, including an additional 17% reduction in the workforce, office closures to yield approximately $300 million in annual cost savings, and an overhaul of the stock-based compensation program with new more credible long-term targets. The board also authorized a $1 billion share repurchase program and Jeff Lawson pledged to personally buy $10 million worth of stock. [*Note*: Following the meeting TWLO shares traded at close to $80; they closed recently at $61.]

I guess we would say so far, so good. There may be some choppiness in the near term depending on the economy, but we think the company's long-term potential in communications software and services remains quite attractive. In our engagement now we're primarily focused on board refreshment, which is a key objective of ours at almost every portfolio company. It's still an open question whether the board understands the cultural change necessary to transform from a growth-at-all-costs mentality to one more focused on profitability. The proof now will be in the pudding as to whether the efforts made so far produce tangible improvements in results and a re-rating of the stock's valuation. Absent that, we wouldn't be surprised if before next year's annual meeting the shareholder base will demand much more, including a CEO change or a sale of the company.

**Would you say there is a typical life cycle to your investments?**

**CK:** It obviously varies, but our average holding period has been just under two years. Everything we invest in we expect to become a core holding – which typically means 8-10% of the portfolio – but we often build the position in steps. We'll put in half to two-thirds of the capital once we've finished our research, but always hold back some because it's rare the stocks we buy go straight up after we buy them. We want to have some dry powder to improve our average entry price.

Everything we invest in also has an activist agenda and the heavy lifting for that – often around corporate governance – usually goes on in the first 12 to 18 months. If we're successful in bringing about the positive changes we think are needed, there's then a period where the benefits of those changes start to show up and the market catches up with it all. That can happen quickly, but it doesn't always.

Sometimes things work out much faster than we expect, even without much benefit from our activist agenda. One fairly recent example of that would be Murphy USA [MUSA], a position we started accumulating in the fourth quarter of 2021 when the stock was around $150. We saw opportunity in a number of areas, including improving the company's fuel margins, expanding its stores' food and beverage offerings, continuing to take market share in a highly fragmented market, and stepping up share repurchases of a heavily discounted stock.

As we engaged with the company, the fuel-margin aspect of our thesis started playing out better than we expected and the stock went up a lot. Within the first year very little activism actually occurred but the shares doubled, so we exited. That speaks to our valuation sensitivity – if we think something is fully priced we don't stick around just to complete our activist agenda. [*Note*: MUSA shares now trade at around $303.]

**ON BUYING:**

**We always hold back some dry powder because it's rare that the stocks we buy go straight up after we buy them.**

**Your investment in Momentive, the parent of online survey company SurveyMonkey, didn't play out particularly quickly, or as well. Describe what happened there.**

**Sagar Gupta:** Chris spoke to you about this four years ago [*VII*, August 30, 2019] when the company was then called SVMK Inc. We are and were huge fans of the core SurveyMonkey business, but we thought there were a number of corporate governance and financial-disclosure initiatives the company could implement to improve its standing on Wall Street and ultimately create incremental value for shareholders.

One key element of our due diligence is always to assess not only what needs to change at a company but also the likelihood that change can happen. We're often our own catalysts in that regard, pursuing a reconstitution of the board of directors and/or management if we think that's what's required.

After several quarters of trying to work with the management team here, we ultimately concluded the company would best realize value in a sale, and it announced an agreement in October of 2021 to sell to Zendesk for approximately $28 per share in stock, shunning an all-cash offer from private equity of $27.25 per share. But as technology stocks fell sharply into 2022, the Zendesk deal fell apart. One lesson from that was the magnitude of business disruption that can result from a failed M&A deal. The company ended up being bought in March [by Symphony Technology Group for just under $9.50 per share]. While we ended up with only a modest loss on our fund's position, the time and effort expended on it was clearly an opportunity cost.

**CK:** We try to learn lessons from activist investments – both our own and those of others – that have gone wrong. Activists are trying in most instances to affect change at the board and management level that can result in incremental top-line growth and improving profits margins. If the metrics improve, so should the valuation on the stock. But if we're well into the process and none of that is happening, odds are we've misjudged the situation in some important ways. It also can happen that as an activist you find yourself 12 to 18 months into an engagement trying to solve a much expanded or different set of problems than the ones you signed up to solve on day one. We generally consider ourselves problem solvers, so let's solve problems. In these situations, rather than dig in further we hope to have the discipline to move on.

**We've spoken in the past [*VII*, August 30, 2019] about Primo Water [PRMW], in which you've successfully invested twice. Explain why you're back for what you call a "third bite from this apple."**

**Susan Xu:** Primo is the only publicly traded pure-play drinking water company, formed in its latest iteration after merging with Canada's Cott Corp. at the beginning of 2020. It sells water dispensers used at home and work but generates almost all its revenues – 95% of which is on a recurring basis – from refills done through direct delivery and through bottle exchanges and refill machines located at thousands of third-party retail locations. More than 70% of its customers are in North America, where it has a roughly 35% market share. The #2 and only other scale player is Nestlé's former North American spring and purified water business, which was sold to a private equity consortium led by One Rock Capital Partners in 2021.

We think the secular trends for bottled water remain very attractive. Driven by increased concerns over municipal water quality, bottled water's share of U.S. beverage consumption has increased from 13% in 2010 to 22% today. Consumers continue to shift from carbonated soft drinks to healthier choices like water. Primo is also an excellent ESG story. A five-gallon bottle of branded Primo water is sanitized up to 40 times and is then fully recyclable. That volume of water delivered is comparable to more than 1,500 single-serve bottles that are less able to be recycled and take hundreds of years to decompose.

So we believe the market opportunity is there and that as the scaled market leader the company is well positioned to take advantage of it. Doing so should translate into incremental top-line growth, higher margins and better returns on invested capital. All that of course should result in upside for the stock as well.

**Describe how you've handled the communication of all that with the company and the results of those efforts so far.**

**CK:** As is always the case, we begin any engagement with a portfolio company behind the scenes, hoping to work collaboratively. As time went on we decided in March of this year to launch a proxy campaign, focused on refreshing Primo's board. We reached a settlement agreement with the company on May 3rd. Two Legion nominees were appointed to the board and two long-tenured directors stepped down. Less than a month later the current CEO announced he would retire once the board recruits a successor. These changes are big victories and we think can significantly improve the probability of substantial shareholder value creation going forward.

**From today's price of $14.20, what kind of value creation can you envision?**

### INVESTMENT SNAPSHOT

**Primo Water**
(NYSE: PRMW)

**Business:** Provider of bottled-water products, systems and services to at-home and commercial customers sold primarily online and through third-party retail locations.

**Share Information** (@7/27/23):

| | |
|---|---|
| **Price** | **14.20** |
| 52-Week Range | 12.15 – 16.47 |
| Dividend Yield | 2.2% |
| Market Cap | $2.27 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $2.24 billion |
| Operating Profit Margin | 6.5% |
| Net Profit Margin | 1.9% |

**Valuation Metrics**
(@7/27/23):

| | PRMW | S&P 500 |
|---|---|---|
| P/E (TTM) | 53.5 | 20.4 |
| Forward P/E (Est.) | 17.9 | 20.7 |

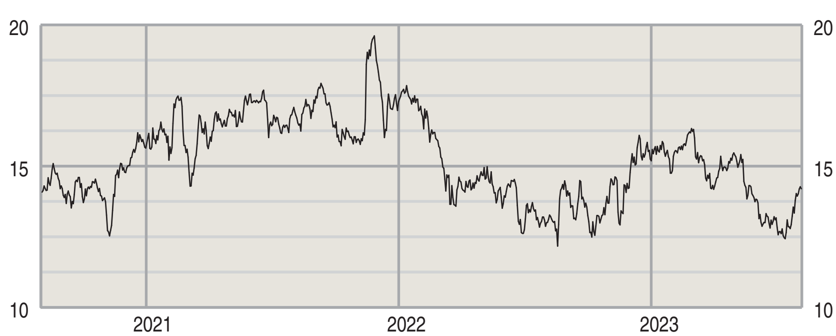
**Largest Institutional Owners**
(@3/31/23 or latest filing):

| Company | % Owned |
|---|---|
| BlackRock | 9.9% |
| Vanguard Group | 7.0% |
| Fidelity Mgmt & Research | 6.0% |
| J.P. Morgan Asset Mgmt | 5.0% |
| Fuller & Thaler Asset Mgmt | 4.9% |

**Short Interest** (as of 7/15/23):

| | |
|---|---|
| Shares Short/Float | 0.7% |

**PRMW PRICE HISTORY**




**THE BOTTOM LINE**

Given its leading market position in an attractive end market, the company under a revitalized board and a still-to-be-named new CEO should improve its organic sales growth and operating profitability, says Susan Xu. Applying what she considers a fair 14x EV/EBITDA multiple to her estimates for 2025, the stock would trade at around $30.

Sources: Company reports, other publicly available information

**Ted White:** This might be a good point to speak about one aspect of our valuation work that we consider an important risk-mitigation tool, which is to always try to assess if the company were sold tomorrow to either strategic or private-equity buyers, who would buy it and at what price. We almost never lead with that on our agenda for activism – nor are we advocating for this outcome today for Primo – but going through that exercise gives us a lot of insight both into the potential upside as well as the risk of a value trap. If our due diligence tells us this is an asset nobody wants at a reasonable price, we're going to look elsewhere.

In this case, we believe Primo operates in an industry that is highly attractive and we have a good comp in the estimated 12x EV/EBITDA at which the Nestlé business sold two years ago. We'd argue that Nestlé was a motivated seller and that multiple might be conservative, but applying it to Primo's 2022 EBITDA would result in a share price of more than $22. Seeing a credible takeout value of almost 60% above the current share price gives us a lot of conviction in the opportunity.

**SX:** Under a new CEO and a revitalized board, we think annual organic sales growth can be in the high single digits and that EBITDA margins by 2025 can reach 22%, up from 19% today. On our resulting estimates and with what we believe would be a fair re-rating to 14x EV/EBITDA for a then well-run business with a leading position in an attractive industry, the stock would trade at roughly $30.

**What attracted your attention to recent portfolio addition Garrett Motion [GTX]?**

**SX:** This is the largest global manufacturer of turbochargers, highly engineered components of internal combustion engines that use the engine's exhaust gas to increase its power and burn fuel more efficiently. It also has spent heavily over the past decade in developing new technologies for zero-emission vehicles and now has successful product offerings that transfer its knowhow from turbos into components such as e-motors that smooth out the vehicle's acceleration process and compressors that help cool its battery.

The recent history here is rather colorful, and not in a good way. Garrett was spun off from Honeywell in 2018 but wasn't really investible due to the exploitative amount of debt and asbestos liabilities dumped on it by its former parent. Garrett first sued Honeywell to try to remedy the situation, but then the pandemic hit and it ended up filing for voluntary Chapter 11 bankruptcy to address what turned out to be a non-viable balance sheet. It reemerged from bankruptcy in April 2021 having eliminated the problematic asbestos indemnity with Honeywell and raising $1.3 billion in new preferred equity, the lead investors in which were Oaktree Capital and Centerbridge Partners. Just this month all preferred shares were converted into what is now a single class of common stock, significantly simplifying the capital structure and taking the market cap from around $500 million to around $2 billion currently.

All of that we think has obscured what a good business this is. In turbo, Garrett is the global leader with roughly one-third of the market and the only similar scale

## INVESTMENT SNAPSHOT

### Garrett Motion
(Nasdaq: GTX)

**Business:** Design, manufacture and sale of turbocharger and electric-boosting technologies used in the production and repair of light and commercial vehicles worldwide.

**Share Information** (@7/27/23):

| | |
|---|---|
| **Price** | **7.77** |
| 52-Week Range | 5.57 – 8.68 |
| Dividend Yield | 0.0% |
| Market Cap | $2.01 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $3.67 billion |
| Operating Profit Margin | 14.1% |
| Net Profit Margin | 10.4% |

**Valuation Metrics**
(@7/27/23):

| | GTX | S&P 500 |
|---|---|---|
| P/E (TTM) | 10.7 | 20.4 |
| Forward P/E (Est.) | 7.8 | 20.7 |

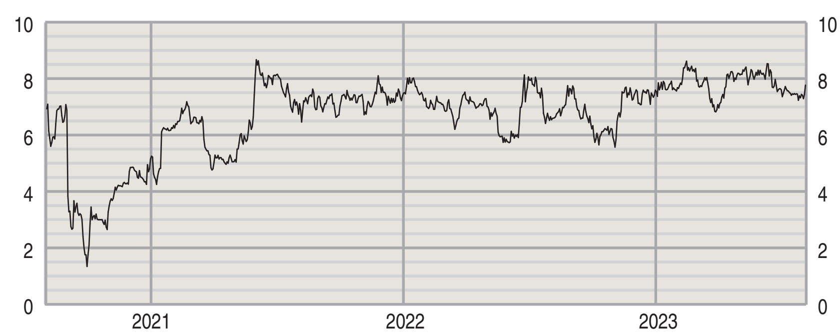
**Largest Institutional Owners**
(@3/31/23 or latest filing):

| Company | % Owned |
|---|---|
| Oaktree Capital | 16.6% |
| Centerbridge Partners | 15.9% |
| Cyrus Capital | 13.1% |
| Sessa Capital | 9.5% |
| Baupost Group | 8.0% |

**Short Interest** (as of 7/15/23):

| | |
|---|---|
| Shares Short/Float | 0.3% |

**GTX PRICE HISTORY**




**THE BOTTOM LINE**

The company's difficult road to becoming independently publicly traded seems to have obscured what a good business it is, says Susan Xu, well positioned in traditional and evolving areas of its end market. Assuming 6% annual revenue growth and modest margin expansion, at 7x EV/EBITDA on her 2026 numbers the shares would trade at around $16.

Sources: Company reports, other publicly available information competitor is Borg Warner, whose market share is in the high-20s. Garrett's technology is considered superior and that has translated into a win rate of new business above 50% since 2015. Given how long and involved the vehicle-development process is, once a supplier wins a contract the revenue visibility on it is high and the customer relationship is quite sticky. There's also a large aftermarket business, which benefits market leaders the most.

It's critical that the company is positioned well for the transition to zero-emissions vehicles, and we believe it is. Management has laid out a credible plan targeting $1 billion in annual revenue from zero-emissions technology by 2030, implying 30% or so compound annual growth from today. With the visibility into the core turbo business going forward, if they're as successful as they expect in the new businesses that will drive materially higher growth in the overall business.

**What is your activist agenda here?**

**SX:** It's actually quite simple for now, focused primarily on improving investor communications and attracting more analyst coverage. It's an interesting, unique company that has been dramatically simplified and is now far more investable. From almost no coverage at all, UBS put out a special-situations report on Garrett earlier this month, and the company is in contact with 15 or more Wall Street firms that could potentially launch regular coverage on it. Because of the attractiveness of the story, we'd expect that to generate a lot of buyside attention.

**How inexpensive do you consider the shares at today's price of around $7.75?**

**SX:** The business generates a lot of free cash flow, close to $300 million this year after interest. On today's market cap that translates into a 15% free-cash-flow yield. On this year's estimated $600 million in EBITDA, the EV/EBITDA multiple is 5.5x.

Assuming 6% or so annual revenue growth – in line with historical levels and not building in much upside on the electrification front – and around 100 basis points in EBITDA-margin expansion, we estimate 2026 EBITDA at around $800 million. Applying what we think is a more reasonable 7x multiple to that would give us a share price of roughly $16.

**Is debt at all a concern?**

**SX:** The company outsources the capital-intensive parts of the business and with strong free cash flow generation plans to reduce its 2.7x net debt to EBITDA ratio to around 2x over the next two years. There should be plenty of cash flow left over to also fund share buybacks, we think to the tune of up to $200 million per year, or nearly 10% of the current market cap.

**Walk through your investment case today for digital infrastructure investment firm DigitalBridge [DBRG].**

**SG:** DigitalBridge is an alternative asset manager that specializes in cell towers, datacenters and fiber networks. After a significant restructuring under the current CEO Marc Ganzi, the company today has two basic businesses, investment management and the direct minority ownership of operating companies. On the investment management side they run private equity and credit funds that earn management and performance fees on nearly $30 billion in fee-paying assets. The operating stakes are now in two datacenter companies, called DataBank and Vantage SDC.

The exponential rise in data usage is fueling tremendous demand for digital infrastructure and for the capital to fund it. Estimates are that over $400 billion in capex annually is needed to meet digital infrastructure needs globally over the next six years. We think DigitalBridge is ideally positioned to benefit from that.

Institutional investors have shown considerable appetite for these types of assets and have various options for acting on that. They can invest directly in companies like American Tower or Equinix that own and operate towers and datacenters. They can invest in diversified private equity firms like Brookfield, Blackstone and KKR, which are emphasizing infrastructure-related funds. DigitalBridge is a unique alternative, dedicated to investing only in digital infrastructure with a team that has a long and successful track record in doing just that as an investor and operator. Under new management the company has consistently exceeded fundraising targets and believes it can increase fee-earning assets to roughly $50 billion by the end of 2025.

**It sounds as if your happy with the direction of the company as is.**

**SG:** We respect Marc and believe the overhaul of the company – which included a significant refresh of the board, the sale of non-core legacy assets, and significant share repurchases – has been very well executed. The next big step is to exit the minority operating businesses. The sale of DataBank is underway and we expect news on Vantage SDC soon as well. Proceeds from those sales would represent a significant portion of the current market cap and could fuel additional share repurchases. We'd also expect a resulting pure-play in asset management – which is a superior business and would have a much cleaner financial profile – to earn a re-rated valuation multiple from the market.

**How are you looking at valuation from the current $14.60 share price?**

**SG:** The stock came in a lot last year as tech multiples compressed and the fundraising environment got tougher, and it now trades at 50% of where it was at the beginning of 2022.

The company in April actually came out with a presentation detailing what it thought its stock was currently worth, valuing separately the fee-related earnings, carried interest, and the operating segment. Using a range of multiples – from current ones on the low end to historical averages on the higher end – they arrived at a value range of $21 to $29 per share based on 2023 estimates.

That's interesting for a couple of reasons. First, the math largely matches ours

## INVESTMENT SNAPSHOT

**DigitalBridge**
(NYSE: DBRG)

**Business:** Invests in and operates a wide variety of "digital-ecosystem" assets, including cell towers, data centers, fiber-optic networks, small cells and edge infrastructure.

**Share Information** (@7/27/23):

| | |
|---|---|
| **Price** | **14.59** |
| 52-Week Range | 9.99 – 23.44 |
| Dividend Yield | 0.2% |
| Market Cap | $2.36 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $1.62 billion |
| Operating Profit Margin | 2.2% |
| Net Profit Margin | (-16.9%) |

**Valuation Metrics**
(@7/27/23):

| | DBRG | S&P 500 |
|---|---|---|
| P/E (TTM) | n/a | 20.4 |
| Forward P/E (Est.) | n/a | 20.7 |

**Largest Institutional Owners**
(@3/31/23 or latest filing):

| Company | % Owned |
|---|---|
| Vanguard Group | 15.2% |
| Wafra Inc | 8.9% |
| BlackRock | 6.6% |
| Wolf Hill Capital Mgmt | 5.6% |
| Capital Research & Mgmt | 5.5% |

**Short Interest** (as of 7/15/23):

| | |
|---|---|
| Shares Short/Float | 8.4% |

**DBRG PRICE HISTORY**


**THE BOTTOM LINE**

Offering an alternative as a specialist asset manager, the company should benefit from the ongoing need to build out digital infrastructure and the strong institutional investor interest in providing the capital for it, says Sagar Gupta. He generally agrees with the company's own valuation work estimating its current fair value at $21 to $29 per share.

Sources: Company reports, other publicly available information

and doesn't reflect the likely step-change increase in earnings above current expectations if the company is successful in hitting its 2025 target for fee-earning assets. Second, it's unusual for a company to be this public about its goals – if they don't hit them and/or the stock doesn't re-rate, there's going to be tremendous pressure on management to answer for that. We think that would result in exploring an eventual sale of the company, and as a specialist in an attractive sector there should be no shortage of traditional private equity firms that would be interested.

One last thing of note here is that Marc Ganzi would earn a roughly $100 million payout if the share price hits $40 by mid-2024. We don't need that to happen to like the stock today, but it's an interesting indicator of his aligned interest in increasing shareholder value.

**Why are you high on the prospects for software company Nutanix [NTNX]?**

**SG:** This is a company we'd followed since its 2016 IPO because we admired its technology and market position, but we didn't seriously get interested in the stock until it eliminated its founder's super-voting power at the beginning of 2022 and then the stock got slammed in last year's tech rout. We established our position in the second and third quarters of last year with a cost basis in the low-$20s.

Nutanix pioneered a space called hyperconverged infrastructure [HCI] software, which helps large enterprises build and manage datacenters across private and public cloud environments. The software essentially manages the resources of the compute, storage and networking components of a modern datacenter. It helps optimize resource usage to improve performance and cost efficiency, while simplifying the complexities involved in dealing with multiple hardware vendors. As demand for hybrid public/private cloud computing and datacenters continues to explode, almost all new datacenter architecture development is based on HCI.

HCI software is a duopoly between Nutanix and VMware [VMW], which control roughly 50% and 40% of the market respectively. While we consistently hear Nutanix has superior technology, the relative share between it and VMware has remained steady for years. One important aspect of our investment case is that that's about to change with VMware's pending sale to Broadcom. Broadcom is known for cutting costs at its acquired businesses and has already announced plans to eliminate over $3 billion in operating expenses from VMware as it focuses on its largest and most profitable customers. We believe that level of disruption can provide a long-term tailwind to Nutanix in acquiring disgruntled customers and talent.

**Bain Capital invested $750 million in Nutanix in late 2020 and after some changes to the board a new CEO, Rajiv Ramaswami, took over in early 2021. Are you supportive of his efforts so far?**

**SG:** The company has completed its transformation to an almost purely subscription software business, much of the executive team has been upgraded, and they've made progress on reigning in out

## INVESTMENT SNAPSHOT

**Nutanix**
(Nasdaq: NTNX)

**Business:** Provider of a software platform that enables large enterprises to manage and administer datacenters across both in-house and third-party cloud environments.

**Share Information** (@7/27/23):

| | |
|---|---|
| **Price** | **29.83** |
| 52-Week Range | 14.22 – 33.73 |
| Dividend Yield | 0.0% |
| Market Cap | $7.03 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $1.75 billion |
| Operating Profit Margin | (-19.3%) |
| Net Profit Margin | (-22.3%) |

**Valuation Metrics**
(@7/27/23):

| | NTNX | S&P 500 |
|---|---|---|
| P/E (TTM) | n/a | 20.4 |
| Forward P/E (Est.) | 43.6 | 20.7 |

**Largest Institutional Owners**
(@3/31/23 or latest filing):

| Company | % Owned |
|---|---|
| Fidelity Mgmt & Research | 14.6% |
| Vanguard Group | 10.8% |
| Generation Inv Mgmt | 8.6% |
| BlackRock | 5.4% |
| Champlain Inv Partners | 3.2% |

**Short Interest** (as of 7/15/23):

| | |
|---|---|
| Shares Short/Float | 2.0% |

**NTNX PRICE HISTORY**


**THE BOTTOM LINE**

While the business is much improved under a new CEO since early 2021, Sagar Gupta doesn't believe the market adequately appreciates the company's strong market position and growth potential in a dynamic enterprise-software end market. At the valuation its top competitor is being sold, on his 2025 estimates the shares would trade at closer to $50.

Sources: Company reports, other publicly available information

of control spending. Gross margins are now above 80% and operating margins this year should finally be positive, after running significantly negative when Bain Capital got involved.

Things are heading in the right direction, but valuation is likely to remain a problem until financial performance more consistently improves and management is more transparent about the goals they set and how specifically they plan to achieve them. The company has announced it will hold an Investor Day in September where management will lay out the updated long-term operating plan. If that's not well received, we could imagine further pressure being put on the board to realize value, likely by selling the company. VMware being taken out – at roughly 5x revenue and 6x gross profit – validates the strategic value of the space.

**From today's price of around $29.80, what potential upside do you see in the stock?**

**SG:** This is a much better company today than it was three years ago when Bain Capital got involved at around the same share price. The company's position in a large and fast-growing market we think can drive 15-20% annual revenue growth at very high gross margins for some time. If you apply the 5x multiple of revenues at which VMware sold – and at which infrastructure-software company Citrix Systems was acquired last year by private equity – the stock on our 2025 estimates would trade closer to $50. We think that's conservative. Similar companies with similar growth profiles to Nutanix typically trade or change hands at 8x revenues or more.

**Outdoor advertising hasn't been a great sector for investors for some time. Why do you expect Clear Channel Outdoor [CCO] to buck that trend?**

**SG:** Clear Channel has only been a standalone out-of-home advertising company since it separated in 2019 from radio-station operator iHeartMedia. Out-of-home advertising typically refers to billboards and posters displayed alongside highways and in transit stations and airports. The business model is fairly simple – the company owns the display structure, leases the site where the display stands, and then rents use of the display to advertisers for varying periods.

Out-of-home ads are one of the few forms of traditional media that have maintained their share of the media-mix pie, in large part because the industry for years now has been converting print displays into digital screens that can showcase a rotating series of ads every few seconds. The economics of the new displays work extremely well, with a digitized billboard generating roughly 4x the revenue and 6x the profit of a legacy, static billboard. IRRs on conversion run from 20% to 40% and there is a long runway ahead. Only 5% of Clear Channel's assets have been converted to digital, but the share of revenue they generate is almost 40%.

There are a few reasons the shares have performed poorly. The investment required in the conversion process depresses cash flow, the process is playing out slowly, and the incremental revenue generation is only fairly recently having a material enough impact on the growth

## INVESTMENT SNAPSHOT

**Clear Channel Outdoor**
(NYSE: CCO)

**Business:** Owns and operates out-of-home advertising assets – mostly in the U.S. and Europe – including billboards and space in airports, train stations and bus shelters.

**Share Information** (@7/27/23):

| | |
|---|---|
| **Price** | **1.57** |
| 52-Week Range | 0.95 – 2.14 |
| Dividend Yield | 0.0% |
| Market Cap | $758.1 million |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $2.50 billion |
| Operating Profit Margin | 10.2% |
| Net Profit Margin | (-1.7%) |

**Valuation Metrics**
(@7/27/23):

| | CCO | S&P 500 |
|---|---|---|
| P/E (TTM) | n/a | 21.5 |
| Forward P/E (Est.) | n/a | 17.6 |

**Largest Institutional Owners**
(@3/31/23 or latest filing):

| Company | % Owned |
|---|---|
| PIMCO | 21.7% |
| Ares Management | 11.6% |
| Vanguard Group | 9.1% |
| BlackRock | 5.7% |
| Legion Partners | 5.1% |

**Short Interest** (as of 7/15/23):

| | |
|---|---|
| Shares Short/Float | 9.1% |

**CCO PRICE HISTORY**


**THE BOTTOM LINE**

The company's regard by the market would significantly improve if it streamlined operations in order to focus on its transforming U.S. business and used the asset-sale proceeds from that effort to pay down its problematic level of debt, says Sagar Gupta. On his 2024 estimates he values the shares on a sum-of-the-parts basis at around $3.50.

Sources: Company reports, other publicly available information

in total revenue. The company's balance sheet is also extremely highly leveraged – no debt is due until 2025, but current net debt to EBITDA is around 9x, which is not fun territory.

**What are the key elements of your activist engagement here?**

**SG:** The company has a sizable presence in Europe and a subscale operation in Latin America, and we believe it ultimately should focus exclusively on the U.S. They've made steps in that direction but the only sales announced so far have been of the lower quality and less digitized businesses in southern Europe.

We've had a number of discussions with industry executives and other experts and believe there's significant demand for the non-U.S. assets, which we've conveyed directly to management and the board. Sale proceeds for those assets would go a long way to addressing the leverage situation, and we'd expect that plus the pure-play focus on the U.S. to result in a material re-valuation of the stock.

**What do you think the shares, now at $1.60, might be more reasonably worth?**

**SG:** On our 2024 adjusted EBITDA estimates – which are in line with the low end of management's current guidance – if we apply an 11.5x EV/EBITDA multiple to the U.S. business, a 7.5x multiple to the Europe and LatAm businesses, and net out the value of corporate overhead and debt, we arrive at a sum-of-the-parts value of just over $3.50 per share.

That's unlikely to happen without the company reducing debt and simplifying its corporate structure. But if it does that, there's plenty of upside from there as the digital rollout continues. As one additional data point on valuation, Blackstone last month announced it had a acquired a majority stake in New York City-based outdoor advertising firm New Tradition Media at what we believe was 18x EBITDA.

**If you're wrong here, why do you think that would be?**

**SG:** There is clearly a macro element to the business and a severe recession causing a sharp downturn in advertising spending would be problematic. We're highly confident this would be survivable, but that would likely push the thesis out.

**Would you argue that there's a particular case for activist investing in today's market environment?**

**CK:** We don't think people invest with us just because we're activists, but because they believe we're good at identifying mispriced stocks that are going to go up. There should always be demand for that regardless of the market.

I would say, though, that if the environment has in a more fundamental way changed from one that just rips higher every day, that should benefit an active approach focused on identifying undervalued securities and pursuing a specific agenda to make them more valuable. If we do that well our success should be much less reliant on favorable economic or market tailwinds than is the case for more passive strategies.

One issue for active equity managers has been the massive flow of money from institutional investors into traditional private equity. I think there's a good chance that ends up being money chasing yesterday's returns, at a time when returns in a higher interest rate environment won't be as attractive. If that turns out to be so, we'll hopefully see some of those funds flow back to active public equity.

**TW:** While ESG has its detractors, we continue to see increasing interest by investors in the G aspect of that as well. So much money is managed passively that we'd argue that poor governance is as prevalent as it's ever been – particularly among the smaller market cap companies we target. We think that presents incremental investment opportunity for shareholders like us who actively hold management and boards accountable and try to make sure they're thinking and acting like owners.

**Any parting advice for company management when an activist like Legion comes calling?**

**CK:** We want nothing more than a productive relationship with every management team we work with. We've worked very hard to build a reputation for the quality and depth of our research and analysis, so we hope at the very least to get a full hearing when we engage with a company. Most companies, even big ones, are receptive to that and recognize the importance of input from their shareholders. If they don't and just want these darn activists to leave them alone, the way to do that is pretty straightforward: get your stock price up. VII

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The Composite performance data referenced in the article is from 8/22/11 inception date through 6/30/2023 and includes: Completed Co-Investment Projects: 1) Co-investment** project in CRI (8/22/11 - 4/16/12) - prior to the actual formation of Legion Partners Asset Management in April 2012, the Legion Principals identified the investment opportunity, developed the strategy and assisted the client with the engagement on this investment, but the client had discretion over the assets, allowing the client to handle the trading on their own desk and to have a say in determining the timing of both purchasing and selling the investment; 2) Co-investment** project in TKR (6/5/12 - 5/17/13) - Legion Partners identified the investment opportunity, developed the strategy and led the engagement on this investment, but the client had discretion over the assets, allowing the client to handle the trading on their own desk and to have a say in determining the timing of both purchasing and selling the investment; 3) Co-investment** project in RCMT (11/1/11 - 11/14/17) - prior to the actual formation of Legion Partners Asset Management in April 2012, the Legion Principals identified the investment opportunity, developed the strategy, led the engagement, won the proxy contest and had discretion over the assets; 4) Legion Partners Special Opportunities, L.P. IV which was launched 6/1/16 and exited 10/18/17; 5) Legion Partners Special Opportunities, L.P. VI which was launched 6/7/17 and exited 11/29/17; 6) Legion Partners Special Opportunities, L.P. III which was launched 4/5/16 and exited 12/31/17; 7) Legion Partners Special Opportunities, L.P. V which was launched 1/30/17 and exited 5/22/18; 8) Legion Partners Special Opportunities, L.P. VII which was launched 7/31/17 and exited 9/7/18; 9) Legion Partners Special Opportunities, L.P. X which was launched 6/11/18 and exited 12/21/18; 10) Legion Partners Special Opportunities, L.P. VIII which was launched 12/13/17 and exited 1/18/19; 11) Legion Partners Special Opportunities, L.P. IX which was launched 4/23/18 and exited 1/14/20; 12) Legion Partners Special Opportunities, L.P. XII which was launched 3/19/19 and exited 12/31/20; 13) Legion Partners Special Opportunities, L.P. II which was launched 12/14/15 and exited 4/21/21; 14) Legion Partners Special Opportunities, L.P. XV which was launched 10/26/20 and exited 2/23/22; and 15) Legion Partners Special Opportunities, L.P. XVII which was launched 7/1/21 and exited 5/31/23; and Ongoing Co-Investment Projects: 1) Legion Partners Special Opportunities, L.P. I which was launched 7/1/14 (6 co-investment projects to-date of which all six are exited as of 10/18/19, but kept open for the next project); 2) Legion Partners Special Opportunities, L.P. XI which was launched 2/07/19; 3) Legion Partners Special Opportunities, L.P. XIV which was launched 10/26/20; 4) Legion Partners Offshore I SP I which was launched 1/1/2021; 5) Legion Partners Special Opportunities, L.P. XVI which was launched 4/29/21; and 6) Legion Partners Special Opportunities, L.P. XVIII which was launched 11/10/21; and Legion Partners Commingled Funds: 1) Legion Partners, L.P. I (CalSTRS fund-of-one) which was launched 1/2/14 and 2) Legion Partners, L.P. II (commingled fund) which was launched 8/1/14. Comparison of Legion's Composite performance or the performance of any of Legion's individual Vehicles to a market index may be inappropriate because, among other things, the respective Legion Vehicle is not as diversified as a market index. Each market index assumes all dividends are reinvested back into its index. Market index returns are from the first co-investment's inception date 8/22/11. Market index information was compiled from sources that Legion Partners believe are reliable. However, Legion Partners makes no representation or guarantees about the accuracy and completeness of such information. Unlike the Composite, which is actively managed, draws down and returns capital over time and may maintain a cash position, an index is unmanaged and fully invested. The comparison of the Composite's performance to these indices may be inappropriate because the Composite may be more or less volatile than these indices. Russell 2000. The Russell 2000 is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index (3,000 publicly held US companies representing approximately 98% of the investable US stock market) representing about 10% of the total market capitalization of that index.

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* Note these co-investments may depart from the industry standard definition of a co-investment project