

# IDIOSYNCRATIC RISK

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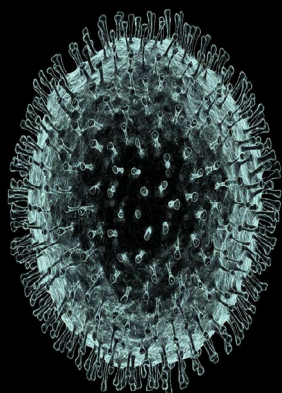
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Idiosyncratic Risk is a monthly investment ideas newsletter written by Eric S. Jensen, Jr., CFA, and published by Antrim Investment Research, LLC.



*Sick of this picture yet?*

## A LETTER FROM THE EDITOR

These pages represent the first issue of the first volume of a monthly investment ideas newsletter I plan to write and distribute to subscribers. Since some of you may be wondering why, or indeed – how – it arrived in your inbox, I felt it would be appropriate to devote some space in this issue to my background and experience as well as my goals and investment philosophy, that you might better be able to determine whether or not you will find my content useful to your investment process.

I am a CFA charter-holder and value investor with nearly 11 years of buy-side institutional money management experience. After graduating from UVA in 2008, I spent the next 9 years working as a research analyst for an institutional investment management firm in Richmond, VA, managing over \$20B at peak in client assets primarily in long only equity strategies. I spent most of my time as an analyst for the firm's Mid-Cap Value equity strategy, but also worked closely with the portfolio managers of their long/short funds on short idea generation. Following that experience, I spent the majority of the next two years as an Investment Manager for a multi-billion-dollar single family office in Richmond, evaluating a stable of existing alternative investment manager relationships and working as a portfolio manager for a \$100M pool of internally managed capital earmarked for equity investments.

At present, I have decided to embark on an entrepreneurial journey of my own.

In these pages I hope to offer specific, actionable investment ideas with an absolute return focus, both on the long and the short side. To that end, I focus on equities I believe to be under (or over-valued), special situations that lead to exploitable market inefficiencies, and attempt to identify specific catalysts for a security's appreciation (or depreciation, as the case may be). I only recommend ideas in which Antrim is also invested, or in which Antrim also plans to invest. My hope is that my focus on special situations and short ideas in addition to run of the mill buy recommendations will set my work apart from

the research that floods your inbox daily and add value to your research process. And in addition, I hope to be able to show my readers a verifiable track record of success by putting my own money where my Word cursor goes, and by offering transparent performance data for each of the ideas discussed in this letter as the future unfolds.

At this time, I am distributing copies of **Idiosyncratic Risk** free of charge, and encouraging readers who find it useful to forward it to anyone they believe may also have an interest, but I will add the caveat that in the future I plan to charge a small annual subscription fee to those who wish to continue receiving the letter monthly. In addition, I am currently working towards filing for the necessary regulatory approval to turn Antrim Investment Research into a Registered Investment Adviser, at which point I plan to offer ongoing institutional quality equity coverage of the investment ideas found in these pages, all of which are held in Antrim's own portfolio, to those investors willing to pay a higher rate for a more comprehensive suite of research services.

In any case, given the volatility, and therefore, the opportunity present in today's market environment, I decided it was time to begin publishing **Idiosyncratic Risk**, which I hope to distribute on the first of every month going forward. Please just let me know if you'd not like to receive it ever again.

**I hope this finds you and your portfolios well,**

- Eric S. Jensen, Jr., CFA



## ON THE DIFFERENCE BETWEEN RISK AND VOLATILITY

### OR HOW I LEARNED TO STOP WORRYING AND HOLD DESPEGAR

With the inaugural issue of **Idiosyncratic Risk**, I made the decision to interrupt your regularly scheduled Covid-19 programming in order to talk about something completely unrelated – the travel industry in South America. All kidding aside, as a DESP shareholder and type-1 diabetic, I am an extremely interested observer of the unfolding global pandemic and I have done everything I can to educate myself about the virus, the appropriate individual preventative measures that I should take, and the actual global response that we've observed, but I would suggest that my readers should not seek that information in this newsletter, but rather from more qualified sources.

In truth, the travel industry and travel industry related stocks have been absolutely battered by the real world impact of the novel coronavirus pandemic AND the market sentiment surrounding it. As I write this article DESP is trading down nearly 60% from its mid-February intraday peak, and by the time I am able to distribute the letter it may well be lower (or higher, who can say?). If it seems an odd choice for a newsletter entitled **Idiosyncratic Risk** to dedicate its first issue to the discussion of a stock that is 100% correlated in the near term to the super-salient issue driving negative market sentiment during the 2020 bear market, it is. But it's only because DESP and my DESP positioning well illustrate another topic near and dear to my heart, which is the difference between volatility and risk for the well capitalized long-term investor.

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*In the absence of financial leverage, the volatility of a security is not equivalent to the risk of its permanent capital impairment.*

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Despite that it's been written before and proselytized by value investors of much greater stature and success than your humble author, I am about to offer the same investment principle three times, in three different ways. In the absence of financial leverage, the volatility of a security is not equivalent to the risk of its permanent capital impairment. Or, for investors with ample liquidity and a sufficiently long term horizon, temporary market price fluctuations are irrelevant. Or (for those who prefer simple common sense), all else equal, an investment for sale at a reduced price can't possibly be worse than a security offered for sale at full freight. The trick of course, is maintaining ample liquidity, a long term horizon and philosophy, and actually doing enough diligence to determine that all else is, actually, equal.

## DESPEGAR FINANCIALS

### Market Capitalization

Price:	\$5.67
Shares Outstanding:	69.2M
Market Capitalization:	\$392.5M
Net Debt (Cash):	(\$221M)
Enterprise Value:	\$171.6M

### Revenue Breakdown

Brazil:	39%
Argentina:	20%
Mexico:	15%
(Pre- Best Day Acquisition)	
Rest of LatAm:	26%

### 2019 Bookings Growth

F/X Neutral:	+23%
As Reported:	+ 6%

### 2019 Revenue Growth

F/X Neutral:	+19%
As Reported:	- 1%

### 2019 Income Statement

Revenue:	\$524.9M
Gross Profit:	\$345.3M
Margin %	65.8%
EBIT:	(\$ 8.9M)
Margin %	-1.7%
Net Income:	(\$ 20.9M)
EPS:	(\$0.30)
Operating Cash Flow:	\$51.1M
Free Cash Flow:	\$14.5M

The principle applies to businesses as it does to investors. Temporary demand and supply shocks can be weathered by well capitalized businesses with low physical and working capital needs. Operational leverage cannot, however, be tolerated by heavily indebted businesses with intense capital requirements. Which brings us, in roundabout fashion, back to the topic of this article: Despegar.com (NYSE:DESP), which is the leading online travel agency in South America.

Those investors unfamiliar with Despegar are likely more familiar with its U.S. counterpart and 14% minority owner, Expedia (Nasdaq:EXPE). While there are minor differences due to the peculiarities of the South American end markets that DESP operates in, for the intents and purposes of this article, the two business models are identical. Despegar.com sells hotels, flights, ancillary services, and complete travel packages to its customers online and through the use of a mobile app. In normal times, a successful online travel agency is one of the best businesses in the world, for two primary reasons. First, the business is internet based, which means it requires virtually no fixed capital investment and operates with economies of scale. There is no bricks-and-mortar infrastructure to build or maintain, and the “agency” model means that DESP takes its fees on a transaction basis. They do not take on “inventory” (generally speaking, that is – in a small number of markets DESP knows well they DO take inventory risk) that needs to be sold, and they need not worry about the occupancy rates of the hotels for which they sell reservations. Second, DESP operates with negative working capital when revenue growth is in positive territory. That is to say, when a customer books a hotel room on Despegar.com, they pay Despegar in full for the room. The hotel receives payment from Despegar over a month after the customer has actually stayed in the hotel. This means that as Despegar’s transaction numbers grow, they can finance investment in their business with their customers’ own cash, and they have little need to ever approach the capital markets for capital (growth or otherwise). This need is even further reduced by the presence of \$221M in cash on the company’s balance sheet (pro forma for the 2020 up front payment associated with the acquisition of Mexico’s leading travel agency, Best Day, announced this January)<sup>1</sup>.

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*We have a business with ample liquidity, near zero capital requirements, financing its own growth and taking market share in a fragmented growth industry trading over 80% below its all time highs.*

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And Despegar does have a long runway for future growth. Euromonitor estimates that the \$116B LatAm travel market is growing at 6% annually, and online bookings at 9%<sup>2</sup>. These trends are supported by demographic trends typical to emerging markets. Disposable incomes are growing (over the long term) faster than in developed countries. Mobile penetration is increasing from the currently low rate of 62%. Credit card ownership is growing from a low current ratio of 54%. To further illustrate the underserved and undersaturated nature of the travel market in Latin America, I’ve turned to Copa Airlines, who serves South and Central America through their dominant position in their Panama City hub, positioned to connect airline passengers travelling between North and South America. Their 2019 investor day presentation states, “81% of the markets we serve have less than 20 passengers per day each way.”<sup>3</sup> It does not appear controversial to me to assume that as South American economies modernize and the middle class emerges, so to speak, travel demand will outpace the growth we see in developed markets like the United States.

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<sup>1</sup> Source: Despegar to Acquire Best Day Travel Group presentation, January 27<sup>th</sup>, 2020

<sup>2</sup> Source: Despegar investor day presentation, December 10<sup>th</sup>, 2019

<sup>3</sup> Source: Copa Airlines investor day presentation, December 3<sup>rd</sup>, 2019

The astute investor will no doubt wonder at this point, “what’s the catch?” We have a business with ample liquidity, near zero capital requirements, financing its own growth and taking market share in a fragmented growth industry trading over 80% below its all time highs, and down 60% from its price from a mere two months ago.

The catch is simply that, at present, Despegar is neither growing (in its reporting currency, USD), nor is it profitable. There are three reasons for this, two of which are fairly easy to understand. First of all, travel demand in South and Latin America has been decimated over the past 5 years as economies in South and Latin America have fallen into various degrees of either recession or outright depression, and GDP growth has fallen in the region to a low of -0.7% in 2016, and remained low, reaching +0.2% in 2019. Second, DESP has **chosen** to invest in their business during and throughout this period of distress, in order to gain share in the region and cement their position as the leading travel agency (online or otherwise) in South America. They have continued to grow headcount and selling, general & administrative expenses in order to maintain their business, even as demand and revenue growth has fallen (in USD terms) from +27.4% in 2017 to -1.1% in 2019. In local currency, bookings and revenue have continued to grow, but the strength of the USD and the relative weakness of South American currencies has led to a reduction in translated profits and revenues as DESP is listed on the NYSE and reports results in U.S. Dollars. In addition, the company has maintained travel package pricing at a discount to its “fair value” given the currency movements, in some cases selling whole dollars for \$0.70 in order to cement their value proposition with loyal customers and drive smaller travel agencies out of business, and they have stepped up their efforts to use their own balance sheet to finance customer ticket purchases and hotel reservations. It is important to note, however, that these decisions are discretionary, and not permanent. It would be inappropriate to place a terminal value on Despegar’s discretionary investment losses, as the company has the freedom to reduce those activities at a moment’s notice, should their pristine balance sheet ever come under strain due to extraneous shocks like the Covid-19 pandemic and its associated travel restrictions.

The third reason for reduced earnings has to do with a peculiarity of the payments market in South America that will be unfamiliar to most U.S. based investors. In South America, many consumers are accustomed to making larger purchases (like vacation and travel arrangements) through the use of installment payments, paid to the merchant over a period of 3 to 6 months, as the case may be. Despegar, though they finance some of their customer purchases, is not a bank or financial institution, and normally seeks to factor their receivables, taking a reduced lump sum payment from a bank up front, which is based on the net present value of the expected future installments at the prevailing interest rate. In South America, and in Argentina specifically, where inflation has run wild and interest rates have risen into the mid teens or higher, these lump sum payments have been dramatically reduced all at once, leading to a reduction in reported earnings and cash flows. Despegar investors do need to note that we await a normalization of interest rates in LatAm, either from more conservative governments with more rational fiscal policies, or an eventual weakening of the dollar relative to global currencies as a result of the U.S. Federal Reserve Bank largesse, before things can, as they say, “get back to normal.”

So how to value a business with no earnings? I tend to default to a full DCF model based on what I deem to be reasonable assumptions about the next five years, and use a 15% discount rate to reflect conservatism, or rather to reflect my exacting demands as it pertains to expected absolute returns. But reasonable assumptions about the next five years are difficult to generate at the moment, so let’s use another heuristic and simply look at a couple of recent years that we might consider more “normal” for Despegar. In 2017 and 2018, the company generated over \$60M of net income, cumulatively, and over \$40M of operating cash flows. That implies that they were averaging, in an extremely weak South American economy,

\$0.43 in earnings per share, and \$0.29 per share of cash flow, three years ago. In 2017 alone, the company earned \$0.61 per share, and they've continued to grow revenue in local currency at a 20%+ annual growth rate. At a mere 15x that \$0.61 in normalized earnings, DESP would trade over \$9 per share, over 60% higher than its mark today. In truth, I believe DESP is worth quite a bit more, but the realities of our current global situation and its impact on the travel industry demand conservatism, and there are those who would argue vociferously that my analysis is not conservative enough.

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*Despegar offers investors who can withstand near term volatility the opportunity to purchase shares in one of the best businesses in the world.*

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While an in depth analysis of the state of South American fiscal policy, or even a detailed discussion of the merits of DESP's announced acquisition of Mexican travel agency "Best Day" is the subject of a different letter for a different day, I would summarize my findings thusly: Despegar offers investors who can withstand near term volatility the opportunity to purchase shares in one of the best businesses in the world, at an 80% discount to its all time highs. Despite that DESP is currently choosing to invest, and therefore lose, money, public investors get the chance to make what amounts to a late stage venture investment, in a firm that has already proven that it can and will be successful, and in a firm stamped with the imprimatur of 13% ownership by one of the world's premier late stage venture firms, Tiger Global (as a quick aside, I fully expect Tiger's holdings will have been dramatically reduced by the time they file their March 31, 2020 13-F, as they are not in the habit of holding public equities with falling prices). And for those who do not believe that late stage venture constitutes a "value" investment, I would suggest watching an episode of Shark Tank. You'll get to see a bit of made-for-TV theater, and then you'll note that these venture capitalists and angel investors spend over half the time they are allotted to speak arguing over, you guessed it, **valuation**.

In Antrim's portfolio, I am long DESP, though I have not yet been adding aggressively to my position during the pandemic-related selling, preferring simply to hold through the volatility. I have sold out of the money covered calls to generate income from the position, which I fully expect will never be exercised, and I am not concerned about Despegar's liquidity, despite the one time cash outlay for investor refunds which will likely result in the near collapse of DESP accounts payable of \$261M. With regard to their current liabilities, I retain some comfort in that DESP did include a "material adverse change" provision in their merger agreement with Best Day, which is subject to New York State law, and is therefore unlikely to go forward at the previously agreed upon price, if I were to hazard a wild guess.

## **PRICED FOR PERFECTION AND POISED TO DISAPPOINT**

### **KINSALE CAPITAL GROUP IS OUR APRIL SHORT IDEA FOCUS**

The great short seller James Chanos has remarked on record that he places the vast majority of his short ideas into six buckets: (1) Booms that go Bust, (2) Technological Obsolescence, (3) Consumer Fads, (4) Growth by Acquisition, (5) Accounting Games (Fraud), and (6) Silly Trades. Since our focus in this month's missive does not fit neatly into one of Jim's first five categories, I think it's worth a discussion of just what exactly is a "Silly Trade." For Jim, I assume it's risk arbitrage. There are occasional opportunities afforded the vigilant, professional investor to sell a security for more than it's worth and buy it for exactly what it's worth. And such trades, resulting from whatever technical market inefficiency led to their

existence, are ambrosia to active day traders and pros. What is NOT simply a “Silly Trade” is a silly price. David Einhorn of Greenlight Capital once wrote, “twice a silly valuation is not twice as silly,” and your author agrees.

In the case of a short sale, which is necessarily a leveraged trade since the shares you’ve sold are borrowed, it is not possible to simply ride out any and all volatility until you’re eventually proven right, as I’ve recommended with regard to Despegar. Catalysts do take on an increased importance. But it is also worth noting that in the present market environment, two negative catalysts have ensnared nearly every public equity. Chiefly, we have entered a bear market, at which time investors seeking liquidity will look to sell those assets which they can still sell at reasonable prices, regardless of their underlying quality, AND we are approaching a significant (though possibly brief, if I allow my optimism to show) recession with near certainty. In such an environment, highly valued growth equities levered to pro-cyclical end markets will have difficulty meeting lofty investor expectations at the same time that even long term believers may be forced to liquidate positions in their highly valued equities, whether it’s simply a matter of reducing gross exposure, or an actual margin call. With the market action of the past month, it is difficult to find such opportunities stubbornly levitating at elevated valuations, but I believe that property & casualty insurer Kinsale Capital Group (Nasdaq:KNSL) fits the bill.

To be clear, I believe that Kinsale is a high-quality specialty insurance business with a high-quality management team, operating in an attractive sub-segment of the insurance industry. What I do not believe, however, is that KNSL shares are worth nearly 6x book value, or that the company can maintain the growth rate in premiums written necessary to justify that valuation into the teeth of a deep recession directly affecting key end markets like construction, and key small business and contractor customers, without resorting to disastrously irresponsible underwriting.

With regard to the aforementioned “attractive sub-segment of the insurance industry,” I must note that Kinsale Capital is a pure play on “Excess and Surplus” insurance lines, which are viewed as sources of some of the most profitable underwriting in the property and casualty (“P&C”) insurance industry. The reasons for this are two-fold. First, excess and surplus lines are more often bespoke contracts as opposed to boilerplate property insurance policies. They are less regulated, and therefore, lend themselves to successful “claims management” strategies, which is to say – E&S underwriters can attempt to manage costs by litigating claims and shifting responsibility for payment onto the clients’ other insurers or back onto the clients themselves. Secondly, the market

## KINSALE CAPITAL FINANCIALS

### Market Capitalization

<b>Price:</b>	<b>\$104.53</b>
Shares Outstanding:	22.16M
<b>Market Capitalization:</b>	<b>\$2.32B</b>

Cash & Investments:	\$908.2M
Other Tangible Assets:	\$178.8M
Total Liabilities:	\$ 684M

<b>Book Value:</b>	<b>\$ 406M</b>
<b>Book Value per Share:</b>	<b>\$ 18.32</b>
<b>Price to Book:</b>	<b>5.7x</b>

<b>Tangible Book Value:</b>	<b>\$ 403M</b>
<b>Tangible BV / Share:</b>	<b>\$ 18.19</b>
<b>Price to TBV:</b>	<b>5.75x</b>

<b>Trailing ROE:</b>	<b>15.6%</b>
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### Revenue Breakdown

Excess & Surplus:	100%
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### By End Market

Construction:	18%
Other Commercial:	17%
Small Business:	16%
Excess Casualty:	13%
Commercial Property:	8%
Products Liability:	7%
General Casualty:	6%
Allied Health:	6%
Professional Liability:	5%
Personal Insurance:	4%

for E&S insurance has struggled to fill the void left by AIG as they have reduced exposure to long-tailed liabilities including Excess & Surplus insurance lines. With less competition comes higher pricing, and KNSL has exploited the hardening market by pricing profitably (they hope) but aggressively, in order to grow and gain share. At present KNSL has around 1% market share in this segment, so if you believe, as the bulls do, that they do have a better mousetrap, better underwriting, and better claims management than all of their peers, they may indeed grow these lines profitably for some time. For comparison's sake, public P&C peers, and even those heavily exposed to excess & surplus lines, still generate at minimum 43% of their premiums from more boilerplate property and casualty insurance contracts that are at once more commoditized than E&S lines, and also less flexible with regard to regulatory oversight and claims management.

Growth in premiums has been impressive: +18.4%, +23.4%, and +41.5% in 2017, 2018, and 2019 respectively. The problem, as your author sees it, is that while Kinsale has positioned themselves squarely in the best segment of the P&C insurance industry, and a high quality management team has built a software and personnel infrastructure from scratch to underwrite excess and surplus lines for small businesses and manage the associated claims, they are still **“just”** an insurance company. None of these attractive characteristics support the market's boundless optimism or the valuation of the shares. Over time growth will slow, claims **will** be paid, politicians will philander, you, too, will get old, and KNSL's valuation simply must return to reality.

To add difficulty to an already dangerous high-wire act, Kinsale finds themselves directly exposed to end markets that will be hit extraordinarily hard (OK – maybe not travel industry bad, but bad) by the Covid-19 quarantine and likely future (current?) U.S. recession. While Kinsale's March Investor Presentation states that 18% of written premiums come from the company's “Construction” division<sup>4</sup>, their 10-k tells a different story. I quote, “Construction underwrites general liability coverage on contractors,” while “Small business underwrites commercial general liability on smaller risks with an emphasis on artisan contractors,” and “Excess casualty underwrites excess liability over risks that would fit within the general liability, construction ... and small business lines above.” Adding these three company divisions together, I see a portfolio with 47%+ exposure to commercial construction and small general contractors. In a world where retailers and restaurants are closing their doors as fast as they can and retail bankruptcies seem inevitable, I find it hard to believe that we will see commercial occupancy rates at levels that can continue to support the ongoing commercial construction boom, even with a perpetual zero interest rate policy. In that world, fewer projects are initiated, fewer general contractors exist, and fewer policies are written. In the world as your author sees it, 40%+ growth in gross premiums written is a thing of the past.

Without 40% growth, there is no shortage of “capacity” in the E&S insurance industry, and there is no affirmative catalyst left to justify KNSL's valuation at 5.7x book. Rather, investors simply await claims on the policies that KNSL has already written with bated breath, seeking to determine if KNSL's underwriting and claims management really do support their reserve estimates and mid-teens reported ROE, or if, maybe, KNSL sees the same difficulties with claims management their peers have seen and has to start increasing reserves – further reducing book value growth.

And peers have indeed noted problems managing claims. “Over the course of the past year, our results were also impacted by headwinds from a challenging tort environment ... we continue to believe that social inflation is an environmental issue,” states Alan Schnitzer, Chairman & CEO of Travelers' Companies<sup>5</sup>. A blog post on the Acadia Insurance website laments four major factors driving increased claims costs: “litigation funding, the erosion of tort reform, negative public sentiment

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<sup>4</sup> Source: Kinsale March Investor Presentation, March 19<sup>th</sup>, 2020

<sup>5</sup> Q4 conference call, January 23<sup>rd</sup>, 2020



toward larger businesses and corporations, and desensitization to large jury awards.”<sup>6</sup> It would be foolhardy to assume that KNSL is somehow immune.

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*“We continue to believe that social inflation is an environmental issue.”*

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To make matters worse, and in a sure sign that Kinsale’s growth and profitability has peaked for the more superstitious amongst you, they’ve spent \$5.6M on a tract of land on which they plan to start construction this April of a 150,000 square foot, five story corporate headquarters that will cost the company approximately \$50M (12.5% of Book Value!) to complete. If a recession holds any silver linings for Kinsale, it might be only that this capital could be preserved a while longer yet.

## **SPECIAL SITUATIONS WATCH – (“DON’T BUY!”, YET, MAYBE, NEVER):**

### **HOME DEPOT SUPPLY HOLDINGS PLANS TO SPIN OFF ITS FACILITIES MAINTENANCE UNIT**

Home Depot Supply (Nasdaq:HDS) is one of the largest industrial distributors in North America. The company specializes in the distribution of industrial products for maintenance, repair & operations (“MRO”), and specialty products for construction end markets. They have long reported results in two segments, “Facilities Maintenance,” which sells MRO products for living facilities like apartment buildings, nursing homes, commercial offices, and hospitality customers (hotels), and “Construction & Industrial,” which is more levered to activity within the pro-cyclical end markets that its name would suggest. Traditionally, Facilities Maintenance has been considered the crown jewel of the HDS portfolio, given sticky customer relationships and inelastic demand, which have led to virtually inexorable low-to-mid single digit revenue growth, and EBITDA margins in excess of 17%. Construction & Industrial, however, have EBITDA margins of just over 10%, and a more cyclical revenue growth pattern (though the commercial construction boom over the past decade has helped).

Last September, HDS announced that they planned to complete a tax-free distribution of its C&I segment, White Cap Construction Supply, making HDS holdings a pure-play on its relatively safe, high margin, somewhat-above-average growth Facilities Maintenance business (though the deal timing is unclear as a result of the Covid-19 pandemic and its impact on the financial markets). Normally a business with a high single digit FCF yield on total enterprise value, low single digit growth, 2.4x leverage, and exposure to pro-cyclical end markets at the beginning of a recession would not appeal to me, and in fact, I do not own HDS. But, for a whole host of reasons that will reappear in this newsletter over time, spin-offs are statistically attractive to equity investors. Often, a capital light business trapped inside a capital intensive parent will have over-invested in facilities and capacity which they can harvest as a standalone public company. Sometimes two disparate business units that are valued differently by the marketplace can shrug off their “conglomerate discount” and experience simultaneous multiple expansion. So what is going on at HDS?

None of the above. In your author’s opinion, HDS Facilities Maintenance and White Cap Construction Supply are similar enough businesses, covered by the same analysts, and valued the same way versus the same comps, that the only “benefit” HDS shareholders can expect is dis-synergy and increased public company costs. In my opinion, HDS management simply wants to rid itself of its cyclical, low-margin construction business at a cycle high. The reason I think HDS is worth watching, though, is because I think HDS shareholders are of a similar mind. I expect White Cap to trade at a lower market cap than HDS Facilities Maintenance which will likely lead to forced selling of the distribution in mid and large cap funds that do not

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<sup>6</sup> Source: <https://www.acadiainsurance.com/social-inflation-a-concerning-and-costly-trend/>

extend into smaller cap names. I foresee most HDS shareholders liquidating their White Cap positions anyway regardless, and I am curious if White Cap might actually trade at such a bargain valuation that it would be worth buying even during a recession. For those curious enough to do more work – my starting point is roughly \$320M in trailing FCF for Facilities Maintenance and \$218M for White Cap, pro-forma for the aforementioned dis-synergies. I expect HDS to saddle each segment with around \$1B in debt, and I would be more interested in Facilities Maintenance at a market cap around \$2.2B, or White Cap around \$6-800M. My astute readers will note that my combined valuation represents at least 35% downside to today's price, but that's only where I'd consider buying either piece of this deal, not necessarily where I forecast they'll go. And as with everything else occurring today, it is unclear what impact that social distancing and suppression will have on either of HDS's segments. Normally sheltered from cyclical headwinds, Facilities Maintenance still has 20% of revenue tied to the shuttered hospitality industry, and as far as White Cap is concerned, this letter has already established Antrim is not bullish on construction.

**PLEASE EXPECT AN UPDATE ON ANTRIM'S OVERALL PORTFOLIO PERFORMANCE AND POSITIONING IN NEXT MONTH'S LETTER...**



Remember Me?

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## DISCLOSURES

Antrim Investment Research is long shares of DESP, and short covered calls associated with the position. Antrim is short shares of KNLS. Antrim has no position in HDS or any related derivative instrument. Neither does Antrim nor do I, personally, have any business relationship with any company mentioned in this newsletter.

## AND IF I MIGHT BE PRECOCIOUS ENOUGH TO THANK YOU FOR YOUR SUPPORT...

If you are receiving this inaugural edition of *Idiosyncratic Risk* then you are a friend of Antrim Investment Research (in my eyes anyway – I did say I was an optimist), and if you’ve come to it by other means and gotten this far, then I hope you will be a friend of Antrim Investment Research.

I sincerely appreciate the friendship, support, mentorship, and camaraderie I’ve experienced during my career in Investment Management and I would like to thank my friends and readers for supporting me, whether that means forwarding this email and my contact information along in your network, or merely reading these pages and considering what I have to say.

Feel free to reach out with questions, criticisms, suggestions, and investment ideas if you’ve got any good ones.

