

Finished on September 12, 2024

“Writing is easy. All you have to do is cross out the wrong words.”

- Mark Twain

It is important for me to align with my clients on investments and stay committed to value investing principles. I hope it helps you decide whether to stay longer or bail out. I plan to sit tight with our largest investments and I'll give reasons for that in this letter.

Call to Action, Please Read

- It is a good time now to decide if you're sticking with your account for the long term or bailing out soon from Three Main Points management.
- If you are leaning towards staying for the long term please keep on reading.
- If you're leaning towards bailing out it is best to let me know now via email so that I stop adding contrarian investments to your account.

Chegg stake to increase substantially

Because I believe in the severe undervaluation of Chegg, I plan to increase our holdings of Chegg from ~5% to 10-15% of total portfolio size. Someone surely will think I'm a lunatic.

Chegg trades at 0.4x EV/last 12 months revenue, \$60 per subscriber, 2.5x - 4x cheaper than its all time low of 2016. I don't believe AI is going to replace more than 50% of Chegg revenues in the next 5 years, thus leaving ample cash flows that could break even on Chegg in case of acquisition by a private party, thus making Chegg a safe investment.

Please get back to me if you disagree or would like to provide insight on AI.

Context

Post-pandemic turned some hypergrower companies into pumpkins with shrinking revenues. For example, Zoom in a matter of 2 years captured nearly all of its addressable market.

- Zoom revenue increased 7x in 2 years from Jan 2020 to Jan 2022 (4.1 bil).
- Stock price went from \$62 at IPO to \$559 on October 20 to \$55 as of mid August 24.
- Its revenue growth is now at 2% YoY clip, in line with US GDP growth.

I believe our key holdings such as Vimeo (VMEQ), Chegg (CHGG) and to an extent Block (SQ, aka Square) also suffer from that pumpkin image right now.

In the case of Chegg there is also big fear that AI development will destroy its business model. Just like NVIDIA is richly valued right now, Chegg is on the opposite side - extremely cheaply valued. Both valuations could have its merits but I see a lot of value in Chegg.

CHEGG valuation

Disclaimer: a person whom I trust very much and who is a proven world leading expert on GenAI told me that it is very likely that GenAI will capture Chegg's offerings within 2-4 years from now (please correct if I'm wrong). Yet, Chegg still offers a lot of value because GenAI companies need a consumer facing product and marketing in place to sell to those prospective students. Chegg offers just that with their strong ability to market to students. That same person said that 200mil appears cheap and Chegg could be a target of acquisition when GenAI infrastructure catches up to capture this market. For that to occur though, we'd need the head of US FTC to change due to the amount of impediments FTC created to recent acquisitions. Nevertheless, I still want to offer you my own opinion below.

Three main points on Chegg

- Double whammy from
 - Post pandemic revenue shrinkage due to return to campus.
 - GenAI onslaught *eating some but not entire* revenue.
- Cash and investments outweigh its debt burden so bankruptcy is unlikely. To generate more cash Chegg cut 23% of staff to cut pandemic swollen costs.
- Management keeps reiterating the 2025 target of \$100 mil in free cash flow. We could be buying the company at 2.6x of 2025 free cash flow. That's pretty cheap!

It seems Mr. Market has written off Chegg as a casualty of the genAI. A closer look at the numbers suggests that this conclusion might be a bit hasty. Take LivePerson, a company that's been in the AI bot conversation space for three decades. Let's compare their revenue growth over a few key periods. We will be slightly forward looking into Q3 2024, since both companies provided Q3 2024 revenue guidance at this point.

Time periods	Liveperson, revenue	Chegg, revenue
5 year: Q3'19 revenue to Q3'24 midpoint guidance	down 5%	up 42%
Pre-covid (Q3'19) to best covid quarter	up 67%	up 64%
Pre-chat GPT (Q3'22) to Q3'24	down 45%	down 19%

From this table it is obvious that in the GenAI vs Liveperson match up, GenAI has already eaten away from Liveperson the entire pandemic revenue bump and then some.

GenAI vs Chegg match up is different. It reminds me of the Ali vs Foreman [boxing match](#). Throughout the match Ali was taking in heavy punches yet still standing strong. Ali persevered and triumphed. In GenAI vs Chegg the crowd cheers for GenAI and strongly believes that Chegg is nearly done. Yet, the company takes moderate revenue hits and keeps targeting 100 mil in free cash flow for 2025. Even if revenue of Chegg would revert back all the way back to 2019 we would still own a good deal as if Chegg would trade with PE of 12.

What about Chegg valuation?

On top of pandemic high, Mr. Market wanted to pay \$3400 per subscriber or 23 times revenue for the company and now it is only given 0.4x times revenue for the company and \$60 per subscriber. Mr. Market wide fluctuations made Chegg 60 times cheaper from its top to the current bottom. Chegg now is even 2x-3.5x cheaper than at its lowest 2016 point when it was starting to transition from textbook rentals to student services.

	EV	TTM revenue	EV to revenue	EV to subscribers	Revenue, YoY change	Subs, mil
Early 2016	220 mil	283 mil	0.8x	\$220	-20%	1
Q4 2019 pre-pandemic	4.7 bil	411 mil	11x	\$1880	32%	2.5
Q4 2020 pandemic	15 bil	644 mil	23x	\$3400	74%	4.4
Q2 2024	260 mil	683 mil	0.4x	\$60	-11%	4.4

To conclude on Chegg

I might be wrong on this one, but it appears to me that Mr. Market decided that Chegg is a dinosaur. It very well could be. Yet it still has a few years to live and produce cash. In light of long term AI development, Chegg situation appears to me like shorting brick and mortar retailers in 2000 in light of the Amazon and Webvan, i.e. bit too premature. I'm not an AI expert, but I do believe that if AI was capable of replacing Chegg **NOW**, its revenues would collapse at a much faster clip, like Liveperson. Problem with Chegg is timing. It might take a while until revenue flatlines and starts growing again. Until then it will be in a world of pain. If flatlining happens we will see a rosier picture, just like one painted by VIMEO recently.

I'm prepared to sit tight.

Should Mr. Market go back to its conservative 2016 valuation we should get a 2x-3x boost from current prices on Chegg.

Action items for you dear reader

I plan to 2x-3x our existing investment in Chegg.

- Let me know if you disagree asap.
- Do you have some AI insights that otherwise would tell me to short Chegg?

Why I am excited about our investment holdings

“It never was my thinking that made the big money for me.
It always was my sitting. Got that? My sitting tight!”
Edwin Lefèvre, Reminiscences of a Stock Operator

Through our share ownership we are really holding on to small pieces of real companies.
It is worth examining what those companies are doing and what we are paying for it.

VMEQ, SQ, MOMO and OPRA represent more than 50% of our holdings. I like the direction the majority of our holdings are taking right now. Hence it is important to keep sitting tight.

All of these companies are moving in the right direction.

Vimeo (VMEQ) is growing enterprise revenue while stabilizing self-serve revenue, all the while proving it is a truly (GAAP) profitable company. Once post-pandemic revenue shrinkage subsides, VMEQ will likely become a growth company again and Mr. Market will reprice it.

Block (SQ) is founder led, went for drastic prioritization and cost cutting. With Dorsey's focus on Adjusted Rule of 40, Block is on track to deliver nice Opex efficiency improvements that will lead to healthy revenue and income growth. Usually it leads to Mr. Market repricing.

Hello group (MOMO) keeps on making sound capital allocation decisions while growing overseas business, maintaining a MOMO cash cow and turning around TanTan.
At current stock price MOMO, returned 18% in a form of cash dividend and stock buybacks.

OPRA keeps growing revenue at ~17% clip, keeping operating expenses in check with marketing dollars focused on high ARPU users. This all leads to a return on equity of 22%, a very healthy metric and Opex efficiency a bit below SQ.

	ev / recurring gross profit	Opex efficiency	net income yield (net income / EV)
VMEQ	1.6x	3%	6%
OPRA	3x	14%	8%
MOMO	0.8x	n/a	40%
SQ	4.4x	20%	2%

Few more details on Vimeo, Opera and Momo

VIMEO appears to be getting above its rock bottom and has positive revenue trends.

- Had a second consecutive quarter with modest revenue growth.
- Company started buying back its shares at what I consider low prices.
- On track to flatline annual revenue and hopefully resume growth in 2025.

VIMEO is a conservatively priced company with some safety in it. It is profitable with 2.5% yield on current market price or ~4% yield on enterprise value. Not cheap on this metric, but in line with long term US treasuries. Recently got a new CEO with fresh skin in the game.

In terms of valuation, as of today it trades at 11x EV / last twelve months operating cash flows, or 1.6x EV / recurring gross profit. While the company is not cheap on operating cash flows, it is fairly cheap on EV / recurring gross profit basis.

At its recent lowest ZOOM traded at 2.7x EV/recurring gross profit. Given that Zoom and Vimeo have similar opex efficiency (albeit Zoom being much larger company) it is fair to compare them in terms of Mr. Market valuation. If Mr. Market valued Vimeo just like Zoom, it'd be trading somewhere in \$8-\$10 per share. I believe (could be wrong on that) Vimeo would need to demonstrate further revenue growth around 5-10% YoY to get to that stock price.

OPRA fairly valued a good company with fair current price and fair opex efficiency. Please note that most of you hold OPRA at 1.5x - 3x cheaper than it currently trades. At present prices we're promised 5.5% annual dividend yield. Company revenue growth is 17% and is delivered in a capital efficient way with opex efficiency of 12-15%. Not as exciting as Magnificent 7 of course, but still reasonably good and at a much lower price point for us shareholders. I'd love to see that efficiency jump. Q3/Q4 might surprise us with such a jump as company management hints on new e-commerce integrations that could drive more revenue than they're forecasting.

By holding on to this stock we de facto hold an VC like option on:

- EU its Digital Markets Act ([link](#)) to open up closed garden platforms (iOS/Android), which in turn should theoretically make it easier to switch between browsers on device.
- AI integrations could unlock new revenue streams.
 - It is a matter of time before AI products will roll out sponsored links and recommendations. In general, chatGPT users volunteer a ton of data which will make product recommendations easier and timelier.
 - Right now Google pays Opera to be the default search engine. Eventually there will be a default AI extension too that wants to be featured and willing to pay.

MOMO is a great company at a terrific price in very suboptimal jurisdiction.

Looking at the company as a whole I think it is still largely misunderstood by Mr. Market that oftentimes looks at the revenue growth without even trying to understand how that topline growth is achieved. With MOMO, they really have three major app categories - Momo, TanTan and their international expansion apps. And within these apps they have value added services

(VAS) and streaming. VAS has high margins, streaming has low margins. Company has been deprecating low margin revenue and had its topline revenue collapse while its net income was going up until recently (and now going down a bit). Hence price to last 12 months earnings ratio is 6.

I believe this is the most Buffet-like investment in our portfolio:

- Business with a deep moat.
- With motivated management. (founder/CEO hold 25.5% together)
- Focus on delivering business results without trying to impress institutional investors.

I've been invested in MOMO for so long and I still believe in it. In fact my conviction has become stronger over time as I realized that it is unlikely to have fraud accounting due to dividends and realized how fractured MOMO's revenue stream is.

However I'm prepared to sit very patiently on this investment. Breaking down the value-added services business, a clear picture emerges - one apps revenue growth fast while two others are losing revenue. Should this trend continue, revenue will stabilize around 2026. Should one of the apps stabilize its revenue sooner than 2026, Mr. Market is likely to reprice MOMO sooner than 2026.

That's it, thanks for reading!
Boris.