# CHADD GARCIA ON BUSINESS BREW PODCAST

## JULY 21, 2022

**Bill Brewer:** I'm excited to be in person this time with Chadd Garcia. Thank you very much for the hospitality last night. I appreciate it.

**Chadd Garcia:** My pleasure.

**Bill:** Yeah, it was super fun.

**Chadd:** We owe a little bit thanks to Jerry Capp for providing us dinner. A nice steak restaurant.

**Bill:** That was fun, man. I enjoyed that steak a little. Peter Luger. And then what? We got to learn how the waiter was day trading, right? So that's always interesting.

**Chadd:** I'm just glad that he had his day trading account and his retirement account separated.

**Bill:** Yeah, I like how he was like I day trade on Robinhood and I have my retirement assets at Schwab. I thought that that was the appropriate way to do things. So, you know something that I truly enjoyed talking to you about investments and investing because you're one of those guys. That one I think enjoys teaching a lot and to selfishly, I learn a ton from. So, thank you. I was hoping if you could talk a little bit about HEICO and what got you like first interested in the company and if you could talk a little bit just about like building through acquisition and what you've seen from that entity and then maybe we can see where the conversation goes from there.

**Chadd:** Well, HEICO has a lot of lessons. I moved to Florida in oh six and I heard about the company because it's based here. But I never really spent too, too much time looking at it. When I moved to Florida, I wasn't in public markets, I was in private equity. And one of the law firms that I used on my deals was the outside counsel on HEICO's deals. And so, we had a little connection there. The law firm had an event that I was invited to in May of 2014, and Larry, the CEO of HEICO, was one of the panelists, and I got to hear the story from him on the panel and how he talked about taking the company over in 1992 and compounding earnings at a 20% CAGR (compound annual growth rate) since then and compounding the stock price, a 20% CAGR. And so not knowing too much about the business, I said, well, there's something here because this sounds pretty special. Yeah.

**Bill:** Not many businesses can do that.

**Chadd:** No, and then I did have the opportunity to meet Larry at the cocktail event afterward and talked about the challenges in this business. And the first thing that came up was the accounting, because one of the things that they do is when they buy a business, they'll buy perhaps 80% of it and let the management team roll 20% of it. And so, he was complaining that if the company does well, then they have to go and adjust their valuation of the earnout, which flows through and lowers their earnings, which sometimes their stock gets hit when that happens. But it's a good thing because it's performing, and it means they're going to pay the earnout. And if you're paying the earnout, then the business that you bought is doing better than you thought it would do when you bought it. So that's a good thing. And so, I was like, okay, there's going to be some interesting accounting here. And I went back to work the next week and started to look at it, and it was back in the days when the first thing I would do would be to start to put a model together. And, you know, I learned that this business is going to be very, very hard to model because when you model cash flows out on the business, your cash flows, it's driven by your assumptions on the income statement. But when you're acquiring assets, your income statement is going to go up, but you're paying for the working cap. And so, the working capital would get double counted in a lot of M&A models. And through the years of looking at the company, I think it's probably just easier to take a starting point of free cash flow for a share and then assume some growth rate over 15 years. And that's your assumption. And then you're probably better off just doing something simple like that and growing the cash flow at an assumed growth rate. Then you are just building a full model.

**Bill:** Yeah. So, if you were to do that, first of all, taking a step back for people that don't know HEICO does parts that go into airplanes that are not highly engineered. So, they can be sort of, I guess private label is the best way that I think about that. Is that a fair characterization?

**Chadd:** They can be reverse engineered so they can make the parts. And the secret sauce of HEICO is that every part of an airplane has to be approved by the FAA. And so, their value add is to be able to navigate that approval process. They can get about 500, 550 parts a year through that approval process, which is multiples of what their next largest competitors can do. And once they get that through, their competitor when they're selling to an airline, would be the manufacturers, the original equipment manufacturers. So, let's say GE makes a part for an airplane. GE has a monopoly on that part by virtue of the FAA approval process, until such time as a competitor gets a part through the process. And so, they ensure a position of that of a duopoly with the original equipment manufacturer, and they price their products about 30% lower than. The OEM and they'll capture about a third of the market, which is interesting because they use the OEMs size against them. GE is not going to slash the prices on their parts to get into a pricing war with HEICO, because if they do that, they're going to kill the margin on the 70% of the business that they have left. They're just going to let HEICO have that 30% and then they're going to continue to make high margins on the business that they have left. And so, I think that's a really interesting competitive advantage HEICO has.

**Bill:** Yeah, no, it's super interesting. And it's one of those or certainly appears to be one of those like win-win type relationships for HEICO and the end user. And meanwhile, the sort of incumbent that you're attacking just simply can't respond.

**Chadd:** Right. And, you know, they have a reasonable amount of organic growth because their organic growth is going to be determined by miles flown. And then they take their excess cash, and they buy up smaller businesses. So, let's say you worked at the oh, let's say you work at Honeywell or GE and you're an entrepreneurial person and you launch your own business and maybe you grew it to $50, 100 million of revenue. But that's maybe about as far as you can grow it on your own because you're selling to the deltas. The American Airlines of the world, they may not want to take the risk of a small business that doesn't have a balance sheet behind him or a history behind him. Tyco can come in, buy the business, pay a lower than market price for that business, but then give the credibility of their reputation to that business and then help the business grow by helping that entrepreneur navigate the FAA approval process and get more parts manufactured.

**Bill:** Yeah, it's like a true example of where the multiple arbitrage is warranted, correct? Yeah. So, when did you find HEICO? Like, what years are we talking about? Because now it's one of these compounders that has just grown to the moon, and everybody knows about it.

**Chadd:** You know? Like I said, I started looking at it in May of 2014. It was probably trading at a price I thought was rich at the time of maybe a five, five and a half percent free cash flow yield. It was about 3 billion market cap, which was about the size, the minimum size that the shop I was at would invest in just given our position sizes. However, I was discouraged from doing too much more work on it because it has two classes of shares, and so that 3 billion rule didn't really apply to them. I headed to have maybe 3 billion in the common stock, you know, before we look at it closer. So, I waited a little bit, and I went to my next shop, and I didn't have that constraint. And we started to build the position in January of 2015.

**Bill:** You know, it's kind of interesting for me to watch what HEICO has become and how often it's talked about. And what I find interesting about it is by the time that sort of the cat is out of the bag and people have realized what you found years and years ago, now the stock has already compounded at whatever and insane rate. Right. And you're paying a lot for the business. And the acquisition engine almost by definition has fewer engines in front of it than it does behind it or certainly than it did in 2015. Right. And it's a question I ask myself a lot is what is the size of the business that I should be looking at to give myself the runway because base rates eventually apply? Or alternatively, like, do you spend your time looking for businesses where the base rates just simply don't apply? Or how do you think about sort of what I just said?

**Chadd:** Well, I can manage two funds and the larger of the two funds has HEICO and has had it in it for a long time. I still think that there's a long runway for growth for them. Keep in mind that they do have two businesses. They have highly engineered defense business, which is interesting. And for a long time, I thought that that was going to be where a lot of the acquisitions would come from. But if you listen to the last HEICO earnings call, I mean, they're very bullish on a lot of acquisitions coming into the flight support group. But I do spend a lot of my time looking for the earlier companies, the earlier stages. HEICO in 2014.

**Bill:** Right? Yeah. Well, there's just a lot of return in front of you when that happens. And I guess that that's a fairly. Oh, before we move on, the question that I wanted to ask you, because I know people will love hearing about this, do you mind talking a little bit about the nuances of acquisition accounting? And if you don't mind also talking about what makes asset heavy businesses at the accounting different?

**Chadd:** HEICO is very disciplined in the price that they pay and their focus on cash-on-cash returns, which is something that I want to see as an investor. I mean, I'm not really too concerned about gap earnings, accretion, dilution. I'm focused on cash-on-cash returns. And one of the ways that you can see if a company is focused. Son. That is how they do acquisitions. So, there's three ways to buy a company. You can buy the equity of a company; in which case you step into their shoes with respect to the tax basis of the acquired business. So, tax depreciation is highly accelerated, especially in the last few years with bonus depreciation, etc. The businesses get a lot of depreciation up front. And so, if you acquire the stock of a business, you may be in a position where you have very little to no depreciation of the assets that you acquired. The second way to acquire a business is through an asset purchase. So, you buy the assets of a company that allows you to step up the valuation on a tax basis for the assets that are acquired to a fair market value. And then you also get to write off some goodwill, which accountants call intangibles, but really, it's just goodwill. And you write that off over a 15-year period and you get to take it against your taxes. So, it's a free gift from the government. Sellers don't like asset purchases because the liabilities of that business stay with the sellers, so sellers would rather have a stock sale.

**Chadd:** The government came up with a middle ground called a three 3810 election, which is a stock sale that's treated for tax purposes like an asset. Now, when the assets get stepped up, the seller has to pay the taxes on it. So, the seller takes a bit of a hit, but that's all negotiated in the price of a deal for HEICO. HEICO certainly prefers to do three, three, eight, ten age ten elections and asset purchases, but it's a little less relevant to them because their businesses are very high ROIC businesses that are capital light. And so that type of election will allow them to step up a little bit of the assets and then give them some of the goodwill write off. But it doesn't make two too much difference to their cash-on-cash return. If you look at fin twit investor favorite GFL, which is a waste hauler, that's a very asset intensive business. And so, I would say that a company that's doing acquisitions in that space that doesn't do an asset purchase or three 3010 election, which would be somewhat negligent because they would be missing out on a massive amount of tax write offs. And if you look at the history of the waste hauling space, I've heard it described as some companies are roll ups or roll ups. And so clearly in the early days there was a lot of optimizing for gap accretion dilution as opposed to cash-on-cash returns. But I think everybody at this point has that figured out.

**Bill:** I just want to make sure that that people really hear what you are saying. So, do you mind? Just like really closing the loop on why a company like GFL should make the election. What is it, the three 3010 election? Yeah.

**Chadd:** Well, otherwise they would get little to no depreciation tax write off from the assets that they purchased. Now, a really good case of this is a Berkshire company and I don't think it's Warren, probably one of the other guys, but Axalta, which is a paint company. And so, Axalta was owned by, I think DuPont and then Carlyle bought it from DuPont and then subsequently IPO'd it and then Berkshire invested in it. When Carlyle bought it from DuPont, they did a three 3810 election. And so, you can see the assets of the business grow right when the acquisition occurred because they did the write up. So, what did that do to the financial statements and the screening ability of Axalta? Well, first the assets went up and so your denominator increase, so it's going to lower your ROIC. You are depreciating stepped up assets and you're depreciating goodwill through the amortized intangibles, which is going to lower your earnings. So, your ROIC goes down, your PE goes up. And there was no decision here from the management of the company, the management of the sellers. It was Carlyle, the buyer that made the decision. So, when I look at ROIC and I look at ROIC as a way to judge a company's acquisition capability, but in this case, it wasn't their decision. So, you really need to look at return on tangible capital because to get a truer picture of Axalta’s ROIC, because that would exclude the effects of the 330 election, of which the company had no decision making.

**Bill:** I wonder if that's kind of an interesting screen if you were to screen. The difference between a higher return on tangible capital versus return on invested capital. I wonder if that would exploit some sort of bias that people have against lower ROIC businesses but are actually high tangible return businesses?

**Chadd:** I haven't looked at Axalta in several years, but I think if I go back the gap, if you will, ROIC is maybe high teens, whereas the ROTC is in the forties. So, it's not an immaterial difference.

**Bill:** Yeah, not at all. You know, like do you think that that is and when I say that I'm talking about like accounting irregularities or accounting sort of differences between what may look like reality and what's economic reality. Do you think that Buffett like that's one of his mental models that he's looking for?

**Chadd:** Well, I think that's the point of having his owner's earnings. That's exactly the point of it. And then if you go into deeper into the Berkshire family, if you look at Lew Simpson in The Washington Post article in the late eighties that he gave and he talked about his investment style. And then you fast forward and you look at what was said in the Warren Buffett CEO. He clearly made a change where he focused on free cash flow as opposed to GAAP earnings. And the free cash flow is just a basically a different way to get to Buffett's owner's earnings.

**Bill:** You know how dumb I am. I in college, I mean, I majored in accounting, and I remember talking about the cash flow statement with my teacher. And I mean, I was so naive. So, I did learn what the error of my way is. But for a while I was like, well, what does it really matter? The cash flow. Because you can stretch your working capital or whatever. And I can't believe that I ever had the thought that the cash isn't what matters, because now I think the cash is all that matters.

**Chadd:** Now, getting back to HEICO, I love Larry's quote, which he says often that earnings are opinion and cash flows. Fact.

**Bill:** Yes, I mean, cash you can actually pay the bills with. Right. So, you know, I want to talk a little bit about what you see in your current portfolio. And the company that I think you're the most excited about is eDreams. I want to say this with the caveat of you're about to hear probably the most bullish person on eDreams in the world. But what about that idea do you like so much?

**Chadd:** Well, there's a couple of investment opportunities that I really like. I like number one, advantaged business models. And you see that with HEICO, its ability to use its competitors' size against them. And I like business transformation. So, when a business goes from one state to a better state or better to competitive position and eDreams has both of those characteristics. So, if you look at what eDreams is, it's an online travel agency that's based in Spain. It's the number one travel agency by far with respect to flights and flights in the US may not be that interesting of a business because the top four airlines control 85% of the routes. But if you look at the top four airlines in Europe, they control maybe 29% of the routes. So, Europe is highly fragmented. There shouldn't be too many cases where an airline can underprice an online travel agency because an online travel agency can book you on one plane outbound or one airline outbound and a different airline inbound. So, they should be able to be any airline at any time. And eDreams was put together through several acquisitions of private equity owned companies, the IPO around 2015, and then they immediately splattered, which caused the European institutions to leave it for dead. Shortly after that, they replaced the CEO.

**Bill:** What did you say? They immediately did?

**Chadd:** Splattered.

**Bill:** Splattered. I just want to make sure that I heard that right. What does that mean?

**Chadd:** They reported some bad numbers immediately after IPO. Okay. So, okay, so they replace the CEO with the CEO who's an American. This guy is very sharp. Wharton Capital Markets at JP Morgan, McKinsey. He worked in an airline, so he's got the trifecta of experience. And what he sought out to do was to create a stickier relationship between eDreams and their customers and to remove Google and meta searches as a factor in their business. And so, he first started doing that by developing an app. And I think they have the best app in the travel space in Europe. I mean, they will give their customers airline level customer service with respect to the ability to change your flights and get notifications if your flight's delayed, which that's something that the Americans take for granted. But good customer service in Europe for flights is not the norm. And then what he did was he started to create a subscription business. So, he's transforming the business from a transaction model to a subscription model. And that to me is quite interesting because if you are a customer and you pay €55 a year to be in their subscription program, which they call Prime, because it's modeled after Amazon, you get immediate savings on your bookings, and it usually pays back within two bookings. And so, what does that do for you if you're eDreams? Well, the customer, instead of going through Kayak or going through Google when they want to fly, they just come directly to you via your app or going directly to your website. So, it kind of locks in that customer for you and it eliminates the customer acquisition cost 75% of time. So, they're prime customers go direct 75% of the time.

**Bill:** On the return booking?

**Chadd:** On the return bookings. Repeat bookings.

**Bill:** Yeah, that's it. That's right. That's it.

**Chadd:** It eliminates a large portion of their customer acquisition cost and they it out in flights and they're starting to move into other parts of travel. They will sell you hotels as well. And so, hotels are a fantastic business. It's even higher margin than flights in their competitors' bookings. And here's where I see a lot of parallels between HEICO and eDreams, because eDreams will sell you a package of a flight and a hotel. Who knows where the discount is coming from if you're the customer or if you're the supplier, Bookings can't underprice their hotel suppliers? So, if bookings are a Marriott hotel in London, they can't price it cheaper than Marriott can. But if you have a flight plus hotel and you get a nice sized discount, who knows where the discounts come from?

**Bill:** And the reason Booking can't do that is they have an agreement with Marriott that says you're not going to undercut our best offered price, right?

**Chadd:** Correct. But if you have a dynamic package, you know, more than one service, it obfuscates where that discount comes from.

**Bill:** Yeah. So, I guess one of the questions that I've been thinking about is so I pay the prime subscription, why is that a stickier relationship or a lower customer acquisition cost over time than if you just like if your dreams if you just gave me the best deal all the time, like don't I have a habit that forms anyway? Like what incremental customer stickiness is created from prime? Or is it just that once you've committed to paying 55 bucks, you're going to go back?

**Chadd:** It's like boot camp. It costs you a lot to join the Marines, but once you're made it through the boot camp, you're gung-ho about it. So, I think having the buy in ties you to it.

**Bill:** Yeah, that makes sense. And then something that has been shocking to me when I've looked at the numbers is how quickly that prime membership has ramped, like what have they done to communicate that value proposition to the customer maybe a little bit better recently? Or is it just that they rolled it out and people just love it so much that it just like exploded?

**Chadd:** So, they have done no advertising for it, which is something that they can do. And I would expect you to be in the tube in London and see an advertisement for it at some point in the future. But they haven't done any of that, but they have done is they've bid hard for travel flights on metasearch apps and Google, etc., because there's another 75% number. If they get in front of a new client, 75% of the time, that client turns into a prime subscriber so they can realize the lifetime value of that subscriber. You know, they have a very low attrition rate. And so, there is a long life to the subscriber. And so, what they do is they'll give the customer their booking fee in the form of discount, the prime fee of €55 a year. They can give some or all of that to Google the first year. And so, the first year, they're not going to see much with respect to the financial statements, earnings, and cash flow from that subscriber because they're basically given away the booking cost to the customer and the prime fee to the lead. But when that anniversary is the second year, they keep the subscription fee. And so, no matter how many trips the customer takes, the customer is always going to get the booking fee back in the form of a discount. And you can get that €55 per year.

**Bill:** And it seems to me that the type of customer that they're looking for is a customer that takes more than one trip a year. Like you're really, I would think, looking for the avid travel fan. Maybe I'm wrong on that, but that seems to be how you would save the most money, right? Is like these avid travelers. The reason I'm asking is it just I wonder, like that customer seems super sticky to me if you can actually save them a lot of money and they're booking often. I've just been trying to kill this idea because, you know, we talked about it and I've been thinking about it since and it's just like, okay, well, I guess how many people you are actually targeting is one question that I have. And then the other question is, which is totally unrelated, but I'm just trying to figure out like what makes this business different from like the OTAs that have had a lot of trouble in the past and sort of how. How do you kill this idea? It was the other thing that I'm thinking about.

**Chadd:** Well, the OTA's have had a lot of problems in the past because they've never solved the Google issue. And doing a subscription business is not easy, and I think it requires dynamic packages. TripAdvisor recently launched a subscription offering and, in the end, it just turned into a rebate program, which is the same thing as every other travel company has. The subscription program is unique. I think that their addressable market is every leisure traveler in Europe and presumably ones that would travel more than twice because it pays back in two bookings. Their addressable market is quite big in their largest markets. They may have a 3% market share. And so, I think that the early stages, not to mention going into hotels like they'll sell you a hotel now, I think that they believe the way that their software works right now is they're not getting full credit for how much money they're saving on hotel bookings. And so, I would expect them to rework their software and how it looks and how it feels to the customer. I would expect that to take a year to 18 months. Right now, if you want to book a hotel, it needs to be in conjunction with a flight. I would suspect that that was going to change over time once they get the user interface figured out. So yeah, it's exciting.

**Bill:** How do you think about a business like this that has such low market share? And if it is true that all of the travelers, like the leisure travelers in Europe are your TAM, how do you think about like owning this kind of an entity versus selling it if it hits a price target? And what would you be looking for to exit a position like this? Because it sounds to me like it's a multi-year ownership.

**Chadd:** Well, it is multi-year. So let me go through that. I mean, they had their fiscal year end is in March. And so, the beginning of last fiscal year, they were still dealing with COVID. The numbers on bookings didn't start to get to pre-COVID levels until June. The margins are lower because Europeans were taking less complex trips, they're traveling shorter distances. And so, the basket size hadn't normalized yet. It still hasn't. But in my model, you're looking at how many subscriptions will anniversary this year, which most of them will be in the latter half. I think they're going to do at least 80 to 85 million of EBIT (earnings before interest and taxes) this year. They had €3 million of EBIT last year. And so, you're going to get a huge increase in earnings. I think they're going to be compounding their top line over the next three to four years, around 20%. The bottom line is going to be compounding at triple digits given the low base of a €3 million. And that's just growing out prime numbers. That's not introducing doing a full court press on hotels. That's not taking that model to the US. And if you go on LinkedIn and look at job openings, there is a US airline relationship manager posting, so they're going to bring that to the US too. And I think that if you have the flights and the hotels, the model will work in the US just as well as it works in Europe.

**Bill:** Presumably, the airlines in the US are going to fight back a little bit harder. The reason that I say that is the airline industry in the US is so consolidated and every time I check out that says, hey, do you want a hotel, or do you want a rental car with this? That said, I think what you may answer is the airline is not selling a bundled package. They're selling you the ticket and then they're selling you the hotels. So, there's the same constraints on the airline that there would be on a traditional relationship with, say, Booking or whatever. When it comes to the hotel sale.

**Chadd:** I don't think I've ever booked a rental car or a hotel via an airline. I think Allegiant maybe does pretty well with that, but I've never flown Allegiant.

**Bill:** Yeah, I think I did when I was long airlines. But that was motivated behavior. Yeah, it's interesting. I mean, like so it's a big position for you. How did you go through like trying to kill this thing? Right. Because, you know, when I hear you talk about it, I'm like, boy, this is, you know, one of the best ideas I've ever heard. Right? But it's pre-morteming. Something like this is, I think, a very useful exercise. So, kind of like, what does your process look for once you find an idea like this, how do you try to disprove it to yourself?

**Chadd:** I try to kill the business model and the management is proven to be correct. They went from 1 million subscribers as of June 1st last year to 3 million subscribers June 1st this year. So, they're correct in the sense that Prime is highly valued. They did that without any outside marketing. And so now we'll see the cash flow through the financial statements this year. I mean, if the cash doesn't flow through the financial statements this year, then that 75% of customers doing repeat bookings through cheap channels and. Right and management would have lied to me, but I don't think that's the case. So, I try to kill the business model. If I can kill a business model, then in the business models did. Infuriating. Then it's a quick sell.

**Bill:** So, I mean, you had mentioned that one of the mental models that you have is that you like business model changes. This is stupid to say out loud, but there are obviously business models that are morphing to higher margin businesses. So, one that I'm familiar with that you're also involved in is Green Plains. And I was curious to hear you talk about what you saw. And what I'm really trying to get at with these questions is one of the things that I find very cool about you and talking to you as an investor is you appear to me to be somebody that's really looking for early inflections and businesses that you can own for a very long time. And I want to be that kind of investor. So selfishly, I'm looking for some mentorship through this conversation. So, if you don't mind talking a little bit about GPA, that'd be fun for me.

**Chadd:** Yeah, yeah. Green Plains, I guess 1.0 is exactly the type of company that I would not invest in. It's a legacy ethanol manufacturer, and so it's highly capital intensive. It's very cyclical. You have commodities as an input, which is corn, you have crush margins that you're dealing with. And so, it's complex. It's an industry that overpromised and under-delivered. And so, it's very ugly and perhaps maybe does 50 million of EBITDA a year with a lot of variability. Some years it's down 80, some years it's up. So yeah, not a pretty business, but one of the byproducts of ethanol manufacturing is dry distiller’s grains, which is used in animal feed. And I worked at Cargill as my first job out of college making animal feed. And so, I know that product quite well and I know why it's used in the feed. If you look at the nutrient components of dry, discolored grains, it has about 25% protein, which in animal feed is a middle protein and it is high in energy. And because of the fermentation process in the ethanol manufacturing and the yeast that was introduced to it, in that process, it tastes good to animals. And so, you use it in animal feed for a flavor enhancer and for the energy.

**Chadd:** And so, the value of that product is much higher than the protein level that product would say it should be worth. And so, you really don't get paid for the protein. And what Green Plains did was they bought a company that had a processing technology that allowed them to separate out the protein from the rest of the dry distiller’s grains. And so, what you ended up with was a high protein corn meal, and the protein level right now is about 60%. And then you're left with dried distillers, grains, asterisk, or light. So light protein. Now they can still sell that dry disordered grain light for the same price that they would sell regular distiller’s grains because people aren't buying it for the protein, but they can take that protein that they extracted from that and sell it for a very high price per ton. And so, what they've done is they've taken a byproduct, which is the grains and turned it into the primary product of the business. Ethanol is now an afterthought, and the primary way that they're going to be making money is through this high protein corn meal, which, by the way, the quality of the revenue is increasing dramatically.

**Chadd:** And you're going from ethanol, which the revenue is all over the place, to locking in customers such as pet food manufacturers or dog food manufacturers. And what is a dog food manufacturer are looking for? Well, they're looking for the nutrients that the protein is going to deliver to them. They're looking for the flavor of the product, which is coming through the brewer's yeast. And they want the product to look the same and smell the same and feel the same as a bag that they sell in Seattle versus a bag that they sell in Miami. And so, they're not going to be making changes to their formulations too often when something like this comes along, which is an ingredient that's going to add immense value to them, they'll make the change and then it's locked in. It's like a roach motel, you know, you get in, you don't get out. And there's other animal nutrition industries where he had the same dynamics. So, they just launched a joint venture with a company that produces salmon and trout. I think it's the largest trout producer in the world, certainly in the US, same deal. They don't want to make changes to their formulations too often once they're in there.

**Bill:** In how often are you rebidding an RFP on something like this? Like how often can they push price is really the question that I'm asking versus, you know, are they just pricing off like corn and soy substitutes? Like how does this additive stay away from being a commoditized sale?

**Chadd:** Well, I think it's going to be price close to cornmeal, which is commoditized. But when I underwrote this, the protein prices were much cheaper than they are today. So, I'm comfortable with the low variability.

**Bill:** Yeah, that makes sense. Data to Kyle who we both know.

**Chadd:** Yes. Yes. Kyle gave me a little help with that in the early days, and I think I reciprocated with Archaea Energy, which has a little bit of some of the same. I mean, Green Plains, I think is going to do well with the business transformation, but there are also some tax benefits that they're going to be getting because they can sequester the carbon that's produced in there and their manufacturing process, which isn't I'm not going to underwrite it on the on the tax benefits, but it's real. So, Kyle gave me a lot of help with that.

**Bill:** The carbon sequestration stuff is pretty interesting, and I started noticing it not all that long ago, but we're in an interesting time. And I think that there is I have this theory that may or may not be dumb, but that some industrial companies are at the center of some changes that could create a pretty interesting group of compounders.

**Chadd:** Well, I mean, let's look at that. We talked about GFL earlier with respect to the tax implications of their acquisitions, but Archaea Energy, which Kyle, and I both worked on, and he helped me out a lot on, what do they do? They collect methane from landfills. Landfills have organic matter as it breaks down. It produces methane for like 30 or 40 years at a very slow decline rate. And so, what waste companies can do is to drill holes in their landfills, collect the methane, clean it, and burn it on site, which in my county they do. I've seen they have five power generators, and they burn it. And the power generators burn the methane, the streets, the electricity, and they sell them into the grid. And with that comes some LCS credits, which is low carbon fuel standard credits which some states require or what they could do with it is they could clean it and inject it into a natural gas pipeline and sell those natural gas with those low carbon fuel center credits attached to it. And when I started working on this, I asked one of the sell side analysts who's supposed to be the best in the waste space about it. It's about a year ago, April, and he kind of pooh poohed it. They've been working on this for years, you know, nothing going there.

**Chadd:** And then he starts asking questions to his management teams on the Q1 call and then followed up shortly after that by his company's main conference. And he gets positive responses and then he keeps asking these questions. And by the second quarter conference call, he asked GFL's CEO about it and he said these are 40% plus IRR projects. It's the best use of capital in my business and the markets that's been almost a year in the market still has even picked up on that. Now, granted, they're just putting these projects in place and it's not flowing through the cash flow yet. But I think FLS quoted estimates for the free cash flow per year of these projects is 100, 100 and quarter or 100, 150. They've also said publicly that internally their cash flow projections for this are 150 to 200 million per year and they have it separated out into its own LLC, which means if you have a hot IPO market for a quote unquote clean energy company, I mean, what can they IPO this off? Do you have 200 million a year of free cash flow that's clean energy? I mean, is it 20 times EBITDA? I don't know. But there's probably 3 to $4 billion of market cap value in this project that nobody's even looking at right now.

**Bill:** Yeah, sometimes I've heard similar idea with a carbon capture company and sometimes I wonder if I'm like getting myself a little bit to Wall Street when I start thinking about what could they spin something off? Versus like just thinking like, boy, if these returns are real, which they are, right, but let's say they materialize. I'd almost rather have the business continue to trade at the same multiple and just like buy the shares in. I mean, either way you win, right?

**Chadd:** Well in GFL's case they'll.

**Bill:** Assuming that it comes to fruition in GFL.

**Chadd:** Saw a $200 million a year in which they can continue to roll up the waste space. That's not a bad outcome either.

**Bill:** That's right. I'm just kind of wondering if there's a lot of this going on in the industrial space that I don't know?

**Chadd:** Well, if you find some, please tell me. I think I've found one in the waste space. But yeah.

**Bill:** It's one of the things that I really like about Kyle. It's kind of married to people that may not know him, but I think he does really interesting work and I like looking at some of the stuff that he follows.

**Chadd:** Another fellow eDreams shareholder, I just might, might point out for disclosure purposes.

**Bill:** Yeah, that's right.

**Chadd:** Kyle's very smart.

**Bill:** Yeah. There you go. Yeah. We'll have to run this by his. Lion's team. I'm sure you won't mind. Do you want to talk a little bit about your fund and what you are and are not focused on?

**Chadd:** Sure. I mean, with.

**Bill:** Like a moral aspect.

**Chadd:** Yeah, we can start with the investment part of it and then we'll get to the moral aspect and then we can tie how that goes back into the investments.

**Bill:** Yeah, that'd be awesome.

**Chadd:** So, I run the Ave Maria Focused Fund and so we are a legal non-diversified fund. And so, within some guardrails I can take big swings at companies. So, you're not going to see this fund have 30 to 50 holdings, you'll see it have 20 or either side of 20 holdings. And so, I can take some big swings at companies that I like. And as we've discussed earlier, I'm looking for companies that can compound for a long time and I'd prefer to catch them early. And but there are some larger companies that people would know Microsoft, Adobe, Tyler, or would be examples. Equinix was in there for a good period of time, but the rest of it, I think, would be more obscure companies where I think an inflection is happening and I can hold it for a long time and do quite well with it. With respect to the moral component, it was founded by Catholics and was founded with the promise of allowing Catholics to invest in a way that's consistent with their moral beliefs. And so, what we have is a board of advisors that set up a list of industries or practices that companies do that we cannot participate in. And so, we have some negative screens and screens out those businesses. So, for example, pornography would be one. So ,you're not going to see us in Rick's know that's an easy one because Rick's is all porn, but we have a zero tolerance policy and so you won't see us in cable, for example, even though cable is an interesting space and as an investor you might want to invest in it, and the pornography might be a de minimis amount of their business. We have a zero-tolerance policy, so we won't do that.

**Bill:** So. what's the difference between like a cable company and Equinix, for example? Right. Because Equinix is sort of facilitating the transfer of pornography. At what point do you draw that line?

**Chadd:** Well, it's like Amazon might sell you porn and UPS might deliver it. I think UPS is s a step removed. Know they're not the ones that are distributing like producing the content or selling it. Selling it, yeah. And so that's where we would draw the lines. But with respect to Equinix, they were what was it, one that was facilitating only fans or there was somebody was facilitating child pornography like one of the websites. And it was Ackman that came out and called out the credit card processors for processing payments of it.

**Bill:** I believe when he was on that kick.

**Chadd:** Yeah, it was like June of 2020. Yeah. I mean I've met people at Equinix and I found that in one data center that they hosted it and I sent that to him and I sent Ackman's tweet and I sent MasterCard response and I didn't get a response back, but kind of through backchannels, I've heard that they may be when the contract comes up for renewal, that they weren't going to be renewing it. So hopefully we did some good work there. You know, as it relates to our investors, our investors invest with us for more than one reason. Number one, they want returns just like anybody else. These are private individuals that are funding their retirements. This is health care institutions and universities and other endowments. And so, they need returns to fund their operations. But there's also the moral component that's important to them. And what I've noticed is that it tends to make our customers or clients stickier, which is good for me as a portfolio manager, but it's also good for them too, because nothing's going to destroy wealth, like interrupting, compounding, and trading too much. And you know, if they're redeeming on me, when you have a period of poor performance, then it makes it harder for me to do my job. But in the end, it's like they're not serving themselves well in doing that. And so, what I've seen is that it tends to make them very sticky, which is good for both of us.

**Bill:** Yeah, that would be, you know, it's hard to find somebody that's aligned, right? So, if you have that kind of mission alignment, that's a nice filter.

**Chadd:** I'm pretty suspect of a lot of ESG and I think it's marketing. But in our case, we have hard screens, and we enforce them. And so, if a company we call them offenders of company is not an offender but subsequently becomes one, it's a quick sell, it's immediately sold, and we've done that on several occasions. Consequently, if the company was an offender and ceases to be one because they changed their business practices, then that opens it up. And we're thinking like Adobe at one point was an offender because of some of the corporate contributions that they made, and they stopped making those contributions to Indian organizations and it opened it up for us.

**Bill:** Oh, that's interesting. You may find some things change with the recent Supreme Court decision, but, you know, you just monitor it, right? Yeah.

**Chadd:** We do have some outside organizations that do some screens for us, but a lot of it is internal as well. I mean, due diligence in companies. There shouldn't be outside scrutiny. Service should know. My portfolio company is better than I do. Yeah. And so, we often find or not often, but it's, it's not uncommon to find a company that a screen service would say is an offender. But when you dig into it, they're not and sometimes most things. And so, it’s incumbent upon us as we're doing our financial due diligence to also do the diligence on our moral screens.

**Bill:** Are you I guess the only way that I know how to ask this question is to ask it directly. Are you going to call people and say like, are you guys' funding like travel for abortions or is that not something?

**Chadd:** I think that that is a question that's.

**Bill:** Almost a privacy issue potentially?

**Chadd:** I don't know. Well, companies are very public about this right now, and I think that is a question for the.

**Bill:** Big ones are.

**Chadd:** Yeah, well, I've actually seen some small ones too. Yeah, I think that's a question for our advisory board. On if the travel aspect is a violation or not. And I think it's something that they are going to be thinking about and discussing at their next meeting.

**Bill:** Yeah, it makes sense. It's an issue that we haven't had to think about for a while right now. It's an issue that people are going to think about.

**Chadd:** So, but certainly corporate contributions to Planned Parenthood, which was one of our screens, and we went looked for it. And if it was there, we didn't invest in that company.

**Bill:** Yeah, I guess if I were on your advisory board, I would say that corporate contributions to Planned Parenthood are almost a corporate endorsement of Planned Parenthood, whereas supporting an employee may not be as much of a corporate endorsement. It may be more of like a facilitating the employees. Right. A benefit, yeah. Which I don't know.

**Chadd:** I would draw the distinction with respect to like if there's a matching contribution, the company has a matching contribution and an employee donated to Planned Parenthood and the corporate match. We historically have viewed that as a benefit to the employee and the employee's choice as opposed to a direct corporate contribution.

**Bill:** That makes sense to me. Yeah, because the corporation is not saying go out and do this. It's saying I will match whatever you choose to do and then somebody else. Yeah, that makes sense. That's an interesting distinction.

**Chadd:** But I mean, you know, to get back into like how the financial due diligence can be done when you do the or how the moral screen's diligence can be done when you do financials. I mean, it was probably summer of 2015, I was looking at Jarden, and Jarden didn't come up, but in one sentence in their annual report, they talked about buying this company in Germany that was an offender and it was just one line. And the financials of that company are probably de minimis to Jarden. But I found it. I'm like, okay, well, can't do that.

**Bill:** Yeah, well, that's what people are hiring. Well, that's what some people are hiring you for. Right? So, it's nice to know that you're looking out for those kinds of interests.

**Chadd:** Yeah. The whole world doesn't need to be Catholic, but it is nice to have a place for Catholics to invest and do it in a way that's in alignment with their values.

**Bill:** Yeah, I would posit that there are some other religions that may have some overlap with Catholic beliefs, and I've always associated it with somebody that wants to feel morally clean in some way, shape or form. This is a reasonably good product for them to take a look at, right? Yeah. Does it ever frustrate you? Are you ever like you're on like a good idea, like charted, for example? Well, I guess you start with it now.

**Chadd:** Well, look at the benefits that I have for the benefit that I have is a stickier investor base. And so, the moat of our business is the adherence to our values. And so that mode is way more important than finding another good investment idea. I co run two funds. Right? So, the Focused fund is 20 names, but even the more diversified fund is not. It's around 30. And so, we don't have to find too many good ideas to buy and hold for a long time. Yep. So.

**Bill:** And you'll go global, obviously, right? eDreams of Spain?

**Chadd:** And eDreams of Spain.

**Bill:** GFL?

**Chadd:** Canada. More operations in the US but yes. Canada.

**Bill:** Yeah. Okay. I was thinking where it's listed but interesting.

**Chadd:** Brookfield's dual.

**Bill:** Yeah. What did you think of the recent Equinix short?

**Chadd:** I think that the thesis has been around for a longtime and it was the challenges that I got when I first presented it as an investment opportunity, you know, fair enough. But if I would have listened to that, I'd been much. For what?

**Bill:** You're the one that recommended tubes to me, I think. Right, right.

**Chadd:** Yeah. That's how I really learned. And then Tubes talked about how these network engineers go to find access points to various websites. And through that, I was able to find all the access points for the largest software and website companies, cloud companies in the world, and saw that Equinix may have 30% access share to Amazon Web Services access points. I mean, that's a moat that's not going anywhere. I mean, these access points are part of the critical infrastructure of the internet. And if you want access to us, I mean, that's where you go. You don't go to Amazon's hyperscale data center to access AWS. You go to an interconnected data center. That in part is what he's missing.

**Bill:** Yeah. So, the short thesis is that you could go directly to an AWS or that will disintermediate the system, right?

**Chadd:** Yeah. Which sounds to me like he's probably long Microsoft and Amazon and Google because maybe they're compelling valuations right now and he's, you know, he wants to pair it with something.

**Bill:** Yeah, I don't know. That'd be interesting. Whenever I hear somebody talking about a short position, I always like to know, what are they long? What are they seeing, what are they offsetting, what are they hedging? But financial reporting doesn't really do things that way, so you never know.

**Chadd:** Yeah, the GFL short was a really interesting one.

**Bill:** Oh yeah.

**Chadd:** You mind spruce point one?

**Bill:** Yeah.

**Chadd:** The Spruce Point put together this this 8000-page slide deck on GFL, where they basically called the CFO Mafioso and all kinds of nasty things. And you know, whenever a short report comes out, I respect the shorts, so I want to learn about it and read it and consider it. But the one thing that tipped me off was they sent the report where they alleged fraud and all kinds of stuff and just sent it to the SEC. Or if you think there's fraud going on you since the SEC. But they sent it to the Department of Justice, which regulates anti-competitive and competitive behavior like the FTC. Right. And so why would you send it to the FTC? Well, what was going on in the industry, what was going on in industry was that Waste Management was vying advanced disposal. And for whatever reason, the FTC said, we want you to divest a certain amount of assets because for competitive purposes and for whatever reason, known only to the government, they only wanted that sale to happen to one company. They didn't want them to piece it out for whatever reason. And I don't know why. And it's the government's prerogative on how to run the process. And that's what they chose. Well, the only company of size that wouldn't have any other competitive issues was GFL. So, the reason why they sent that report to the FTC was to get that purchase stopped. So, I believe that Spruce Point had a short on GFL, as they said they did. But I also believe that the bigger short was Advanced Disposal. Because of that deal got killed, that stock was going to plummet.

**Bill:** Hmm. Interesting. See old? Why am I reading this now? And why did they send it here?

**Chadd:** Right.

**Bill:** Right. Yeah. You know, you and I have talked about in the past Ubiquiti, and I think that's another one where I think reality of the situation was that the motive behind the short report had to do with a basketball team. I don't actually think the short report turned out to have as much merit as they maybe would like.

**Chadd:** I mean, it's been a long time since he wrote it, but I think the only thing that he got right, he been left, got right was there was an error in the number of users in their community.

**Bill:** Yeah. They had to restate that eventually.

**Chadd:** Yeah, they had to restate that. But I don't think that was material to any of the investors. Again, like look at what was going on. There was a put call scenario that was coming due the following November. The report came out in September. So, the CEO of Ubiquiti was the controlling shareholder of the Memphis Grizzlies. The number two shareholder publicly stated he wanted to buy and own a basketball team. And so, if you're a CEO, that doesn't take a salary and your wealth is tied up in the equity of the company that you founded and run, if that stock price goes down, you're going to have less ability to borrow against or sell those shares in order to cash out a partner in another business.

**Bill:** Yeah, I don't know, man. The older I get, the more I ask, why is someone leaking this? It's funny. Like, I read the newspaper. We were actually talking about this last night, right? Like I read the news, and if I know about something, I'd be like, I don't think this is right. But then the next article I'd be like, well, this is right. And it's kind of like once I realized that logical fallacy, I almost like, stopped reading the news a little bit too much. And I need to get back to reading it and saying like, okay, well, who's trying to leak this and just like skim it that way?

**Chadd:** I have the opposite view, because if you know something well and then you know, the news is getting it wrong and you're like, well, if the news is getting wrong and it can sound really convincing, like, does that mean everything else is just wrong?

**Bill:** Yeah, that's right. And it got me to stop reading a fair amount of news for a while. And I need to I think I need to balance the competing thoughts in my head. But it's why I've actually been reading the actual Supreme Court cases, because I've said to myself, like, I'm certain that the coverage of these is not going to be accurate. So, there is an app that you can listen to some of them, and like the really highly political ones I'm forcing myself to listen to.

**Chadd:** They're entertaining to read.

**Bill:** Yeah, yeah. They're quite good.

**Chadd:** I'm not a lawyer, but I have read several of them, including the recent ones.

**Bill:** Yeah, I think the only frustration that I have with the Supreme Court, and I've always had this with con law. I didn't do very well because I came to realize that at the end of the day, it's usually an outcome and then really smart people figure out how to argue to the outcome. But, you know, I think it's important to look at source documents and everything. I actually think one of the best like Transdigm, for example, when I was researching that, reading their testimony to Congress, I think is like one of the greatest sources of due diligence. Right? Like, I just think that Buffett says a lot that he only operates on public information. Mm hmm. I think now with Berkshire's data set, it's probably more private information than public. But there's a lot of very valid public information out there that no one else is looking at. Right. So. Well, do you want to talk about anything else? Man, I've really enjoyed this. I came over to your hometown. You put me up. I've got coffee. Thank you very much. This has been great.

**Chadd:** My adopted hometown.

**Bill:** Yeah, well, that's fair.

**Chadd:** I'm not a Floridian by birth.

**Bill:** Well, very few are, but I think we're all happy to be here now. So, thank you very much for your time, man.

**Chadd:** Great. Great. Yeah, I was happy to be on.

**Bill:** Yeah. All right, cool. Well, have a good one.

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As of 6-30-22, the holding percentages in the Ave Maria Focused Fund of the stocks mentioned in this commentary are as follows: eDreams ODIGEO S.A. (12.5%), Green Plains, Inc. (4.7%), GFL Environmental, Inc. (11.7%), Archaea Energy, Inc. (4.0%), Microsoft Corporation (4.0%), Adobe, Inc. (4.0%), Tyler Technologies, Inc. (2.1%), Equinix (no longer held) and Brookfield Asset Management* (7.6%). Fund holdings are subject to change and should not be considered purchase recommendations. There is no assurance that the securities mentioned remain in the Fund's portfolio or that securities sold have not been repurchased. The Ave Maria Focused Fund's top ten holdings as of 6-30-22: DigitalBridge Group, Inc. (14.3%), eDreams ODIGEO SA (12.5%), GFL Environmental, Inc. (11.7%), APi Group Corporation (9.4%), Brookfield Asset Management* (7.6%), Green Plains, Inc. (4.7%), NEXTDC Ltd. (4.7%), Texas Pacific Land Corporation (4.5%), Microsoft Corporation (4.0%) and Archaea Energy, Inc. (4.0%). The most current available data regarding portfolio holdings can be found on our website, www.avemariafunds.com. Current and future portfolio holdings are subject to risk. * Combination of Brookfield Asset Mgt Reinsurance Partners and Brookfield Asset Management, Inc.

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