



Geometric Fund

# KOGAN: Short Position, Historical case study

2022

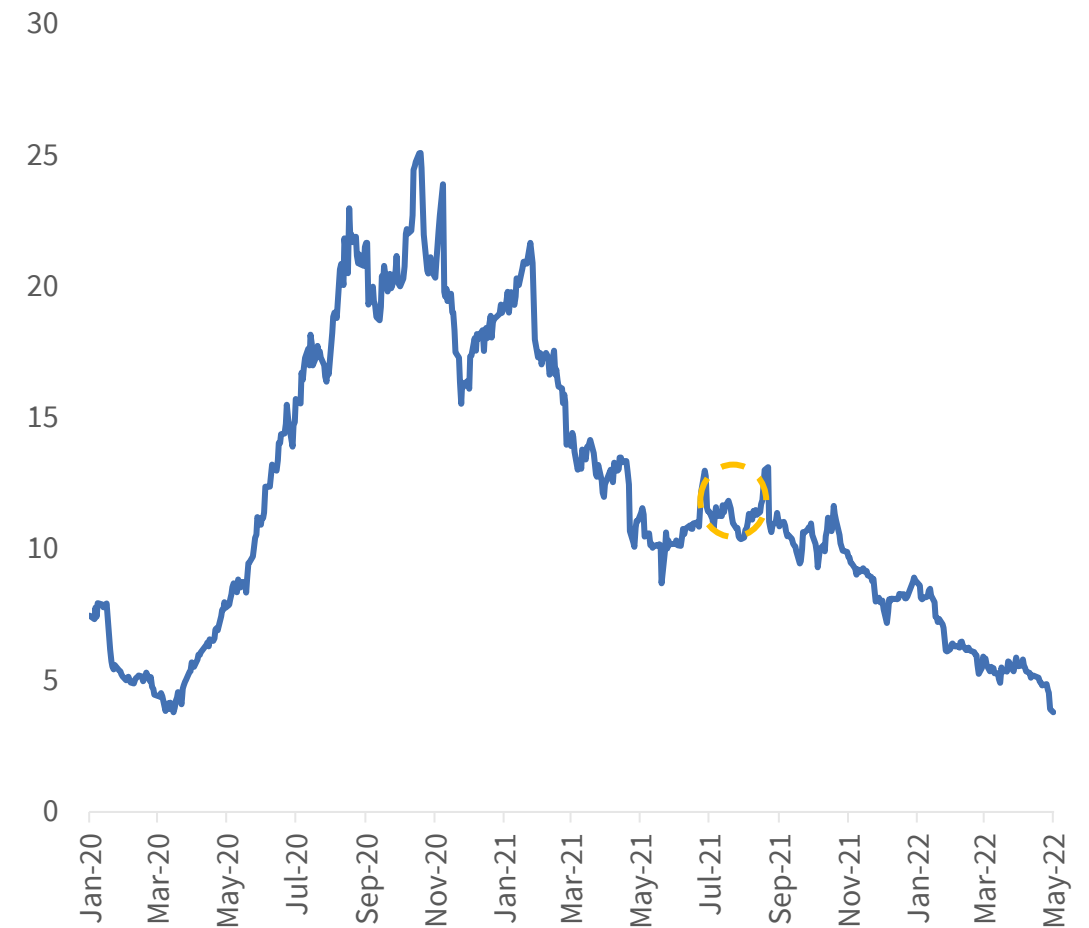
kogan.com

# Summary

## KGN (A\$, ASX listing)

- Geometrica short sold KGN shares in August 2021
- Initially we looked at KGN as a potential long
  - the share price had halved from recent highs and;
  - Australia was entering a COVID lockdown again (share price increased ~5x during previous lockdown).
- Data and Red flags quickly disabused us of this notion
- The company missed earnings expectations successively when reporting FY21, 1H22 and 3Q22 earnings

KGN Share price (AUD)



Source: Bloomberg

# Quick business overview

## Segment information: Financial year ended 30 June 2021

- Kogan is an Australian online retailer, founded in 2006 by CEO Ruslan Kogan
- 75% of Gross Profits is generated by segments that take on **inventory** from suppliers
- Kogan’s Private Label business – “Exclusive Brands” – is the primary driver of the business’ Gross Profits
- Third Party Brands & Marketplace drive a greater **product range** and help **drive traffic...**but only contribute 25% of Gross Profits in total

AUD M	Inventory Risk			No Inventory Risk			Total
	Exclusive Brands	Third-party Brands	Mighty Ape	Marketplace	Mobile & other verticals	Advertising & other	
Revenue	378.0	271.7	80.2	23.4	20.2	7.2	780.7
Gross Profit	105.1	28.1	20.0	23.4	20.2	6.8	203.6
Gross Profit Margin %	27.8%	10.3%	24.9%	100.1%	99.8%	94.8%	26.1%
<b>Gross Profit Mix</b>	<b>51.6%</b>	<b>13.8%</b>	<b>9.8%</b>	<b>11.5%</b>	<b>9.9%</b>	<b>3.4%</b>	<b>100.0%</b>

Source: 2021 Annual Report

# At Geometrica, it is always about data and evidence

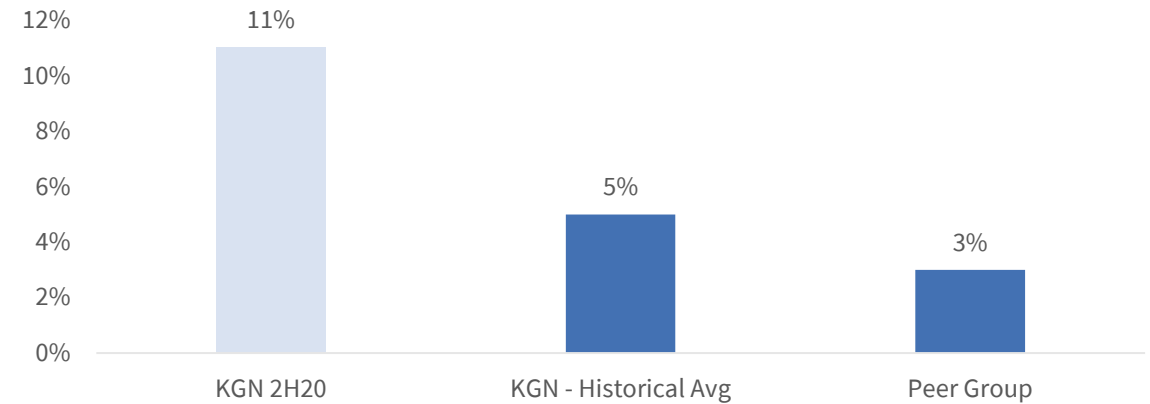
## Why did we short sell KGN after investigating it as a potential long investment?

- 1 Thesis:** > Earnings & Multiple elevated from COVID...Unsustainable...Large downside to valuation if margins normalised
- 2 Data Point #1:** > Product pricing data showed KGN was discounting stock aggressively
- 3 Data Point #2:** > Web traffic data showed that demand was easing
- 4 Data Point #3:** > Key cost inputs were increasing
- 5 Red Flag #1:** > Insider Selling
- 6 Red Flag #2:** > Management Compensation & Related Party transactions
- 7 Red Flag #3:** > Accounting
- 8 Catalyst:** > We anticipated that consensus would downgrade their expectations for FY22 earnings based on our modelling.

# Thesis: Margin & Multiple reversion

- COVID resulted in a spike in e-commerce demand as shoppers went online
- **EBITDA Margin expanded to an all time high of 11%**
  - >2x the historical average, >3x peers.
  - Unsustainable
- Driven by:
  - Stronger realised pricing
  - Declining customer acquisition costs
  - Operating leverage (e.g warehousing)
- Market extrapolation, capitalising a peak demand period, with **peak valuation**
  - >30x EBITDA vs pre-COVID avg of 14x.
- **Short Thesis:** >50% downside as Margins and Multiple revert to historical levels upon easing of lockdown restrictions

## EBITDA Margin



## Forward EV/EBITDA (x)



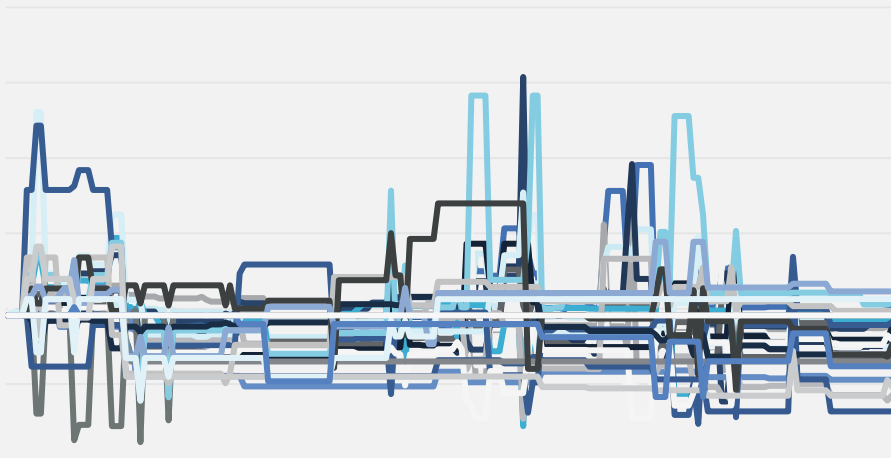
Source: Bloomberg, Geometrica analysis

# Building a data edge on Kogan: daily data by SKU

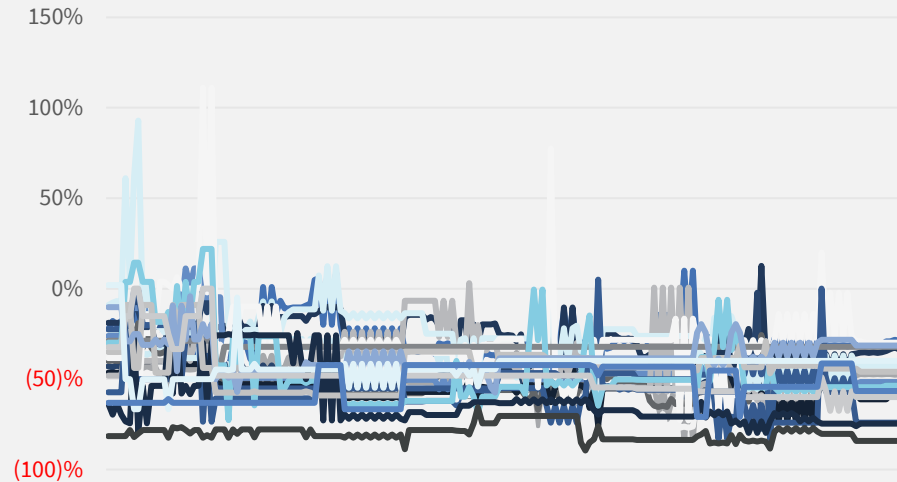
date	sku	title	category	price	kogan_first_price	was_price	price_type	on_sale	promo_pill	free_shipping	stock
28-Oct-21	KALED42RT9220SVA	Kogan 42" Full HD LED Smart TV Ar	LED TVs	\$ 369.00	\$ 359.00	\$ 459.99	Full	FALSE	SELLING FAST!	FALSE	In Stock
10-Feb-22	KAWWASH9D6A	Kogan 9kg/6kg Washer Dryer Com	Washer Dryer Combinations & Sets	\$ 669.00	\$ 649.00	\$ 899.99	Presale	FALSE	HOT!	FALSE	In Stock
10-Mar-22	KALED50XU9210STD	Kogan 50" 4K UHD HDR LED Smart	TVs	\$ 649.99	\$ 499.00	\$ -	Full	FALSE		TRUE	In Stock
03-May-22	FCS-40547530703023	AU FOCUS Diesel Heater 12V 5KW	Other Plant Care & Accessories	\$ 499.00	\$ -	\$ -	Full	FALSE		TRUE	Low Stock
29-Oct-21	KAMINWB2KSA	Kogan Mink Dot Weighted Cotton	Blankets & Throws	\$ 39.99	\$ 29.99	\$ 199.99	Full	TRUE	EXTRA 30% OFF AT CART	FALSE	In Stock
28-Oct-21	KA7ZLMFMTQA	Kogan 7 Zone 8cm Thick Lavender	Mattress Toppers & Protectors	\$ 49.99	\$ -	\$ 249.99	Full	FALSE		FALSE	Sold Out
28-Oct-21	KA7ZLMFMTQA	Kogan 7 Zone 8cm Thick Lavender	Mattress Toppers & Protectors	\$ 49.99	\$ -	\$ 249.99	Full	FALSE		FALSE	Sold Out



Price by SKU in real time

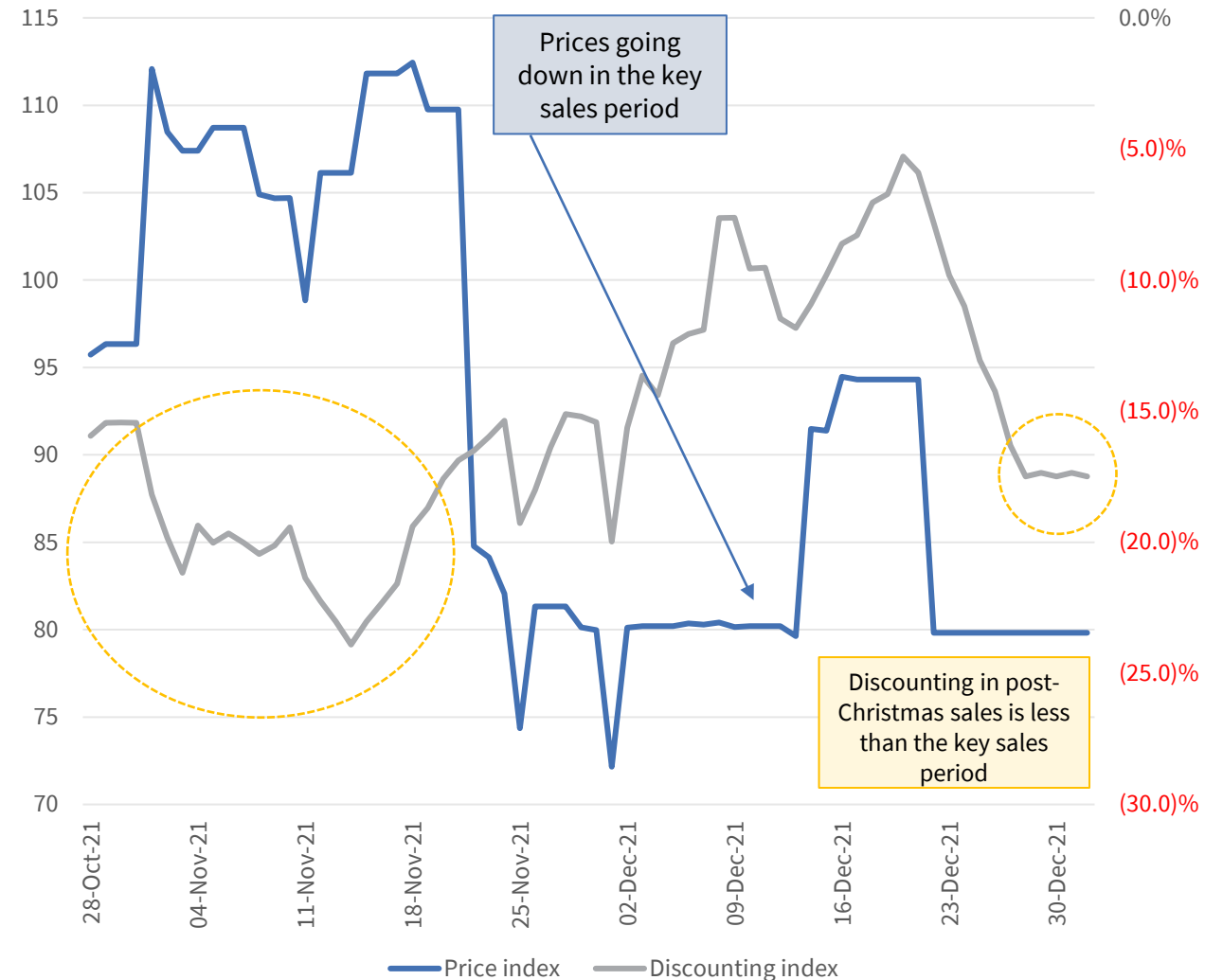


Discount activity by SKU in real time



# Building a data edge on Kogan: Price x Volume

- November and December are key sales months for Kogan
- Aggregating a price weighted index showed **increased levels of discounting and promotional activity**
- Lower Realised Prices will put pressure on KGN's margins.
- Risk of additional inventory write-offs

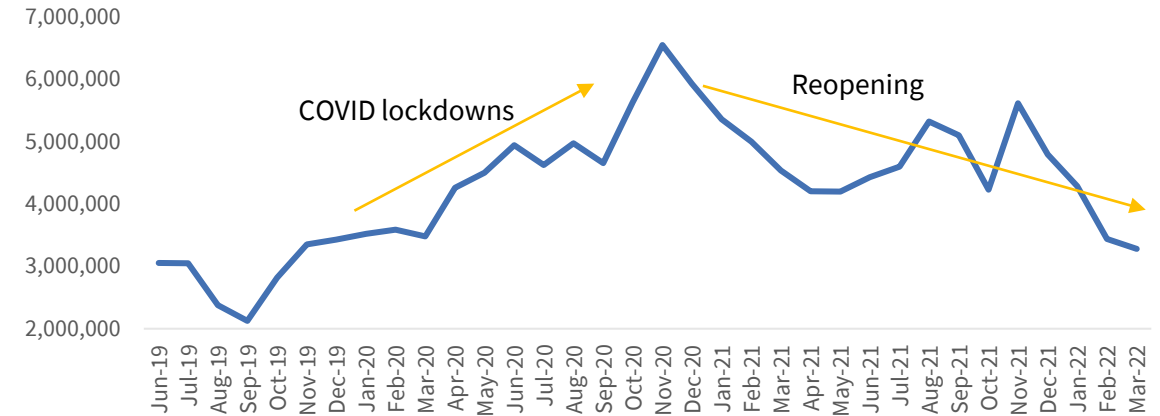


Source: Geometrica Analysis, Kogan.com/au

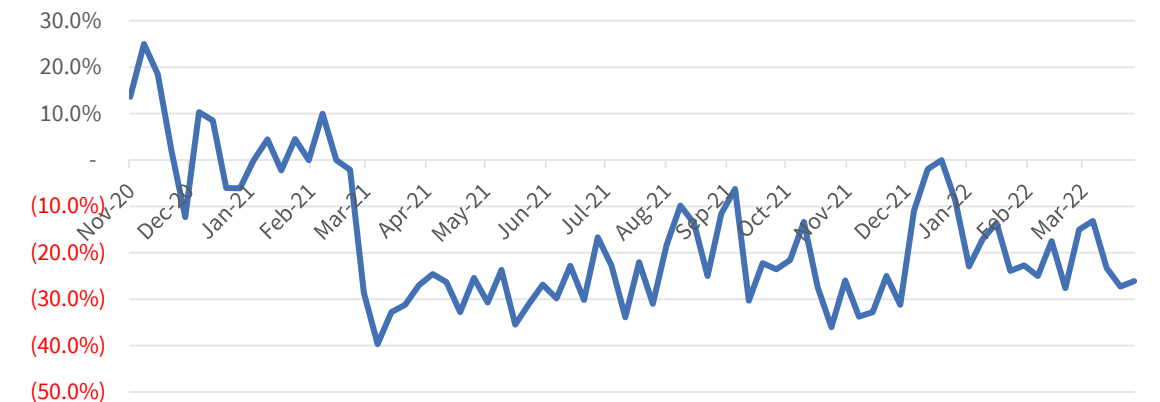
# Building a data edge on Kogan: Price x Volume

- Unique visits to KGN's website was declining as lockdown restrictions were removed
- Traffic proxy data showed declining yoy % growth
- Less traffic to the website would likely mean lower transacted volumes

Kogan.com – unique visits



Traffic Data: yoy (%)

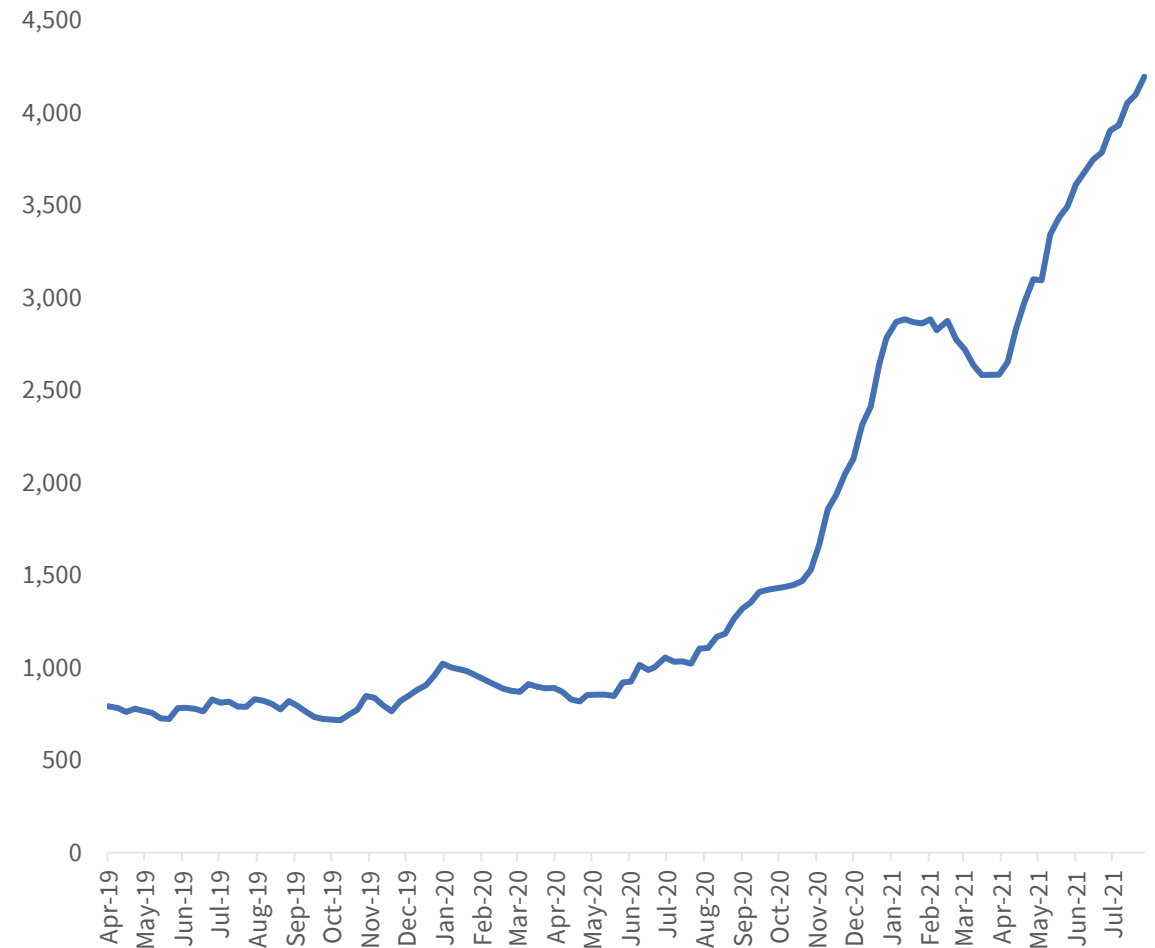




# Building a data edge on KGN

- Just as demand was weakening, key cost inputs were increasing putting additional pressure on margins
- **Customer acquisition costs** and **COGS** were increasing as retailers competed for supply and online customers.

## Shanghai Shipping Freight Index



Source: Bloomberg

# Red Flag #1: Insider selling...

## Selected insider transactions

Date	Event	Security transaction	#	AU\$/each	AU\$ total
19-Aug-2020	CEO/Executive Director/Founder – Ruslan Kogan	Share Sale	5,284,441	21.60	114,143,926
19-Aug-2020	CFO/COO/Executive Director – David Shafer	Share Sale	2,025,214	21.60	43,744,622
<b>24-Aug-2021</b>	<b>FY21 Earnings Announcement</b>				
31-Aug-2021	CFO/COO/Executive Director – David Shafer	Share Sale	350,000	11.50	4,025,000
1-Sep-2021	CFO/COO/Executive Director – David Shafer	Share Sale	350,000	11.18	3,913,000
2-Sep-2021	CFO/COO/Executive Director – David Shafer	Share Sale	300,000	10.95	3,285,000
		<i>Total share sales</i>	<i>8,309,655</i>		<i>169,111,548</i>

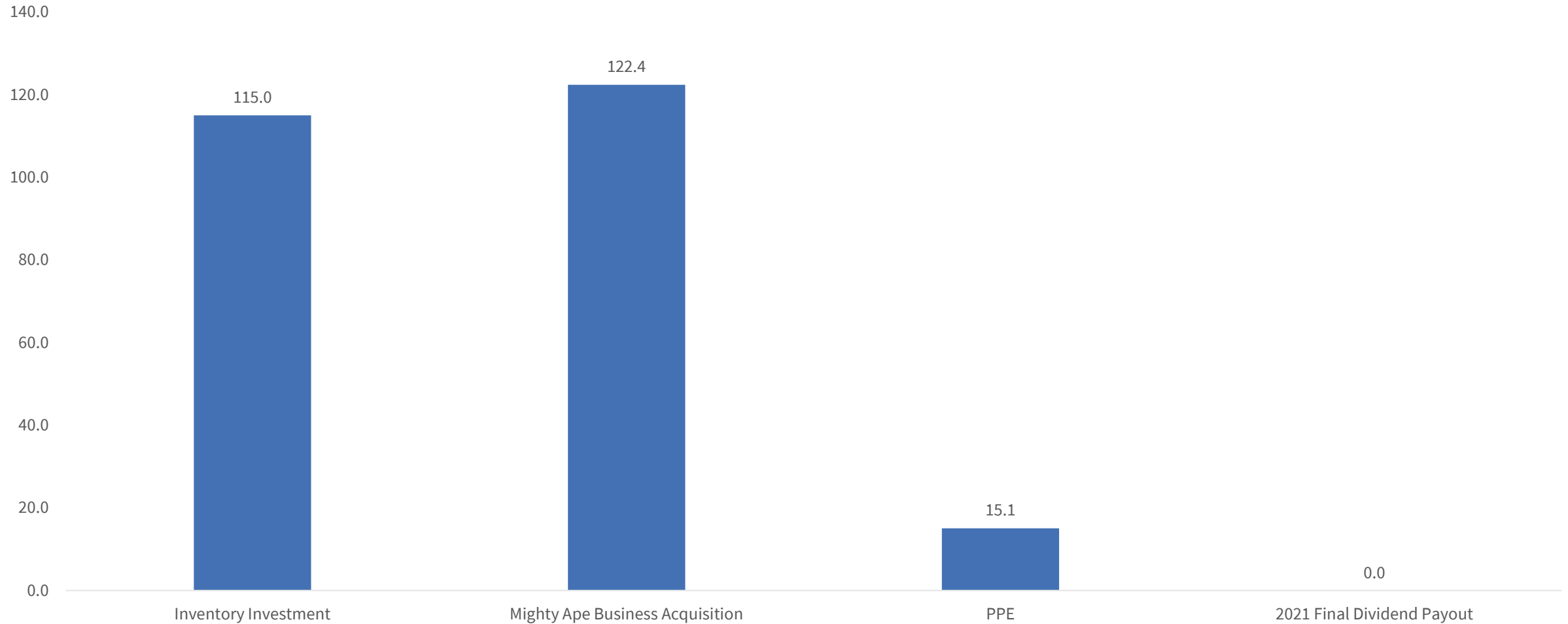
Source: ASX Announcements

“ In the race of life,  
always back self-  
interest; at least you  
know its trying”

Jack Lang, former Premier of NSW

# ...whilst making large Growth Investments

## FY21 Capital Allocation Decisions (AUD M)

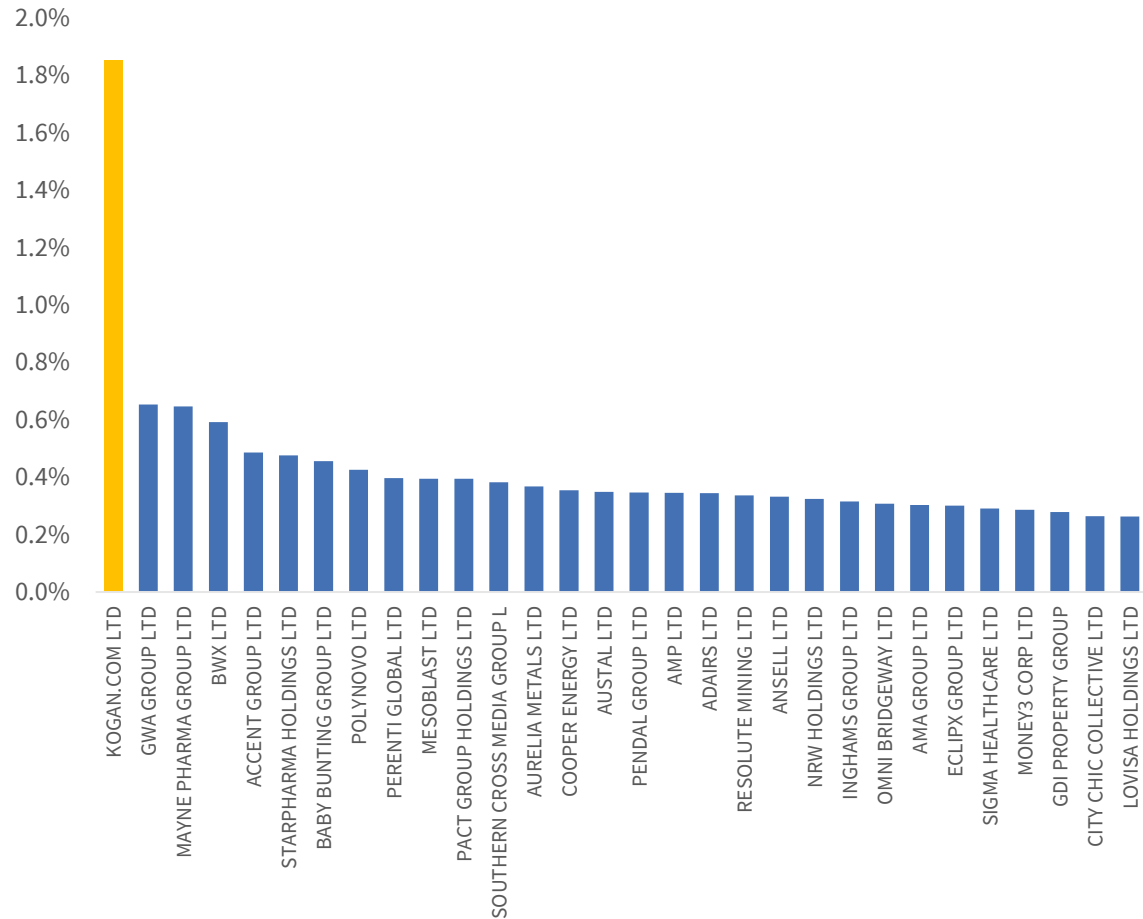


Source: Company Reports

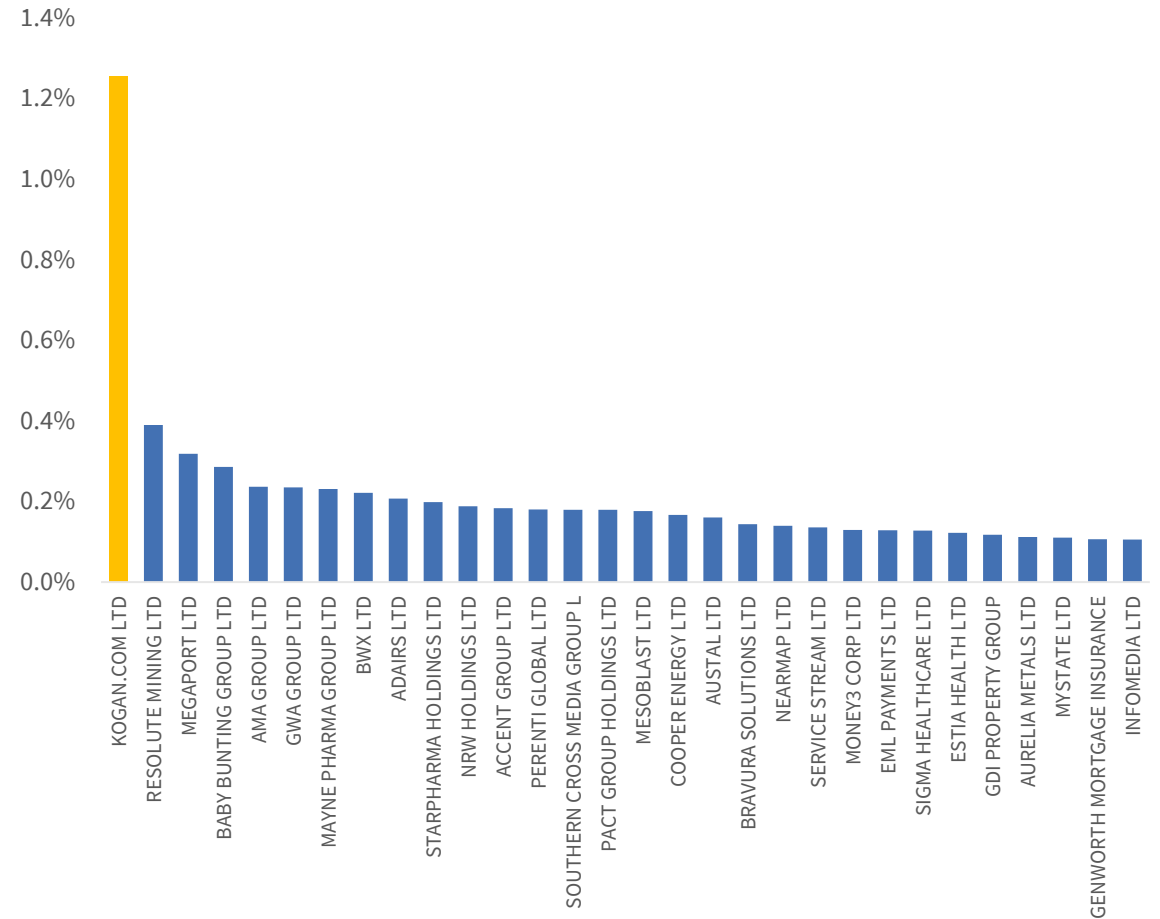
# Red flag #2: Executive compensation...

In 2021, the CEO/Founder was paid \$9.0m, and the CFO paid \$6.1m...

### ASX300 CEO Pay: % of Market Cap



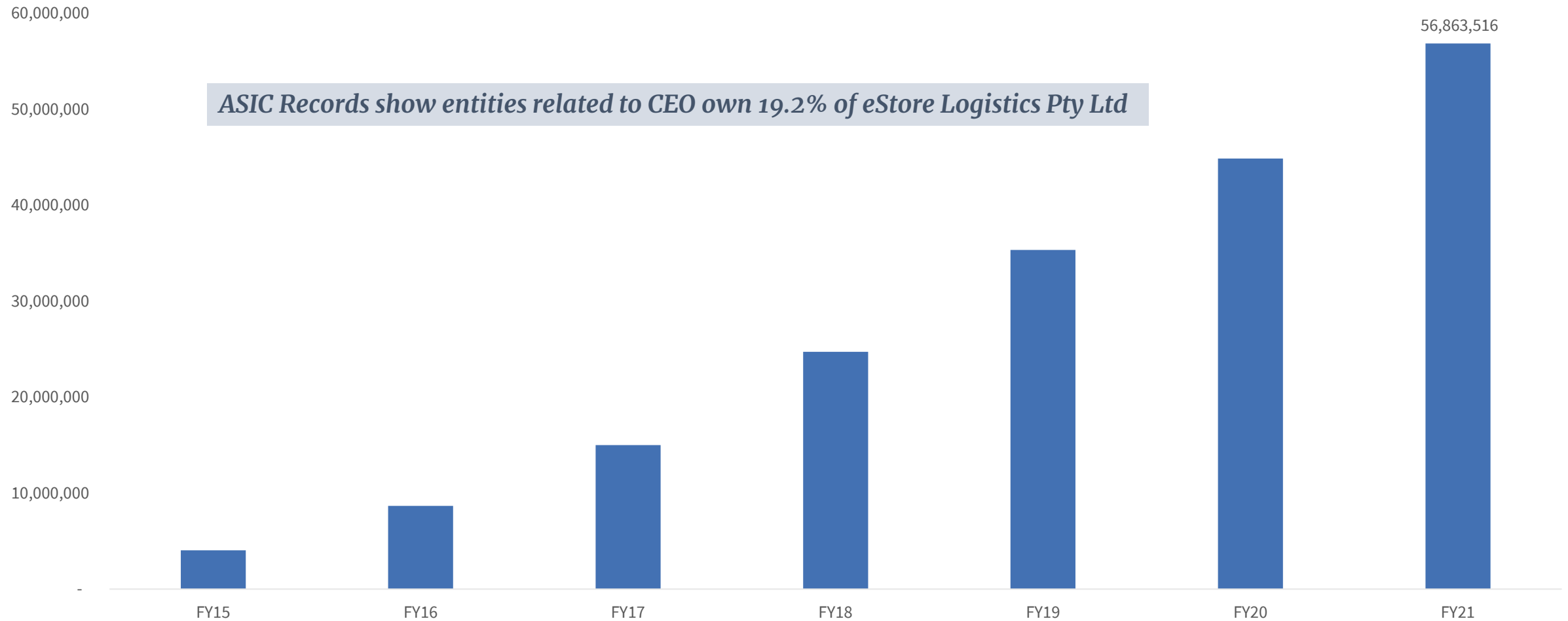
### ASX 300 CFO Pay: % of Market Capitalisation



Source: Bloomberg, 2021 Pay / Market Cap as at April 2022

# ...and material related party transactions

## Cumulative Payments to eStore Logistics (AUD)



Source: Company Financials, ASIC

## Red Flag #3: Accounting

Earnings adjustments that inflate Adj NPAT



Disclosure changes



Restatements

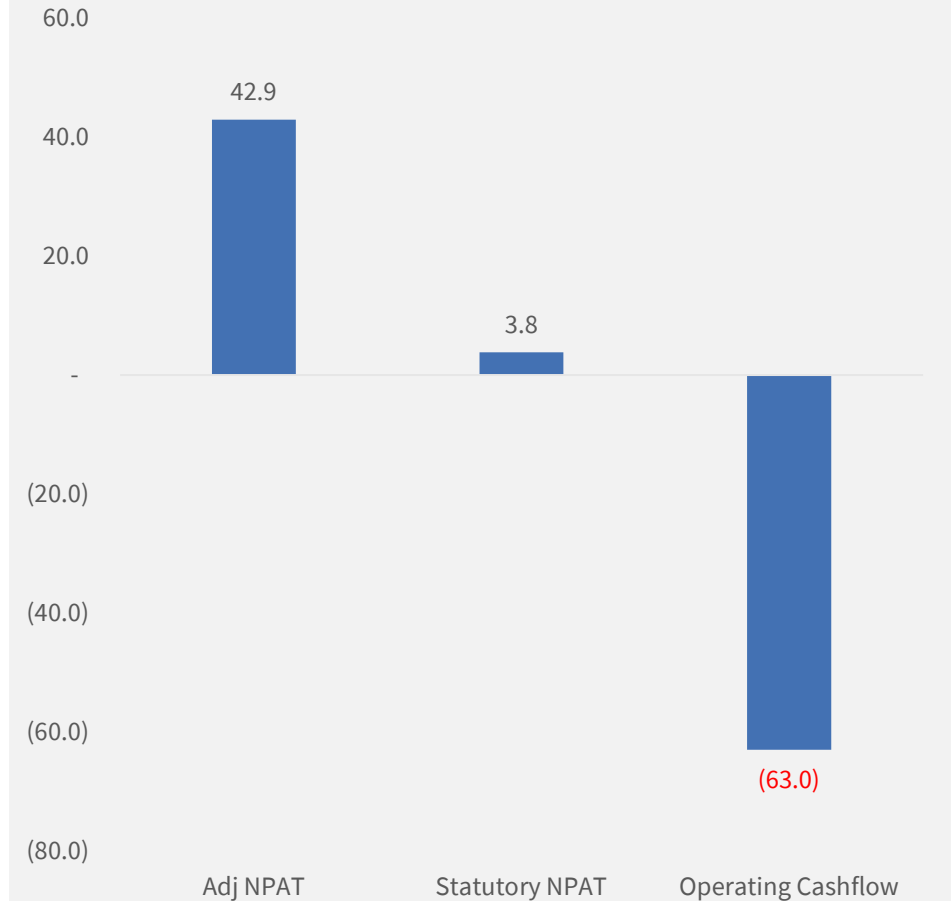


- For FY21 NPAT, the company normalized \$9.9m of inventory/logistics related costs and \$15.6m of stock-based compensation

- Inconsistent Segment Disclosure

- Cost & Income classifications changing over different time periods

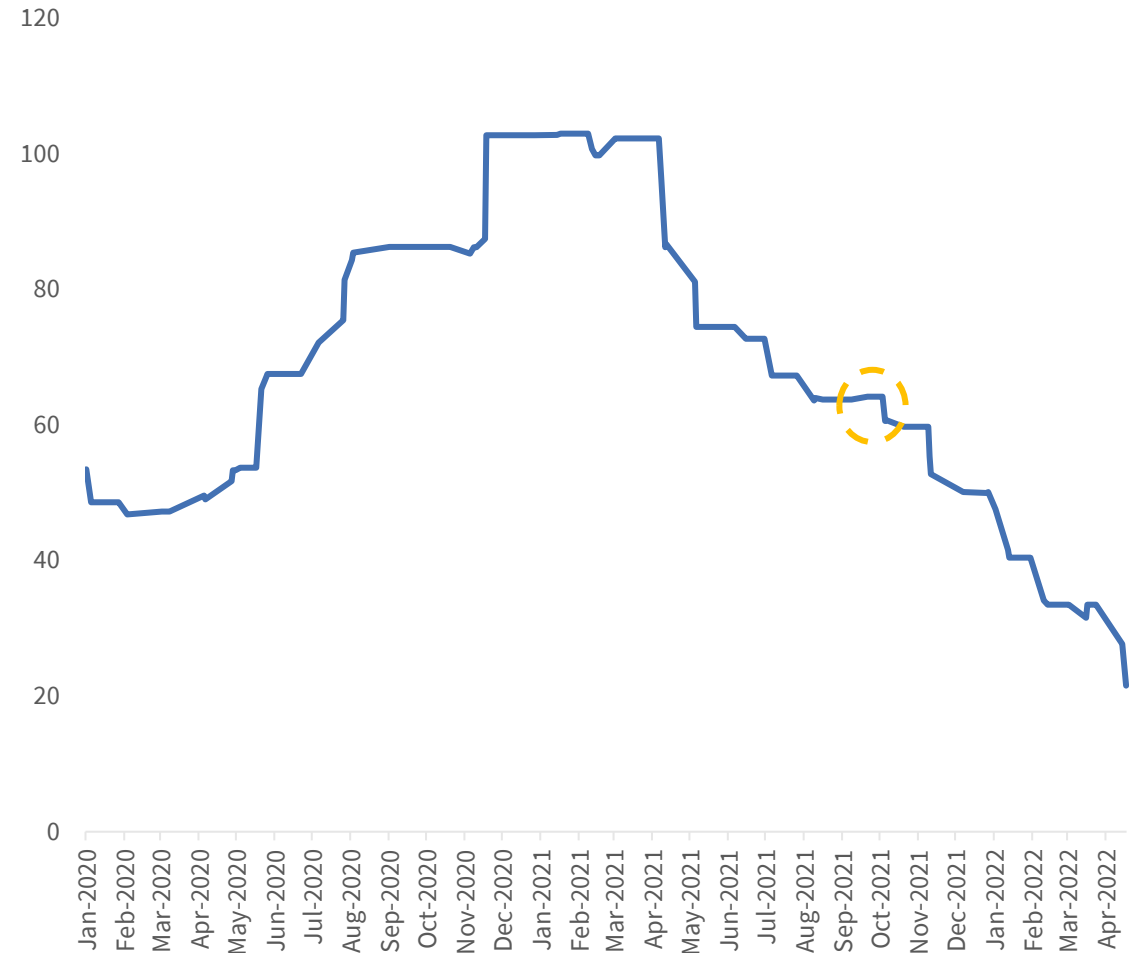
### 2021 Financials



# Dashed Expectations

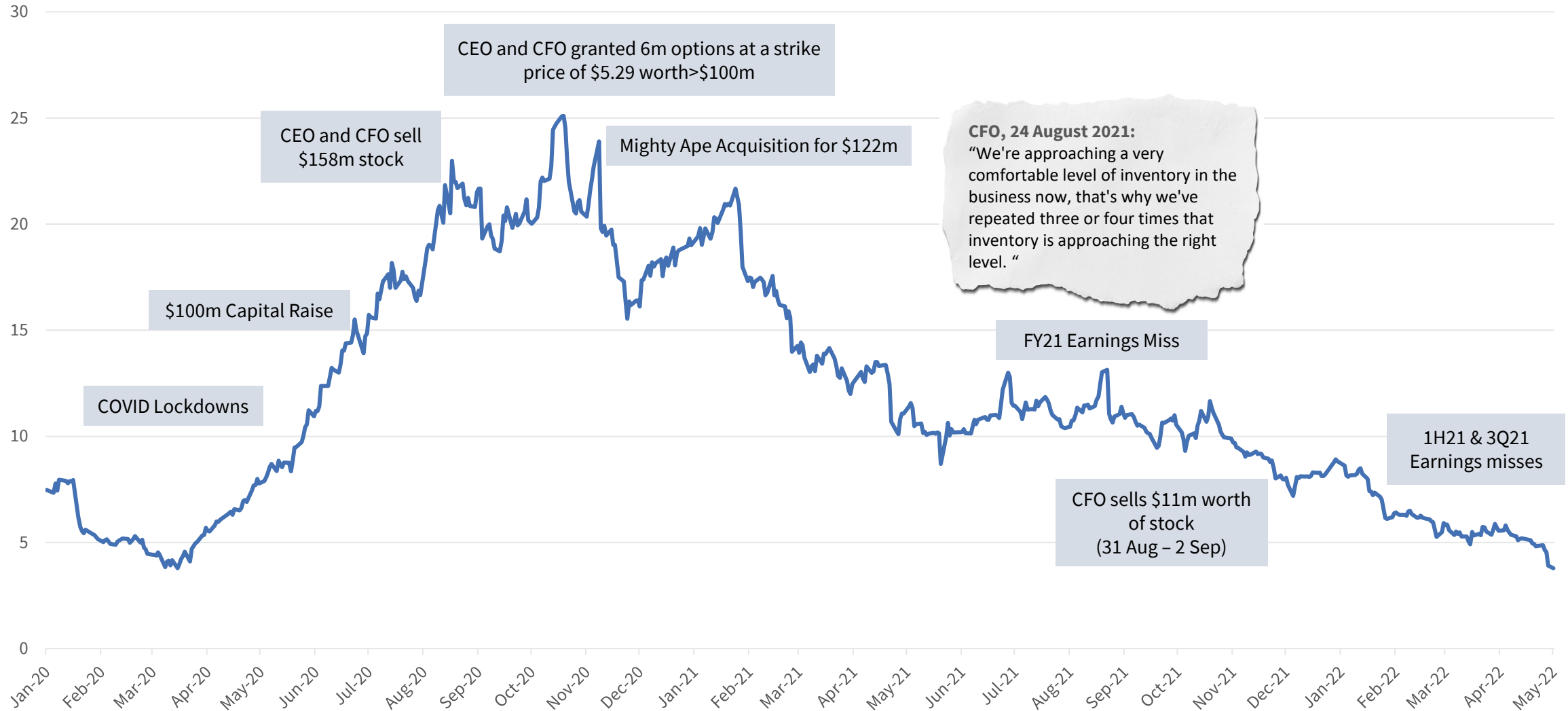
- KGN reported a large profit miss for FY21 (August 2021)
- Trading Updates for 1Q22, 2Q22 and 3Q22 prompted continued downgrades to expectations.
- Excess inventory and promotional pricing endure
- Potential further Balance Sheet issues to come.
- Share price has fallen 67% from our Avg short sell price of \$11.32

## Consensus FY22 EBITDA Forecast



Source: Bloomberg

# Dashed Expectations





# Disclaimer

---

This document has been prepared as general information only for wholesale investors in the Geometrica Fund and should not be distributed in any form to any retail or other investor that is not a wholesale investor as defined by the Corporations Act 2001.

Geometrica Management Pty Ltd (the Manager) (ABN 25 633 189 929) has prepared this document and is a Corporate Authorised Representative (CAR No. 001275640) of Geometrica Capital Pty Ltd (ABN 91 633 189 330, AFSL No. 533212) and is authorised to provide advisory, dealing and incidental custody services in connection with the Fund to wholesale clients only.

The nature of investment necessarily involves the risk of loss. The Manager is of the view that the information provided herein is accurate and complete, however, no warranty of accuracy, completeness or reliability is given, and no responsibility for loss or damage whatsoever or howsoever arising as a result of any representation, act or omission whether express or implied, is accepted by the Manager, its directors, employees or related bodies corporate. The Manager does not provide accountancy or tax advice and you should seek independent advice on these matters. Any advice is general advice only and does not take into account your personal financial position, needs or objectives.

This document does not constitute an offer. Any offer of units in the Geometrica Fund can only be made pursuant to an Information Memorandum which details the relevant risks related to investing in the Fund and other important information you must read and acknowledge prior to making any investment in the Fund.

The Fund is not suitable for all investors. Investing in any security or fund involves significant risk. The price of any security or fund may decline as well as rise.

**Past performance is not predictive of future performance and no guarantee or representation as to expected future returns is or can be made.**