Geometrica Fund

Investor Newsletter – December 2019

We seek asymmetric investment opportunities informed by the coalescence of rigorous fundamental analysis and alternative data discovery.

The Geometrica Fund aims to deliver outstanding returns to unitholders via highly targeted investments in the global mid-cap equity universe.

Overview

Net of costs and fees, the Fund closed the month of December -1.6% (Founders Class – Lead Series) with NTA at $1.0048 per unit.

In the same month, the S&P/ASX200 Index closed down -2.37% and the S&P500 Index closed up +2.86%.

Gross exposure at month end was 29%.

Our negative performance during the month was almost exclusively attributable to two factors:

First, a 3%+ intra month appreciation of the AUDUSD and AUDJPY stripped off around -0.8% (most of our equities are ex Australia).

Second, a fall in Sezzle of almost 13% stripped off another -0.8%.

The Fund is firmly in positive territory for January as we write, with gross exposure having lifted to 44% as some new names enter the portfolio.

Risk management

In early January, Sezzle fell a combined 33% in a few days as a negative regulatory pronouncement hit the wires in California.

I have seen plenty of 30%+ price drops in my time.

Two questions matter on such a day.

1. **Is your thesis busted?** If you didn't contemplate whatever it was that caused such a hit, then this is the default premise.
2. **If not, do you have capacity to buy more?** If you profess to like something, and it gets a whole lot cheaper, *logically* you should be *buying* more, not cutting and running.

In this case we *knew* that state-based risk was a factor when we bought the stock; especially in California, New York and possibly Florida (some others too but they're rounding errors). All the operators face this. Some navigate better than others.

In Canada for instance, the Sezzle product has some different features that require the company to use geolocation in accepting new customers.

In addition, because underlying sales continue to grow (absent the hiccup in California) we don't see the thesis as busted. If we did, we would exit post haste.

Equally, because the position is a small cap (it's the *only* sub US$1bn mkt cap stock we hold) and we're at a full days turnover, we didn't think it an assiduous use of the Fund's (i.e. your) precious capital to double down.

But ordinarily, if the thesis is not busted and provided the position size is not excessively large or illiquid, and noting the mathematical reality that when a position falls it gets smaller, we typically buy *more* in such a calamity.

Now, in recent days, several positive announcements have seen the stock trade back up, almost fully erasing the recent losses.

We are also expecting a positive quarterly sales report in the next two weeks and results thereafter.

So, it appears things are back on track with this stock. But we wanted to share with you how we think about single stock risk in these situations.

Portfolio notes

Texas Pacific Land Trust
(Ticker: TPL.US, US$6.2bn mkt cap)

TPL was our biggest positive contributor in December, rising 15.7% during the month.

It entered the portfolio back in October, when the stock momentarily dipped below US$600/share.

In TPL we own exposure to possibly the world's largest oil producing reservoir, the Permian Basin in Texas.

The Permian Basin currently produces more than 4 million barrels of oil each day.

In contrast, Saudi Arabia's largest producing field Ghawar is thought to produce at a rate of ~3.8 million bbl/day, having produced more than half of all Saudi oil production to date.

Despite the apparent attraction of rising production and revenue, investing in operators in the Permian Basin has generally been a bad idea due to factors such as cost blowouts and equity dilution.

This is where TPL is somewhat unique.

TPL holds a massive library of non-participating royalty interests (NPRI), which entitle it to a share of oil production or the monetary equivalent thereof, to some of the best acreage in the Midland and Delaware areas of the Permian.

For this, TPL bears none of the capital or operating costs; it's a free rider in the best sense of the term.

The background to this is that TPL received 3.5m acres of Texan land after the bankruptcy of the Texas & Pacific Railroad in 1888. Owing to its trust structure TPL was unable to prospect for and produce oil when production started to ramp in the Permian Basin in the 1920s.

So TPL spun off all its sub-surface mineral rights into a company called TXL Oil Corporation in the mid-1950s, which was subsequently acquired by a forebear of Chevron.

As part of the spin off, TPL structured a retained non-participating royalty interest over much of the underlying mineral interests.

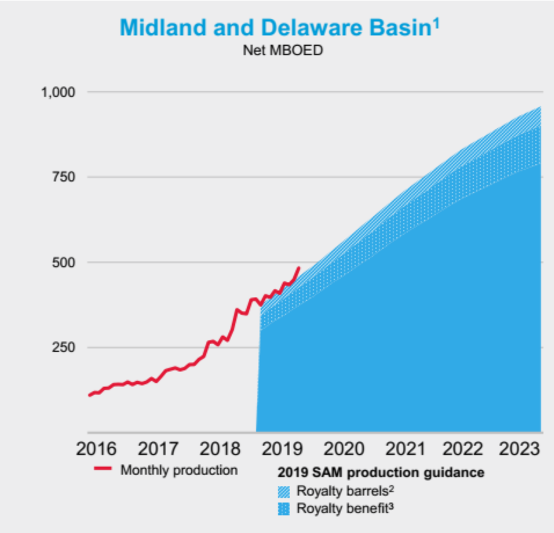
TPL has an attractive concentration of interests in the highly productive Midland and Delaware basins within the Permian.

In recent years, TPL's royalty revenue has been rapidly rising. We think this has some ways to go.

First, we can see that whilst many wells have been drilled on TPL's NPRI acreage land, many of these are yet to enter production, as the constraints of insufficient pipeline transport capacity are slowly solved.

Second, the largest operators of TPL NPRI acreage have quite aggressive production growth targets that involve TPL acreage.

Chevron is a case in point as the largest operator on TPL lands, it plans to double its production over the next 4 yrs.



Source: Chevron 3Q investor presentation

Exxon has similar plans for its Permian operations, which intersect to a material degree with TPL NPRI acreage.

Forward revenue and earnings growth for TPL appears robust to say the least.

Add to this an activist campaign to convert the trust to a corporation, and we have the potential for accelerated value realisation in this investment.

Shake Shack
(Ticker: SHAK, US$2.6bn mkt cap)

When SHAK fell from over $100 a share to $60 in November we built a position.

This is a business with phenomenal potential that just went on sale.

SHAK started as a hot dog stand in Madison Square Park in 2001, as a request made of famed restauranteur Danny Meyer. It became a cultural icon, with ever present queues. An expanded menu followed, as did a permanent site a few years later.

Then the current SHAK CEO said to his boss Danny, “hey, lets try to open another one”.

The Manhattan based SHAK sites average sales of ~US$7 million a year. For a burger joint selling $5 burgers, that is an insane level of productivity. The average Chipotle, selling more expensive burritos, turns ~$2 million a year.

When SHAK IPO’d in 2015, people said the idea wouldn’t travel.

But it did. There are over 250 sites globally now. 173 of them in the US. Not one single site loses money. Unit economics are extremely attractive.

In the 3Q result, management indicated that the full year 2019 same store sales number was likely to be 1.5%; because the prior guidance had been 2.0%, this implied a *negative* 3% for the 4Q 2019. The share price tanked.

But when you think about the causes of this, they are almost entirely transitory.

In August, SHAK announced it had selected GrubHub to be its sole delivery partner, an arrangement slated for launch in November 2019.

But as soon as it was announced, UberEats, DoorDash and the other spurned delivery providers dropped SHAK down their menu pages and jacked up their delivery fees to SHAK.

So SHAK’s delivery sales were hit. SHAK in turn dropped some delivery menu items, further impacting their delivery sales.

And GrubHub only started onboarding SHAK’s in November. We think this takes two quarters to cycle through.

Because cutting off myriad delivery partners was the cause of the negative same store sales guidance, its logical to think that when GrubHub is fully integrated, there will be a bounce in same store sales, and thus the stock price.

A few days ago the company noted at a conference that the integration is progressing better than expected.

We have no real idea if the comp sales will turn positive in this quarter or the next; but we have a very strong view it will be within the next 12 months, and when that happens the share price should move firmly in the right direction.

Team

We welcome Ben Wolrige to the team starting 1 Feb 2020. Ben and I last worked together at Contrarian Value Fund Limited. Ben is an experienced analyst with a proven capacity to generate returns and complements the strong analytical, quantitative and programmatic skill set of James Bradley who has been with the Fund since inception.

19 December 2019.

Fund overview (Alpha Units)

Fund	Geometrica Fund	Investor Eligibility	Wholesale only
Structure	Wholesale unit trust	Minimum Investment	A$250,000
Mandate	Global long short Mid-cap focus	Fees	1.5% management (+GST) 20% performance (+GST)
Gross exposure range	0 - 200%	Benchmark	RBA Cash Rate
Net exposure range	1 - 100%	High water mark	Yes
Single stock long limit	15% at cost	Liquidity	Monthly
Single stock short limit	5% at cost	Admin & custody	Mainstream Fund Services
Buy / Sell Spread	Nil / 0.25%	Platforms	Ausmaq

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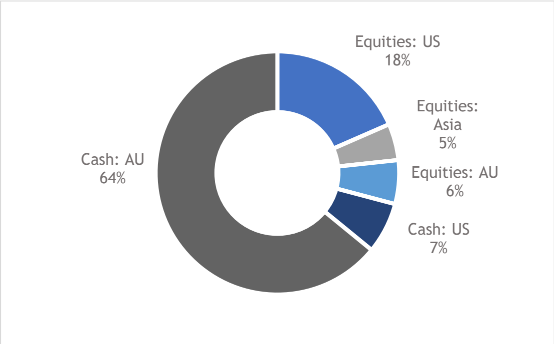
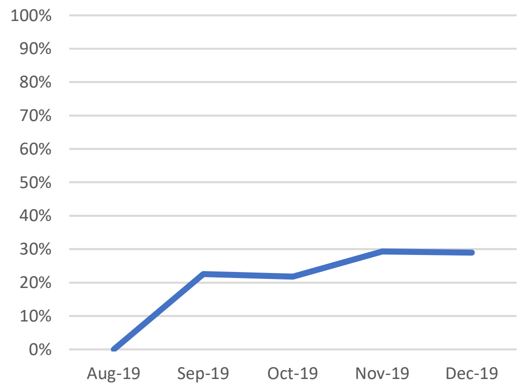
Asset allocation



Gross exposure



Investment performance (net)

	Founder Lead Series - 2019
Jan	-
Feb	-
Mar	-
Apr	-
May	-
Jun	-
Jul	-
Aug	-
Sep	1.1%
Oct	0.8%
Nov	0.1%
Dec	-1.6%