O'KEEFE STEVENS
ADVISORY, INC.

Q1 2024 April 25, 2024

A Welcome Surprise

After discussing Graftech's (EAF) challenges throughout 2022 and 2023, Groundhog Day came early in 2024, with the stock declining 39% in January. The selloff likely stems from indiscriminate selling by Brookfield Asset Management and shares distributed by BAM due to the fund ending. We were again left wondering what we were doing in this business and stock. However, when things look bleakest, the sun rises.

In February, Nilesh Undavia filed a 13D, signaling his intention to nominate himself and others to the board at the upcoming annual meeting. Graftech's business and stock have underperformed our expectations, with CEO changes, a plant closure, and other setbacks. A significant shareholder willing to step up and make his voice heard is welcomed.

Though Mr. Undavia's regulatory filings were submitted in a lackadaisical manner, and lacks direct steel industry experience, he has **significant skin in the company**. His 5.7% stake, acquired with PERSONAL capital, speaks volumes about his commitment to the business and his outlook on the electric arc furnace and graphite electrode industry. Having a board member with substantial ownership is something we're open to, even if his background and filing process were imperfect.

We held calls with both parties. One emphasized accountability, while the other offered excuses. As my father used to say, "losers make excuses." Graftech shareholders desperately need someone to hold management accountable. A complacent board requires a shake-up, where management owns only 0.15% (mainly through option grants).

Management opposed Mr. Undavia and instead backed incumbents Debra Fine and Anthony Taccone. Arguments against Mr. Undavia included no relevant work experience, a disorganized filing process, and no new business ideas. Mr. Undavia's arguments included Graftech's loss of market share, CEO turnover indicating underlying issues, significant ownership, and willingness as an outsider to hold management accountable.

When we met with management months ago, they seemed overconfident, like a wide receiver celebrating a touchdown when the team is down 30. As Sabres fans, we understand the importance of accountability. When asked about the rationale behind firing head coach Don Granato, Dylan Cozens said, "We want to be pushed harder and held to a higher standard." Granato was popular but couldn't lead the team from good to great. Similarly, Graftech's management and board need a new approach.

WE RECOMMEND VOTING FOR NILESH UNDAVIA. WITHHOLD DEBRA FINE & ANTHONY TACCONE.

We appreciate Mr. Undavia's efforts and capital investment in bringing about change at Graftech. We remain committed shareholders and optimistic the business cycle bottomed early in 2024. We anticipate electrode prices recovering throughout the year, and volumes improving in 2025.

New Position

In Q1, we initiated a new position in Aercap (AER). We outlined the thesis in our Q4 2023 letter and discussed the thesis on Hustlehub. We will refer you to these resources for the thesis. We've added to the position several times and believe that even though the stock was up 20% in Q1, it has 40% near-term upside as the market continues to underappreciate the duration of the leasing hard market.

BGC Group - A Thesis Playing Out To Perfection

During the quarter, BGC Group announced several milestones and key elements of our thesis. First, the company provided its Q4 business update, stating it expects to be around the high end of its previous guidance range. Fenics (fully electronic business) revenues increased 20% y/y, led by Rates and Credit trading, which saw revenues rise 25% and 42.6% y/y, respectively. The market underestimates these segments' normalized revenue and earnings power after a decade-long 0% interest rate environment. We believe these lines are just getting started in what is the normalization between treasury issuance and trading volumes.

In January, after many delays, BGC announced FMX Futures Exchange received CFTC approval and would soft launch in the summer. The exchange will compete directly with the CME, attacking their monopoly business. We detailed the key thesis on why we believe FMX can take a significant share from CME on X(Twitter), which can be found here.

The most impactful announcement was BGC's inclusion in the S&P 600 Small Cap index, leading to the purchase of 46 million shares by price-agnostic buyers. A core tenet of the C-Corp conversion was the index inclusion opportunity. Management continues to execute its strategy with a healthy business environment and the imminent FMX launch. Despite the stock rising 11.5% in Q1 and nearly 50% over the past year, it remains undervalued. Normalized earnings power will show as Fenics becomes a more significant portion of revenue, with higher margins, lower capital intensity, and an improving business environment. We continue to hold the position and believe fair value is north of $10/share.

Market Outlook

Hopes of a soft landing drove the S&P 500's 11% gain in Q1. While we remain concerned with inflation, the macro environment appears calmer despite ongoing geopolitical tensions. The market anticipated five rate cuts at the start of the year, which we doubted. Cutting rates while inflation remains above target could lead to a resurgence. We expect rates to stay higher for longer, benefiting those in or nearing retirement by offering them a safer alternative with satisfactory returns.

However, we have small concerns with higher rates. Homebuilders offered teaser rates, or buydowns, for new homebuyers, expecting rates to drop after a few years. Refinancing might not be an option if rates remain high. Do homeowners have the income to afford higher interest payments? If yes, how much does this hurt disposable income?

Moreover, S&P Global reports $1.49 trillion of speculative-grade debt maturing in the next 36 months, raising concerns about companies unable to refinance. While bankruptcy and post-reorganization investing have been muted in recent years, we expect more opportunities in this area. Good companies with bad balance sheets could emerge, offering potential investment opportunities.

Within the OSA portfolio, Five Point Holdings (FPH) and Graftech extended their maturities in 2023. Higher rates increase interest costs, though the added time allows for cash generation and net debt reduction before maturity, a trade we are happy with.

Conversely, companies in the portfolio with low long-term debt benefit significantly from higher inflation and rates. Higher inflation should lead to higher revenue and free cash flow in absolute terms, reducing overall net leverage. Management teams can then repurchase the discounted debt, assuming they have no other attractive investments. Warner Brothers Discovery(WBD) fits in this bucket.

Portfolio Top 5 Holdings

At the end of Q1 24, our top 5 holdings represented ~34% of assets, with NVDA representing almost 15% of the portfolio. The remaining four include QCOM, AMGN, BKRIF, and HCC. We sold NVDA call options, which expire in June and are deep in the money. Once exercised, as opportunities arise, we will deploy cash generated from the covered calls over time.

Research Ideas

During the quarter, we published a short report on EXP Realty (EXPI), a long thesis on Roku (ROKU), and a neutral report on Blackbaud (BLKB). We are happy to discuss any ideas and send the EXPI and ROKU thesis (Dominick's email is below).

EXPI – The market underestimates the impact of recent NAR settlement and regulation changes. EXP's buyer-tilted business model affects them more than typical real estate brokers. We walk through the unit economics of the changes at a broker and corporate level.

ROKU – An idea that would have seemed unthinkable just a few years back when low P/E or low multiple meant the stock was cheap. Roku is free-cash-flow positive, EBITDA breakeven, and GAAP Net Income unprofitable. Historically, investors tend to shy away from unprofitable businesses. Deeming them too risky. Roku has a $2B net cash position and is reinvesting in the business, grabbing Connected TV market share. Geographic expansion takes time and capital. They have a dominant share and have many tailwinds. Walmart's acquisition of Vizio adds to the already heightened uncertainty. We can't remember seeing a company with such "negative" sell-side coverage. 9 buys, 10 holds, and 4 sells. Nearly all reports discuss weighting for clarity, which is why the opportunity exists. Wells Fargo has the lowest price target at $45, or 26% downside. We see a reasonable case for a $100 stock in the near term and long term, owning a compounder with an attractive business model, secular tailwinds, and dominant market share that can translate into a desirable return over the next several years.

Blackbaud (BLKB) – We were first introduced to this company at a conference in 2023 and found the business intriguing. They provide services to the non-profit/charity industry through payment processing, CRM software, and other products. While in the early stages of implementing a new contract structure, moving from a 3-year contract with 1-year renewal and no price escalators to a 3-year contract with 3-5-year renewals and yearly price escalators. The initial mid-teens price increase will flow through the P&L at a high rate due to little incremental costs. After discussing the new structure with customers, we have concerns about retention and the duration they can push the price at the current rate. The valuation was marginally too expensive, though we continue to follow the name should the market present a better entry point.

Regards,

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