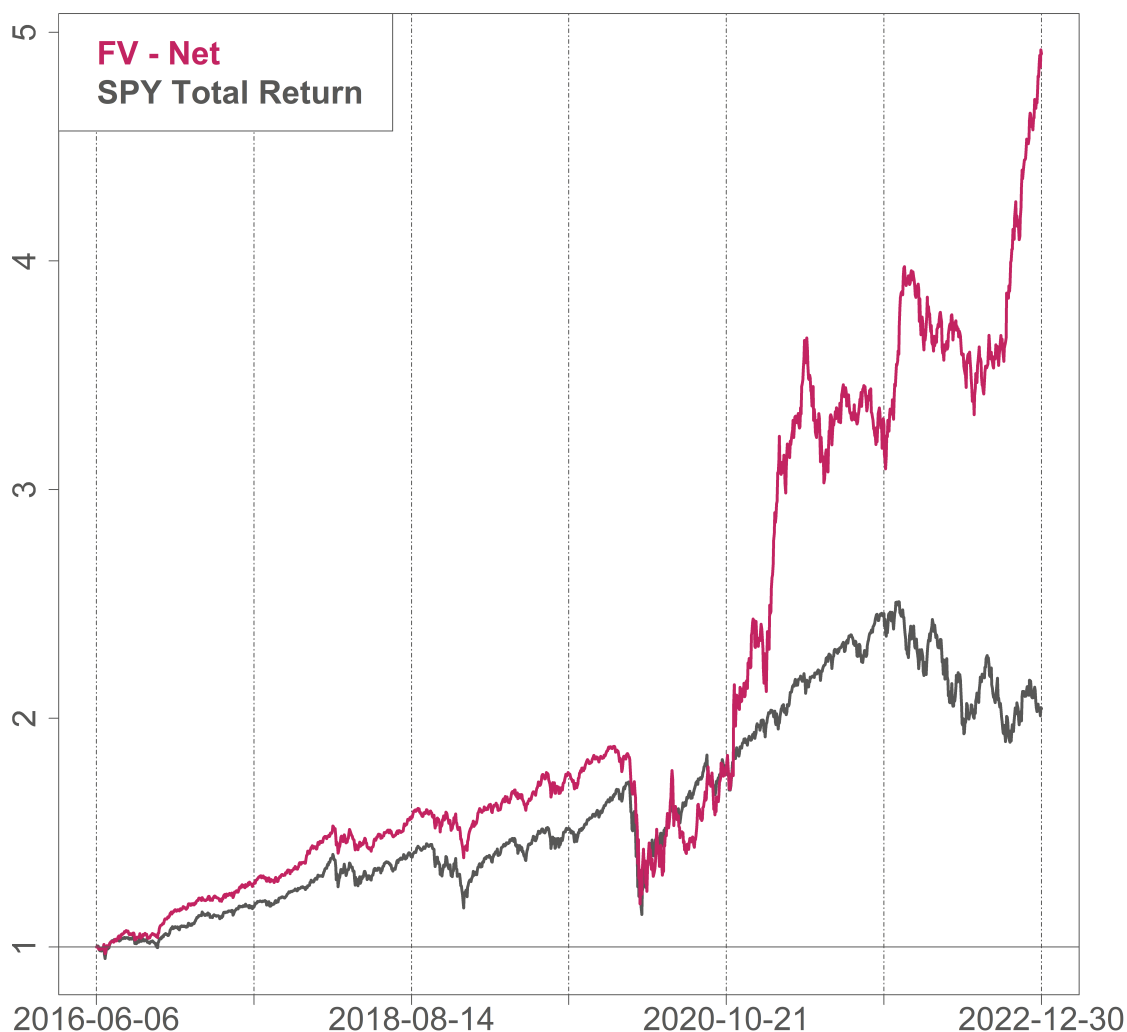


## 4Q22 Quarterly Report

Fundamental Value had one of its best quarters to date, returning 34.7% net of fees vs 7.6% for the S&P 500. The strategy has now compounded at 27.4% annualized, besting the market by nearly 16% a year. While it will be almost impossible to maintain this level of absolute or relative performance, we are still very optimistic about the composition of the portfolio relative to the index today.<sup>1</sup>



Period	FV - Net	SPY
4Q22	34.7%	7.6%
2022	36.0%	-18.2%
2021	48.5%	28.7%
2020	29.8%	18.3%
2019	22.7%	31.0%

2019	29.7%	31.2%
2018	-1.1%	-4.6%
2017	26.0%	21.7%
2016	15.7%	7.5%
Since Inception	390.6%	104.2%
<b>Annualized</b>	<b>27.4%</b>	<b>11.5%</b>

***Programming note:** We've released a new book which includes all of our investor letters since the beginning of the pandemic, including this letter. If you'd like a physical copy, please reach out! You can find a digital copy here: [Investing through the Pandemic: Letters from Bireme Capital](#).*

### Market commentary

When the year 2022 began, we had just finished our “Everything Bubble” series, and the path ahead seemed remarkably clear to us. In that series, we [wrote](#):

Extreme valuations presage real returns that investors will find severely disappointing -- and likely negative -- for many asset classes over years to come...

We believe inflation is likely to be the catalyst that ultimately pops the everything bubble. If we are correct, eventually the Fed will have to reverse course, tightening policy and raising interest rates. When this happens, investors who have speculated in low or no-yielding assets like SPACs, high-flying growth stocks, and NFTs may find their portfolios permanently impaired...

The barbell market presents enormous opportunities for discerning active managers on both the long side and the short side. We have never been so enamored with the available opportunity set.

Those predictions have largely come true, and we have appropriately capitalized on them, with Fundamental Value outperforming the S&P by 54% in 2022.

The path forward today is less clear. Inflation, though still uncomfortably high, is moderating as we [expected](#). However, inflation “moderating” from a headline ~8% should be cold comfort. We think the most likely outcome is that it settles well above the Fed’s 2% target -- say, 5%, roughly the current best estimate for [wage growth](#) and persistent [components](#) of the CPI -- necessitating years of painfully high interest rates. But the CPI could also plunge into dangerous deflationary territory; the steep path of rate increases and quantitative tightening after a nearly uninterrupted decade of ZIRP could shock the economy to a standstill.

Or, of course, inflation could fall rapidly to 2% by the end of 2023 and stay there indefinitely. It’s possible, but fanciful. Yet economists and traders increasingly seem to [expect](#) that most benign of possible outcomes.

This Goldilocks view for the economy permeates the equity market. Valuations remain stubbornly high, and analysts continue to estimate earnings growth for future years despite the likelihood that margins will fall from record levels due to rising labor costs, rising interest payments, withdrawal of pandemic-era fiscal stimulus, and a slowing economy.

Since we published [Part III: Apex of a Bubble](#) on September 21st 2021, we’ve seen the largest reduction in fiscal stimulus on record, the fastest spike in real yields, the worst annual performance

for Treasuries, the fastest pace of monetary tightening in generations, and the reversal of a decade of quantitative easing and zero interest rates.

Astonishingly, the S&P is down *less than 7%* since that day.

What level should the S&P 500 trade at today? There's no correct answer to that question. But it is clear that the risks remain highly asymmetric to the downside.

The equity risk premium here is perilously thin. As an illustration, consider XLP, the S&P 500 Consumer Staples ETF, which comprises solid, if ponderous, companies that one hopes will enjoy GDP+ growth. As of this writing, XLP [trades](#) at 24x earnings, an earnings yield of 4.2% -- exactly the [yield](#) of a riskless 2-year US Treasury.

Complacency reins. And this is complicating the Fed's attempt to tighten financial conditions, as the Fed is [all too aware](#):

Participants noted that, because monetary policy worked importantly through financial markets, an unwarranted easing in financial conditions, especially if driven by a misperception by the public of the Committee's reaction function, would complicate the Committee's effort to restore price stability.

The Fed will need to push back. We wrote [last quarter](#):

The Fed put is now a Fed call: rather than a limit to how much investors can lose, there is a limit to how much they can make. We caution investors that the Pavlovian response to buy the dip will not necessarily lead to the same rewards as it has in the past... A more appropriate maxim for the foreseeable future might be "sell the rally" instead of "buy the dip."

Investors who so eagerly repeated "Don't fight the Fed" to rationalize the decade-long bull market seem to have forgotten that mantra now. Hope springs eternal. Despite our fears that the equity market as a whole is priced for asymmetric downside, we continue to find some exceptions that are priced for asymmetric upside, such as META, a [transcendent](#) company in a secular growth industry trading for a single-digit multiple of normalized earnings (full thesis [here](#)). While we are increasingly constructive on our long book, we remain conservatively positioned at a roughly 80% net long, retaining significant dry powder to aggressively increase our holdings on market weakness. Our short book is smaller than it was at the peak of the madness a year ago, but many securities continue to trade at transparently irrational prices. We expect our shorts to continue to generate not just alpha, but positive absolute returns.

It's a great time to be an active value investor. We wrote in our [1Q22](#) letter:

The past decade has rewarded valuation-agnostic and meme-chasing investors, culminating in the unhinged growth stock mania that defined 2021. We think the next era will be marked by a return to sanity, rewarding disciplined, discerning and value-conscious investors -- and we think that era has just begun.

It's not too late to join us at Bireme. Please reach out.

## Portfolio commentary

RCI Hospitality appreciated more than 40% in Q4, rising from \$65 to \$93. The company reported robust results on December 14th, with fiscal year EBITDA up 44% to \$87m and EPS of almost \$5 per share. The company also announced the acquisition of six nightclubs and a few one-off bar / restaurant locations. The nightclubs were acquired at about 5x EBITDA, a price made even cheaper by a seller-financed 7% loan. This is an extremely attractive cost of debt given that AAA bonds were [yielding](#) over 5% in November. The acquisition appears likely to increase RICK's FCF by 15-20% and only required the issuance of 200k shares (around 2% of the fully diluted total).

Netflix appreciated 25% in the quarter, well off its lows but still down more than 50% on the year. Q3 results saw a return to subscriber growth, with the firm adding 2.4m and finishing at an all time high 223m subscribers. Netflix also debuted its much-anticipated advertising tier in November, pricing it at a 30% discount in the US. While it is still very early days, we think by 2028 Netflix's ad-supported tier will have tens of millions of subscribers and generate \$10+ billion in revenue at high margins. We expect earnings to exceed \$30 per share by then, roughly triple what the company earns today.

Bolloré stock was up 10% in the final quarter of the year. Q3 results saw sales in the transportation segment up 25% year-over-year, as the firm's port terminals and freight forwarding businesses continue to recover from the pandemic. The company also disclosed that L'Odé, the holding company which controls the majority of Bolloré voting shares, [purchased](#) 103m Bolloré shares through Q3 for EUR 485m. We view this as a clear vote of confidence in Bolloré's valuation and essentially a share buyback due the circular nature of the ownership. Despite the Q3 rise, Bolloré shares continue to trade at a large discount to the value of its assets, which include a \$7b stake in Universal Music, the \$5.1b sale of its African assets (which [closed](#) on 12/21/22), its \$3b stake in Vivendi, and the remaining freight forwarding business which will likely generate about 7b EUR of revenues in 2022. The total market capitalization of Bolloré after properly accounting for treasury shares is just \$7.3b.

The Twitter deal closed just before Halloween as we mentioned in our [Q2 letter](#), giving control of the social media platform to the one of the world's richest men and providing a near 50% return on investment to Bireme clients. Musk clearly knew what was coming in the Delaware Court of Chancery and decided to fold his hand.

Many of the companies in our short book continued to languish.

Overstock.com was down 21% in Q4, as investors have finally realized that the company's bitcoin-trading pivot was a farce and they are left with a COVID-era "winner" that faces major headwinds as the pandemic subsides. Current Street estimates predict a -28% sales decline for 2022, EBITDA margins of just 3%, and essentially zero net profit. Arguably Overstock's largest asset is the cash on its balance sheet, rather than its marginally profitable, zero-growth namesake eCommerce site.

Nikola, the "manufacturer" of alternative-energy vehicles, was down 31% in Q4 to new all-time lows. Contrary to 2021, the company did book revenues this year. They sold a few hundred trucks. However the company failed to generate even a gross profit, losing \$59m before considering costs like marketing, G&A, and depreciation. Nikola has burned about \$500m of cash this year but management prudently (albeit partially) financed this by selling over \$100m of newly issued stock into the open market. But even with the stock down 75% from its de-SPAC price we think these new investors may never see a positive return.

Tesla shares were down 48% in the quarter, as Musk was forced to sell shares to finance his other adventures and investors seemed to question the strategy of running four firms at once. Admittedly, Tesla is still growing furiously, with revenues up 55% in Q3 over last year and EBITDA margins a healthy 23%. But we continue to question whether that level of margin is sustainable over the long term, as the competition in EVs heats up and Tesla continues [moving](#) out of luxury price points to meet their volume goals.

Tesla's hyper growth phase may also be ending. Wait times for Tesla's cars are just [a few days](#) now, down from multiple months last year. That is a bad sign for growth at the \$350b market cap automaker.

Even the meme stocks AMC and GME declined more than 20% in the quarter after previously sidestepping the 2022 bear market. AMC's Q3 operating results demonstrated their ongoing problems in a post-COVID world, with a net loss of \$226m for the quarter and \$686m on a year to date basis. The company has burned more than \$700m of cash so far in 2022, partially financing this with long term debt [yielding](#) a whopping 15% to maturity.

At the current AMC share price around \$4, the fully diluted market cap of the company — including the “AMC Preferred Equity” shares (whose ticker is, of course, “APE”) — is around \$6b. This is despite the fact that the firm has \$4.7b of net debt outstanding and generated less than \$300m of EBIT even in pre-COVID times. We think it is clear that some type of restructuring will occur at AMC in the next few years. We pressed our short bet during the quarter by increasing our short position in AMC and buying a corresponding number of APE shares, which, despite being economically equivalent, trade at a massive discount for no reason. We were therefore pleased to see management [announce](#) a vote to convert APE shares into AMC shares. Though the discrepancy persists, this has reduced the discount between the two securities and created a paper profit for our clients.

We are grateful for your business and your trust, and a special thank you to those who have referred friends and family. There is no greater compliment.

- Bireme Capital

Follow our content by subscribing [here](#).

---

<sup>1</sup> Net calculations assume a 1.75% management fee. Fee structures and returns vary between clients. FV inception was 6/6/2016.

The performance in the charts is the performance of the securities in all Bireme accounts ("Bireme Master Account") and the strategies that make up the account holdings from inception through 12/31/2022. The performance in the tables is the performance from inception and from 10/1/2022 through 12/31/2022. Past performance is not indicative of future results. It is not possible to invest directly in an index. Index performance does not reflect charges and expenses and is not based on actual advisory client assets. Index performance does include the reinvestment of dividends and other distributions. The performance in the Bireme Master Account is shown as net of 1.75% advisory fees. Some clients may receive services at a lower advisory fee with a performance fee based on the gains in the account. Returns are shown net of fees at the account level, and gross of fees at the individual strategy level. For current performance information, please contact us at (813) 603-2615.

Sources: Bloomberg Finance LP, Interactive Brokers LLC, S&P Compustat, Bireme Capital LLC.