STERN IAG

Board of Advisors Meeting

Feb 19th, 2021

Table of Contents

I. Letter 2

II. Performance Analysis 3

III. Key Holdings Update 7

IV. Update Notes 14

V. New Position Proposal 18

Letter from Portfolio Managers

Dear Board of Advisors,

First and foremost, we would first like to congratulate the five new portfolio team members: Alexander Isaac, Alice Yu, Amy Chen, Niranjan Narasimhan and Rahul Parikh! They are the first cohort to go through the new internship structure and we are pleased with the results thus far. We look forward to seeing their contributions to the club going forward.

We are happy to report that IAG outperformed the S&P 500 by 19%, resulting in an AUM of ~$60K. Looking back at the historical reports, we believe this is a record in terms of both returns and AUM. That said, it would be ill-served not to recognize the highly positive environment in which we are currently operating in. To use fishing as an analogy, we are using the same fishing pole and bait to catch fish that are substantially larger than usual, which puts us on higher alert than usual. Nonetheless, we are cautiously optimistic about the remainder of the academic year.

Moving on to recent developments in the markets, we had mixed feelings watching the gamification of markets these last few months. It served as a reminder for how low the entry barriers are to public equity investing, as well as how market pricing is influenced not only by the perception of intrinsic value. However, as GME, the posterchild for market gamification, fell from ~$480 to ~$50, our conviction in our process was quickly strengthened. Also, while some aspects such as the retail investor participation is novel, short and gamma squeezes are not (i.e., VW briefly being the most valuable company in the world in 2008). History does not repeat itself, but it often rhymes.

Another topic that has been on our minds is when and where consumer spending will bounce back as the economy opens back up. One area where we have a particular interest is leisure travel. The picture below was taken at Cancun airport a few days ago and clearly suggests that consumers are itching to escape their homes. TSA checkpoint data is still drastically lagging prior years, but we are confident that we can benefit from this potential leisure travel boom indirectly through current positions such as TDG but also more directly through potential new positions next meeting.

Today, we are pleased to share the following proposals:

1. At Home Group (NYSE: HOME) – a home décor retailer on the cusp of completing a successful turnaround with promising growth prospects
2. Diamond Hill Investments Group (NASDAQ: DHIL) – an undervalued investment advisor that manages mutual funds and separately managed accounts

We are happy to continue being a source of information to the Board and encourage you all to reach out with feedback or clarifications.

Best,

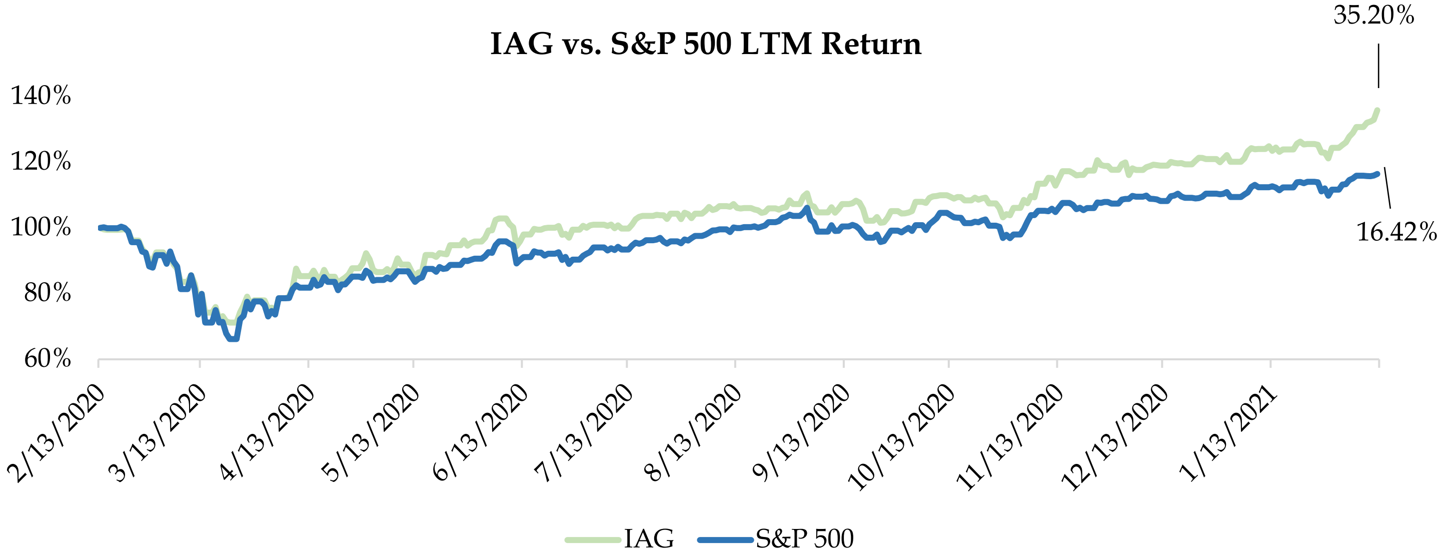
Chen Zhou & Jaro van Diepen

Portfolio Managers

II. Performance Analysis

Holdings Summary *(as of Feb 17th, 2020)*

Holdings Summary										
Company Name	Ticker	Coverage	Date of Purchase	% of Portfolio	Share Count	Price At Purchase	Share Price	Current Return	Morningstar Industry	Holding Type
Allison Transmissions	ALSN	Cody Fang	12/3/19	**3.4%**	50	$47.42	$41.65	(12.2%)	Industrials	Core
APi Group	APG	Srikar Alluri	9/24/20	**4.9%**	160	$14.23	$19.10	34.2%	Industrials	Core
Berry Global	BERY	Sophie Pan	12/3/20	**4.7%**	50	$54.60	$58.02	6.3%	Consumer Staples	Core
BorgWarner	BWA	Larry Wang	3/14/19	**4.0%**	55	$38.34	$44.57	16.2%	Industrials	Core
CVS Health Corp	CVS	Michael Giese	12/6/16	**2.4%**	20	$77.28	$72.71	(5.9%)	Healthcare	Core
First Energy	FE	Liam Coohill	10/29/19	**2.6%**	50	$47.30	$31.95	(32.5%)	Utilities	Core
Grocery Outlet	GO	Larry Wang	5/14/20	**3.4%**	50	$36.45	$42.17	15.7%	Consumer Staples	Core
HCA	HCA	Srikar Alluri	9/26/19	**5.4%**	19	$119.20	$176.44	48.0%	Healthcare	Core
Identiv	INVE	Tony Wang	9/24/20	**7.9%**	400	$6.26	$12.15	94.1%	TMT	Oppt.
Office Properties Income	OPI	Cody Fang	10/29/20	**5.3%**	130	$17.73	$24.98	40.9%	Real Estate	Oppt.
Palo Alto Networks	PANW	David Zhou	9/24/20	**6.4%**	10	$244.75	$395.42	61.6%	TMT	Core
Points International	PCOM	Tony Wang	10/29/20	**5.8%**	240	$9.95	$14.87	49.4%	TMT	Oppt.
Recro Pharma	REPH	Srikar Alluri	10/29/19	**1.1%**	160	$13.20	$4.42	(48.3%)	Healthcare	Oppt.
TransDigm Group	TDG	Jaro van Diepen	4/9/20	**2.8%**	3	$360.46	$570.37	58.2%	Industrials	Core
United Rentals	URI	Caleb Nuttle	3/14/19	**6.3%**	14	$118.07	$277.81	135.3%	Industrials	Core
XPO Logistics	XPO	Chen Zhou	10/20/19	**8.7%**	45	$74.41	$119.00	59.9%	Industrials	Core
ZTO Express	ZTO	David Zhou	3/14/19	**6.0%**	100	$19.28	$36.91	91.4%	Industrials	Core
SPDR S&P 500	SPY			**5.1%**	8		$392.39			Core
Total Equity Holdings				**85.9%**			**$53,126.58**			
Cash				**14.1%**			**$8,703.33**			
Total Portfolio Holdings				**100.0%**			**$61,829.91**			

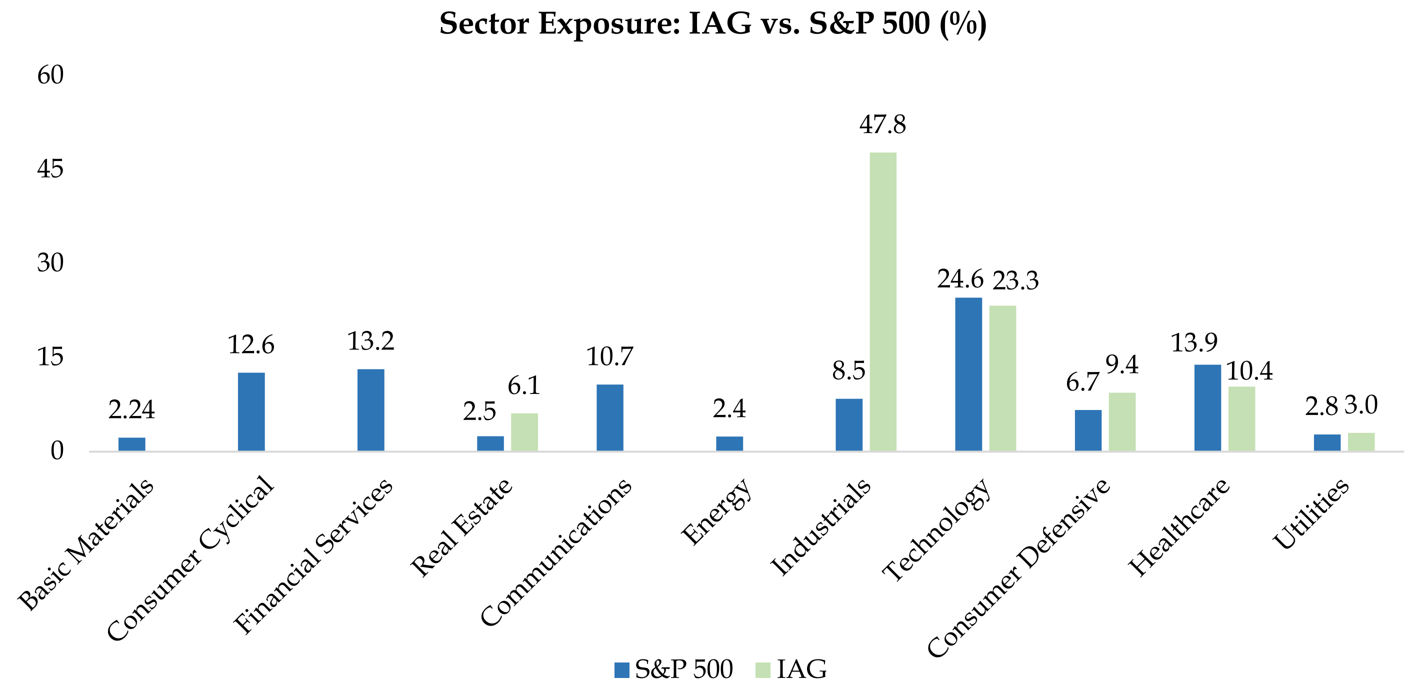


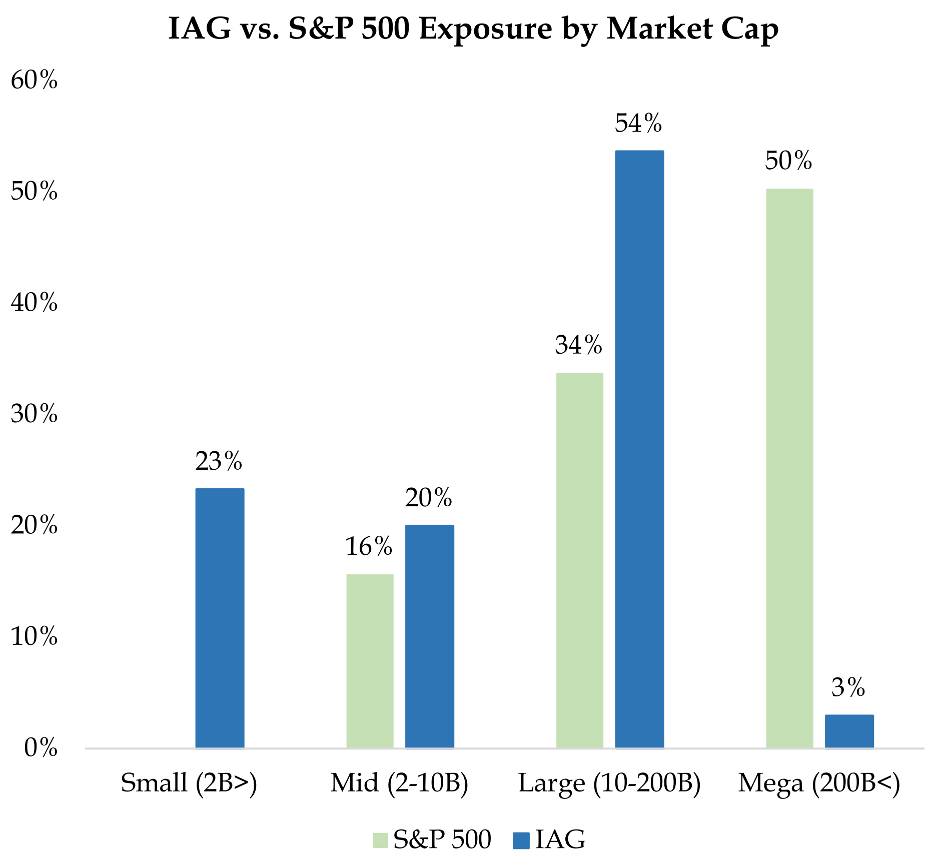
Portfolio KPIs	
Indicator	Number
Daily Sharpe Ratio	0.06
Annualized Sharpe Ratio	1.00
Portfolio Beta	1.08
Daily Volatility	1.52%

On a last twelve-month basis, **IAG's portfolio has returned 35.2%** while the S&P 500 returned 16.4%. This outperformance is partially due to the portfolio being positively skewed to an economic re-opening due to heavy industrial weighting. Since the last oversight meeting, **the spread between IAG's portfolio and the S&P 500 contracted from 0.1% (11/30/2020) to 18.8% (2/17/21).**

Our opportunistic positions now represent ~20% of our portfolio which is in line with our expectations.

Portfolio Exposure vs. Benchmark





IAG continues to use the S&P 500 as the core benchmark as specified in the fund mandate. While our industrial exposure is still substantially overweight, the two proposed positions today will help improve the composition.

IAG continues to be underexposed to mega-cap positions, yet drastically overexposed to small-cap companies. We will continue to look at the mega cap space for potential opportunities but do not think that the underexposure poses a major issue.

Pitch Log Since Dec 2020 Meeting

Internal Pitches Since Dec 2020 Meeting

	Company	Stage	Date	Analysts
1	At Home Group	Quick Screen	2/2/21	Caleb Nuttle
2	Alico Inc	Quick Screen	2/2/21	Cody Fang
3	Daily Journal Corp	Quick Screen	2/2/21	Tony Wang
4	Vapotherm	Quick Screen	2/2/21	Srikar Alluri
5	MasterCraft	Quick Screen	2/2/21	Sophie Pan
6	At Home Group	First Update	2/9/21	Caleb Nuttle
7	BJ's Wholesale	Quick Screen	2/9/21	Vinny Ye
8	Match Group	First Update	2/9/21	Simran Korpal
9	Diamond Hill	Quick Screen	2/9/21	Tony Wang
10	MasterCraft	First Update	2/9/21	Sophie Pan
11	Daily Journal Corp	First Update	2/9/21	Tony Wang
12	Diamond Hill	First Update	2/16/21	Tony Wang
13	At Home Group	Second Update	2/16/21	Caleb Nuttle
14	SiteOne Landscape	Quick Screen	2/16/21	Achyut Seth
15	BJ's Wholesale	First Update	2/16/21	Vinny Ye
16	Match Group	Second Update	2/16/21	Simran Korpal

Active Pipeline

	Company	Stage	Date	Analysts
1	Match Group	Second Update	2/16/21	Simran Korpal
2	Daily Journal Corp	First Update	2/9/21	Tony Wang
3	MasterCraft	First Update	2/9/21	Sophie Pan
4	SiteOne Landscape	Quick Screen	2/16/21	Achyut Seth

Oversight Meeting

	Company	Stage	Date	Analysts
1	At Home Group	Second Update	2/16/21	Caleb Nuttle
2	Diamond Hill	First Update	2/16/21	Tony Wang

III. Key Holdings Update

Portfolio Updates Since Dec 2020 Meeting

Company	Ticker	Update
Allison Transmissions	**ALSN**	We propose to hold our stake in Allison Transmissions (ALSN), currently down 10.2% from our cost basis of $47.42. The company has been significantly impacted by the pandemic with Q3 NA on Highway volumes down 24% and a 9% decrease in the replacement parts and retransmissions business. Monthly US class 6-7 on-highway volumes were trending upwards towards the latter half of 2020 with 7.5% retail sales growth in October (month over month) vs 4.8% in August and 4.6% in September. Additionally, the company has continued to develop its next generation e-axle technology although management believes that the adoption of EV's in NA on highway should occur in 2024 or 2027 along with the next wave of emissions standards. In regards to municipal spending, the company highlighted comments from Blue bird stating that 25% of US school buses are >15 years old – the legal maximum age for school buses in many US municipalities. Overall, while the company has been materially affected by the pandemic, the stock holds strong reflecting increased Class 8 metro and Class 4-5 penetration (7% and 16% respectively) and strong international expansion opportunities. With ~20% of revenues tied to municipal spending, the thesis still holds in a post-COVID world.
APi Group	**APG**	Not much has materially changed since opening the position four months ago. The company announced a series of small acquisitions in the late fall of last year totaling about $300M. As we look forward, the company hints at larger acquisitions and we are waiting to see the progress of that. Greater focus on the European market is interesting as the company claims the European market is even more fragmented than the United States. The company has a large amount of cash on the balance sheet with $750M as some of the warrants from the SPAC transaction have been cashed in.
BorgWarner	**BWA**	**Sell note in the packet.**
CVS Health Corp	**CVS**	We propose holding our stake in CVS Health Corp (CVS), which is currently down 9% from our cost basis of $77.3. Not much has changed since the last update in December. In regard to the Amazon effect, it was recently announced that Haven Healthcare, a joint venture between JP Morgan, Berkshire Hathaway, and Amazon focused on lowering costs for U.S employees, is shutting down at the end of February, which could be most likely attributed to leadership issues and different goals. Although Amazon will continue to pose a threat, this supports how CVS is still able to maintain a defensive business model in a highly competitive and regulated industry. Moreover, the fundamentals of the business have not changed and valuation is attractive at current discounted multiples. Management aims to delever until it can reduce debt to about 3x, so EPS growth should improve in 2022 when it can reinitiate its share repurchase program. While Aetna continues to contribute to top-line growth and CVS expects to deliver on its $900 million run-rate synergy target by the end of 2021, management also expects to open 1,500 HealthHub health clinics by end of 2021, which could bolster foot traffic at retail stores. Although margin pressure is likely to continue in the near future, we are confident that CVS will be able to maintain its dominant position in the industry and expand market share.

Portfolio Updates Since Dec 2020 Meeting

Company	Ticker	Update
First Energy	**FE**	We propose holding First Energy at $31.9. Since July 17th, 2020, First Energy has been under investigation on potential corruption and racketeering charges tied to House Bill No.6 which provided subsidies to Energy Harbor (Nuclear Power Plant for First Energy). The company is investigated for funneling 61 million dollars through a non-profit to House Speaker of Ohio. The non-profit has recently taken a plea guilty to federal racketing and this could have implications on First Energy. While the direct impact to the company may be small given only 20% of their operations are in Ohio and most of their contracts are fixed till 2024, the indirect impacts are much more uncertain and difficult to calculate. However, the market is pricing in far too great of a drop due to the uncertainty and looking at historical precedent we believe the company can recover. Additionally, the company has continued to shift from their unregulated business to move towards the regulated utilities side which has provided additional stability in earnings. Management has also stated that they plan to continue their dividend plan as is with a payout at roughly 59%. Looking at the core business, it is functioning well and growth for the next few years is expected to be 6-8% growth.
Grocery Outlet	**GO**	GO now expects 34 store openings vs our current estimate of 28, highlighting the strength of the business development team that manages through the time of pandemic. Hire of new EVP of East Region to accelerate development of east coast infrastructure. Management further sees opportunities to continue expansion in the southern California region and in East coast Pennsylvania / New Jersey, where there are strong real estate pipelines. New development of store level inventory APIs to localize inventory management, allowing store managers to adjust their inventory level according to the buying pattern of local customers and dynamically features deals or strategies that reduce over stocking and stock-outs. This is especially important for discount retailers that are selling goods with close expiration dates, potentially delivering a positive impact on its GO's margins in the long run. There have been concerns about GO's slower recent comps vs. conventional retailers, partly attributed to an acceleration in e-commerce. However, we continue to hold our view that GO is 100% e-commerce proof due to its discount pricings and location in lower-tier cities. There has been modest de-leveraging from 2.8x to 1.9x net debt / EBITDA. Our updated price target is $57.40 (~40% upside)
HCA	**HCA**	Recently, the company has been handling the second wave of Covid-19, but this time, the business has better adjusted to it and been able to do more complex medical procedures. The company has been able to decrease the leverage ratio and is looking to expand by spending $3bn on potential acquisitions as well as new construction in hospitals, surgery centers, and rehab facilities. At current valuation levels, it does appear a little higher than the historical average, but it is fine as the company has a long runway to growth. Continued pain by smaller hospital operators may create attractive consolidation prospects in some markets. Looking forward, we do hope for a return to normal at the end of the year, and a full return of surgical procedures. With regards to the initial thesis on the political pressure, we see most of the potential for short-term large reform as muted, but we are monitoring the continued push by CMS for pricing transparency. We propose a hold on this position as our thesis remains intact.

Portfolio Updates Since Dec 2020 Meeting

Company	Ticker	Update
Identiv	**INVE**	Since our last meeting, INVE has appreciated substantially and we are currently sitting 60% above our cost basis. While I haven't pinpointed the reason for last week's rally, it does seem that RFID growth is finally getting priced in. Identiv took out a term loan and two promissory notes over the past 12 months to fund its RFID expansion. The business has prematurely retired the term loan and one promissory note (total principal paydown of $5.7mm); the announcement on December 30 sent shares up ~6%. This early deleveraging indicates the strength of RFID sales over the period, as well as confidence that future growth can be funded by CFFO. I've reached out to a fund that is also long to see if they had uncovered anything I missed. I will update if they reply. Quick recap of the thesis: Identiv was a small-cap, money-losing business operating at ~50% capacity. However, underlying NFC adoption trends and supply-side advantages could clearly push this business to scale. Sell-side frankly didn't really understand the scope of this opportunity, especially given the fact that a major competitor (Smartrac) had recently left the space. We are betting that the business will expand EBIT margins to 15-25% from the RFID sales ramp. Identiv also presents itself as an attractive acquisition target. Neither of these points have been fully substantiated but we seem to be well on our way.
Office Properties Income Trust	**OPI**	We propose to hold out stake in Office Properties Income Trust (OPI), currently up 41.5% from our cost basis of $17.73. The stock has reacted positively to vaccine news, reflecting the market's anticipation of and end to work from home in the near future. Pursuant to that belief, rent collections have remained strong with OPI collecting 99% of contractual rent. Going forward the expectation is a 25% decrease in AFFO pushing the payout ratio from ~50% to ~80% with the company seeking a 75% payout ratio. Management has also hinted that occupancy should be meaningfully lower in 2021 with two large move outs (20 Mass Ave in DC and IRS in Fresno). The company is expecting 7% of its ABR to be vacated in 2021 and the story is now the company's ability to release its assets. Additionally, the company's capital recycling plan also looks to resume with OPI selling off a $130 million property in Richmond, VA in January after acquiring a $15.3 million property in Georgia in Q3. Despite ongoing headwinds, the ~12% dividend yield looks to continue to remain intact and despite a short-term pop, the company remains attractive from a dividend perspective.

Portfolio Updates Since Dec 2020 Meeting

Company	Ticker	Update
Palo Alto Networks	**PANW**	Several months ago, we added PANW into our portfolio as a strong incumbent in Network Security (with 7w+ installed customers, still adding approx. 3000 per quarter) expanding into the next generation of cybersecurity products, specifically cloud/hybrid, endpoint, and analytics, through a delicate and well-executed M&A strategy. We believed that this active expansion plan allows PANW to enter the larger TAM and faster-growing security markets, leveraging the synergies that exist between its product portfolio. The stock closed at $379.8 as of last Friday, yielding a 55% gain since our entry. From a 6-month price movement perspective, PANW has outperformed its incumbent peers, Fortinet and Check Point, but underperformed the new security peers. Nevertheless, this is clear evidence that investors are starting to appreciate the expansion strategy that PANW is implementing. The past two strong quarters with consistent strong growth in Next Gen. products (25% of total billings, 53% growth, whole ARR guidance=$1.15B as of Q1FY21) has boosted investors' confidence in those new offerings and proved PANW's ability to executed its M&A strategy. A re-valuation process is underway. Moving forward, we believe PANW remains a safe and profitable investment in the medium-to-long term. Fragmented as it is, cybersecurity is a large market with growing importance within a digital and inter-connected world. Growth in key industry segments will drive value accretion to players with strong positions in those verticals. ZS, CRWD, VMW, MSFT, PANW are all potential beneficiaries, but PANW's dominance in Network Security and the breadth of its product portfolio is especially unique. We reiterate the story as presented in the original pitch: 1) Powerful and strengthening position in legacy market with large installed base; 2) Transition to next gen. security through cross/up-selling kindles new era of growth; 3) Margin expansion by selling higher-margin offerings and through M&A synergies.
Points International	**PCOM**	Since our last meeting, Points has reported preliminary Q4 and full year results. Gross profit is expected to fall in the $34.8-35.2mm range (down 46% YoY). The business is ~adjusted EBITDA positive~. More importantly, total funds available (cash/equivalents and funds payable) is $79mm, up from the 68mm in Q3. The business has amended covenants to guide on minimum adj. EBITDA and liquidity through Q2 FY21. Points had previously drawn $40mm from its credit facility and has since paid down $25mm ($15mm of which was in Q4, a promising trend). There was sequential gross profit improvement of 50% in Q4 due to increased promotional activity by airline clients and also new business won through the Amadeus IT partnership. I think it is interesting that the business is still winning partners in this environment. I will have to look further into this IT partnership. As a side note, I've spoken with an analyst who's hyper bullish and believes that PCOM is an acquisition target for a business like ICE (I don't really buy this but thought it was interesting to bring up). Obviously, the easy money has been made already, but the business is still decently cheap relative to our bull case (which seems to be materializing). Further, the balance sheet is still quite clean. KPI's to watch include major airline RPM's, hotel nights booked, and daily new cases in key geographies.
Recro Pharma	**REPH**	We propose a hold in our stake of Recro Pharma, although we remain concerned about various risks such as management not being fully aligned with shareholders. However, we are confident in REPH as a going concern and given the current investor sentiment relative to our business development expectations, we remain a hold on this position. According to the company, Clinical Trial Materials (CTM) and Logistics Services launched in Q2 seeing positive results. The company has been able to expand its business development team and continues to win contracts. We would like to see short term catalysts like these play out before potentially selling.

Portfolio Updates Since Dec 2020 Meeting

Company	Ticker	Update
TransDigm Group	**TDG**	We propose holding our position in TransDigm at 571.85 USD, a current return of 58.7%. Since our last meeting, TDG published Q1 earnings and while the results were significantly worse on a year over year basis, we are happy with the performance given the tough environment. Additionally, as TDG has little control over the general commercial aviation space, they are focused on the three areas where they do have control: cost cutting, liquidity, M&A/Divestitures. On the cost cutting front, TDG was almost able to maintain their margin profile on half the revenue base and considering the substantial scale implications, we expect some of these cost savings to be more permanent. In regard to liquidity, TDG raised an additional 1.2B USD in senior subordinated bonds in order to fully repay the 6.5% senior subordinated debt. This was initially meant as an additional liquidity injection but given that the environment is beginning to improve, management decided to paydown debt. Lastly, TDG divested several Esterline businesses that were nonproprietary/non aviation in order to keep their proprietary revenue at ~90%. Overall, we believe that this is a better business than it was last oversight and when we bought into the position.
United Rentals	**URI**	United Rentals has recently closed out their FY' 20 and reported Q4 earnings. Overall, the performance was well received by the market, with the company beating on both revenues and EBITDA. The company reported $2.3B in Q4 revenue, beating consensus by 5.3%, and Adj. EBITDA of $1.04B, beating consensus by 5.9%. Simple earnings figures aside, the quarter's performance raised a few questions and flags for investors. Firstly, EBITDA margins came in at 45.5% (a 1.5% decrease from Q4'19), and gross margins on equipment declined by -2.9%, decreasing for the 8th consecutive quarter. As for management guidance, sales YoY estimates seem to have been the only positive development, with management projecting further pressure on EBITDA in 2021. There was also room for some continuing optimism, however. Liquidity at the end of the year was ~$3.1 billion, with the company's net leverage ratio at ~2.4x. Fleet productivity similarly saw an improvement from Q3'20. This quarter, fleet utilization declined -3.8% YoY, but when compared to Q3's -8% YoY, the company is clearly making up ground. Management also has been floating around the idea of continuing their M&A strategy in 2021, as the company has significantly improved its financial leverage position. Overall, I recommend holding the position.

Portfolio Updates Since Dec 2020 Meeting

<table>
<tr><th>Company</th><th>Ticker</th><th>Update</th></tr>
<tr><td>XPO Logistics</td><td>XPO</td><td>To revisit, XPO will reorganize into two parts in 2H21 per December announcement:

• NewCo: pure-play contract logistics. Long-term contracts with blue chip customers – high revenue visibility, with growth levers such as outsourced e-commerce fulfillment.
• RemainCo: LTL, freight brokerage (original roll-up), and others, of which the former two make up 90% of EBITDA.
    • Asset-heavy business: Third-largest LTL operator with top-notch and still shrinking operating ratio (to reach ~$1B in EBITDA in 2022)
    • Asset-light business: the initial roll-up, now the second-largest freight broker with a digital brokerage market place with the fastest carrier adoption rate in the industry (mid-teen revenue growth in 2020).

On a SOTP basis, XPO currently trades at 9.6x 2021 EBITDA, which is below non-unionized LTL (15.3x), contract logistics (11.2x), and freight brokerage (13.1x) peer groups. Assuming closure of valuation gap, we are sitting with 30%+ upside post-spinoff. I incline towards holding the LTL business post-distribution and potentially selling the contract logistics spin-off, subject to valuation in 2H21.</td></tr>
<tr><td>ZTO Express</td><td>ZTO</td><td>We propose to hold our stake in ZTO express. During the past quarters, we've seen intensified competition in the delivery industry, partly due to emerging new competitors such as J&T. Ticket price deviated from volume growth, and thus profit growth deviated from revenue. However, we do not believe this level of competition is sustainable because 1) the operating cash flow of Tongda peers does not support further leverage increases to make capital investments, and 2) the new entrants will need significant investments to truly scale their businesses. In the long run, the consolidation story remains intact that a 30% - 40% market share player will emerge from the price competition as tail players exit the market. In addition, ZTO is increasing investment in its international business, which we believe bodes well for additional opportunities. Despite some short-term headwinds, ZTO is still on track to become the future monopoly and drive compounding stock gains.</td></tr>
</table>

IV. Update Notes

Buy Note: Methode Electronics (NYSE: MEI)

Dear Board of Advisors,

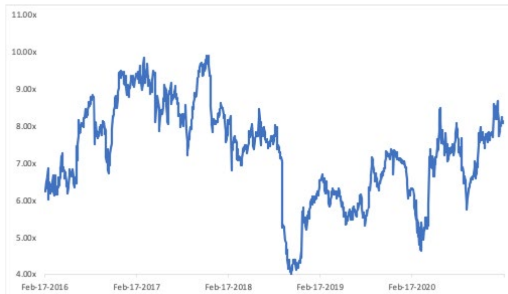
We would like to add to our portfolio Methode Electronics, a global manufacturer and supplier of electrical, radio remote control, electronic, LED-based lighting, wireless, and sensing technologies to the automotive, white goods, and broader industrial markets. Since the last meeting, the company reported strong earnings in its latest quarter (Q2 FY'21), displaying strength in its automotive segment that aligns with key strategic initiatives, such as EV exposure. Despite strong fundamentals, MEI continues to trade below historic multiples (~8-9.5x EV/EBITDA) and the industry median (10.6x EV/EBITDA), which makes current valuation an attractive entry point to buy shares.

Stock Overview (LTM)

	Last Meeting:	Current:
Share Price:	$35.32	$38.76
EV/EBITDA	7.7x	7.6x
EBITDA Margin	19.3%	20.4%
Net Income Margin	12.3%	13.2%

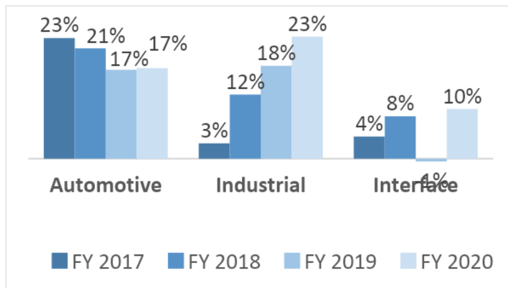
Thesis #1: Misunderstood Competitive Dynamics of a Highly-Specialized Supplier with Strong Fundamental Automotive Business: In a highly competitive space, MEI focuses on operating in niche product spaces that are less competitive, and then expanding its market share by consolidating and specializing. Not only is MEI recognized as a "*one-stop shop for LED lighting solutions, integrated interfaces, and sensors*", but MEI is aggressively expanding its product offerings within lighting solutions with the past two acquisitions. Despite suppliers to OEMs suffering from margin erosion of up to 5%, MEI is able to vertically integrate & currently maintain industry-leading margins for its automotive segment. MEI's fundamentally strong automotive business can capitalize on several tailwinds that can boost top-line growth: auto OEMs ramping up production, growing $ content/vehicle, and EV exposure (expected to be >10% of sales by FY22).

Fig. 1 – 5 Yr Forward TEV/EBITDA



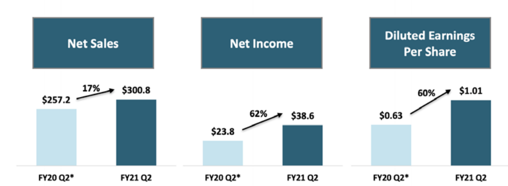
Thesis #2: Strength of Non-Automotive Segments and Accretive Acquisitions Not Fully Reflected in Price on Multiples Basis: Despite >70% of MEI's annual sales coming from its automotive segment and its two largest customers (GM & Ford) contributing ~35% of total sales, earnings and margins aren't as significantly impacted by headwinds of auto industry as the market expects. Much of this is attributed to the fast-growing industrial segment that grew 21% YoY and is now a fundamentally higher-margin business than MEI's automotive segment. Furthermore, along with opportunities to cross-sell products, management expects its industrial segment to continue seeing margin improvement between '20-'22 from acquisitions that should reduce the company's dependence on its automotive segment.

Fig. 2 - EBIT Margins



<u>**Latest Earnings Update (Q2 FY'21):**</u> MEI reported record sales of $301 million and record EBIT of $45 million, with 17% increase in net sales, 62% increase in net income, and 60% increase in diluted EPS YoY. The recovery of the automotive industry is reflected in the company's record automotive segment sales (up 20% YoY), with much of the organic growth coming from Asia that is seeing production ramping up in light vehicles. Furthermore, our thesis point of MEI tapping into EV exposure with its recent acquisitions in order to increase top-line growth is evident by EV sales representing >9% of Q2 consolidated sales. Management continues to be confident of achieving $300 million in EBITDA by FY'25 with a new 5-year long-term incentive plan, with non-automotive segments also displaying strength in demand, especially industrials (4% sales growth YoY) and user interface (38% sales growth YoY).

Fig. 3 - Latest Earnings



Since last board meeting, MEI's stock price has appreciated 8%. Ultimately, the fundamentals of MEI have not changed, with specialization, operational efficiency, and synergies driving growth in earnings and margins. At current valuation, we continue to be confident in MEI's ability to create upside.

Best,

Achyut Seth

Sell Note: BorgWarner (NYSE: BWA)

Dear Board of Advisors,

We would like to propose selling our stake in BorgWarner at around $45 a share, representing 19% upside. After reviewing the company's prospects and the latest industry challenges, as well as given that our portfolio is heavily weighted toward the industrials sector, we believe it is right time to exit the position.

BWA has proved to be resilient this year with COVID and has pushed cost-saving initiatives to led to strong beats in earnings. However, our initial investment theses will mostly be overlooked by long term negative macro trends and the uncertainty of the acquisition. Our rationale to exit the position includes:

Thesis Point 1: Internal combustion engine business is expected to capitalize on rising demand for fuel economy (Partially Realized): Original expectation is that BWA's engine segment – particularly fuel-efficiency products such as turbochargers – will benefit from near term demand as regulators pressure OEMs to reduce CO2 emissions, differentiating from the market's view that the industry is dying. However, while the segment was resilient prior to the Pandemic, current diesel and sector production headwards have caused BWA to greatly miss out on this opportunity. It would take 2-3 years for the whole auto sector to return to pre-COVID production level; the effects of this regulatory tailwind would be much limited by then.

Thesis Point 2: Strengthening position in the hybrid market (Realized): This segment has been very promising, as BWA continues to secure and win across multiple Hybrid architectures and products in both Asia and Europe. However, with the Hybrid era shrinking as OEMs shift their focus toward EV development, we expect the value of this segment to diminish over time.

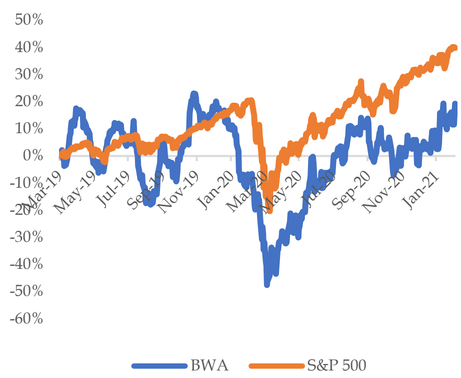
Thesis Point 3: Future M&A efforts to expand electric vehicle segment (Not Realized): BWA indeed made an acquisition to strengthen its EV segment, but it was much different than we expected. The magnitude and the cost of the Delphi acquisition created lots of uncertainty ahead. It would take a long time for the two companies to successfully integrate, and BWA's growth and margin profile will clearly be impacted by Delphi in the near-term. With the threat of major OEMs insourcing electrified powertrain becoming more notable, BWA's long-term success in this segment remains an open question.

Best,
Larry Wang and Chen Zhou

Stock Overview

	At Purchase	Current:
Share Price:	$38	$45
EBIT Margin	12.3%	10.1%
Net Debt	$1.37B	$715M
EV/EBITDA	5.4x	5.9x

BWA Performance Since 03/2019



Sell Note: BorgWarner (NYSE: BWA)

BWA Model Update

	2020E	2021E	2022E	2023E
EBITDA				
BWA - Engine	757.4	1,004.4	1,241.0	1,303.5
BWA - Drivetrain	384.4	548.0	620.8	670.7
DLPH	306.2	443.0	507.0	480.0
Total EBITDA	**1,448.0**	**1,995.4**	**2,368.7**	**2,454.2**
Applied EV/EBITDA Multiple				
BWA - Engine	6.0x	6.0x	6.0x	6.0x
BWA - Drivetrain	7.0x	7.0x	7.0x	7.0x
DLPH	6.5x	6.5x	6.5x	6.5x
Enterprise Value				
BWA - Engine	4,544.2	6,026.2	7,445.7	7,821.3
BWA - Drivetrain	2,690.7	3,836.3	4,345.3	4,694.9
DLPH	1,990.6	2,879.2	3,295.4	3,120.0
Total EV	**9,225.5**	**12,741.7**	**15,086.4**	**15,636.2**
Synergies Schedule				
SG&A + Procurement	**-**	**37.5**	**75.0**	**125.0**
% Realized	0%	30%	60%	100%
NPV @ 15%	**-**	**142.6**	**237.7**	**330.2**
Enterprise Value	**9,225.5**	**12,741.7**	**15,086.4**	**15,636.2**
(+) PV Synergies @ 15%	-	142.6	237.7	330.2
(-) Total Debt	5,147.0	5,147.0	5,147.0	5,147.0
(+) Cash	2,553.0	2,553.0	2,553.0	2,553.0
(-) Minority Interest	284.0	284.0	284.0	284.0
Total Implied Equity Value	**6,347.5**	**10,006.3**	**12,446.1**	**13,088.3**
Shares Outstandings				
BWA shares	207.3	207.3	207.3	207.3
Additional shares issuance	94.0	94.0	94.0	94.0
Total Expected shares outstanding	**301.3**	**301.3**	**301.3**	**301.3**
Equity Value / Share	**$21.07**	**$33.21**	**$41.31**	**$43.44**
Implied Upside / (Downside)	-53%	-26%	-8%	-3%

V. New Position Proposal

At Home Group Inc. (NYSE: HOME)

Turning Lemons into Lemonade; Fractured Industry Creates Tailwinds for Value Retailer

Caleb Nuttle
Senior Analyst
Caleb.Nuttle@stern.nyu.edu

Price Target: $29.76 - $33.34 (23.72% - 38.61%)

February 17th, 2021

Business Description:

At Home Group is a home décor superstore retailer, founded and based out of Plano Texas. The company was originally founded in 1979 as "Garden Ridge Pottery", but was renamed and turned around in 2014, following AEA Investors – a private equity firm – acquiring the company in 2011. At Home currently operates 222 locations across 40 states, but most of their locations are primarily clustered in the Midwest, and South-East. Additionally, the store locations which At Home uses are significantly larger than most comparable retailers, at an average of 105,000 sq. ft. per store, using a warehouse format, similar to Kirkland or IKEA. This format obviously requires more real-estate, which is why At Home locations are primarily located in or nearby suburban shopping-centers. Alongside the warehouse retail format, the company positions itself as a "value" player within the home décor industry, with an average item price of $15. Revenues in FY'20 were 53% Accent Décor (i.e., candles, pillows, vases, artificial flowers, etc.) and 47% Home Furnishings (i.e., mirrors, rugs, wall art, etc.).

Business Quality:

- **High ROI on New Store Locations:** At Home has expanded very quickly over the past 7 years, growing store counts from 58 to 220, representing a CAGR of ~21%. The reason for this expansion has to do with the attractive ROIs on new store locations. New stores require between $4 - $5 million of upfront investment when leased (or $2 - $3 million if built by the company with a sale lease-back), and typically mature within ~6 months from opening. Additionally, the average payback period on these locations have historically been 2 ½ years if leased, and less than 1 ½ years if built. The average mature At Home location generates ~$6.4 million in revenues a year, at an EBITDA margin of ~27%. Management slowed new location expansions in 2020, due to COVID headwinds and debt concerns (discussed in detail below), but following a quick rebound this summer, they anticipate continuing growing store count at ~10% per year.
- **Private Label Products**: Over 70% of the products which At Home sells in a year are "private label", meaning that the company works with manufacturers both domestically - ~35% of merchandise – and internationally – primarily coming from China, India, Vietnam, and Turkey – to source unbranded, higher margin, products. On average, private label products generate 25-30% higher margins than standard 3rd party manufacturer brands. Additionally, as of Q3'21, the company directly sources ~15% of inventories.
- **Warehouse and Distribution Strategy:** At Home operates a leaner inventory management and distribution strategy than other home décor competitors. The company currently operates two distribution facilities, one in Plano, Texas and the other in Carlisle, Pennsylvania. These DCs operate as cross-dock facilities, with the entire supply chain holding no inventory (i.e., no warehouses). This is because the warehouse style retail format allows At Home to quickly restock inventories with less manual touchpoints than direct competitors. With the two DCs, At Home's management believes they can service up to 350 locations.
- **Superior End Market Experience:** At Home is popular within their end markets, raking high in consumer surveys for Home Décor, and has seen strong results this past year in growing their "insider perks" member base. As of Q3'21, the company has over 8.3 million registered members, up 27.7% this past year. This popularity has translated to an organic annual comparable growth rate per store is ~3% per year historically, once the stores enter maturity – i.e., 16 months after opening. The average At Home customer's basket size is ~$75, and despite the fact that they operate as the value player within the fragmented industry, they do not heavily rely on steep item discounts to clear inventories (such as BBBY or Pier 1). Roughly 80% of products are paid at full price.

Key Ratios and Statistics:

Recommendation	**Buy/Long**
Price Target	$29.76 - $33.34
Implied Return	23.27% - 38.61%
Share Price (2/17/21)	$24.05
Market Cap	$1.56 B
52-Week Low	$1.20
52-Week High	$28.44

Figure 1 – (HOME) 52-Week Stock Performance

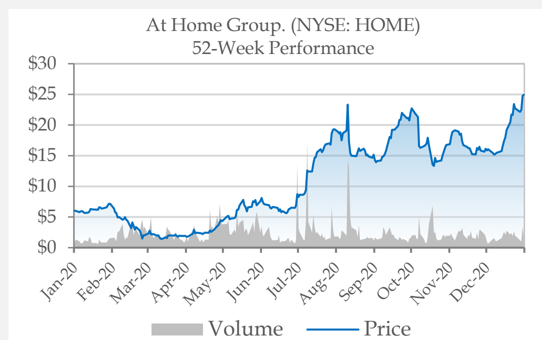


Figure 2 – Map of At Home US Locations

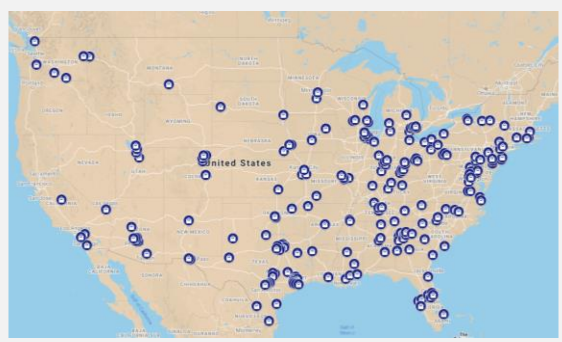
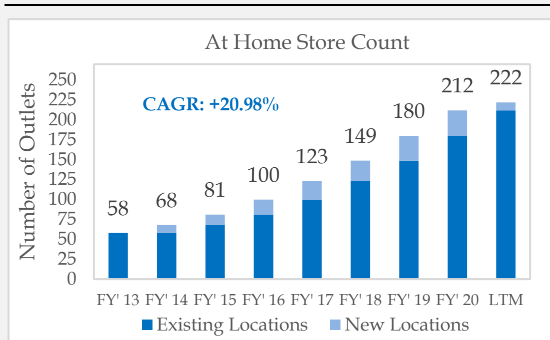


Figure 3 – At Home Store Expansion Historically



Industry Drivers:

- **Fragmented Industry:** The home furnishings/décor industry is fairly fragmented among several large retailers. The space can largely be split into three main groups of competitors to At Home. The first are the specialty home décor retailers (e.g., Bed Bath & Beyond, The Container Store, Home Goods, etc.), the second are the club retailers (e.g., IKEA, Costco, Walmart), and the third are the online retailers (e.g., Amazon and Wayfair). The most direct competitors to At Home are these specialty home décor stores and Wayfair. The other large outlets generally dedicate only a small portion of their store space to home furnishings, and generally focus on only the most popular products. The retail furnishings industry generated ~$117.8 Billion in revenues for 2019.
- **Suburban Housing Boom:** US new home sales have garnered a lot of attention over the past few months, as COVID has pushed a large number of families to move from densely populated cities into the nearby suburbs. This shift greatly increased new home starts and sales to reach levels higher than '08 and has been a significant tailwind behind the broader home décor industry. The US Census Bureau publishes monthly data on new home permits, starts, completion and sales (*Fig. 6*), and 2020 has seen new home sales increase by ~18.7% YoY, with over 9.76 million new homes being purchased. While the longevity of this trend is still unknown, it has created a large opportunity for smaller residential players (such as At Home) to grab market share.

Investment Thesis:

- **Significant Whitespace Opening Up Within the Home Décor Industry:** 2019 was undeniably a very poor year for At Home. The company was experiencing and reporting negative same-store comparable revenues for the first time in their history and closed the year out at a -4.9% YoY same store revenue growth. The market strongly punished the company during this time and pushed the stock down over 75% during the year. However, this disappointing performance was largely attributable to the flash fire sales and steep discounts At Home's competitors (namely BBBY and Pier 1) were offering, often times taking losses to clear their old inventories. These steeply discounted prices directly impacted At Home's "value" positioning, as they lost order volume, a risk which comes from operating at the lowest rung of the industry. However, COVID has actually cleared the industry of these underperforming retailers, creating lower volatility for At Home's pricing power going forward. With Pier 1 Imports filing for Chapter 7 bankruptcy in May 2020 (closing ~1,000 locations in the process) and Bed Bath and Beyond closing ~200 locations, At Home is well positioned in their local markets to fill the demand vacuum. Management previously reported that over 90% of At Home locations are within 6-miles of a Pier 1, and my own research has found that of the ~200 stores BBBY has closed (or is in the process of closing) 10% of At Home locations will be losing their closest BBBY competitor.
- **Resistance to Online Retail Threat:** At Home's value positioning is additionally attractive in this industry, in that it provides a cost barrier to online retailers. Generally, since At Home retails their products for ~$15, it become unprofitable for shippers such as Wayfair and Amazon to match or beat them on price. Since At Home generally sells larger and bulkier items that are pre-built (i.e., wall décor, mirrors, rugs), the shipping costs are quite high. It costs Amazon ~$5 - $8 in shipping costs per package to deliver these bulkier items, and it is reasonable to assume similar rates for Wayfair. While Amazon will often eat these costs by offering free shipping, Wayfair will actually offload $4.99 in shipping on to the consumer if your order in under $35. Either way, shipping costs eating between 33%-50% of margins on a cheap $15 product is very unprofitable for online retailers. This is why Amazon and Wayfair instead focus on bundling items together at lower per unit prices or by focusing on the premium end products, which cuts more into higher-end décor companies rather than At Home. Doing a simple price check on a "standard" wicker basket shows the bundling pricing strategy perfectly (*Fig. 8*).
- **Room for Margin Expansion:** There are several ways which At Home can expand their EBITDA margins going forward, however I am choosing to focus on two clear avenues which management has explicitly stated they will take. First, the ongoing push to have more direct sourcing for At Home's private label goods will certainly push margins higher going forward, with management estimating 1-2% higher EBITDA margins at their goal of 30% direct sourcing.

Figure 4 – Home Furnishings Market Share

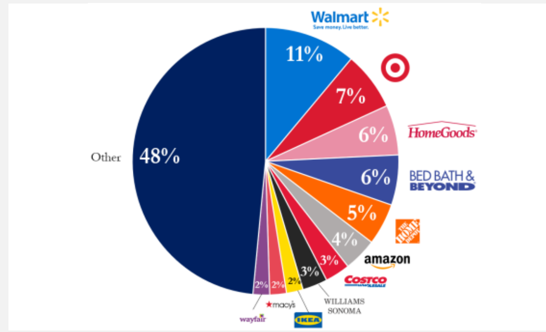


Figure 5 – Furniture and Home Furnishing Revenues

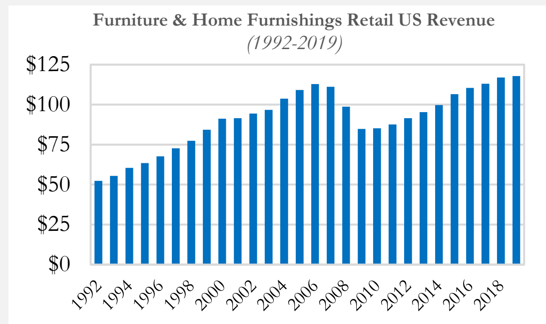


Figure 6 – US New Home Construction and Sales

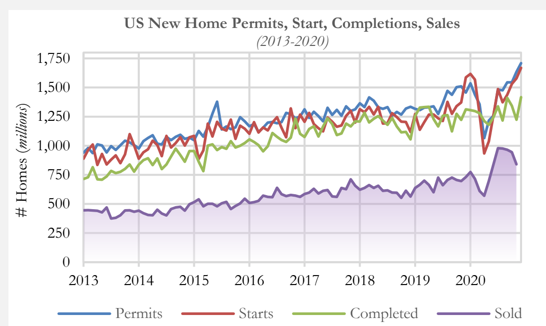
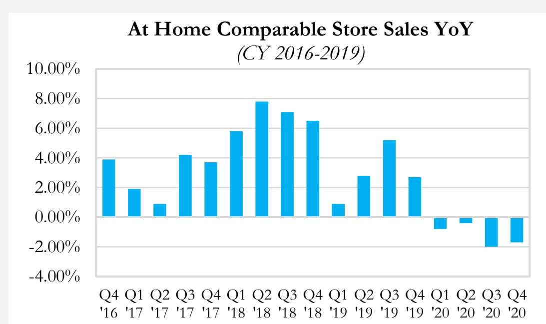


Figure 7 – At Home Comparable Store Sales YoY



Secondly, the opening of At Home's 2nd distribution facility in PA marks the end of a ~2-year corporate saga of the company being inefficient in their rollout of the facility, with several delays and additional "one-off" investments. However, as the company begins to expand their store count further within the Eastern US, the fixed costs of the facility will be more evenly spread across stores, lifting reported gross margins.

- **Disciplined Management Going Forward:** Up until recently there has been a lot of concern surrounding At Home's liquidity. The company was taken public with significant leverage already on their balance sheet, and management fueled their store count expansion primarily through new debt issuance. These concerns came to a head during the Spring of 2020, as with weak retail sales and illiquid inventory ballooning, the market feared bankruptcy. Luckily however the company has come out of COVID and used significant amounts of its operating cash flows to pay down and refinance its previous debt balance. The company now sits at an all-time low leverage ratio, and management has signaled they intend to solely use operating cash flows to meet their 10% store count growth rate going forward, signaling a change of tone from their aggressive expansion strategy before.

Risks:

- **Tariffs:** One area of risk which has historically impacted At Home, is their reliance on foreign manufacturers to produce their value-end private label products. While management has worked to diversify their supply chain away from China, the ongoing economic tension between the US and China is unlikely to abate even under the new administration.
- **Strengthening Bed Bath and Beyond:** At Homes impressive growth of market share has been driven by the ongoing struggles of the competitors such as HomeGoods and Bed Bath and Beyond. However, with the recent turnaround strategy being employed by Bed Bath and Beyond, such as expansion into private label products and heavy reinvestments into their supply chain, At Home may soon face stiffer competition within their local markets.
- **Reversion or Sharp Decline in Home Data:** Many home décor companies have been quickly adjusting their inventory levels to take advantage of the recent spike in demand from new home sales, especially in the suburban areas. At Home is no different in this regard, with management working to quickly ramp up inventory purchases over this past summer. Should new home sales decline sharply, or home décor demand prove to be less than expected, At Home may be left with unclearable, low salvage-value merchandise.

Figure 8 – At Home vs Wayfair Price Check

Company	at home (The Home Décor Superstore)	wayfair
		
Retail Price	**$21.99**	**$80.99**
Per Unit Price	*$21.99*	*$20.24*

Figure 9 – At Home Leverage Ratios

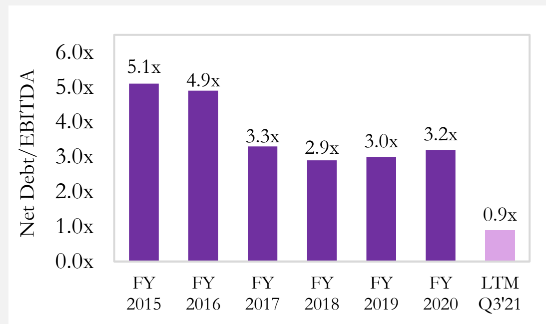


Figure 10 – At Home Brand Awareness Data

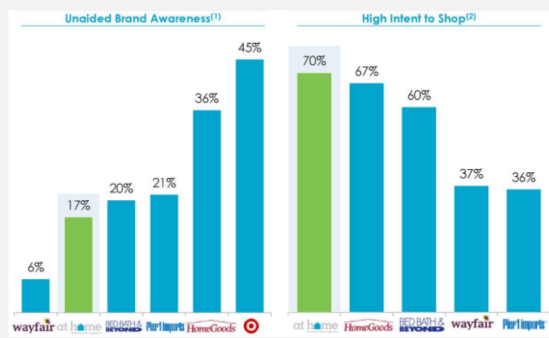
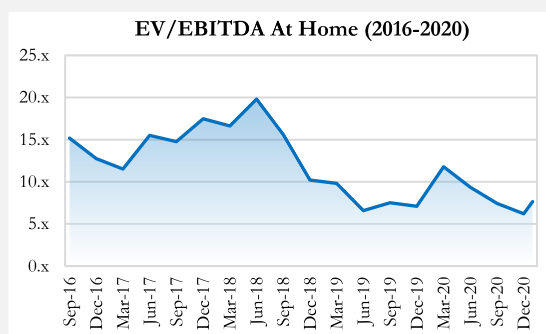


Figure 10 – EV/NTM EBITDA At Home (2016-2020)



Business Overview

At Home Group Inc. History & Overview

At Home Business Overview

- At Home Group is a home décor superstore retailer based out of Plano, Texas
- The company was founded in 1979, but was turned around in 2014 by a group of private equity investors
- Operate over 226 locations nationwide, utilizing a warehouse style retail strategy
- Positions themselves within the fragmented industry as a value player, with average item prices of $15 and basket sizes of $75

at home®
The Home Décor Superstore

At Home Store

New Store ROI Metrics

- Above industry average store size, at **105,000 sq. ft**. per location as of 2019
- **~$4-5 millio**n in net investment for new Leases
- Average payback period of **2 ½ years**
- **83%** of new stores are leased at time of opening
- Typically mature **in ~6 months**
- The typical mature At Home location generates **~$6.4 million** in revenues per year
- Store-level **EBITDA margin of ~26%**
- Typical **organic same-store YoY growth rate of ~3%,** primarily driven by increased repeat visits, in normal non-COVID & 2019 years

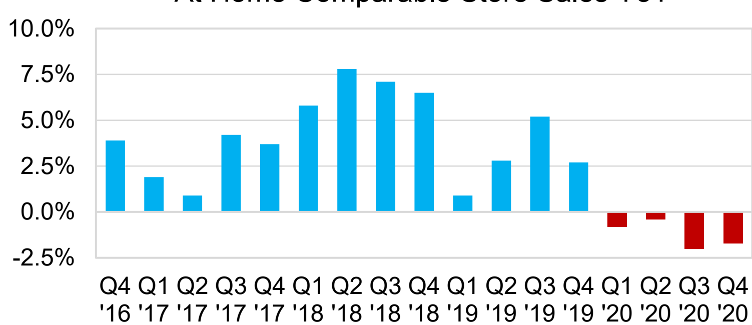
Business Overview

2019 Comparable Stores and 2020 COVID Impact

What Happened in 2019?

- 2019 was a tough period for At Home, as they posted, for the first time, negative same store YoY sales growth
- Management also cut guidance for their FY20 by 50% in one day

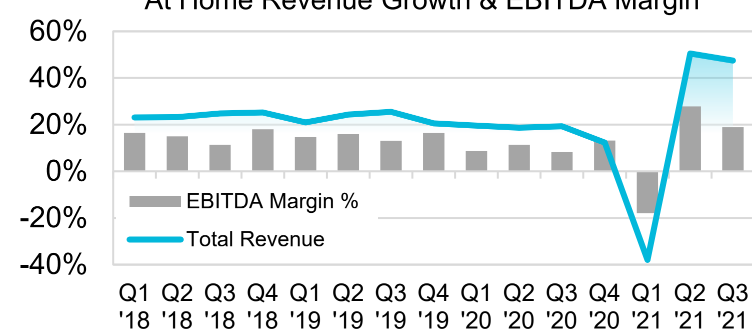
At Home Comparable Store Sales YoY



COVID Impact

- The initial liquidity fears from COVID disappeared after a very successful rollout of BOPIS during the summer
- FY'21 estimated to close out at 25% topline growth

At Home Revenue Growth & EBITDA Margin

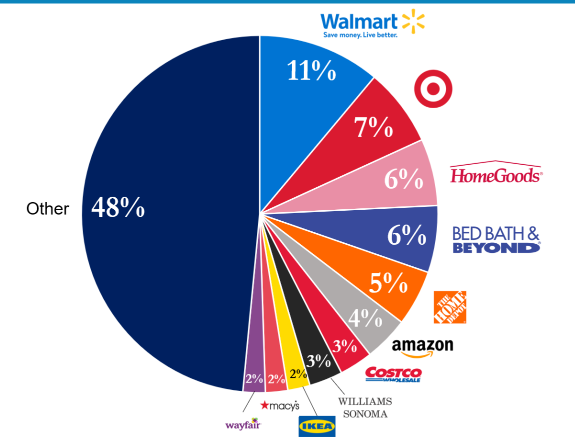


Industry Overview

At Home Historical Market Share Growth

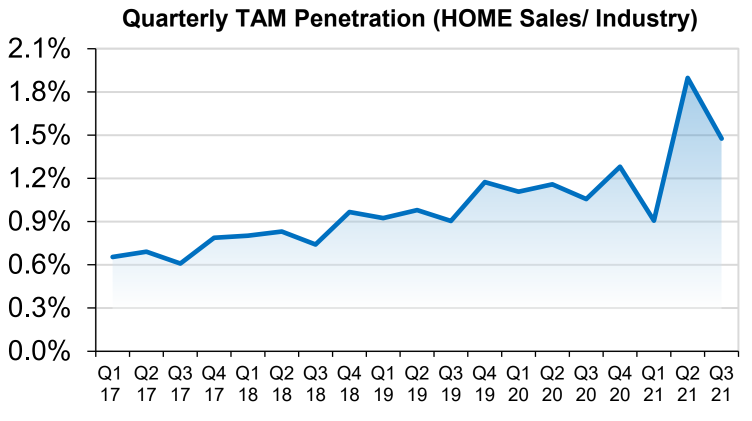
Fragmented Industry

- The Home Décor industry is fairly fragmented across three competitive "groups"
- The first, and largest, are the traditional mass market retailers (i.e., Walmart, Target)
- The second, are specialty Home Décor retailers (i.e., HomeGoods, IKEA)
- And the third are online operators (i.e., Wayfair, and Amazon)
- COVID has significantly impacted the 2nd group, opening "whitespace" for At Home to grow



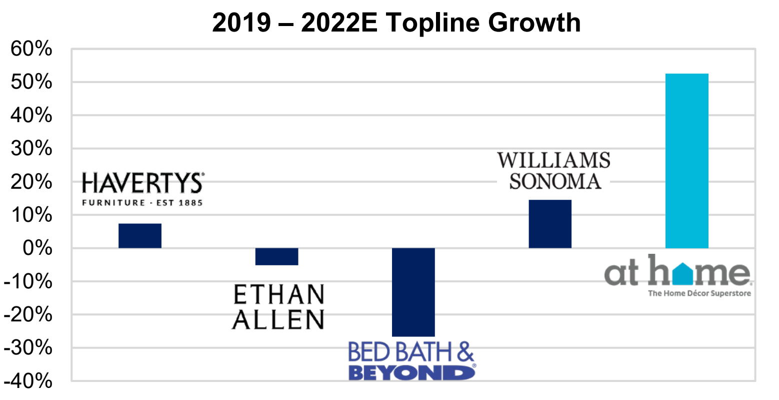
At Home Market Share

- At Home has grown in Market Share over recent years, supported by store closures of competition



At Home Top Line Growth Comparison

- Within the industry, At Home is the fastest grower on a top-line basis



Industry Overview

Bed Bath & Beyond and Pier 1

Bed Bath and Beyond

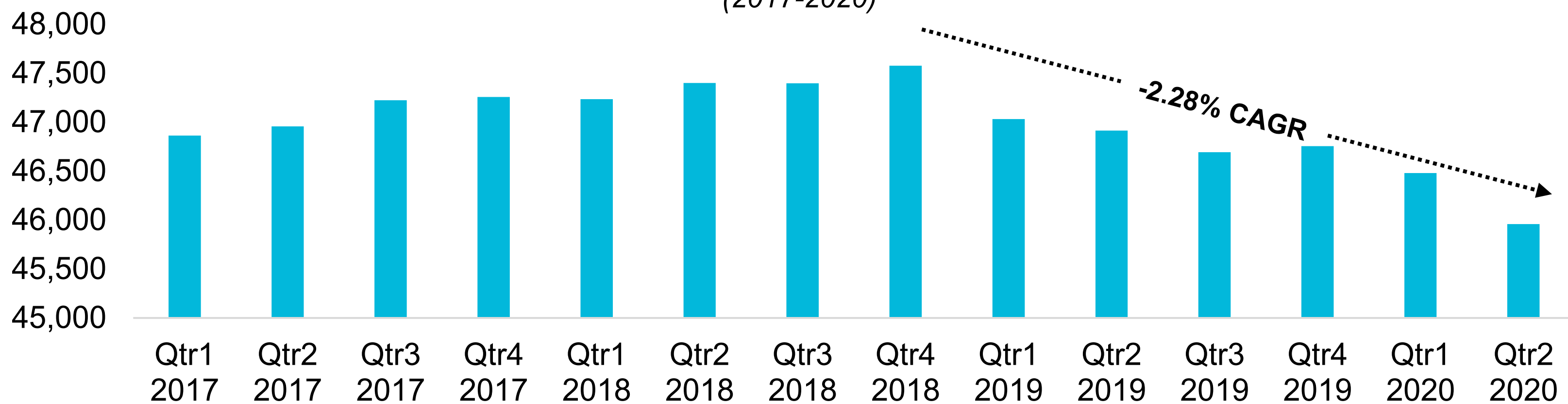
- Bed Bath and Beyond is the closest competitor to At Home, with a longer operating history and national footprint
- However, BBBY has been shuttering stores over the past year
- Management plans to shut down ~20% of their stores (200 locations) by the end of 2021
- The company has already announced ~150 stores to be shuttered or are currently being shuttered
- ~10% of At Home stores will be losing their closest BBBY competitor

Pier 1 Imports

- Pier 1 filed for bankruptcy back in February 2020, but later announced in May they would be liquidating assets
- The company has been shutting down their 942 store locations nationwide
- Nearly 90% of At Home locations are within 6 miles of a Pier 1 store, and ~35% are within a mile
- Management argued that Pier 1's steep discounts during 2019, was a primary reason for At Home's same-store comp. declines

Industry Competition Gradual Decline Even Pre-2020

Number of Home Furnishing Stores
(2017-2020)



Valuation

Base Case ($ in Thousands)	Fiscal Year End January 25, 2018	2019	2020	2021	2022	2023	2024	2025
Base Case								
Net Revenues	$ 950,529	$ 1,165,900	$ 1,365,035	$ 1,697,841	$ 1,567,450	$ 1,752,646	$ 1,970,242	$ 2,074,008
% Growth		22.66%	17.08%	24.38%	-7.68%	11.82%	12.42%	5.27%
Cost of Sales	649,688	786,411	984,709	1,138,678	1,074,934	1,191,417	1,329,366	1,404,332
Gross Margin	**300,841**	**379,489**	**380,326**	**559,164**	**492,516**	**561,230**	**640,877**	**669,676**
% Margin	31.65%	32.55%	27.86%	32.93%	31.42%	32.02%	32.53%	32.29%
Selling, General, & Administrative Expense	195,825	249,534	293,980	408,670	370,702	405,445	455,454	479,095
Stock-Based Compensation	13,764	49,526	7,423	6,791	7,837	8,763	9,851	10,370
Pre-Opening Expenses	18	22	27	12	14	15	16	18
Operating Income	**91,234**	**80,407**	**78,896**	**143,690**	**113,963**	**147,006**	**175,555**	**180,193**
% Margin	9.60%	6.90%	5.78%	8.46%	7.27%	8.39%	8.91%	8.69%
Interest Income (Expense)	(21,704)	(27,056)	(31,801)	(33,181)	(30,860)	(30,860)	(30,860)	(30,860)
Goodwill Impairment	(2,422)	-	(255,230)	(319,732)	-	-	-	-
One-Time Expenses	(1,451)	(4,372)	16,872	(3,294)	-	-	-	-
Earnings before Taxes	**65,657**	**48,979**	**(191,263)**	**(212,517)**	**83,104**	**116,146**	**144,695**	**149,334**
Income Tax (Expense) Benefit	(33,845)	17	(23,172)	44,629	(17,452)	(24,391)	(30,386)	(31,360)
Net Income	**$ 31,812**	**$ 48,996**	**$ (214,435)**	**$ (167,889)**	**$ 65,652**	**$ 91,755**	**$ 114,309**	**$ 117,974**
% Margin	*3.35%*	*4.20%*	*-15.71%*	*-9.89%*	*4.19%*	*5.24%*	*5.80%*	*5.69%*
EBITDA	**146,129**	**143,299**	**155,940**	**241,162**	**212,358**	**248,627**	**282,513**	**294,138**
% Margin	*15.37%*	*12.29%*	*11.42%*	*14.20%*	*13.55%*	*14.19%*	*14.34%*	*14.18%*

Number of Store Locations
(Count of Operating Stores)

Upside Case				227	245	265	287	311
Base Case				225	241	259	279	301
Downside Case				224	238	254	272	292
Choice	**149**	**180**	**212**	**225**	**241**	**259**	**279**	**301**

New Store Locations
(# of New Stores)

Upside Case				15	18	20	22	24
Base Case				13	16	18	20	22
Downside Case				12	14	16	18	20
Choice	**26**	**31**	**32**	**13**	**16**	**18**	**20**	**22**

Valuation

Base Case ($ in Thousands)	Projected Fiscal Year End Jan. 25, 2021	2022	2023	2024	2025
Base Case					
Discounted Cash Flow Valuation Analysis					
After-Tax EBIT Method	$ 188,319	$ 96,512	$ 122,615	$ 145,169	$ 148,833
(+) Depreciation	97,472	$ 98,395	$ 101,621	$ 106,958	$ 113,944
(-) Changes in Net Working Capital	98,565	(38,922)	(5,010)	(5,233)	9,072
(-) Capital Expenditures (excl. Financed CapEX)	81,575	101,200	119,790	137,700	152,130
Free Cash Flow to the Firm	**105,651**	**132,629**	**109,456**	**119,660**	**101,575**
Terminal Value					**2,292,613**
Discount Period	*0.25*	*1.25*	*2.25*	*3.25*	*4.25*
Present Value	**26,031**	**123,316**	**96,013**	**99,025**	**1,869,220**

Firm Value	
Cash on Balance Sheet	33,864
Market Value of Debt	319,005
Market Value of Equity	1,928,465
Market Value / Share	64,810.00
Implied Share Price	$ 29.76
Current Share Price	24.05
Implied Upside	23.72%

Terminal Value	**1.5%**
Organic Growth Rate on Same Store Post 2022	2.50%

WACC Table	
MV of Equity	$ 1,620,000
Cost of Equity	**5.45%**
Risk-Free Rate	1.09%
Beta	0.92
ERP	4.72%
BV of Debt	$ 319,005
Cost of Debt	**8.75%**
% Equity	*83.55%*
% Debt	*16.45%*
WACC	**6.00%**

Valuation

WACC	Terminal Value							
	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%
9.5%	-46.52%	-43.69%	-40.52%	-36.95%	-32.90%	-28.28%	-22.95%	-16.73%
9.0%	-42.69%	-39.47%	-35.85%	-31.74%	-27.05%	-21.64%	-15.33%	-7.87%
8.5%	-38.40%	-34.73%	-30.56%	-25.80%	-20.31%	-13.90%	-6.32%	2.76%
8.0%	-33.59%	-29.36%	-24.52%	-18.95%	-12.44%	-4.75%	4.47%	15.75%
7.5%	-28.13%	-23.22%	-17.56%	-10.96%	-3.15%	6.22%	17.66%	31.97%
7.0%	-21.90%	-16.15%	-9.44%	-1.52%	7.99%	19.61%	34.14%	52.82%
6.5%	-14.71%	-7.90%	0.15%	9.80%	21.60%	36.36%	55.32%	80.61%
6.0%	-6.33%	1.84%	11.65%	23.63%	38.61%	57.87%	83.55%	119.50%
5.5%	3.58%	13.53%	25.70%	40.91%	60.47%	86.54%	123.05%	177.81%
5.0%	15.45%	27.81%	43.26%	63.12%	89.60%	126.68%	182.29%	274.97%
4.5%	29.96%	45.65%	65.82%	92.72%	130.37%	186.86%	280.99%	469.26%

WACC	Organic Same Store Annual Growth Rate (2023 Onwards)							
	0.0%	0.5%	1.0%	1.5%	2.5%	3.0%	3.5%	4.0%
9.5%	-58.07%	-53.93%	-49.75%	-45.52%	-36.95%	-32.59%	-28.20%	-23.76%
9.0%	-54.50%	-50.04%	-45.53%	-40.98%	-31.74%	-27.05%	-22.32%	-17.54%
8.5%	-50.42%	-45.60%	-40.72%	-35.80%	-25.80%	-20.73%	-15.60%	-10.43%
8.0%	-45.73%	-40.48%	-35.18%	-29.82%	-18.95%	-13.43%	-7.85%	-2.22%
7.5%	-40.26%	-34.52%	-28.72%	-22.86%	-10.96%	-4.92%	1.18%	7.35%
7.0%	-33.81%	-27.48%	-21.09%	-14.63%	-1.52%	5.14%	11.86%	18.65%
6.5%	-26.07%	-19.05%	-11.94%	-4.77%	9.80%	17.20%	24.67%	32.22%
6.0%	-16.64%	-8.75%	-0.78%	7.28%	23.63%	31.94%	40.32%	48.80%
5.5%	-4.86%	4.11%	13.17%	22.32%	40.91%	50.35%	59.89%	69.52%
5.0%	10.27%	20.62%	31.08%	41.65%	63.12%	74.02%	85.03%	96.15%
4.5%	30.42%	42.62%	54.95%	67.41%	92.72%	105.57%	118.55%	131.67%

Diamond Hill Investment Group, Inc. (NASDAQ: INVE)

Overcapitalized, underfollowed investment manager in harvesting mode

Tony Wang
Senior Analyst
akw401@nyu.edu

Price Target: $190.11 (31.54% Upside) February 19th, 2021

Business Description:

Diamond Hill Investment Group is a value-oriented, low-cost, multi-asset investment manager with $26.4bn in AUM. The business runs 13 strategies, 9 of which are equities-based and 4 of which are fixed-income based, and generates revenues from the associated fees (linked to AUM) for each account. Additional information regarding each fund's respective performance can be found in the Appendix, but the majority of these strategies have outperformed their benchmarks since inception. The business has a notable cap on AUM at $60bn for capacity reasons and has around 17% insider ownership.

Investment Thesis:

- **Underfollowed business with inflated multiples:** As a small-cap equity with $1.9mm average daily trading volume, DHIL receives minimal institutional scrutiny. With no sell-side analysts, no quarterly earnings calls, and bare-bones investor relations, Diamond Hill's common stock creates an opportunity to capitalize on an underfollowed and mispriced asset. The large balances of cash and securities on the balance sheet also inflate the multiples (e.g. 13x LTM earnings), meaning that the business does not screen well. The core operating business netting out cash trades at 9x earnings. Furthermore, after netting out the investments as well, the core business trades at 6x earnings. We believe that these prices create an attractive level of downside protection. As the business continues to whittle down its cash balances through dividends and buybacks, the core operating business is a candidate for multiple expansion, given the strong performance and track record of 6-9% annual AUM growth. However, given the commoditized nature of this business, this optionality is not factored into our models.
- **Increasing levels of distributable cash flow:** Given management has ceased all future openings of new strategies, increasing amounts of cash flow will be returned to shareholders. Specifically, Diamond Hill has been approved for a quarterly dividend in October 2020. With the heavy insider ownership structure and historical precedent (special dividends sequentially increasing for the past 5 years), we believe that incremental value will accrue to shareholders through sensible capital allocation (opportunistic share buybacks and further special dividends). Within the past two years, Diamond Hill has returned a combined 15% of its market capitalization through these initiatives. These cash flows provide substantial protection against AUM outflows or future negative deltas in the business' take rate.
- **Institutional Consultancy AUM Growth (OTM Call):** Diamond Hill has taken on numerous initiatives to win institutional consultancy business (essentially managers for university and hospital endowments). While this share gains are low-visibility for aforementioned reasons, these clients could meaningfully impact future AUM balances. Such clients prove quite sticky and Diamond Hill's established performance track record and industry-leading expense ratios make for compelling value propositions. Regarding general AUM flows, the business' client composition is quite diversified across several distribution channels, mitigating a portion of the redemption risk associated with asset managers. Finally, even projecting 10% annual declines and -1 basis point delta for the next 5 years, our conservative valuation would imply 9% downside.

Key Ratios and Statistics:

Share Price (2/17/21)	$142.90
Market Cap ($mm)	$452.02
Enterprise Value	$348.70
52-Week Low	$75.00
52-Week High	$162.00
Revenue (FY19)	$136.62
EBIT (FY19)	$47.94

USD: mm	2018A	2019A	2020E	2021E
AUM	19,108	23,399	26,400	27,984
Revenue	145.63	136.62	127.65	151.11
EBIT	71.26	47.93	38.73	52.89

Figure 1 – DHIL Price Action

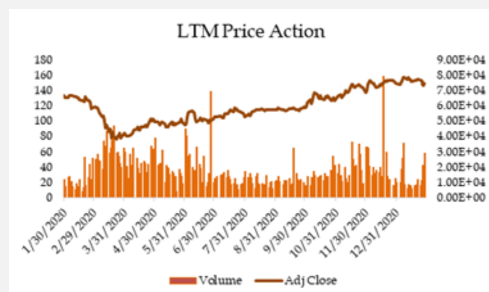
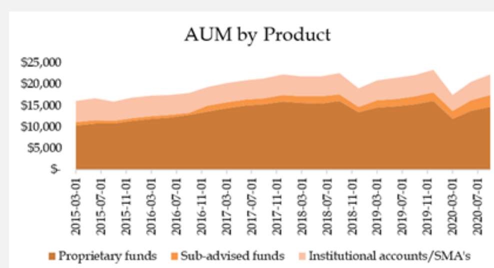


Figure 2 – AUM History



Initial Valuation – Earnings Power

Initial Valuation - The initial valuation assigns no value to future AUM growth and steady-state take rate of 50 basis points. Assuming conservative margins (largely influenced by personnel costs) and a 9% cost of capital, we generate sustainable earnings power with a solid margin of safety.

Rough Valuation (USDmm)		
Input	**Amount**	**Rationale / Note**
AUM	26,400	Last reported Dec. 31, 2020
Take Rate	50 bps	Decline of 10+% (losing pricing power)
Revenues	132	AUM * Take Rate
EBIT Margin	35%	Normalized EBIT margin (40% 10-yr avg.)
Tax Rate	32%	5-year average tax rate
NOPAT	31	Revenues * EBIT Margin * (1 - Tax Rate)
Cost of Capital	9%	Calcluated WACC of ~6%
Earnings Power	**349**	**NOPAT / Cost of Capital**
Cash	118	3Q20 Value
Investments	116	DHIL's personal investment in funds
Minority Interest	8	Redeemable balance on consolidated funds
Capital Gains Tax	2	Long-term deferred capital gains tax
Excess Capitalization	**224**	**Cash + Investments - Minority Interest - Tax**
Equity Value	573	Earnings Power + Excess Capitalization
Market Cap	463	February 17, 2021 closing value
ROI	***23.91%***	

Cost of Capital \ Take Rate					
23.91%	48 bps	49 bps	50 bps	51 bps	52 bps
7.00%	41.59%	43.53%	45.47%	47.41%	49.35%
8.00%	29.95%	31.65%	33.34%	35.04%	36.74%
9.00%	20.89%	22.40%	23.91%	25.42%	26.93%
10.00%	13.65%	15.01%	16.37%	17.72%	19.08%
11.00%	7.72%	8.96%	10.19%	11.43%	12.66%

EBIT Margin \ Take Rate					
23.91%	48 bps	49 bps	50 bps	51 bps	52 bps
30.00%	10.54%	11.84%	13.13%	14.43%	15.72%
32.50%	15.72%	17.12%	18.52%	19.92%	21.32%
35.00%	20.89%	22.40%	23.91%	25.42%	26.93%
37.50%	26.07%	27.68%	29.30%	30.92%	32.54%
40.00%	31.24%	32.97%	34.69%	36.42%	38.14%

Cost of Capital \ EBIT Margin					
23.91%	30.00%	32.50%	35.00%	37.50%	40.00%
7.00%	31.61%	38.54%	45.47%	52.40%	59.33%
8.00%	21.22%	27.28%	33.34%	39.41%	45.47%
9.00%	13.13%	18.52%	23.91%	29.30%	34.69%
10.00%	6.66%	11.52%	16.37%	21.22%	26.07%
11.00%	1.37%	5.78%	10.19%	14.60%	19.01%

Formalized Valuation – Dividend Discount Model

Dividend Discount Model						
Period	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
AUM	26,400	27,984	29,663	31,443	33,329	35,329
Take Rate	*55 bps*	*54 bps*	*53 bps*	*52 bps*	*51 bps*	*50 bps*
Revenue	36.30	151.11	157.21	163.50	169.98	176.65
EBT	12.71	52.89	55.02	57.23	59.49	61.83
Taxes	4.07	16.92	17.61	18.31	19.04	19.78
Net Income	8.64	35.97	37.42	38.91	40.46	42.04
Dividend	5.18	21.58	22.45	23.35	24.27	25.23
Discount	*0.98*	*0.91*	*0.84*	*0.78*	*0.72*	*0.67*
PV of Dividends	**5.08**	**19.60**	**18.88**	**18.18**	**17.50**	**16.84**
ROE	*16.77%*	*17.45%*	*18.16%*	*18.89%*	*19.63%*	*20.40%*
SGR	*6.71%*	*6.98%*	*7.26%*	*7.55%*	*7.85%*	*8.16%*

DDM	
TV	428.83
PV of TV	286.29
PV of Stage 1	96.09
Enterprise Value	382.38
Minority Interest	8.04
Cash	117.75
Investments	116.43
Equity Value	608.53
Market Cap	462.60
ROI	**31.54%**
Implied NTM P/E	*17.61x*
Stage 1/EV	*25.13%*

Key Levers, Assumptions, and Rationale		
AUM Growth	*6%*	At historical levels of 6-9% CAGR, kept at bottom of range for conservatism
Take Rate Delta	-1 bps	Accelerated decline vs historical levels to express conservatism
EBT Margin	*35%*	Below historical levels, perhaps overly conservative or not granular enough
Effective Tax	*32%*	5 year average tax rate (substantially lower in LTM given COVID)
Payout	*60%*	Adjusted to account for cash returned through buybacks + quarterly div.
Discount Rate	*8%*	No debt, cost of equity likely around 6%, perceived business risk (redemption)
Terminal Growth	*2%*	Assumes dividend grows 2% in perpetuity, proven by special dividend hikes

Sensitizing Key Levers – Evident Downside Protection

Take Rate Delta \ AUM Growth	-4%	-2%	0%	2%	4%	6%	8%	10%	12%
-3.0 bps	-7%	-3%	2%	6%	12%	17%	23%	29%	36%
-2.5 bps	-4%	0%	5%	10%	15%	21%	27%	33%	40%
-2.0 bps	-2%	2%	7%	13%	18%	24%	31%	38%	45%
-1.5 bps	0%	5%	10%	16%	22%	28%	35%	42%	50%
-1.0 bps	3%	8%	13%	19%	25%	32%	39%	46%	55%
-0.5 bps	5%	10%	16%	22%	28%	35%	43%	51%	59%
0.0 bps	7%	13%	18%	25%	32%	39%	47%	55%	64%
0.5 bps	9%	15%	21%	28%	35%	43%	51%	60%	69%
1.0 bps	12%	18%	24%	31%	38%	46%	55%	64%	74%

Payout \ EBT Margin	30%	32%	34%	36%	38%	40%	42%	44%	46%
40%	-4%	-1%	2%	6%	9%	12%	15%	18%	21%
45%	2%	6%	9%	13%	16%	20%	23%	27%	30%
50%	8%	12%	16%	20%	24%	28%	32%	35%	39%
55%	14%	18%	22%	27%	31%	35%	40%	44%	48%
60%	20%	24%	29%	34%	39%	43%	48%	53%	58%
65%	26%	31%	36%	41%	46%	51%	56%	61%	67%
70%	32%	37%	43%	48%	54%	59%	65%	70%	76%
75%	37%	43%	49%	55%	61%	67%	73%	79%	85%
80%	43%	50%	56%	62%	69%	75%	81%	87%	94%

Discount Rate \ Terminal Growth	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
5%	56%	66%	78%	94%	115%	145%	189%	263%	410%
6%	38%	44%	52%	61%	73%	88%	109%	137%	180%
7%	25%	29%	35%	41%	48%	57%	69%	83%	103%
8%	15%	18%	22%	27%	32%	38%	45%	53%	64%
9%	8%	10%	13%	16%	20%	24%	29%	34%	41%
10%	2%	4%	6%	8%	11%	14%	17%	21%	26%
11%	-3%	-2%	0%	2%	4%	6%	9%	12%	15%
12%	-7%	-6%	-5%	-3%	-2%	0%	2%	4%	7%
13%	-11%	-10%	-9%	-8%	-6%	-5%	-3%	-2%	0%

Take Rate Delta \ Terminal Growth	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
-3.0 bps	4%	6%	9%	13%	17%	22%	27%	34%	43%
-2.5 bps	7%	9%	13%	16%	21%	26%	32%	39%	48%
-2.0 bps	9%	12%	16%	20%	24%	30%	36%	44%	54%
-1.5 bps	12%	15%	19%	23%	28%	34%	40%	49%	59%
-1.0 bps	15%	18%	22%	27%	32%	38%	45%	53%	64%
-0.5 bps	18%	21%	25%	30%	35%	41%	49%	58%	70%
0.0 bps	21%	24%	29%	33%	39%	45%	53%	63%	75%
0.5 bps	24%	27%	32%	37%	43%	49%	58%	68%	80%
1.0 bps	27%	30%	35%	40%	46%	53%	62%	72%	85%

Comparable Companies Set – Public Active Asset Managers

Active Managers Comp	Ticker	Market Cap	Net Debt	EV	Sales	EBIT %	NI %	EV/Sales	EV/EBIT	P/E	P/TBV
Manning & Napier, Inc.	MN	102.9	(54.6)	41.2	126.3	12%	2%	0.33x	2.69x	51.00x	1.36x
Cohen & Steers, Inc.	CMS	3,130.0	(76.0)	3,099.3	427.5	22%	18%	7.25x	32.42x	41.72x	14.52x
Pzena Investment Management, Inc	PZN	139.8	(36.8)	162.3	137.2	40%	NM	1.18x	2.98x	NA	5.42x
Silvercrest Asset Management Group Inc.	SAMG	146.1	2.9	180.4	107.4	21%	10%	1.68x	7.88x	13.79x	NA
Victory Capital Holdings, Inc.	VCTR	1,431.9	771.4	2,203.3	793.5	43%	23%	2.78x	6.45x	8.01x	NA
Ashford Inc.	AINC	18.7	68.4	566.9	162.5	NM	NM	3.49x	NA	NA	NA
Waddell & Reed Financial, Inc.	WDR	1,572.5	(632.5)	940.0	1,041.5	13%	8%	0.90x	6.80x	18.06x	2.63x
Westwood Holdings Group, Inc.	WHG	92.8	(69.4)	23.4	66.6	NM	NM	0.35x	NA	NA	0.96x
SEI Investments Company	SEIC	7,578.5	(742.0)	6,836.5	1,684.1	26%	26%	4.06x	15.33x	17.62x	5.49x
WisdomTree Investments, Inc.	WETF	774.0	78.9	985.5	253.7	22%	NM	3.88x	17.76x	NA	NA
Diamond Hill Investment Group, Inc.	**DHIL**	**440.8**	**(115.1)**	**333.8**	**127.3**	**38%**	**27%**	**2.62x**	**6.91x**	**12.83x**	**2.14x**
Mean		**1,498.7**	**(69.0)**	**1,503.9**	**480.0**	**25%**	**14%**	**2.59x**	**11.54x**	**25.03x**	**5.07x**
Median		**460.1**	**(45.7)**	**753.5**	**208.1**	**22%**	**14%**	**2.23x**	**7.34x**	**17.84x**	**4.03x**

Customer Profile – Diversified Institutional Clients

Client	Product	2015	2016	2017	2018	2019
Registered investment advisor	Proprietary funds	16.17%	18.10%	17.97%	16.97%	15.40%
Independent broker-dealer	Proprietary funds	13.83%	15.08%	16.05%	15.18%	15.23%
Wirehouse	Proprietary funds	11.66%	10.38%	11.92%	12.14%	12.93%
Bank Trust	Proprietary funds	16.24%	16.38%	15.49%	13.98%	12.42%
Defined contribution	Proprietary funds	7.23%	7.92%	8.24%	9.96%	11.64%
Other	Proprietary funds	3.19%	2.41%	1.91%	2.10%	1.39%
Sub-advised funds	Sub-advised funds	3.95%	7.46%	6.80%	7.11%	8.67%
Institutional consultant	Institutional accounts/SMA's	14.07%	10.70%	10.56%	11.11%	10.24%
Financial intermediary	Institutional accounts/SMA's	8.75%	7.01%	7.58%	7.88%	7.59%
Direct	Institutional accounts/SMA's	4.91%	4.57%	3.48%	3.57%	4.48%

Appendix – Fund Synopsis

Returns as of December 31, 2019	Inception	1 Year	3 Year	5 Year	10 Year	From Inception
Diamond Hill Small Cap Fund	**12/29/2000**	**21.75%**	**4.76%**	**4.90%**	**9.26%**	**10.01%**
Russell 2000 Index		25.52%	8.59%	8.23%	11.83%	8.18%
Diamond Hill Small-Mid Cap Fund	**12/30/2005**	**27.74%**	**6.66%**	**7.76%**	**11.74%**	**8.91%**
Russell 2500 Index		27.77%	10.33%	8.93%	12.58%	8.84%
Diamond Hill Mid Cap Fund	**12/31/2013**	**25.82%**	**7.62%**	**8.29%**	**NA**	**8.22%**
Russell Midcap Index		30.54%	12.06%	9.33%	NA	9.97%
Diamond Hill Large Cap Fund	**6/29/2001**	**32.18%**	**12.84%**	**10.31%**	**12.09%**	**9.00%**
Russell 1000 Index		31.43%	15.05%	11.48%	13.54%	7.71%
Diamond Hill All Cap Select Fund	**12/30/2005**	**30.77%**	**11.45%**	**8.45%**	**11.35%**	**8.61%**
Russell 3000 Index		31.02%	14.57%	11.24%	13.42%	9.24%
Diamond Hill Long-Short Fund	**6/30/2000**	**23.11%**	**6.65%**	**5.74%**	**7.01%**	**6.93%**
60% Russell 1000 Index / 40% ICE BofA U.S. T-Bill 0-3 Mo Index		19.15%	9.69%	7.37%	8.37%	4.74%
Diamond Hill Research Opportunities Fund	**3/31/2009**	**25.51%**	**7.42%**	**5.29%**	**8.90%**	**11.78%**
75% Russell 3000 Index / 25% ICE BofA U.S. T-Bill 0-3 Mo Index		23.38%	11.36%	8.75%	10.23%	12.33%
Diamond Hill Global Fund	**12/31/2013**	**30.34%**	**12.97%**	**8.51%**	**NA**	**7.53%**
Morningstar Global Markets Index		26.24%	12.14%	8.37%	**NA**	7.63%
Diamond Hill International Fund	**12/30/2016**	**23.56%**	**12.99%**	**NA**	**NA**	**12.99%**
Morningstar Global Markets ex-U.S. Index		21.57%	9.94%	NA	NA	9.94%
Diamond Hill Short Duration Total Return Fund	**7/5/2016**	**4.85%**	**4.12%**	**NA**	**NA**	**3.90%**
Bloomberg Barclays U.S. 1-3 Yr. Gov./Credit Index		4.03%	2.15%	NA	NA	1.71%
Diamond Hill Core Bond Fund	**7/5/2016**	**7.93%**	**4.53%**	**NA**	**NA**	**3.24%**
Bloomberg Barclays U.S. Aggregate Index		8.72%	4.03%	NA	NA	2.49%
Diamond Hill Corporate Credit Fund	**9/30/2002**	**13.20%**	**7.11%**	**6.95%**	**7.12%**	**7.22%**
ICE BofA U.S. Corporate & High Yield Index		14.28%	6.03%	4.89%	5.97%	6.19%
Diamond Hill High Yield Fund	**12/4/2014**	**15.44%**	**8.82%**	**8.18%**	**NA**	**8.12%**
ICE BofA U.S. High Yield Index		14.41%	6.32%	6.13%	NA	5.91%