JDP
CAPITAL MANAGEMENT

Survivor & Thriver Fund, LP

2024 Half Year Letter

"Change is the law of life. And those who look only to the past or present are certain to miss the future". —John F. Kennedy

**John F. Kennedy was the 35th President of the United States.*

Dear Partner,

In the first half of 2024 the Survivor & Thriver Fund was up 13.77% net to investors. This compares to a gain of 15.29% for S&P 500 including dividends. Individual returns will vary based on timing of contributions.

The prospect of lower interest rates, increasing consumer recession fears, political uncertainty and an acceleration in technological change has created a rich backdrop for stock picking.

Like the S&P 500, our performance in the first half was driven by a few positions like Spotify and Amazon. This was offset by smaller stocks especially linked to consumer discretionary and enterprise software. This trend started to reverse in July with our laggards now beginning to show life.

Going into the second half of 2024 there is plenty of juice to squeeze within our portfolio especially among the names that underperformed the most in the first half.

Portfolio Updates

Similar to investing in GEICO in 1950's, Wal-Mart in the 1970s or Starbucks in the 1990's, we want to own businesses benefiting from secular change and competing against lethargic competition.

Doing this in a way that has a chance of beating the index over long periods requires swinging the bat when there appears to be a large price gap between a business's valuation and future earnings power. Our advantage is the ability to think about what will be more relevant in 5 or 10 years when it is out of consensus today.

The other side of this is being able to sell when the thesis has changed, or a much better idea has emerged. We recognize that most investments will not be big winners or even turn out as we expect. Part of our process is to continuously prune the portfolio and cut stocks where the trajectory of the underlying business no longer meets our hurdle rate regardless of if the stock has worked or not.

In the first and second quarters we exited many smaller positions in order to add capital to others where we have watched the business improve while the price has declined precipitously all year. Caesars Entertainment and Tesla are two such examples.

Caesars Entertainment (CZR)

Caesars is a unique combination of an industry-leading consumer business trading for a deep value price with strong tailwinds in the transition to online gaming. We had a small position in CZR for more than a year before building a full position in June around $33 per share.

Despite what we estimate to be a 20%+ forward free cash flow yield on equity, CZR is down 15% year-to-date, down 13.8% over the past 5 years, and down 67% from its 2021 peak.[1]

Casino stocks have been hammered this year over fears the consumer slowing down after record spend on travel after COVID. Casino/hotels also have leveraged balance sheets and small market caps that make for a losing combination in a "high for longer" interest rate environment. While physical casinos trade for low single digit multiples of cash flow, pure-play online gaming apps like DraftKings trade for double-digit multiples of revenue.[2]

There are excellent buys across the gaming sector that make sense even if growth were to pause, especially for best-in-breed brands in a financial position to participate in what we think will be **a multi-decade secular trend to online gambling** in the US.

Background

The modern CZR is the result of the 2020 merger of Eldorado Resorts and assets of the 2017 Caesars Entertainment bankruptcy. Caesars is led by CEO Tom Reeg who I admire for his financial discipline, shareholder-first mindset and focus on customer loyalty.

Caesars Entertainment is one of the largest casino, hotel, and entertainment groups in the US with 52 properties totaling 44,700 hotel rooms across marquee locations on the Las Vegas Strip like Paris Las Vegas, LINQ, Flamingo and Caesars Palace, plus large regional properties in 15 states outside of Nevada, plus Canada. The company also owns Caesars Forum, a 550,000 square foot convention center on the Las Vegas Strip. About half the properties are owned and half are leased.

Caesars also has a high-growth online gaming business with an estimated 5% US market share that could become more valuable than the current market cap someday.[3]

Why Caesars over even cheaper peers?

We prefer Caesars over other cheaper peers because of the quality of management, size of the footprint spanning Vegas Strip and key regional locations and upside in online gaming not priced in the stock. More importantly the debt is manageable with most maturities recently pushed out to 2028 and 2032. In our view the insolvency risk to CZR is limited even in a severe recession while fair value for the stock is at least $100 per share.

As of June 2024, Caesars had $11.7 billion in net debt, ~$12 billion in lease obligations, $4 billion in EBITDAR and a $7.5 billion equity value.[4] An outsized impact to free cash flow should have an outsized impact on the equity, up or down.

[1] As of June 28, 2024, Capital IQ, JDP estimates
[2] Capital IQ, JDP estimates
[3] https://x.com/radnorcapital/status/1801686365718946277?s=12&t=VqC1erf1FPXXXfOShtYT-A
[4] Caesars 1Q 2024 earnings, JDP estimates

Even with stagnant growth CZR could generate $1.5+ billion in free cash flow in 2025 that could be used for a large buyback or debt repayment. Notwithstanding a blowup in consumer spending, our back-of-the-envelope math for 2025 pre-tax cash flow has Caesars earning $4.5 billion in EBITDAR with ~$2.5 billion in interest, leases, and capex expenses. This does not include potential asset sales or a sale leaseback of Caesars Centaur to Vici Properties discussed below.

Although CZR was a drag on our first half performance, there are several pending catalysts that could turn the stock around.

Catalyst 1. Jump in 2025 free cash flow due to four new casino openings in 2024 and construction capex falling to *de minimis* in 2025.

CZR is expecting a jump in free cash flow as capex winds down in 2024 from regional development commitments inherited in the Caesars acquisition including: Harrah's Columbus Nebraska, Caesars New Orleans Horseshoe Lake Charles, Caesars Atlantic City, and Caesars Virginia, Danville.

Catalyst 2. Online gaming going from burning cash to cash-gusher.

Caesars's opportunity to ride the transition to digital gaming wave is being ignored by the market because progress has not yet had a material impact on group's numbers. Caesars's online gaming business is on the precipice of contributing meaningful EBITDA and free cash flow.[5] **Online revenue has grown from virtually nothing in 2021 (and burning money) to over 10% of total revenue today and cash flow positive.**[6]

In the first quarter of 2024 online sports betting grew 23% and iCasino grew 53% year over year. Helping drive the growth in digital gaming is Caesar's loyalty program that cross-sells everything from Formula 1 tickets, Michelin Star restaurants, family holiday packages and online blackjack. A diverse entertainment offering helps Caesars lower customer acquisition costs compared to its digital-only peers.

On the 1Q 2024 earnings call management stated that the online segment has reached a scale where incremental revenue is expected to generate 50% EBITDA margins. If segment growth holds, Caesars's online could generate $350 to $450 million in run rate EBITDA in 2025, up from ~$60 million run rate today.[7]

Catalyst 3. Potential sale-leaseback of Caesars Centaur to Vici Properties (Put-Call Right Agreement)

Prior to the old Caesars bankruptcy it acquired two large regional casinos in Indiana known as Centaur Holdings in 2017. As part of a larger transaction, Vici Properties and Caesars entered into a Put-Call Right Agreement giving Vici the option to purchase the real estate from Caesars in a sale-leaseback by December 31, 2024. Our guess is that the sale-leaseback could generate $1.5+ billion in cash to Caesars if exercised today, albeit at the cost of additional lease obligations. We have no insight into Vici's appetite for exercising the agreement nor have we included this possible transaction in our thesis.

Catalyst 4. Sale of raw land

[5] Caesars 1Q earnings call, JDP estimates
[6] Caesars earnings presentations, SEC filings, JDP estimates
[7] Caesars 1Q 2024 earnings transcript, JDP estimates

On the 1Q 2024 earnings call, CZR management mentioned that they are in the process of selling excess raw land. Although the land is somewhat immaterial to the broader footprint and therefore not detailed in the 10-K, we have heard that CZR owns multiple acres of premium land on the Vegas Strip that could be worth several hundred million dollars that could be used for buybacks or debt reduction.

Catalyst 5. Large stock buyback program that could exceed 20% of the current market cap.

Management has stated they would prioritize a buyback program if the current stock price range held after free cash flow begins to inflect later this year and next.[8] Based on conversations we have had with people directly familiar with the Board's thinking, we believe a buyback funded by free cash flow and asset sales could be large as a percentage of company's $7.5 billion market cap.[9]

Catalyst 6. Continued repayment of debt reducing cash interest expense

Caesars has been using excess cash to pay down debt by ~$1B annually which in turn, frees up more cash flow. In addition to buybacks, expected excess cash flow could be used to accelerate debt reduction. In the first quarter the company refinanced $4.4 billion of its parent-level debt extending debt maturities to 2031.[10]

Where is the bottom?

I should again mention that CZR is a leveraged mid-cap equity that is sensitive to consumer discretionary spend and changes in interest rates. Today we see our investment in Caesars as a long-term hold based on earnings power that looks emotionally mispriced.

Although the business and its balance sheet are well managed, CZR trades on macro factors that could always get worse. We have therefore left capacity in the position size to add more capital under the right scenario or sell if the thesis changes.

Tesla (TSLA)

We have followed Tesla closely since the IPO in 2010 and owned the stock from 2012 to 2013. After initiating a small position in March of this year, the shitshow leading up to the re-vote on Elon's 2018 pay package, along with temporarily weak EV demand, provided an opportunity to build a full position in June at an enterprise value of roughly $520 billion.

TSLA has been in a drawdown for nearly three years despite achieving a unique position in the ability to collect, interpret and efficiently process millions of terabytes of driving data.[11]

The flywheel reinforcing Tesla's data advantage is being used to build transportation, robotics and energy infrastructure that should be immensely more valuable in the future. We think that Tesla's advantages from being a first mover in scaled full-self-driving technology and much less dependent on US tax subsidies compared to competition will protect and grow earnings power more profoundly than the market thinks today. Tesla also benefits from powerful network effects from its connected fleet, a premium brand innovating across

[8] JDP estimate of FCF in 2025 and compared to the current stock price of $36 per share, Capital IQ, JDP estimates, Caesars earnings presentations
[9] JDP estimates
[10] Caesars 1Q 2024 earnings transcript
[11] Capital IQ, JDP research and estimates

sectors with very large addressable markets, and a fanatical retail shareholder base that can only be compared to Berkshire Hathaway.

Spotify (SPOT)

"Next year, our focus may return to top-of-the-funnel user growth, but in the near-term, monetization remains our top priority." —Daniel Ek, 1Q 2024 earnings call

Spotify was the largest contributor to our performance in the first half. The stock continues to be our largest holding even after paring it back in the second quarter.

The market is coming around to the idea that Spotify has untapped pricing power and margin expansion runway that the bears did not believe existed. In the first half of 2024 Spotify raised prices on premium subscription tiers.

As we discussed in past letters, we believe this "surprise" margin expansion is the result of price hikes that included a deal with the music labels to increase spending on Spotify's 2-Sided Marketplace. The company has mentioned that this core search and discovery product effectively has a 100% contribution margin while not broken out as a line item in the reported numbers.

Underpinning Spotify's untapped pricing power are verticals built on top of music like podcasts, audiobooks e-learning which are driving engagement and new user growth.

Spotify's new audiobooks product became the number #2 player in 2024 behind Amazon's Audible after only launching in the US, Canada, UK, Ireland, Australia, and New Zealand in late 2023.[12] With 250,000 books the audiobook product gives premium users 15 hours of listening per month included with their subscription. All listeners can purchase additional listening hours.

In late March Spotify introduced a beta version of its newest and fourth vertical, an educational e-learning video product initially only available in the UK.

In our view Spotify has a long runway of growth and profitability ahead as the world moves away from radio and the monetization gap between online audio and video narrows.

China tech basket

In the first quarter we built a position in a basket of Chinese tech companies and consumer services that we think will benefit as the local economy recovers from its financial crisis. Dominant technology businesses with mid-teens growth selling for single-digit multiples of operating earnings seems like a good setup regardless of US/China trade policy. Additionally, beneficiaries of China's AI chip boom have tiny market caps compared to US peers where product sales to China are either banned or limited.

Looking Forward

There is never a lack of scary macro data points and uncertainty to justify selling stocks and sitting in cash, especially after a runup like the S&P 500 has experienced recently.

[12] Management commentary, 1Q 2024 earnings call

Whenever my mind drifts to unknowable macro scenarios I am reminded of the Peter Lynch quote: **"far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in corrections themselves"**.

Operating without the benefit of hindsight our imperfect solution to managing uncertainty is to remain invested and prune mistakes as soon as they become obvious.

Inflation is falling and the Fed should begin cutting interest rates shortly. This has historically been an excellent backdrop for stocks that have underperformed the market for long periods of time despite having achieved substantial business progress along the way.

Although we have had some outsized winners this year much of our portfolio still feels like a coiled spring.

The majority of my family's net worth is invested alongside yours. Thank you for your trust and support.

Sincerely,

Jeremy Deal