SOME OF OUR FAVORITE NAMES FOR 2024

Last month, we published a piece entitled, "A Picture is Worth a Thousand Words", where we used numerous charts and graphs to make the case that we believe the small/microcap market is significantly oversold and presents a tremendous opportunity for the upcoming year, particularly if the Fed communicated any intention or inkling that it was done hiking interest rates. This scenario came to fruition in late 2023 when the Fed not only indicated it was done increasing interest rates, but expected to cut rates in 2024. Coupled with what we believe is better underlying fundamentals than many investors believe for many microcap companies, we remain steadfast in our belief that small and microcap stocks will experience strong 2024 performance.

As a follow up to that piece, we thought it would be interesting to move from the macro to the micro by providing some thoughts on specific names that we currently own and think are well positioned for value creation in 2024 and beyond. In no particular order, we will discuss Potbelly Corporation, Synchronoss Technologies, Inc., and Comscore Inc.

Potbelly Corporation (PBPB)

We have been investors in PBPB since 2019. PBPB is a fast-casual restaurant chain that sells sandwiches, salads, soups and other lunch focused items at company-owned and franchised locations. We have discussed PBPB in detail in prior shareholder letters and whitepapers, so we won't rehash the entire story here aside from saying we believe PBPB has strong brand recognition, high-quality products, a healthy balance sheet and one of the best management teams we have ever invested in. PBPB has 425 locations, including 75 franchised in 33 states plus the District of Columbia. Additionally, PBPB recently announced that it has development agreements for almost 200 additional shops.

For 2024, we see a number of value-creating catalysts that we believe could push the stock price substantially higher. First, the company has said that it expects to open 40 new franchise stores this coming year, which represents close to 10% growth. Additionally, PBPB is projecting continued growth in average unit volume, shop level margins and adjusted EBITDA margins. Lastly, management expects material generation of positive cash flows that will enable various options for capital allocation including repayment of expensive debt, stock buybacks and/or other forms of return of capital.

Investors are starting to realize the momentum PBPB has entering 2024. Should this momentum continue, we believe that PBPB will command a common franchise-level multiple of enterprise value to EBITDA in the mid-to-high teens from its current low teens multiple. This multiple expansion combined with the cash flow and earnings power of the remade business could lead to further material appreciation in PBPB's common stock.

Synchronoss Technologies, Inc. (SNCR)

SNCR provides white-label technology that enables large corporations to offer customers cloud-based storage of personal data. SNCR's platform powers the personal cloud offerings of a number of Tier 1 companies including Verizon, SoftBank, AT&T, Assurant, British Telecom and Tracfone under long term contracts. We first invested in SNCR as part of an underwritten financing in June of 2021 that allowed SNCR to pay off its punitive preferred stock and recapitalize the company with reduced interest expense while also providing flexibility going forward to execute on strategic options for the business. The first of these strategic alternatives was completed in Q4 2023 with the sale of SNCR's non-core messaging and digital businesses. SNCR is now a pure-play, cloud-focused business with high margins and is on the cusp of generating significant free cash flows.

Our bullish view for 2024 is centered around a number of catalysts that we believe will improve SNCR's balance sheet and demonstrate the operating leverage of the business. First, SNCR has stated that it expects to receive approximately $28 million from a tax refund at some point in 2024. This inflow of capital will allow SNCR to pay down a portion of its relatively expensive outstanding preferred stock and/or debt that matures in June 2026. Second, SNCR is expecting to return to top-line revenue growth after the runoff of historical deferred revenue and continued growth in subscribers at its largest customer, Verizon, and its newest customer, Softbank. Third, the end of non-recurring charges related to restructuring and prior litigation and corresponding settlements, coupled with revenue growth and a material reduction in interest paid on its outstanding debt should lead to material free cash flow generation in 2024 that grows substantially in 2025. Lastly, we should note that in December 2023 we were asked to join SNCR's Board of Directors to help with the company's execution of its next phase of growth.

As we look at what this might mean for the stock price of SNCR, the current price of $5.57 as of January 8, 2024, equates to a multiple of enterprise value to estimated 2024 EBITDA of approximately 6x. This multiple declines to approximately 5.5x if SNCR receives the tax refund and uses it primarily to pay down debt. We do not believe a cloud-focused business with 85-90% recurring revenue, 70-75% gross margins, 25%+ EBITDA margins that also generates positive free cash flow should command such a low multiple. In our opinion, a more appropriate multiple would be in the double digits. We believe 2024 will be a turning point for SNCR both in terms of its business and how investors value SNCR's common stock.

Comscore, Inc. (SCOR)

Our initial investment in SCOR took place in 2021 following its recapitalization by Charter, Cerberus and Liberty Media (Qurate). Our original thesis was centered on multiple factors including our beliefs that: SCOR was a company with uniquely competitive media measurement offerings and proprietary data; SCOR's new investors could help with improved execution, financial performance and overall growth; and SCOR traded at a significant discount to peers.

While SCOR's business has improved dramatically under new management with 33% EBITDA growth over the last two years, SCOR's stock has declined precipitously. We believe this is due to poor corporate governance and uncertainty around SCOR's capital structure. As a result, we have ramped up our activism significantly.

As we look forward to 2024, we see a number of potential value-creating catalysts (in addition to our activism) that could lead to material appreciation in the stock. These potential catalysts include: SCOR's preferred stockholders taking steps to demonstrate an alignment of interests across all stakeholders of the company; SCOR demonstrating the ability to consistently generate double-digit EBITDA margins; and a return to growth for SCOR's digital business. Assuming SCOR can continue to generate mid-teens EBITDA in 2024, then its common stock is trading at just 4.7x enterprise value to EBITDA and 0.75x enterprise value to revenue; we believe this will ultimately prove to be an attractive entry price. We do not believe that either of these multiples are appropriate for a company with unique data assets that generates positive cash flows. We believe a more appropriate multiple would be in the double-digit range. We firmly believe that improvements in SCOR's corporate governance combined with its improving financial metrics and the demonstration of alignment of all stakeholders can lead to material appreciation in SCOR's common stock.

Conclusion

To conclude, as we described in our "A Picture is Worth a 1000 Words" piece, we believe that 2024 has the potential to be a very strong year for small and microcap stocks. Further, a number of names in our portfolio, including those above, are well positioned to participate in this strength.

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