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(Exclusive) SA Interview: Tech Investing With Lucid Capital

Nov. 10, 2020 9:00 AM ET
by: SA PRO Interviews

Summary

- Lucid Capital is a technology-focused fund founded by former product and strategy executives from tech companies. The fund specializes in mid cap tech stocks by harnessing the ecosystems of Silicon Valley and Israel.
- Why P/E and EV/EBITDA are less meaningful valuation metrics for tech stocks, an update on their excellent calls on Nice Systems and Ubiquiti and why power semi players are the new oil are topics discussed.
- Lucid Capital updates a long thesis on Payton Planar and shares a long thesis on CTS Eventim.

Seeking Alpha PRO

(Only PRO Subscribers have access to this article)

Editor's Note: This interview was conducted before the announcement of a potential vaccine on November 9, which caused a significant move in a number of the stocks mentioned. We are sharing this interview today rather than November 14 as the high conviction ideas are particularly timely.

Feature interview

Lucid Capital is a technology-focused fund founded by former product and strategy executives from tech companies. The fund specializes in mid cap tech stocks by harnessing the ecosystems of Silicon Valley and Israel. We discussed how value investors can adapt to a growth market, why they look at the price and multiples only at the final stage of analysis (not at the beginning) and the importance of distinguishing between mispricing and repricing.

Seeking Alpha: Walk us through your investment decision making process. What area of the market do you focus on and what strategies do you employ?

Lucid Capital: In our last interview, we pointed out how common capital market analysis tools, like P/E or EV/EBITDA, are becoming archaic in tech investing. This year and the COVID-19 market turmoil highlighted the difference between those who can underwrite the next three years and those who excel in analyzing the financials.

The problem for the latter group is that anything that can be put into a spreadsheet has been arbitraged away by endless quant investors who chase the same metrics.

The skills required to be a successful investor have been transformed from having financial savviness to strategic acumen, from having a strong stomach to having a lucid vision, and from forecasting industry cycles to distinguishing between tech buzzwords and tech shifts.

There is a common saying that notes that there are three types of companies: tech companies, companies that undergo digital transformation, and companies that will be disrupted by the former two.

This means that even when you analyze non-tech companies, like Target or Bed Bath & Beyond, investors are required to underwrite how advanced the companies are in their digital transformation journeys.

Our team at Lucid Capital consists of leading product and R&D executives with backgrounds in strategic product management and software engineering, who have vast networks in the Silicon Valley and Tel Aviv (Israel) - the top two tech hubs in the world.

We focus on tech investment in the broader sense – not necessarily on tech stocks. Take for example Domino's Pizza (NYSE:DPZ). Anyone who would have had the foresight to fathom the impact and competitiveness of the Domino's app, could have earned 30 times in the last decade.

SA: Your high conviction ideas on Nice Systems and Ubiquiti from your 2018 interview have played out very well – can you update readers on how the thesis has played out and whether they are still a buy?

Lucid Capital: Yes, since the last interview, exactly two years ago, when we recommended NICE and UI, Nice has returned 126% and UI did 135% and we believe that there is room for further appreciation.

NICE, which leads the UCaaS domain, is being transformed into a pure SaaS company with very little harm to their legacy profitable maintenance revenuers. Nice's cloud offering gets higher rankings in both Gartner and Forrester than FIVN, grows faster and enjoys higher %GM. Yet, NICE gets a much lower EV/Rev than FIVN, because Nice actually generates 25% FCF margin so the market punishes it and prices it based on EV/FCF, rather than EV/Rev. The stock has been re-rated and we expect that to accelerate as Nice's cloud business is forecasted to cross 1B$ in revenues in 2021 - See this tweet for more color.

Ubiquity (NYSE:UI) continues to innovate and expand from Wifi access points and cameras into the network backbone. Its latest switches with AR functionality are highly differentiated and will continue to generate an unmatched record of 25%+ ROIC. The founder and CEO holds 89% of the shares outstanding, which leaves very little float for riders who would like to join.

SA: You recently shared an update on Payton Planar, which despite being in the middle of so many high profile secular trends remains under the radar – do you think this is one of the reasons for the low valuation? What do you think it will take for this to be more "on the radar" and in turn for the stock to be re-rated higher?

Lucid Capital: Payton was the only analog semi player who managed to grow YoY in H1/20, as its Planar Transformers play a crucial role in power hungry applications like AI servers, EVs and hyperscaler data-centers. The future looks even brighter as the adoption of high frequency, high density transistors, like GaN and SiC, will make regular transformers obsolete because they cannot stand the heat (literally) of the high frequency/high density circuits.

While the stock has returned ~80% (including dividends) since our first article, it's still in the dark. That stems from the philosophy of the founding family (founder David Yativ and his son, Doron Yativ, are engineers) who long held the belief that results matter more than PR and IR.

Yet, in the recent months, Doron, who has assumed the role of CEO, brings a more open attitude regarding speaking with investors and the media. They already adopted a dividend policy and are investing time in meetings and educating potential investors.

SA: Since your previous interview there are now even more ways for investors to play the electric vehicles ("EV") trend – besides Payton Planar, which ones are the most attractive and why? Are there any companies in the same or related industries that will suffer from the growth of EVs?

Lucid Capital: While some investors say that "lithium is the new oil," we stay away from lithium miners, like ALB, who are classic commodity players that can agonize investors when mining capacity increases (which it is doing).

The new oil is power semi players, like IFX GY (Infineon), the leading designer of high frequency/high density power semi transistors that won numerous design wins with the leading automotive OEMs.

One may consider its key competitor STM (STM electronics) that supplies the same components to Tesla.

On the other hand, energy companies and many of the legacy Tier-1 vendors, like BWA, stand to lose.

SA: What would you recommend to value investors who are looking to participate in many of these growth trends we've discussed but are worried about "overpaying"? How should they approach valuation analysis?

Lucid Capital:

- To us, the value/growth dimensions are not necessarily the right way to think about it. Many think of Warren Buffett as one of the greatest value investors, yet we consider him to be more of a fantastic strategic thinker. He understood, earlier than anyone else, concepts like network effect and as a result bought newspapers. The famous "moat" term is a glossy term for finding oligopolies/monopoles, like Coca Cola

(NYSE:KO) and railway companies. Buffett didn't buy cheaply, he bought long-term flywheels.

- At Lucid Capital, we believe that numbers matter less than the ability to perform due-diligence on businesses and fathom the underlying intricacies.
- To further emphasize this point, Terry Smith showed a fantastic slide in one of his presentations. It's a P&L of a company growing 10% annually with PE 40, which most investors would consider outrageously expensive. The company is Pepsico (NASDAQ:PEP) and the P&L is from 1996. Since then, the company was a huge multi-bagger.

SA: A recurring question in this interview series is about the mispricings created by the coronavirus and its short and long-term impact – can you weigh in on this?

Lucid Capital: Yes, the challenge is to distinguish between mispricing with repricing. With every "mispriced" stock, we ask ourselves key questions like:

- Did the company demonstrate the quality traits that we are looking for in pre-corona days?
- Is it just pull-forward of demand (e.g. WHR) or a water-shed moment for the industry (like digital payments)?
- Assuming Covid-19 is behind us, what will 2022 look like? Even within the same industry, you can find completely different outcomes. For example, within the leisure & travel industries, hotels and airlines derive most of their profit from corporate travel, which will be lagging even in 2022 and onwards, due to cost cutting measures and Zoom adoption by corporates. While consumer tourism will be extremely strong in 2022 that will benefit live event companies, such as Live Nation (NYSE:LYV) and its European counterpart CTS Eventim, which even has a capital light model, with 20% ROIC.

Ultimately, we try to look at the price and multiples only at the final stage of analysis, not at the beginning of the process.

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Thanks to Lucid Capital for the interview.

Disclosure: I am/we are long NICE, UI, LYV, PAYTON PLANAR, CTS EVENTIM. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

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