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2019 Return	July	August	September	Q3	Annual Return	Return Since Inception
MountainWorks	-1.4%	-19.6%	2.1%	-19.1%	1.9%	-23.2%
S&P 500				0.2%	16.0%	68.2%

Dear Member,

In the third quarter of 2019, MountainWorks returned a 19.1% loss on investment, versus a 0.2% gain for the S&P 500, dividends reinvested (according to DQYDJ). Since inception, the Fund has lost 23.2% of its value, versus a 68.2% return from the S&P 500. Regarding the portfolio, our biggest change (and also our largest contributor to losses) has been a sizable investment in Netflix at a price of $335/share. Some quick math reveals that with current NFLX prices at $260, about 12% of the quarterly losses are a direct result of my investment in Netflix. Our significant position in Camping World Holdings has not changed. I wait patiently for the business to return to steady (albeit slow) growth. Directors have been well informed in on other topics via the monthly updates. Given the significant moves in our portfolio you might already begin to see that our discussion will revolve around a highly contentious Internet streaming company treading through a highly publicized streaming war. Down 32% since July, analysts and market pundits alike have crushed Netflix with negative news. How does that relate to my undertaking a position? Is it worth the ~12% loss I've already incurred? Why Netflix? Why now?

The valuation. Since first looking into NFLX, I have contended that the company is overvalued. Any average analyst worth their salt could see that. Under traditional metrics, Netflix trades at a 107x P/E multiple (the average S&P P/E multiple is about 15), and at about 6x Sales (Apple, Disney, and Comcast trade at 3.8x, 3.6x, 1.9x sales, respectively…all three have planned streaming services in the works via Apple TV+, Disney+, and Peacock). So why are investors - including me - paying such a high price for NFLX shares?

Take a look at the figures below, which show annual revenues, EBITDA, and earnings per share for Netflix since 2011, along with the annual growth rate over a seven-year period:

NFLX	2018	2017	2016	2015	2014	2013	2012	2011	Annual Growth Rate
Revenues	$15,794	$11,693	$8,831	$6,780	$5,505	$4,375	$3,609	$3,205	25.6%
EBITDA	$9,303	$7,054	$5,336	$3,822	$3,181	$2,442	$1,753	$1,219	33.7%
EPS	$2.68	$1.25	$0.43	$0.28	$0.62	$0.26	$0.29	$4.16	-6.1%

What stands out to you? Likely, the earnings per share, which has *fallen* by 6.1% per year - that's not a good sign. But, the EBITDA has *grown* 33.7% per year, faster than the revenues! So what you've got is a company that is growing its "gross profit" faster than sales (indicating an increasing margin) but then shrinking its "net profit" by burning through cash (indicating a negative operating cash flow). Therein lies the reason why Netflix is so hard to value. Professional analysts can't pin it down either: a simple online search reveals that among 37 different analysts covering NFLX, the consensus is that the company will grow at an astounding 47.32% per year for the next five years. *Spoiler: they're probably wrong*. So the question remains: how could a company be increasing its margins and operating at a loss at the same time?!

Thinking about this dilemma is reason enough for my beard to turn white. I hate losing money more than I love making money; yet I gravitate toward love-hate NFLX shares like a moth to the flame. Why? Well first, the company is absolutely spectacular, with a visionary CEO in Reed Hastings. Management has done an excellent job creating value, building a moat, and dominating the streaming market while disrupting traditional cable at the same time. It is a growth story that rivals Apple. Second, there are so many analysts, investors, and market pundits circling the wagons on Netflix that this thing is extraordinarily volatile. Furthermore - and this is just my personality coming out - the fact that analysts can't pin this thing down *is the exact reason why I'm investing in it*.

"With Computers, everything has become shorter term. As communication has become better, the entire environment has encouraged shorter-term thinking. I can't do that. That's a constant in how I think about investing. I'm by nature an impatient person, so I have been practicing patience my whole life, and I hope I'm getting better at it." -Leah Zell, Founder, Lizard Investors, 2015

Have Patience. Up to this point I can do nothing but bear the burden of my failures. I don't like that I invested in NFLX at $335/share and it's down ~22%. Yet it's important that you know that my personality tends toward withstanding a sizable amount of portfolio stress. I can be down on an investment near 50% (and currently be down some 23% since I started the Fund) and still hang in there (e.g., Camping World Holdings) not because I am stubborn, but because I'm willing to find a path, a solution if you will, in the long run. I am well aware of certain biases that I am vulnerable to: the "break-even effect" (people make poor decisions in an effort to play catch-up), and a failure to "ignore sunk costs" (if it's time to sell, then sell - that one's easier said than done). I believe that what gets me past those biases is my investment process, which is a blend of different investing styles from Warren Buffett, Joel Greenblatt, Phil Town, and John Kelly Jr. Admittedly, my results show that my current system requires patience, time, and refinement.

I always say failures are the tuition you pay for success […] Otherwise, you don't know what you don't know. - Deborah Harmon, Co-Founder, Artemis Real Estate Partners, 2015.

So here is the crux of my investment in Netflix: the volatility creates opportunity in equity options. What we have is an outstanding company that has a track record of ~20% growth per year. You and I can argue from there what the valuation is, and as far as a price target goes, we could both be right!

> *We define intrinsic value as the discounted value of the cash that can be taken out of a business during its remaining life. Anyone calculating intrinsic value necessarily comes up with a highly subjective figure that will change both as estimates of future cash flows are revised and as interest rates move. Despite its fuzziness, however, intrinsic value is all-important and is the only logical way to evaluate the relative attractiveness of investments and businesses. (Berkshire Hathaway 1994 Letter to Shareholders)*

But whatever price I decide to buy into Netflix, at some point I believe there is opportunity in equity options that can help. However, the intrinsic valuation has to come first. The company needs to have a strong moat (Phil Town). Then, I have to keep on the lookout for buying a "great company at a fair price" (Warren Buffett). Next, I can evaluate the stock price on its earnings to the business as a whole (Joel Greenblatt). Finally, if I find some sort of edge, I can establish a repeatable "bet" that creates optimal returns (John Kelly).

Overall, I think it's an incredibly complicated procedure. The process/system I have just bluntly described isn't easy. All I can say that it has taken me quite a few years to nail it down; although the returns have yet to be seen. To be honest, I'm not quite sure how to explain it in a straightforward way. I'm not pulling one lever all the way; I'm pulling all of them just a little bit - from every theory in moderation. Were it so easy.

> *And the value investors, of course who many of I know because we came from that tradition, the value investors who were honorable are quitting. Boom. Boom. Boom. And what worked for them for years stopped working and they're honorable people they just quit. And they're also rich which makes it easy. But those who aren't rich have a hell of a problem. […] So if your game is money management, you have a serious problem. I don't have any solution for this problem. - Charlie Munger, Daily Journal Corporation Annual Meeting, Valentine's Day, 2019.*

The Ugly Duckling. Investing is scary, and making money in the markets is a serious challenge. In the case of Netflix, I'm definitely not the only one playing the options game - there are thousands of options contracts traded daily. So from a finance perspective, I am "collecting premium" on options. Similarly, my performance to date shows that I am in no way successful, and I'm well aware of that. I struggle the most with having to tell members that I have lost their hard-earned dollars. I'm truly sorry that I haven't performed well for you. Believe me when I tell you that it is a problem I am determined to solve. My hope is that with a combination of patience & process, we can find a solution that is both unique and better than average. At this moment, I believe Netflix is the Ugly Duckling. Camping World is the Ugly Duckling. Maybe MountainWorks is too.

Things are different than they were in the past. Two years ago, I was looking at 80% paper gains on the Fund. However, there were realized losses in the portfolio that were mounting. Eventually they caught up with me. My losses compounded throughout 2018, totaling a number I'd rather not speak of. As we approach the fourth quarter, we have flipped the paradigm and I'm hoping for a good close to the year.

Yours,

Justin Polce
Managing Member