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THE BIG SECRET ON WALL STREET

A Lender Built to Return 750% on Invested Capital

- A Capital Efficient "Real Estate Bank" for Landlords And Flippers
- High Risk, High Reward... And A Sweet Deal for the "Little Guy"

FROM THE DESK OF PORTER STANSBERRY

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High Risk, High Reward... And A Sweet Deal for the "Little Guy"

No one wanted to be in "Yolanda's Little Black Book."

The (alleged) sharp-tongued, sharp-eyed old lady – who called herself "Yolanda Yakketyyak the Real Estate Yenta" – had a passion for spying on celebrity home transactions.

She'd figure out where A-listers lived, what real estate they bought and sold, and exactly how much they paid – details that are usually kept under wraps by high-end brokerage firms.

Then she'd reveal that information on her "Little Black Book" **blog**, along with acerbic, insider comments on the homes' interiors, like "Another damn bridal staircase? Pass. And carpet on the stairs? *Beige* carpet?! Oh Lord, have mercy."

After starting her blog in 2016, it didn't take Yolanda long to rack up 300,000 views per month. And she was good: According to the *Los Angeles Times*, she "wreaked havoc among the city's elite real estate agents and their wealthy clients." Fast Company magazine mused that her "canny ability to report deals even before they were closed drove the industry and its clients bonkers."

The funny thing was, Yolanda Yakketyyak managed to keep her true identity secret. No one knew who she was. Until 2018, that is... when the *Los Angeles Times* started digging.

The *Times* noticed that a lot of the deals Yolanda scooped were brokered by a high-end real estate firm called Compass, Inc. That insight led not to a nosy old granny, but to a mid-twenties former Compass finance manager named James McClain.

James, a self-described "expensive real estate nerd," had gotten addicted to the inside information he'd come across while at Compass, and he launched the "Yolanda" blog as a hobby. He was laid off in April 2018, but, possibly helped by a mole or two at the brokerage, he continued to write "Yolanda's Black Book" almost daily, until the *Los Angeles Times* outed him.

With Yolanda's cover blown – and Compass threatening to sue – James decided it was time to close shop. In a final in-character blog post, Yolanda announced that she was shutting down the "Black Book" to co-found a new media brand: Dirt.com.

Dirt.com is a more sophisticated treat for anyone who enjoyed Yolanda's bare-bones Wordpress website. It's a TMZ-style celebrity real estate gossip site featuring glossy pictures and a staff of reporters (headed by James McClain, of course). It still stalks, scoops, and borderline slanders... and shows exactly which pricy mansions the stars are trading like kids swap Pokemon cards.

And lately, Dirt.com has been dishing on a growing celebrity real estate trend: house flipping.

It's similar to what non-celebrity real estate speculators do, just on a larger scale: famous folks buy multimillion-dollar homes, upgrade them to fancier multimillion-dollar homes, and then unload them on other famous folk.

The transactions can take a year or two (like pop singer Joe Jonas's $14.1 million house, which he bought in 2019 and sold in 2021 for $15.2 million, or singer Ariana Grande's $6.8 million home in coastal California, which sold two years later for $9.1 million), or, sometimes, mere months (supermodel Sofia Richie's $17 million-to-$21.8 million Beverly Hills flip took 10 months). But the transformations all have a few things in common: they're big, they're lavish, and they're happening more and more frequently.

Why are all the beautiful people suddenly channeling "Property Brothers"? Yolanda suggested an answer in a June 2016 "Black Book" post: "Nobody shopping in this price range is ever content to leave things as they are, duh."

The flipping craze is also a result of the shortage of available homes for sale in LA, which currently has just 2.2 months' worth of inventory available for sale (realtors consider 6 months of inventory to be a balanced market). This inventory shortage is keeping home prices elevated and contributing to fast profits for investors. "From an investment standpoint, Los Angeles usually appreciates the quickest. If you buy correctly, you can gain equity or make a profit by holding a property for just a few years," says Carl Gambino, a real estate agent at none other than Compass, Inc.

But, more broadly – and not just in Hollywood – house flipping is big business right now. And it's a big part of the unique real estate opportunity we're presenting in this issue...

Our Next Play on America's Housing Shortage

As **we've written previously**, the U.S. housing market is suffering from a severe supply shortage that could last through the next decade.

Scarred by the 2008 housing crash, many homebuilders cut back on new construction. From 2012 - 2022, U.S. builders completed only 11.9 million new homes, compared with 15.6 million household formations, resulting in a record 6.5 million gap between household formation and single family homes as of year-end 2022. A decade of underbuilding means homebuilders will be scrambling to make up today's supply shortage for years to come.

What's more, a surge of stimulus-happy home buyers during COVID-19, and the Federal Reserve's rate-hiking campaign, have turned a shortage into a famine.

With mortgage rates now hovering around 7%, homeowners who locked in a 3% mortgage a few years ago aren't selling. That means that what is historically the biggest source of home supply – existing home sales – has dipped to near-record lows.

Normally, housing is one of the most interest-rate sensitive sectors of the economy. When mortgage rates rise and push borrowing costs up, home buying slows, dragging down prices and building activity. In today's environment, though, even as demand for homes is slowing, supply is falling even faster as existing homeowners refuse to part with their homes (and rock-bottom mortgage rates). So today, shares of homebuilding companies are approaching new all-time highs... despite the fastest pace of rate hikes in 40 years.

On April 28, we recommended a "land light" home builder that uses **The Magic of Other People's Money** to finance its rapid growth trajectory, while delivering world-class returns on equity. Shares are already up more than 50% since our recommendation, and we believe the best is yet to come as we navigate a potential decade-long American housing shortage.

In this issue, we'll feature another capital efficient real-estate business that's in the early days of a rapid growth phase (and largely ignored by Wall Street… so far). We'll explain how this business could expand from its current size of around $100 million into a multi-billion dollar enterprise in the coming years, while requiring minimal capital investment, and delivering a windfall for investors along the way.

A Real Estate Lender for the Little Guy

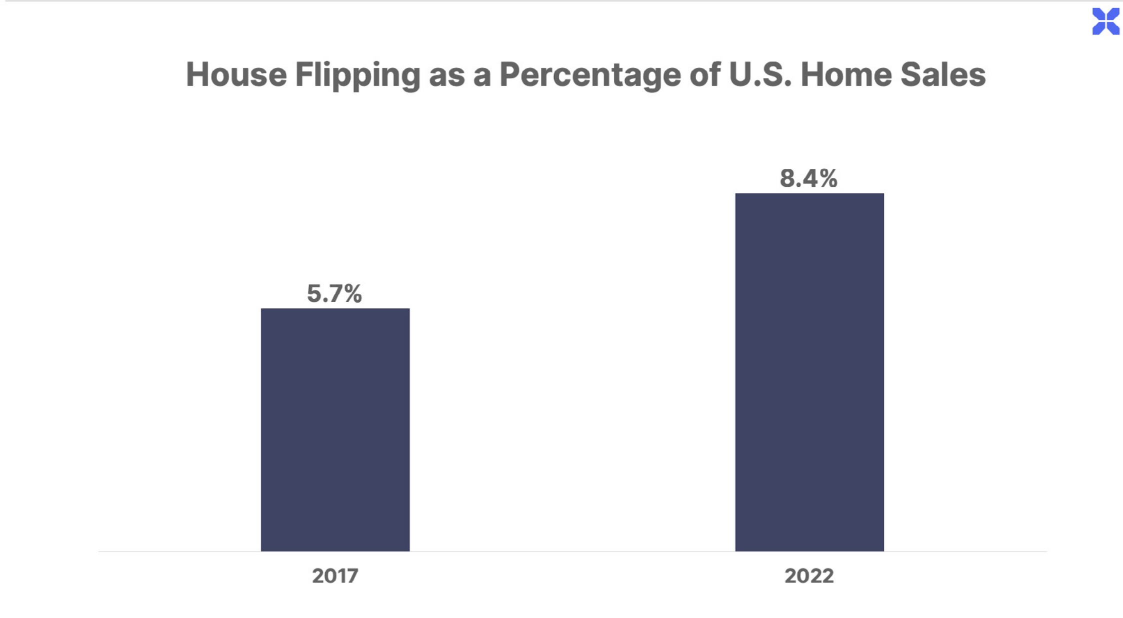
Altisource Asset Management (NYSE: AAMC) is a loan originator. It provides loans to small and medium-sized real estate investors (that is, borrowers), allowing them to finance investment properties to flip and re-sell, or to rent out.

Importantly, AAMC doesn't hold onto these loans. Instead, it sells the loans to institutional investors (that is, buyers), and collects a percentage of the loan value as a fee. This not only reduces AAMC's risk, but it makes for an incredibly capital efficient business. (More on this later.)

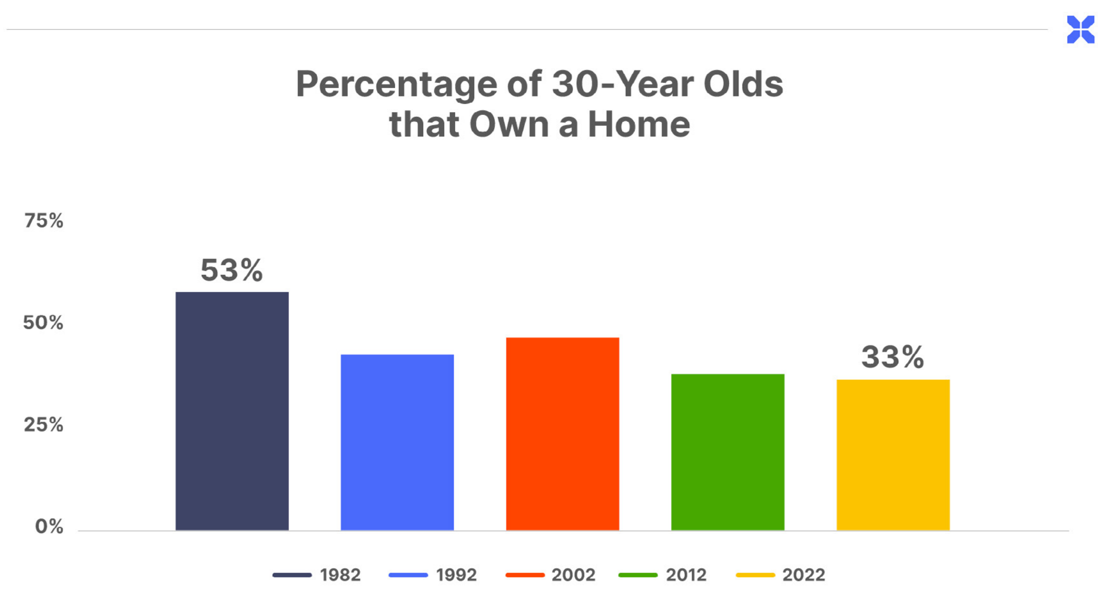
AAMC, as the loan originator, sits in the middle between these two groups: the small-investor borrowers who take out the loan, and the big-investor buyers who then purchase the loan as an income-generating investment. In many ways, AAMC is like a bank that issues and repackages mortgages. However, it's *not* a bank – which means it operates under less stringent restrictions. (More on that later, too.)

AAMC picked a good time to be in the real estate lending business. Its primary borrowers – flippers and landlords – are in high demand due to America's ongoing housing shortage.

Flipping houses – buying distressed properties and fixing them up for resale – has become an increasingly attractive investment proposition as existing home sales drop. In many markets, home prices have risen faster than the input materials and labor required to convert distressed properties into newly renovated homes, resulting in high profit margins for flippers. Over the last five years, the share of U.S. home sales from house flipping has grown from 5.7% in 2017 to 8.4% in 2022.



Meanwhile, demand for rental properties is also booming, driven in part by today's housing shortage. One statistic that captures this trend is the percentage of 30-year olds who own a home, which fell to a 40-year low of just 33% in 2022, down from 53% in 1982.



Source: Census Bureau: John Burns Research and Consulting, LLC (Data: 2022; Pub: Jun-23) As seen in quarterly Burns Single-Family Rental Analysis and Forecast

AAMC's loans help small and medium-sized real estate investors finance investment properties across the house flipping and rental markets. They offer these borrowers two types of loans:

1. **Short-term bridge loans for fixing up distressed properties, known as residential transitional loans (RTLs).** The interest rates on RTLs range from 9.5% - 12% (compared with around 8 - 9% from a community or regional bank), and the term is typically around 12 - 18 months. The average size of an RTL loan is around $500,000 and AAMC collects between 3 - 4.5% of each loan it originates (i.e., each loan it creates for sale to investors).
2. **Long-term loans to finance the purchase of income-producing properties for rental, known as debt-service coverage ratio loans (DSCRs).** The typical loan comes with a fixed interest rate of around 8.5% (compared with around low-to-mid 7% from a community or regional bank), with 40 years in duration. The borrower pays interest only for the first 10 years of the loan, and then begins paying down the principal loan balance (plus interest) over the next 30 years. The DSCR loans average about $300,000 and AAMC collects between 2 - 3.5% for each loan.

After factoring in operating costs, AAMC targets an average of roughly 1.5% in net profit on the value of each loan it originates. (The buyers of these loans purchase them for slightly more than its face value, and AAMC pockets the difference.)

AAMC competes with established local and regional banks who cater to small real estate investors. And, as noted above, it also charges slightly higher interest rates than the banks.

But a growing number of borrowers actually prefer AAMC and feel that it offers them a better deal than a standard bank loan. We spoke to one of those borrowers while writing this issue. His name is Jeff Moore, and his reasons for working with AAMC are compelling.

Why Small-Time Investors Prefer AAMC Over Banks

Jeff is a full-time real estate investor in Lexington, Kentucky, who owns a collection of fix-up and rental properties. This isn’t a hobby for him; it’s how he earns his living. Getting the best loan deals has a direct impact on his monthly earnings.

Since first coming across AAMC in October, Jeff has taken out 13 loans with the company, including both RTLs and DSCRs.

Jeff said that he can’t walk into a big bank like J.P. Morgan to get a business loan. Large banks simply don’t want, and don’t need, the expense and hassle of extending credit to what are considered “higher-risk” loans to small businesses. That leaves small business owners like Jeff limited to working with local community or regional banks to get financing.

Jeff explained that the three biggest challenges dealing with these banks is that they're slow, they often don't appreciate the nuances of his business, and they have strict loan criteria. Part of the problem is that they're hamstrung by regulations, which tightened dramatically in the wake of the 2008 housing bust.

AAMC, on the other hand, solely focuses on lending to real estate investors like Jeff. They understand his needs better than a bank does, and they serve him more effectively. Plus, since AAMC isn't a bank, it plays by different rules, and can create loans on terms that banks simply can't compete with.

Jeff gave us a few real-world examples to illustrate these points. For a recent DSCR loan he was considering, his options were a 7.25% loan with a 12-year duration from a savings & loan (S&L) bank, or an 8.75% loan with a 40-year duration from AAMC, where he would pay interest-only for the first 10 years.

Credit unions are limited by law to only issue loans with a 12-year duration. And they also can't issue loans that are interest-only, for any length of the loan term. But shorter loan terms means higher monthly payments, and that's a big drag on monthly cash flows.

When Jeff did the math, reflecting the fact that the interest-only component of AAMC's loans is fully tax deductible, he realized he could earn higher monthly cash flows with AAMC's loans, despite paying a higher interest rate:

> *"So if you look at the monthly payments on that S&L loan at 7.25%, they're actually higher than the 8.5% - 8.75% interest-only loan from AAMC. Not only that, but you can expense 100% of that interest-only payment because it's all interest... So you can make an economic argument that it actually makes sense to pay that extra 1.5% to AAMC."*

AAMC can offer borrowers like Jeff better loan terms that boost their bottom line. But it also builds in rigorous protection for the big institutional buyers on the other end of the deal.

(**Note:** For Twitter users, we recommend following Jeff **@ragnarisapirate** for the great content he puts out relating to his ongoing experience with AAMC loans and other insights into the company.)

Big Buyers Are Safe With AAMC

AAMC typically requires the borrower to make a 20 - 30% down payment on a property, which provides a margin of safety against a potential default (i.e., in the event of default, the property would have to decline by 20 - 30% before the loan value becomes impaired).

These loans are secured by the value of the underlying real estate, as well as by personal guarantees from the small business owners who take out these loans. Jeff, for example, signed over an ownership interest in his real estate business for his AAMC loans – which means that he could lose a stake in his company if he defaults.

The 8 - 12% yields on AAMC's loans, which come with a margin of safety against default risk, present a compelling alternative to the traditional fixed income investments available to institutional investors, like Treasuries (yielding 4 - 5%) and mortgage-backed securities (yielding around 7%). The market doesn't present many opportunities to earn double-digit yields, where the loan is secured by a tangible asset (real estate), with a 20 - 30% margin of safety.

What's more, AAMC's unusual business model allows it to generate eye-popping returns with minimal risk...

Sell It First, Build It Later

Loan originators like AAMC have been selling loans (or baskets of loans) to institutional buyers for decades.

The originators earn fees on each loan they create and sell. After selling a loan to investors, their capital is then freed up to originate more loans and earn more fees. The institutional investors who buy these loans get a chance to earn higher yields than they'd receive from the standard fixed income alternative of mortgage-backed securities, which currently yield around 7%.

The deal works out well for both the originator and the buyer... unless something goes wrong.

Take residential mortgages (like the one on your home). The originator (often, a bank) will create the mortgage. Then it will hold that mortgage on its balance sheet while it acquires other mortgages it can combine together into a bond called a "mortgage-backed security" (MBS), which it can then sell to institutional investors.

This process of acquiring mortgages, packaging them into an MBS, and then finding a buyer for the MBS typically takes around 4 - 8 weeks, or longer depending on market conditions.

But in the meantime – until the sale of the MBS – those loans will sit on the bank's balance sheet, representing potential risk to the institution, and using valuable capital.

That's fine... as long as the loan value holds up and institutional investors are interested in buying packaged bank loans. But if the MBS market deteriorates and investors stop buying, the bank can get stuck holding onto the loans as they fall in value.

When the bank uses leverage, or borrowed money, to finance these loans, even a modest decline in values can be devastating. In 2008, many financial institutions were leveraged 30x, meaning they had acquired $30 in loans for every $1 of capital (today, leverage in the banking system is more like 10x). That meant a mere 3% decline in the value of loans they held could wipe out 90% of the bank's capital… and that's in part what caused major financial institutions like Bear Stearns and Lehman Brothers to implode in 2008.

The panic over MBS fallout is captured in this snippet of dialogue between bank executives in the iconic Wall Street film *Margin Call:*

> *"What value would you allow to be placed on those assets that might remain on the books, if they had to?"*
>
> *"Why would they remain on the books?"*
>
> *"Because suddenly no one wants to f*cking buy them."*

Although leverage is lower today, big banks still prepare and package mortgage loans and wait for institutional investors to purchase them. And if these investors decide they "don't want to f*cking buy" MBS products, the bank has a problem.

But AAMC has a unique way to sidestep this conundrum.

Instead of stockpiling loans on its balance sheet and hoping to sell them to institutional investors in the open market, AAMC locks in guaranteed buyers before creating a loan. These buyers are multi-billion dollar asset managers, like insurance companies and pension funds, who commit to purchasing AAMC's loans in advance through what are called "forward sales agreements."

By immediately offloading risk onto these large, stable investors, AAMC avoids the risk of holding loans on its own balance sheet… and can safely deploy leverage of up to 10x, without fear of 2008-style repercussions.

This model limits risk for AAMC – and also allows the company to earn enormous returns on every dollar of invested capital.

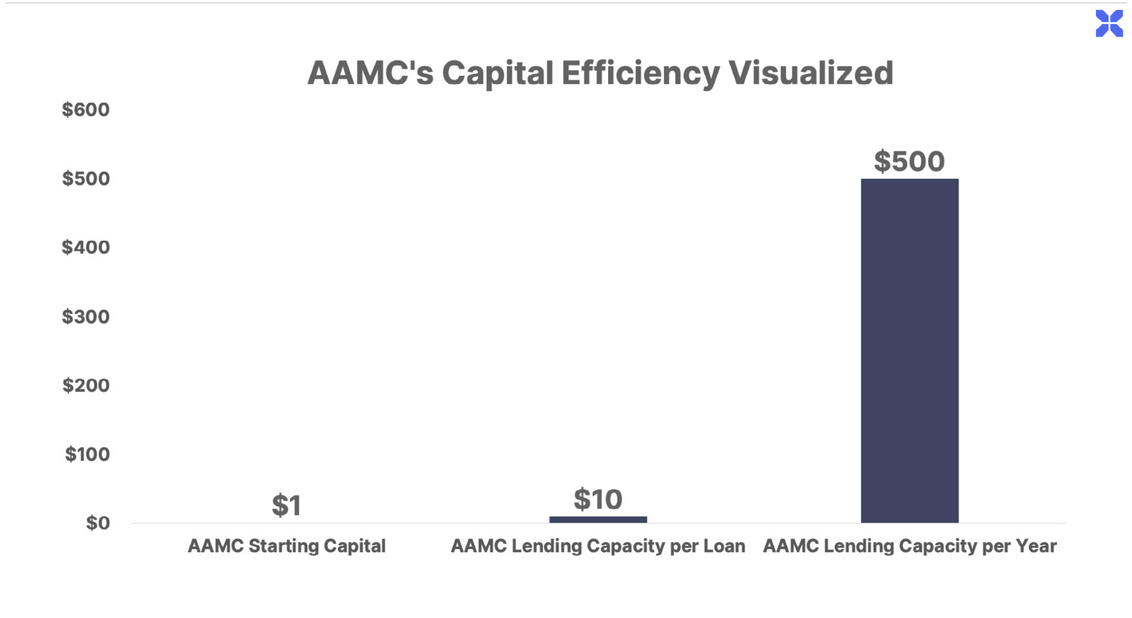
Fast Turnover Leads to Ultra Capital Efficiency

The faster a loan originator can free up its capital, the more new loans it can create… and the more money it can make.

AAMC's fast-moving forward sales agreements allow the company to sell each loan to an institutional buyer within five days of origination, instead of the typical 4 - 8 weeks for a traditional bank. This allows AAMC to redeploy its capital every five days into a new loan origination. Here's how this model translates into the company's bottom line...

Recall from earlier that AAMC can use up to 10x leverage when making loans, meaning it can create $10 in loans for every dollar in capital it has available. Assuming an average loan turnover time of 5 days, AAMC can originate $10 in loans per week for every dollar of capital.

Over the course of a year, that adds up to roughly $500 in loans created for every dollar of capital. Few businesses in the lending world can generate this degree of capital efficiency.



Assuming AAMC can achieve its target of a 1.5% net profit margin on each loan, this $500 worth of loan originations translates into $7.50 in annual earnings power for every dollar of capital.

That translates into an almost unheard-of 750% return on invested capital.

AAMC Has A Long Growth Ramp Ahead

From 2012 to 2018, AAMC CEO Jason Kopcak fine-tuned his deal-making skills while running an investment group for Nomura Holdings, the largest investment bank in Japan. His group bought and sold real estate investment loans, interfacing with the same type of institutional money managers he's now looking to partner with for buying AAMC's loans. He started the group from zero assets in 2012. By the time he left in 2018, he had grown the balance sheet to $4.5 billion, and $200 million in annual revenue.

Kopcak is doing something similar – and more quickly – at AAMC. Barely a year after its March 2022 launch, AAMC has already scaled up its operations from zero to a pace of over $500 million in annual loan demand, with a rapid growth trajectory to potentially exceed $1 billion in annual demand and beyond in the coming months.

AAMC spent most of 2022 building out "marketing channels" to help them find more borrowers (the small investors who need real estate loans).

The two main channels are "direct-to-borrower" (a pipeline that connects AAMC with financial institutions whose customers need loans), and "wholesale marketing," which connects AAMC with sales brokers in the lending market, also called loan officers. These brokers have client lists of potential borrowers that might be interested in taking out a loan from AAMC.

In the company's latest Q2 earnings update in May, AAMC announced it had closed on $17 million of loans through both channels, with $75 million in the pipeline as of May 10. This pipeline represents borrowers who have signed preliminary agreements, but must still go through a 30 - 40 day due diligence process before closing on the final loan agreement.

These preliminary deals provide an early indication of the potential demand in the market. In the seven weeks through May 20, AAMC generated $10.7 million in loan demand per week, or an annualized rate of $556 million per year.

Assuming the company can hit its target of 1.5% net profit margin on these volumes, that suggests that AAMC was on track to generate roughly $8 million in annual earnings as of May 20. If we assume AAMC will trade at a slight premium to the five-year average earnings multiple of the S&P 500 (18.6) of 20x, which we believe is justified given the high capital efficiency of the business, that would imply a market cap of $160 million and a share price of roughly $85 – or more than 45% upside from Thursday's closing price of $58.

But AAMC has far more growth ahead. The table below shows the breakdown of the $45 million in loan demand AAMC built up through its wholesale channel alone in the seven weeks through May 20 (the latest data available as of AAMC's most recent quarterly earnings call).

AAMC's Loan Pipeline in the Wholesale Channel

	Active Date (2023)	Signed Loan Agreements ($M)	# Loan Officers	% Rolled Out
Broker 1	9-Mar	$29.5	4	100%
Broker 2	9-Mar	$15.0	250	2%
Broker 3	27-Apr	$0.5	11	5%
Broker 4	19-May	$0.0	600	0%
Broker 5	9-Jun	$0.0	2,000	0%
Total		$45.00	2,865	< 1%

Note that this volume so far comes from less than a dozen loan officers. As of the company's mid-May earnings call, AAMC had deals in place with five major wholesale lending brokers to distribute its loans, with several more slated to sign on over the next few weeks. That means more than 2,800 additional loan officers are waiting in the wings to begin generating additional demand in the weeks and months ahead.

The bottom line is that the $10.7 million in weekly loan demand the company built up in its pipeline through mid-May is only "scratching the surface," to quote Kopcak.

As the salesforce in AAMC's wholesale channel grows from less than a dozen loan officers to 3,000 or more, loan demand could explode to hundreds of millions of dollars per month or more. Later, we'll dive deeper into analyzing just how much total demand there could be for AAMC loans on the borrower side of the equation.

First, let's consider the demand on the other side of the business, from the buyers of AAMC's loans.

One Insurance Mogul Down – Eight to Go

The big investors who purchase AMC's loan packages are insurance companies, who have permanent capital (from the policy premiums they've already collected) and a mandate to buy the fixed income investments that AAMC loans provide. In Q4 of 2022, AAMC signed up its first big buyer – an institutional money manager that owns an insurance company, and oversees more than $55 billion in assets under management.

AAMC is currently in talks with an additional 6 - 8 buyers, but it needs to ramp up its loan volumes before it can get more institutional clients. These large investors have asked AAMC to produce a minimum of around $75 million a month in volume in order for the deal to be worth their while. AAMC can deliver that outcome… as long as it can grow its loan volumes (that is, sign up more borrowers) quickly.

Longer-term, if AAMC can sign up even 3 - 4 large scale asset managers looking to deploy $300 million per month, that translates into roughly $10 - $15 billion in annual loan demand from buyers.

Now, let's consider the potential scope of demand from the borrowers who take out AAMC's loans.

Flippers and Landlords and Loans, Oh My!

We spoke with CEO Kopcak recently, and discussed the total addressable market (TAM) for the types of loans AAMC makes. (This means the total number of borrowers, like Jeff, who need to take out a loan for their business.)

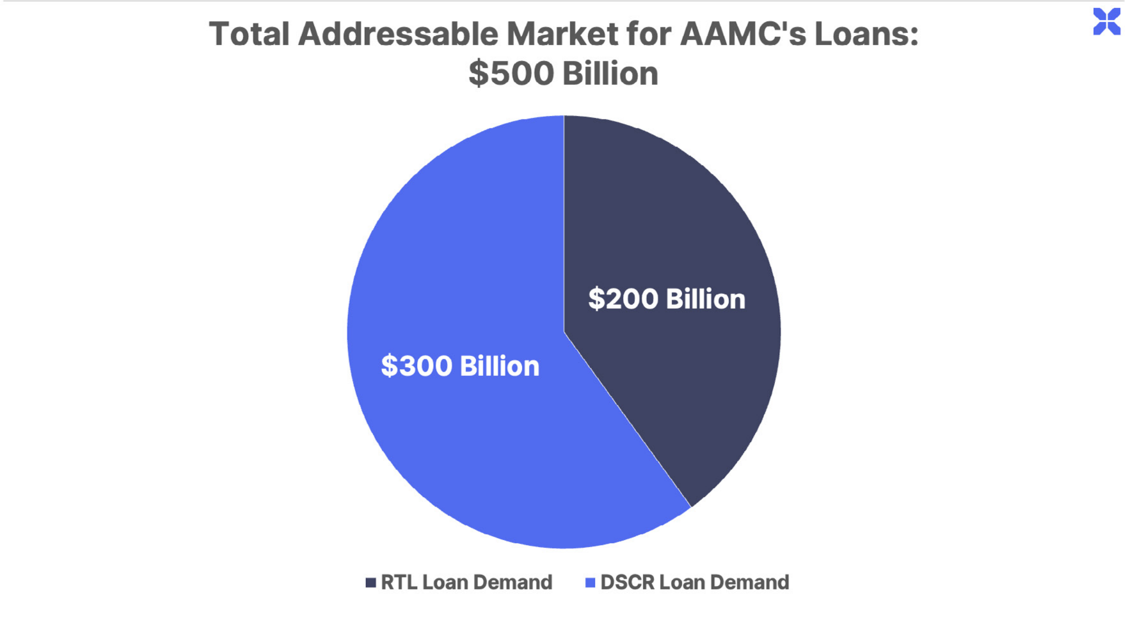
Kopcak estimates the potential market at $600 - $800 billion, but our estimate is slightly more conservative. We arrived at a total market size of roughly $500 billion based on the following math:

First, we assume 6% of the 10 million in annual U.S. home sales are flips, with an average loan value of around $300,000. We believe this is a conservative figure, given that the current percent of home flipping is 8.4% of total U.S. home sales, up from 5.7% in 2017.

That adds up to roughly $200 billion in annual RTL loan demand.

Next, we consider the market for DSCR loans on the roughly 15 million U.S. rental properties owned by small investors. We assume roughly 30% of these properties are held free and clear, and thus don't require financing. We then assume that roughly 10% of this remaining number require loans each year (either from sales or refinancing). Finally, we assume an average loan value of $500,000.

That works out to another roughly $300 billion in DSCR loan demand, for $500 billion in total for both loan types.



The question, of course, is how much of this market can AAMC capture, and how much profit can it realistically generate?

Modeling a Future Path for AAMC

With a $500 billion total addressable market, every one percent market share AAMC acquires translates into $5 billion in annual loan volumes.

AAMC offers a compelling value proposition to both borrowers and buyers of its loans, and it's already seen ravenous demand in its first year. We believe the company can potentially capture somewhere between 1 - 5% of the market to generate $5 - $25 billion in annual loan volumes over the next decade.

The initial loan demand AAMC has generated so far is a promising start, and with thousands of additional loan officers coming on board to distribute its products to borrowers, we're optimistic about the potential demand growth ahead.

Will AAMC hit its target of 1.5% net profit margins on these volumes over the long term? Keep in mind that the company hasn't yet produced a full quarter of operating results with its lending program running at full capacity, so we're taking a conservative approach in modeling the future path for the business.

We've modeled three potential scenarios: a bull case where AAMC hits its target of 1.5% net profit margins, a neutral case of 1.0% margins, and a bear case of 0.75% margins.

Finally, because the business is so capital efficient, we don't believe the company will need to issue any meaningful amount of equity to fund its future growth. It already has all the capital it needs.

Recall that AAMC can leverage every dollar of capital into $500 of loans over the course of a year. The company currently has roughly $100 million in borrowing capacity through revolving credit facilities, enough to generate more than a billion dollars in annual loan volumes. And as the company's earnings grow, so too will its ability to borrow more money.

We expect that AAMC will grow its capital by increasing its borrowing capacity, not by diluting existing shareholders from issuing more shares. Indeed, we anticipate the company will dramatically reduce its share count over time as it returns excess cash flow to shareholders.

But in the name of conservatism, we haven't modeled any of this positive impact into our range of potential future scenarios. Instead, we simply assume today's share count remains constant.

Under these assumptions, the table below shows the potential range of scenarios for AAMC's net income over the next decade, based on a range of market share penetration from 1 - 5%, and a profit margin range of 0.75% - 1.5%.

AAMC 10-Year Net Income Scenarios
Based on Market Share and Profit Margin

Market Share	1%	2%	3%	4%	5%
Loan Origination Volume ($M)	$5,000	$10,000	$15,000	$20,000	$25,000
Net Income at 1.5% Margin ($M)	$75	$150	$225	$300	$375
Net Income at 1.0% Margin ($M)	$50	$100	$150	$200	$250
Net Income at 0.75% Margin ($M)	$38	$75	$113	$150	$188

Next, recall from earlier that we believe AAMC should command a 20x earnings multiple, which is a slight premium versus the S&P 500. Applying this multiple to the net income figures, the same range of scenarios generates the following table of future valuations for AAMC:

AAMC 10-Year Valuation Based on Market Share and Profit Margin

Market Share	1%	2%	3%	4%	5%
Market Capitalization at 1.5% Margin ($M)	$1,500	$3,000	$4,500	$6,000	$7,500
Market Capitalization at 1.0% Margin ($M)	$1,000	$2,000	$3,000	$4,000	$5,000
Market Capitalization at 0.75% Margin ($M)	$750	$1,500	$2,250	$3,000	$3,750

Finally, we compare this future valuation against AAMC's current $100 million valuation to determine the potential upside for shareholders in this same range of future scenarios over the next decade:

AAMC 10-Year Potential Return Based on Market Share and Profit Margin

Market Share	1%	2%	3%	4%	5%
Returns at 1.5% Margin ($M)	1400%	2900%	4400%	5900%	7400%
Returns at 1.0% Margin ($M)	900%	1900%	2900%	3900%	4900%
Returns at 0.75% Margin ($M)	650%	1400%	2150%	2900%	3650%

So even in the least favorable scenario where AAMC only captures 1% market share and achieves half of the company's profit margin target, shareholders could still earn a healthy 650% return over 10 years. In the most bullish scenario where AAMC takes 5% market share and delivers on its goal of 1.5% net profit margins, the returns could be an astronomical 7,400% from here.

And AAMC's stellar capital efficiency may drive these returns even higher...

Recall that AAMC aims to redeploy its capital every five days into new loans, so it can transform every dollar of capital into $500 worth of loans each year. That means for every dollar of invested capital at the start of each year, AAMC could generate up to $7.50 in earnings, and return a substantial portion of that money to shareholders through repurchases. This means the company could dramatically reduce its share count as earnings soar, generating even higher returns than what we've modeled above.

Based on our conversations with management, we expect share buybacks to become a key priority of the company's capital allocation strategy. Kopcak's compensation package is tied directly to how many shares the company buys back over time, so the company has a strong incentive to repurchase.

If AAMC can reach its profit targets, we expect it to become a buyback machine over time. It's a simple, tremendously capital efficient business model, with a compelling value proposition for the borrowers and investors it serves. And we have a lot of confidence in Kopcak as the right guy for the job. He's done a remarkable job growing the business from zero to over $10 million a week in loan demand, with promising signs that this growth is set to accelerate even further in the months ahead.

That said, while the upside potential is compelling, we want to issue a note of caution about the risks involved.

A High-Risk, High-Reward Proposition

As mentioned previously, AAMC is still in the very early innings of proving its business model. It's demonstrated demand in the market, but we have yet to see how that demand translates into bottom-line profitability for the business. The company also faces the risk of operational stumbles as it rapidly scales up its loan volumes.

Plus, there's a risk associated with the company's small market capitalization and thinly traded shares. Each day, only about 20,000 shares of AAMC change hands. In dollar terms, that amounts to just $1 million in average daily trading volume. For comparison, the average mid-to-large cap blue chip stock typically has multiple billions of dollars in trading activity each day.

This lack of liquidity presents risks on the way in and on the way out. When entering a position, we urge investors to use limit orders and exercise patience in building a position slowly over time, at the right price.

Likewise, if AAMC suffers a short-term operational hiccup, or the overall stock market turns down, you may have trouble selling your position without driving the price down further.

For all of these reasons, we are assigning our highest risk rating of 5 to AAMC. We recommend investors control this risk by limiting their position size to a sum that would not cause great discomfort if shares were to fall by 50% or more. And we recommend only entering a position with the aim of holding for multiple years.

Action to Take: Buy AAMC up to $70 per share.

New to the Porter & Co. Portfolio? Start With Our Top 3 "Best Buys" Today

Our goal at Porter & Co. is to bring you world-class investment research, focused on "inevitable" businesses that you can buy and hold forever. This is the surest and safest path to building permanent wealth.

While we don't believe in timing the market, we do keep a constant eye out for bargains. In each edition of *The Big Secret*, we highlight three current portfolio picks that are at an attractive buy point. In addition to today's recommendations, we suggest you focus on these:

1. Dirty energy is never going away... Instead, it will just take safer, cleaner forms, like nuclear energy. **BWX Technologies (BWXT)** is **A Matter of National Security**, and a bargain at 17x enterprise value (i.e., the combined value of equity and debt) to operating income. BWXT has been a leading manufacturer of nuclear reactors and components since the birth of the nuclear power industry over 100 years ago. BWXT is responsible for powering the Navy's submarines and aircraft carriers as well as all the mechanical equipment in the engine room. The company's recession-proof business with the U.S. government is based on long-term contracts that provide a high degree of cash flow stability and predictability. It's also pioneering a revolutionary "bring-your-own-energy" concept for the commercial sector: small modular nuclear reactors (SMRs). These portable reactors could rip up the playbook of energy as we know it today, making nuclear energy a safe, cheap and sustainable global energy source.

2. **Credit Acceptance Corp (CACC)** is a leading subprime auto lender, which we call the **Goldman Sachs of White Trash**. The business of making subprime loans isn't glamorous, but it's tremendously profitable and highly capital efficient. CACC has generated 68% free cash flow margins over the last three years, and today trades at just 16x earnings. (It's at a buy point of $504 per share, or less than 18x earnings.) Shares have recently sold off on fears of a subprime auto lending meltdown, but as we explained in a recent **portfolio update**, CACC is uniquely positioned to benefit from spiking default rates – and that's already showing up in its latest quarterly earnings report. With lending standards tightening and auto delinquencies on the rise, more consumers are entering the subprime category. This was confirmed last quarter as CACC's loan growth surged by 26%.

3. **Viper Energy Partners (VNOM)** is an oil and gas royalty company – the best business in the energy sector, and the **Secret Behind T. Boone's Fortune**. Unlike oil and gas producers, VNOM never spends a dime searching for oil or

drilling holes deep into the earth. It simply owns the land upon which other companies drill, and collects a percentage of the cash flow. That makes it one of most capital efficient businesses you'll find anywhere, with 80% free cash flow margins. VNOM funnels its profits directly to shareholders, instead of back into the ground. VNOM currently trades at a 16% free cash flow yield – the best valuation since the depths of the COVID-19 pandemic. The company is returning capital to shareholders through a 5.3% dividend yield and a repurchase program that has reduced outstanding units by 10% over the last 18 months.

The Big Secret on Wall Street PORTFOLIO

ENERGY & COMMODITIES	Ticker	Description	Purchase Date	Cost Basis	Closing Price	Yield	Income Received	Total Return	Status	Risk Rating (1 - 5)
EQT CORPORATION	EQT	U.S. Gas-Focused E&P	06-03-2022	$47.99	$39.28	1.25%	$0.60	-16.90%	Buy Under $50	4
TELLURIAN INC.	TELL	U.S. LNG Exporter	06-17-2022	$3.53	$1.30	0.00%	$0.00	-63.17%	Buy Under $5	5
VIPER ENERGY	VNOM	Oil and Gas Royalty	09-02-2022	$30.58	$25.11	5.26%	$1.31	-13.60%	Buy Under $34	3
BWX TECHNOLOGIES, INC.	BWXT	Nuclear Power Equipment	12-23-2022	$58.24	$70.90	1.24%	$0.46	22.53%	Buy Under $65	3
BLACK STONE MINERALS	BSM	Oil and Gas Royalty	02-17-2023	$15.90	$15.60	12.31%	$0.48	1.10%	Buy Under $18	2
AMERIGO RESOURCES	ARREF	Base Metals	03-31-2023	$1.21	$1.15	6.96%	$0.00	-4.96%	Buy Under $1.35	4
BITCOIN	BTCUSD	Cryptocurrency	05-12-2023	$27,179.90	$30,312.10	0.00%	$0.00	11.52%	Buy Under $35,000	4
PEABODY ENERGY	BTU	Coal Mining	06-23-2023	$20.69	$21.33	1.41%	$0.00	3.09%	Buy Under $25	4
BATTLESHIP STOCKS										
ALTRIA	MO	Tobacco Maker	07-15-2022	$42.24	$46.09	8.16%	$2.82	15.79%	Buy Under $50	1
PHILIP MORRIS	PM	Tobacco Maker	07-15-2022	$90.18	$97.50	5.21%	$5.08	13.75%	Buy Under $100	1
CREDIT ACCEPTANCE CORP	CACC	Consumer Finance	07-29-2022	$575.91	$504.91	0.00%	$0.00	-12.33%	Buy Under $600	3
NOVO NORDISK	NVO	Pharmaceuticals	10-28-2022	$106.67	$158.25	2.21%	$1.19	49.47%	Hold	2
WINMARK CORPORATION	WINA	Specialty Apparel Stores	09-16-2022	$218.96	$321.68	0.99%	$5.30	49.33%	Hold	1
ACTIVISION BLIZZARD	ATVI	Video Games	03-03-2023	$77.71	$82.70	0.00%	$0.00	6.42%	Buy Under $82	2
DOMINO'S PIZZAS INC	DPZ	Restaurants	02-27-2023	$300.00	$333.78	1.32%	$1.21	11.66%	Buy Under $300	3
DREAM FINDERS HOMES, INC.	DFH	Homebuilder	04-28-2023	$14.83	$22.86	0.00%	$0.00	54.15%	Buy Under $30	4
FRANCO-NEVADA CORP	FNV	Precious Metals Streamer	05-12-2023	$154.74	$137.46	0.99%	$0.34	-10.95%	Buy Under $170	2
ALTISOURCE ASSET MANAGEMENT	AAMC	Asset Management	07-07-2023	$58.20	$58.20	0.00%	$0.00		Buy Under $70	5
INCOME & DISTRESSED DEBT										
MICROSTRATEGY INC	CUSIP: 594972AC5	2025 Convertible Bond	10-14-2022	$758.00	$1,160.60	0.65%	$7.50	54.10%	Hold	4
QURATE RETAIL, INC.	QRTEP	8% Cumulative Preferred Stock	01-20-2023	$40.64	$37.74	21.20%	$4.00	2.71%	Buy Under $50	3
ANNALY CAPITAL MANAGEMENT	NLY	Real Estate Investment Trust	02-03-2023	$23.75	$18.78	18.74%	$0.65	-18.19%	Buy Under $24	2
SABA CAPITAL & INCOME OPPORTUNITIES FUND	BRW	High Yield Bond Fund	03-17-2023	$8.07	$7.79	13.71%	$0.26	-0.24%	Buy Under $9	3
OAKTREE SPECIALTY LENDING CORP	OCSL	Specialty Investments	03-31-2023	$18.57	$19.47	11.30%	$0.55	7.81%	Buy Under $22	2
Property & Casualty Insurance										
W.R. BERKLEY	WRB	P&C Insurance	05-26-2023	$56.10	$59.56	0.67%	$0.00	6.17%	Buy Under $62	2
PROGRESSIVE CORPORATION	PGR	P&C Insurance	06-09-2023	$131.08	$131.68	0.30%	$0.00	0.46%	Buy Under $160	2
CHUBB LIMITED	CB	P&C Insurance	06-09-2023	$191.63	$192.22	0.21%	$0.86	0.76%	Buy Under $220	2
SKYWARD SPECIALTY	SKWD	P&C Insurance	06-17-2023	$24.66	$25.70	0.00%	$0.00	4.22%	Buy Under $35	2
BETTER THAN THE MARKET										
CAMBRIA SHAREHOLDER YIELD	SYLD	Yield Focused ETF	01-06-2023	$61.22	$59.78	2.59%	$0.57	-1.41%	Buy Under $65	2
WATCHLIST										
NVR, INC.	NVR	Homebuilder	NA	-	$6,076.71	0.00%	-		Buy Under $3,500	
FREEPORT-MCMORAN	FCX	Base Metals	NA	-	$37.91	1.58%	-		Waiting For Recession	
SOUTHERN COPPER CORP	SCCO	Base Metals	NA	-	$69.00	4.35%	-		Waiting For Recession	
SHERWIN-WILLIAMS	SHW	Specialty Chemicals	NA	-	$257.37	3.76%	-		Buy Under $150	
HALL OF SHAME										
ICAHN ENTERPRISES	IEP	Specialty Investments	12-09-2022	$50.39	$20.25	39.51%	$4.00	-51.88%	Sell	

Disclaimer: this hypothetical portfolio should not be considered investment advice or a recommendation to buy/sell any financial instrument. For informational purposes only. Investors should perform their own due diligence before buying or selling any financial instrument. No express or implied guarantee of accuracy or applicability to real-world trading. Risk Ratings are based on a security's fundamentals and business model rather than its current valuation.

Rate Hikes Pour Gasoline on the Fire of Today's Red-Hot Housing Market

On April 28, we recommended **Dream Finders Homes (NYSE: DFH)** – a home builder using **The Magic of Other People's Money** to finance its rapid growth trajectory, while delivering world-class returns on equity for investors. While we outlined a path for DFH to deliver 10x returns for investors over the coming decade, we also noted the potential for near-term headwinds caused by higher interest rates.

But one thing we didn't anticipate was how the Fed's rate hiking campaign might have the opposite effect of cooling the red hot housing market. Instead, higher borrowing costs are keeping existing homes off the market, thereby amplifying today's housing shortage.

New data for new U.S. housing starts revealed that new home construction surged by 21.7% in May to a 1.63 million annualized rate, the largest monthly increase since 2016. The number exceeded even the most bullish projections among Bloomberg's survey of economists, and came despite mortgage rates creeping higher towards 7% in May.

This unexpected surge in home construction, even despite 7% mortgage rates, suggests that home building activity won't be slowing down. Instead, all evidence indicates that today's housing shortage is a deep-rooted problem that will not be solved with higher interest rates. The only solution is to build more homes, which will benefit builders like DFH for years to come.

As a result, we're officially raising our recommended "buy under" price for Dream Finders Homes (DFH), from $16 to $30. At this price, the company would still trade at an enterprise value to operating income (earnings before interest, tax, depreciation and amortization) ratio of under 10x. This presents an attractive valuation for any highly capital efficient business, but especially for a company like DFH that's poised for aggressive growth in the years ahead.

The shares closed at $23 on Thursday, up 54% from our original recommendation.

Winmark Continues Winning the Long Game

Since we initially recommended shares of **Winmark Corporation (NASDAQ: WINA)** – the **Resale Company** – on September 16, 2022, shares have rallied 55%.

Winmark is a franchise retailer that owns five resale brands including Play It Again Sports, Plato's Closet, Music Go Round, and others. The franchise model is notable for its extreme capital efficiency. Winmark collects a royalty percentage of every dollar flowing through the registers, while its franchisors foot the bill for new locations, inventory, rent, and salaries. That's how the company can generate incredible 68% free cash flow margins, and return those cash flows back to investors through dividends and buybacks.

Over the last five years, Winmark has reduced its share count by 12%. The company currently pays an $0.80 quarterly dividend, up from $0.25 in 2020. It's also paid out $13.50 in special dividends since December 2020.

Winmark's resale model is the ultimate recession-proof business. When consumer incomes drop, shoppers save money by trading down from new to gently used goods. Winmark was one of the big COVID winners, as an influx of new demand sent earnings per share up 35% from $7.72 in 2020 to $10.48 in 2021. And unlike many other companies, Winmark held on to its COVID-era gains, with earnings per share coming in at $10.82 over the last 12 months.

Winmark doesn't hold quarterly conference calls, but we recently spoke with management to learn more about what's driving the company's strong performance.

One of the key takeaways from our call was that Winmark's customers don't just come for the discounted prices… they come for the used goods "treasure hunt." Recessions create a new flood of cash-strapped customers, and then those customers keep coming back to find more hidden gems. That explains how Winmark capitalizes on near-term recessionary environments, like 2008 and 2020, and then holds onto those gains and compounds them over time.

Winmark franchises are in hot demand, but not everybody gets one…

Management emphasized that they could pursue faster growth in the short run by granting franchise agreements to anyone with the money to open up a new location. But they've seen that model backfire with subpar results in the long run. Instead, they're selective in approving new franchise partners. Applicants must have a demonstrable track record of success operating similar retail stores, in similar market segments as Winmark's stores. This creates a virtuous cycle: the unit economics of the business improve, and the company can use that track record to attract even more quality franchise operators.

At the end of the first quarter of 2023, the company's pipeline of new franchise locations that have been awarded (but not opened yet) grew to 70, up from 44 a year ago.

Our biggest takeaway from the conversation is that Winmark is focused on the long run. They aren't interested in driving short-term results if it in any way detracts from the long-term success of the business. (This explains why they refuse to play Wall Street's quarterly earnings call game.) And the long-term results speak for themselves, with the company compounding investor capital at 20% over the last decade.

Winmark is a hold today at $322 per share.

Mailbag

In The Big Secret on Wall Street mailbag, Porter answers letters from readers. He cannot offer individual investment advice, but can respond to general questions.

Please email us at **mailbag@porterandcompanyresearch.com** if you'd like to be featured in this segment. We'd love to hear from you!

Today's first letter is from F.A., who writes a series of comments and questions that Porter addresses in sequence:

> *F: I'm one of your lifetime members at Porter & Co. I never thought I'd have an opportunity to write to you personally, but since you gave us your email address, I thought I'd take advantage of the opportunity.*
>
> *Like so many others have told you, I really missed your first-hand writing in the newsletter and Friday emails when you took a step back and ultimately stepped away from Stansberry Research. I'm so thankful you are "back in the saddle" writing and sharing your insights again.*
>
> *I think you'd be proud of my portfolio. It's a product of your teaching and philosophy. Some of my top holdings are WRB, HSY, NVR, DPZ, BRK-B and GOOG. (You'll see a few of your recent recommendations in there.) And I remember when you said if your kids could only own one type of stock it would be P&C... so I'm trying to increase my holdings in the niche even further.*
>
> ***Porter: What a portfolio!!!! You've somehow taken all of my best advice and put it into practice with tremendous discipline! Incredible. Just give it time. It will compound.***
>
> *F: Okay... enough about me. Here's my question and request.*
>
> *In the past, you explained how you "reverse-engineered" Buffett's valuation criteria for purchasing P&C companies. He bought when their market cap was at least a 25% discount to the float plus book value.*
>
> *You created the Insurance Value Monitor, which showed the combined value of the float + book value. I still have my lifetime subscription to Stansberry Research so I get the Insurance Value Monitor. Unfortunately, they only publish it once every two to three months.*
>
> *But for those of us that actually paid attention to everything you taught... can you please still list the float + book value of these P&C companies? We can figure out the discount ourselves in two seconds flat from there. That would really help!*

> ***Porter: Regarding the timing of the float and book value updates, these can't be published more frequently as insurance companies only publish new data twice per year.***
>
> ***And as far as providing that information for Porter & Co subscribers: yes, we are currently working on this and plan to have it ready soon.***
>
> *F: One last thing...*
>
> *I truly don't have words to express how thankful I am for you and your work. My family's future is far better because of you and the information you've shared. You've positively changed the lives of so many people. I'm just one of many.*
>
> *From the bottom of my heart... thank you. God bless you and the work you do. You're one of my heroes, right up there with Stallone and Schwarzenegger. Okay... you're slightly behind them. But you're still in the top three, brother!*
>
> ***Porter: By far, this is the best subscriber letter I've ever gotten! I'm gonna have to adjust my schtick when I give live talks and complain that no matter what I do, nobody ever listens to me!***

The next question comes from R.G., who writes:

> *What is your position on the Fed Reserve's FedNow program? Is there any action we should take to protect our wealth?*
>
> *Your input will be greatly appreciated.*
>
> ***Porter: The current stated goal of the Federal Reserve's FedNow program is to "enable financial institutions to deliver end-to-end faster payment services to their customers."***
>
> ***Those are weasel words, of course. The Fed is building a system to phase out cash and private bank accounts entirely from the financial system. That would effectively give the Fed, and by extension the government, total control over every private transaction in the economy.***
>
> ***It's easy to imagine all kinds of Orwellian scenarios in this brave new world of a totally digital payment, controlled by a single central authority.***
>
> ***Digital currency would allow authorities to directly confiscate the wealth of anyone they dislike (and, in the era of "woke," that blacklist is long). It would also make indirect confiscation, through inflation, much easier. With the click***

> ***of a button, the Fed could instantly wire newly created "money" directly to every individual in the economy.***
>
> ***As sovereign governments around the world come to grips with their impossible debt and deficits, we should not be surprised to see them push towards total control over the financial system.***
>
> ***Over the long run, this will make holding cash an increasingly risky proposition. Investors should prepare for this by holding some exposure to the two most trusted alternative stores of value: gold and Bitcoin.***
>
> ***They should also continue to buy highly capital efficient businesses with enduring competitive advantages; these stocks provide a long-term hedge against the demise of U.S. currency. Central banks can create an unlimited amount of new currency, but they can't issue any new shares of Apple or Berkshire Hathaway (at least not yet).***

Porter Stansberry

Porter & Co.

Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have Twitter accounts – you can get acquainted with us **here**.

You can follow me (Porter) on Twitter here: **@porterstansb**