(MSTR) Microstrategy Inc. – Summary Analysis

- Company Description
  - Primarily engaged in two disciplines
    - Provides business intelligence (BI) software that utilizes AI
    - Supports development of the Bitcoin network and adoption of Bitcoin
    - *In the Q1 2024 earnings call, although they repeatedly remarked that they are a BTC development company, I do not see how this is the case; their only involvement in BTC is owning the coin in a levered manner; they do not actually seem to contribute anything to the network or other cryptocurrency protocols themselves*
- Catalysts
  - Implications of 10-for-1 split
  - Subscription revenue has increased 22% YoY; however total revenue decreased 5.5%
  - Bitcoin has the highest stock-to-flow ratio (indicative of its relative scarcity) of any asset in the world
- Risks
  - Bitcoin exposure
    - Although MSTR generates free cash flow, it deploys them in purchasing bitcoin; it has purchased BTC in each of the previous fourteen quarters at an average price of $35,180/coin; BTC is the company treasury's primary reserve asset
    - Moreover, a component of the company's strategy is to raise funding via issuances in the public capital markets (equity and debt) and to use the proceeds from these transactions to accumulate additional Bitcoin
      - Company issued convertible bonds three times in first six months of 2024; total issuance is $1.925B
      - Between August and December 2023, MSTR issued $1.085B in shares over two seasoned equity offerings
      - In total, the company's source of funds for its Bitcoin purchases consists of:
        - $825MM in cash from B/S
        - $3.2B in proceeds from equity issuance
        - $3.6B in proceeds from debt issuance (combination of senior secured and convertible notes)
    - According to Nielson H. Lin (analyst at S&P Global), MSTR can withstand significant drawdowns in the price of bitcoin; its balance sheet will only be challenged once BTC crosses the $6,000 threshold
    - Bitcoin is subject to stroke-of-the-pen risk: governments (including that of the U.S.) could decide that the Bitcoin/blockchain ecosystem is a threat to consumers, institutions, etc. and introduce legislation that precludes future use of these protocols
  - Operating Performance
    - Revenue decreased 5.5% YoY
    - Operating Expenses increased 153% YoY due to impairment expense associated with digital assets segment
    - Operating Loss increased to $204MM in 1Q 2024 from $20MM in the prior year same quarter
    - Company had a net loss of $53MM in 1Q2024 vs. net income of $461MM one year prior
    - The only point of strength is the company's exposure to BTC: it acquired its position in Bitcoin at an average cost basis of $35,164; the market price of BTC as of 31st March 2024 was $71,028; of course, Bitcoin's price is highly volatile, and the risk entailed in this exposure is not properly compensated in my view
  - Leverage
    - Current Debt/EBITDA = 22.1x

        - According to Lin, MSTR has low interest expense (1.3%) despite significant levels of outstanding debt principal; this is attributable to the fact that the debt is primarily comprised of convertible notes with low coupons; therefore, interest coverage ratios are reasonable
    - Corporate Governance
        - Executive Chairman Michael Saylor maintains majority voting rights; he is adamant in his stance on Bitcoin and could further lever the company's capital structure in order to augment its BTC position
- Assessment
    - My overall view is that MSTR has been the beneficiary of tailwinds resulting from its involvement in the two most-discussed phenomena of the business landscape today (i.e., Bitcoin/cryptocurrency and artificial intelligence)
    - Regarding bitcoin, MSTR's most recent 10-Q (dated 29th April 2024 for the quarter ending 31st March 2024) asserts that BTC's recent capital appreciation is the result of institutional adoption in the form of the exchange-traded product complex; however, my view is that market participants have been misinterpreting this dynamic; more widespread involvement of institutions in the cryptocurrency space (principally, financial institutions including broker-dealers and market makers) is not indicative of their belief in the merits of these protocols; rather, I would contend that institutional asset managers have introduced Bitcoin-backed ETPs and broker-dealers have increasingly begun providing custody and clearing services for cryptocurrency because of the attendant revenue associated with offering these services and the fact that the incremental cost for adapting their infrastructure to these uses is nominal; put simply, Citadel et. al. do not have a view on the outlook of cryptocurrency; they are only interested in collecting the substantial (on the order of 1%) bid-ask spread associated with making markets in these relatively illiquid securities
    - Although this analysis is not comprehensive, it suggests that MSTR's share performance is not attributable to its fundamentals or any favorable look-forward prospects
    - Rather, the capital appreciation of this name thus far is the consequence of the following two factors:
        - Highly levered exposure to Bitcoin, itself a highly volatile asset; volatility is further exacerbated by MSTR's decision to lever its balance sheet in order to accumulate the cryptocurrency; therefore, an exposure to MSTR is, effectively, a levered exposure to spot BTC; if you believe in further price appreciation of Bitcoin, then perhaps MSTR is a viable position to enter/maintain; else, if already owned, consider exiting; if not, proceed with caution (or avoid altogether)
        - Market participants' (flawed) view that the consequences of AI will be revolutionary; although I do not doubt the veracity of this claim, it is evident that this is the consensus expectation; therefore, it is likely already priced