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“A Snowball at the Top of a Hill”

Initially concerned by a seemingly high current valuation on Nu Holdings' stock, Andrew Hollingworth explains why he decided he wanted "to own it now rather than waiting for something to go wrong and I got a much better price."

Like many value investors, Andrew Hollingworth of the U.K.'s Holland Advisors takes special note of Berkshire Hathaway's equity portfolio additions. “In all cases we either learn something insightful about the company concerned or about the investment process in general,” he says.

Thus he found himself last December looking into Nu Holdings, an upstart digital bank founded in Brazil in 2013 that has taken that country's staid banking establishment by storm. With what management touts as a “fanatical customer-service obsession,” Nubank has grown rapidly by offering initially generous deposit interest rates and then upselling to new customers additional products and services, usually starting with a credit card. Having just signed on its 100-millionth customer, Nubank in Brazil now has approximately 54% of the country's adult population as customers, 59% of whom consider it their primary banking relationship.

The growth hasn't been at the expense of profits. Having started digital-only, the bank in Brazil boasts an efficiency ratio (non-interest expenses divided by revenue) in the mid-30s, versus 50-60% for the typical banking peer. As customer relationships expand, average monthly revenue per customer has increased from $7 in 2022 to more than $11, while the most-tenured customers generate close to $27. Rapid revenue growth combined with low unit costs has translated into unusually high returns on equity of around 40%.

Likening the company's strategy to the “scale economics shared” approach of Costco, Hollingworth argues that both the high growth and high profitability are sustainable. It has market share to gain in still-underbanked Brazil, he says, as bank incumbents find it difficult to compete with Nubank's structurally lower cost base. The ongoing maturation of its customer base should continue to translate into higher revenue per customer. There's also considerable potential for growth elsewhere, starting in Latin America where the company is expanding first into Mexico and Columbia. “This to us is very much a snowball at the top of the hill,” he says.

While the market doesn't appear un-

INVESTMENT SNAPSHOT

Nu Holdings
(NYSE: NU)

Business: Digital-only bank founded in Brazil offering a range of deposit, credit-card, loan and investment products and services.

Share Information (@5/30/24):

Price	**12.17**
52-Week Range	6.61 – 12.49
Dividend Yield	0.0%
Market Cap	$58.16 billion

Financials (TTM)

Revenue	$4.27 billion
Operating Profit Margin	45.4%
Net Profit Margin	29.7%

Valuation Metrics
(@5/30/24):

	NU	S&P 500
P/E (TTM)	46.8	23.2
Forward P/E (Est.)	30.1	21.5

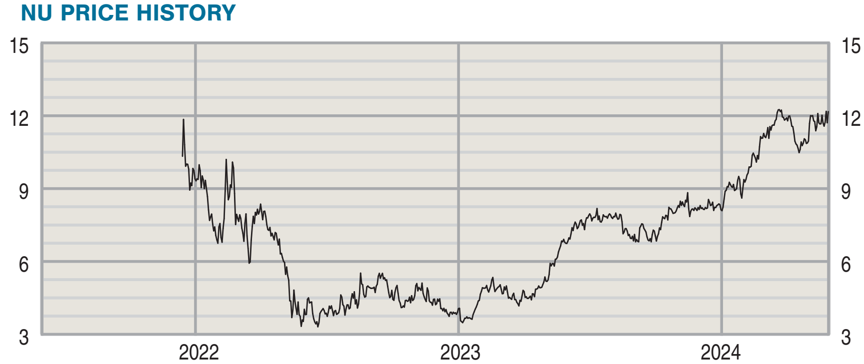
Largest Institutional Owners
(@3/31/24 or latest filing):

Company	% Owned
Rua California	20.2%
Sequoia Capital	5.3%
Tencent Holdings	5.0%

Short Interest (as of 5/15/24):

Shares Short/Float	2.3%

NU PRICE HISTORY



THE BOTTOM LINE

The company's stock trades at 18.5x what Andrew Hollingworth believes it would earn just from today's customer base producing an easily achievable $15 in revenue per customer. He considers that cheap for a company capable of compounding EPS at 25% annually.

Sources: S&P Capital IQ, company reports, other publicly available information aware of the company's potential, Hollingworth argues that its shares are cheaper than they look. If he assumes $15 in average monthly revenue per customer – on just the existing customer base – he estimates that Nu would earn close to 66 cents in earnings per share, translating into a multiple on current normal earnings of 18.5x. He considers that a bargain for a company he thinks can grow EPS at 25% or more annually for at least the next decade.

The primary risk would likely involve credit underwriting: "If you look at why hot new banks of the past have had problems, it's usually because they haven't actually understood lending and have gotten into trouble with respect to credit quality," he says. "Up to this point they've done an excellent job on underwriting and loss ratios are very low, but I'm not blind to that being a potential problem." VII

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