GSR Research

MicroStrategy Cvts: A Double Edged Sword for Outright Cvt Investors; Stellar 2024 Leads to Heightened Risk; Attractive Stk Alt/Arb Play Though

U.S. Convertibles

Manoj Shivdasani, CFA
manoj@gsrresearch.com
Dec 5, 2024

To subscribe/unsubscribe to the U.S. Convertibles distribution please send an email

Legacy Business a Tiny Fraction of the Bitcoin Securitization Business

MicroStrategy's original legacy business provides enterprise analytics, business intelligence (BI), and cloud-based software solutions (Business Segments: Analytics Platform, HyperIntelligence, Cloud Services, and Consulting & Support Services).

However, since 2020 MSTR embarked on a Bitcoin strategy adopting Bitcoin as its primary reserve asset. MSTR has been heavily investing in Bitcoin which has become a significant part of its balance sheet and business purpose. MSTR's stock is closely tied to the price of Bitcoin given its significant Bitcoin holdings.

MicroStrategy considers itself to be a Bitcoin development company committed to the continued development of the bitcoin network through activities in the financial markets, advocacy and technology innovation.

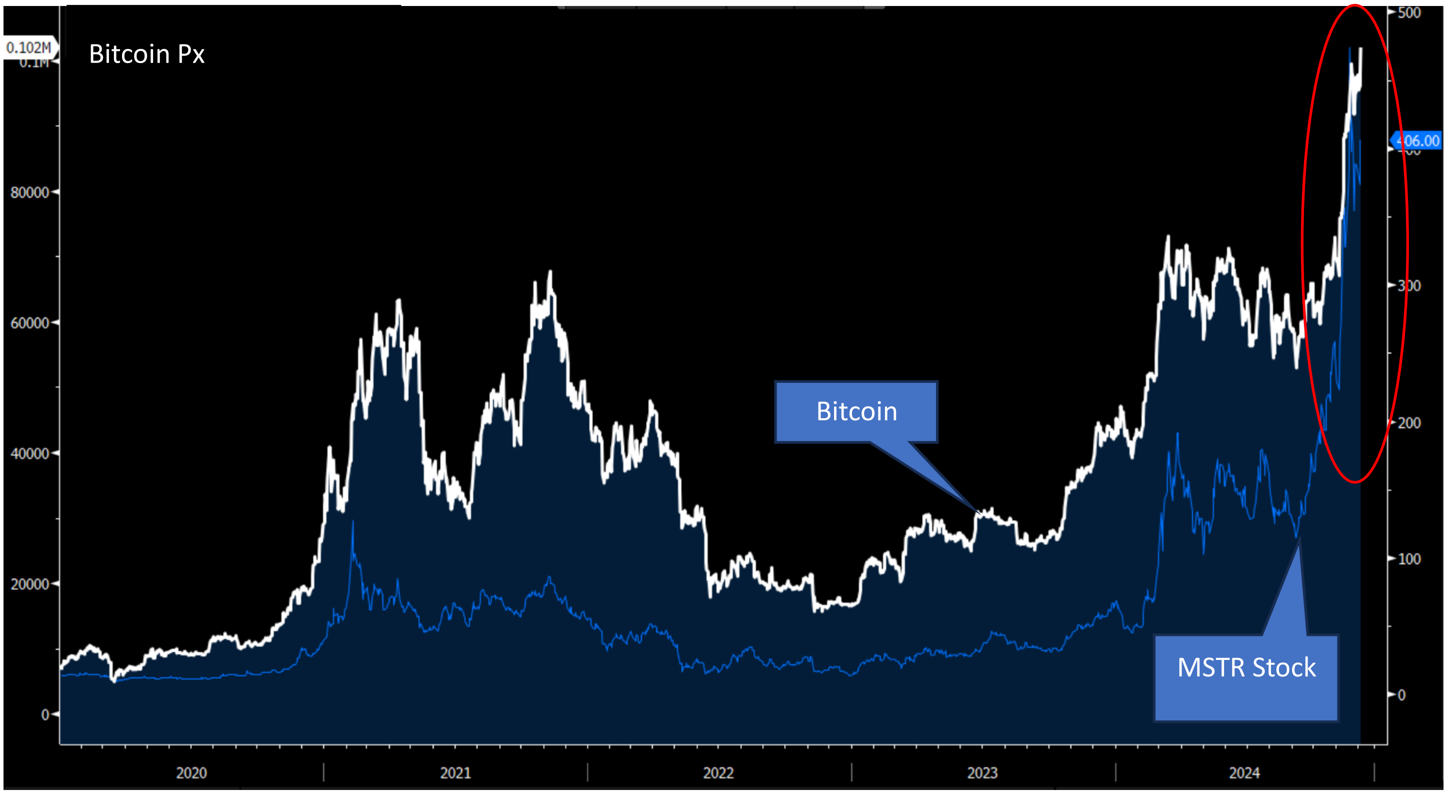
MSTR's Bitcoin Accumulation Strategy

- Primary Treasury Reserve Asset
- Large-Scale Bitcoin Purchases: continuous purchase of Bitcoin, using surplus cash generated by the legacy business, debt, convertible and equity financing.
- Despite the risks of being closely tied to Bitcoin MicroStrategy has stated that it remains committed to accumulating more Bitcoin given its management's favorable view on the long-term prospects of Bitcoin.
- Investors widely view MSTR as a proxy to invest in Bitcoin.

Key Financials (Operations, Revenue etc from the Legacy Business; EV reflects Bitcoin Strategy/Holdings)

In Millions of USD 12 Months Ending	FY 2021 12/31/2021	FY 2022 12/31/2022	FY 2023 12/31/2023	Current/LTM 09/30/2024	FY 2024 Est 12/31/2024	FY 2025 Est 12/31/2025
Market Capitalization	**6,145.1**	**1,635.0**	**10,654.2**	**95,087.4**		
- Cash & Equivalents	63.4	43.8	46.8	46.3		
+ Preferred & Other	0.0	0.0	0.0	0.0		
+ Total Debt	2,241.0	2,456.4	2,254.1	4,270.0		
Enterprise Value	**8,322.7**	**4,047.6**	**12,861.5**	**99,311.0**		
Revenue, Adj	**510.8**	**499.3**	**496.3**	**467.2**	**467.4**	**478.4**
Growth %, YoY	*6.2*	*-2.3*	*-0.6*	*-7.4*	*-5.8*	*2.4*
Gross Profit, Adj	**418.9**	**396.3**	**386.3**	**343.7**	**340.0**	**347.6**
Margin %	*82.0*	*79.4*	*77.8*	*73.6*	*72.8*	*72.7*
EBITDA, Adj	**71.0**	**34.4**	**28.4**	**-38.5**	**33.0**	**54.1**
Margin %	*13.9*	*6.9*	*5.7*	*-8.2*	*7.1*	*11.3*
Net Income, Adj	**120.7**	**-453.6**	**484.0**	**259.6**	**-573.7**	**-18.4**
Margin %	*23.6*	*-90.9*	*97.5*	*55.6*	*-122.7*	*-3.8*
EPS, Adj	**1.20**	**-4.01**	**2.97**	**1.47**	**-3.07**	**-0.02**
Growth %, YoY	*183.41*	*-142.95*	—	*-14.22*		*99.28*
Cash from Operations	**93.8**	**3.2**	**12.7**	**-34.5**		
Capital Expenditures	**-2.7**	**-2.5**	**-2.9**	**-3.0**	**-3.3**	**-3.2**
Free Cash Flow	**91.1**	**0.7**	**9.8**	**-37.6**	**-37.3**	**-1.4**

BITCOIN vs. MSTR Stock Price since 2020 clearly shows the correlation and the recent spike of MSTR & Bitcoin



Unprecedented: 5 Converts Issued this Year to fund Bitcoin Purchases

On Nov 20, 2024 MSTR issued its 5th Convert for the year 2024 ($3 billion 0% Coupon 55% Premium due 2029). The net proceeds from the sale of the notes were approximately $2.97 billion, after deducting the initial purchasers' discounts and commissions and estimated offering expenses payable by MicroStrategy. MicroStrategy intends to use the net proceeds from the sale of the notes to acquire additional bitcoin and for general corporate purposes.

As of November 10, 2024, the Company, together with its subsidiaries, held an aggregate of approximately 279,420 bitcoins, which were acquired at an aggregate purchase price of approximately $11.9 billion and an average purchase price of approximately $42,692 per bitcoin, inclusive of fees and expenses.

On Oct 30, 2024 announced a strategic goal of raising $42 billion of capital over the next 3 years, comprised of $21 billion of equity and $21 billion of fixed income securities. MSTR plans to use the additional capital to buy more bitcoin as a treasury reserve asset in a manner that will allow it to achieve higher BTC Yield.

Bitcoin Holdings, Sharecount and BTC Yield YTD Trend

	12/31/2023	9/30/2024	11/10/2024
Total Bitcoin Holdings	189,150	252,220	279,420
Shares Outstanding (in '000s) (1)			
Class A	149,041	182,995	191,154
Class B	19,640	19,640	19,640
Basic Shares Outstanding (2)	168,681	202,635	210,794
2025 Convertible Shares @$39.80	16,330	-	-
2027 Convertible Shares @$143.25	7,330	7,330	7,330
2028 Convertible Shares @$183.19	-	5,513	5,513
2030 Convertible Shares @$149.77	-	5,342	5,342
2031 Convertible Shares @$232.72	-	2,594	2,594
2032 Convertible Shares @$204.33	-	3,915	3,915
Options Outstanding	12,936	5,678	5,256
RSU/PSU Unvested	2,359	2,034	2,013
Assumed Diluted Shares Outstanding (3)	207,636	235,042	242,758
BTC Yield % (Quarter to Date)			7.3%
BTC Yield % (Year to Date)			26.4%

From MSTR's perspective the recent $3bn 0% convert was an excellent capital raise in our opinion: *MSTR, successfully tapped the convertible bond market yet again. The newly issued converts carry a 0% coupon and a remarkable 55% premium. MSTR successfully monetized the remarkable interest in its stock, heightened volatility and post-election euphoria for the crypto space.*

Microstrategy Convertibles

MSTR has six converts outstanding for a total face value of $7.264 billion and total market value of ~$13.3 billion. The Company has issued 4 converts this year alone.

Issue Date	Size ($mn)	Cpn (%)	Premium at Issue (%)	Maturity Date	Yrs to Put.	Yrs to Mat.	Yrs of Hard Call	Cvt Px	Parity	Stk Px Ref ($)	CV Ratio	Strike Px	Return Since Issue / YTD (%)	Yld to Put (%)	Yld to Mat (%)	Current Yield (%)	Prem. (%)	PC Stx Px % Apprec.	PC Date
11/20/2024	3000	0.000	55.0	12/1/2029	3.5	5.0	2.0	95.75	60.38	406.00	1.4872	672.40	(8.2)	1.25	0.9	0.0	58.6	115%	12/4/26
9/17/2024	1010	0.625	40.0	9/15/2028	2.8	3.8	3.0	240.72	221.63	406.00	5.4589	183.19	135.0	(26.78)	(19.96)	0.26	8.6	-41%	12/20/27
6/14/2024	800	2.250	35.0	6/15/2032	4.5	7.5	4.5	221.18	198.70	406.00	4.8940	204.33	121.2	(15.31)	(8.8)	1.0	11.3	-35%	6/20/29
3/15/2024	604	0.875	40.0	3/15/2031	3.8	6.3	3.3	188.75	174.46	406.00	4.2970	232.72	81.1	(15.51)	(9.24)	0.46	8.2	-25%	3/22/28
3/6/2024	800	0.625	42.5	3/15/2030	3.8	5.3	2.3	259.06	271.09	406.00	6.6770	149.77	131.3	(23.30)	(20.6)	0.2	(4.4)	-52%	3/22/27
2/17/2021	1050	0.000	50.0	2/15/2027	NA	2.2	(0.8)	286.44	283.43	406.00	6.9810	143.25	229.1	NA	(42.44)	-	1.1	-54%	2/20/24

Stock Valuation – Scarcity Value and Public Market Exposure to Bitcoin driving MSTR's high stock valuation premium. Risk controlled exposure makes more sense than owning equity outright.

MSTR's legacy business is relatively small with LTM revenues of just $467 million with adjusted Net Income of $259.6 million. The ~$95 bn market cap is primarily driven by the value of MSTR's Bitcoin holdings with a significant premium (279,420 bitcoin @ $102,000/BTC = ~$28.5b). The software business is far smaller compared to the bitcoin holdings. One can apply say a 5x multiple on revenues leading to a valuation of ~$2.3bn for the software business. Clearly the current Enterprise Value of ~$99bn implies a high premium to the total $28.5bn value for Bitcoin holdings and the software business. Could this continue? Yes. But is it risky? Yes. Bitcoin has had a remarkably strong run and if there were to be some pull back / crypto winter we could see not just the decline in the value of the Bitcoin holdings but also of the premium embedded in the stock relative to underlying BTC holdings. On the other hand, BTC could continue to run up and the demand for MSTR could remain strong. It is hard to predict market moves but given the recent moves and the high interest in the stock we recommend caution given Bitcoin volatility and the premium to intrinsic that MSTR stock trades at. At current levels the downsides outweigh the potential upside in our opinion.

The convert complex would have been a far safer way to gain exposure to MSTR than owning the common but given the strong stock run up most of the converts are deep in the money with a high degree of equity sensitivity. Only the recently issued 0% convert is balanced.

The $28.5bn value of Bitcoin and the legacy business valuation gives a good cushion the total $7.264bn in debt. But let's acknowledge that this not covered by cash flows of a conventional business in a traditional credit sense. If bitcoin trades in a range or pulls back a bit the holdings should still be adequate to cover the debt. And when MSTR issues further equity to purchase BTC that should help increase debt coverage assuming any additional debt issued is termed out further.

So, who is this for? For investors looking for a public market way to gain exposure to Bitcoin. Note that this is inherently a riskier/volatile name and the converts will likely be very volatile too. Not just on account of BTC driven stock price moves and the embedded premium to BTC holdings in the stock but also from credit should BTC experience a drawdown.

Convert Trades & Suggestions: Outrights Beware, Arbs Stay Involved Given Heightened Volatility and Good BTC Credit Coverage

Note: We are not haters of the name. MSTR's team has demonstrated and implemented a bold strategy that has paid off big. Investors have benefited enormously and MSTR's contribution to 2024 U.S. Convert Returns (+15.4% YTD) cannot be overstated (see earlier table). However, the current premium relative to BTC holdings is very large, BTC is a volatile asset and the only thing driving the stock is BTC pricing and sentiment. Basing an investment purely on what the next buyer is willing to pay for a particular asset that is not fundamentally driven is risky in our opinion. And so, we advise caution. That said Bitcoin is likely to remain an in demand alternative asset class albeit with a high degree of volatility.

Outrights: Given the run up in stock, high premium to intrinsic and high volatility broadly it would be more prudent to avoid the in the money names and stick to the more balanced 0% convert. With the Bloomberg U.S. convert index market value at ~$323 billion MSTR's 6 converts account for a significant 4.1% of the market. This name is going to drive returns no matter in which direction and we acknowledge that investors would like to have some exposure to the name. If the investment mandate permits it would be better to hold Bitcoin directly rather than to gain exposure via MSTR at current levels.

Arbitrage investors who are already large holders of the converts will continue to benefit from the volatility in the name. The 2 newest converts and the oldest one have the shortest puts/maturities and are incrementally attractive for arbs in our opinion (incremental credit safety).

One risk to the converts is if fatigue sets in and investors push back should MSTR issue another convert causing existing valuations to come under pressure especially if issued inside the existing put/maturity. More issuance is quite likely given MSTR's October announcement of its $42bn cap raise plan.

IMPORTANT DISCLOSURES

©2024 GSR Research, LLC. GSR Research (GSR) is not a registered investment advisor. The content of this publication is intended for informational purposes only. It should not be considered as legal, tax, or investment advice. The mention of any specific security, index, derivative, or other instrument in the newsletter does not constitute a recommendation to buy, sell, or hold that or any other security, nor does it constitute an opinion on the suitability of any security, index, or derivative. GSR Research hereby expressly disclaims any and all representations and warranties that: (a) the content of its publications is correct, accurate, complete, or reliable; (b) any of its publications will be available at any particular time or place, or in any particular medium; and (c) that any omission or error in any of its publications will be corrected. GSR Research's publications are published and distributed in accordance with applicable United States and foreign copyright and other laws. Without the prior written consent of GSR Research, no person or entity, directly or indirectly, may copy, reproduce, recompile, decompile, disassemble, reverse engineer, distribute, publish, display, perform, modify, upload to create derivative works from, transmit, or in any way exploit all or any part of GSR Research's website, its publications, or any other material belonging to GSR Research. At any given time, GSR Research's principals may or may not have a financial interest in any or all of the securities and instruments discussed herein.