Daseke: Loading Up For A Promising Second Half

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Value, special situations, long/short equity, hedge fund manager
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Summary

- We believe shares of Daseke offer a compelling risk/reward opportunity trading at ~5.5x consensus 2018 EV/EBITDA, an estimate that we think almost certainly is guided higher following 3Q results.
- It appears that negative sentiment following a poorly executed February follow-on offering continues to linger, impacting the price of the stock longer than we anticipated and creating an unfounded narrative.
- We're surprised that recently reported strong 2Q numbers haven't dispelled skepticism about the company and resulted in a boost in Daseke's share price.
- In addition to two recent acquisitions, which should prove to be increasingly accretive, in 2Q, Daseke reported an encouraging 13% organic revenue growth. Given Daseke's high insider ownership, we are confident that management remains significantly aligned to creating shareholder value.
- We note that a 2-EBITDA turn boost to Daseke's currently undemanding valuation (on numbers we believe are too low) would imply a share price in excess of $14, or ~60% upside to shares.

"Those who stay will be champions."

That was the slogan that was popularized by Bo Schembechler, the legendary college football coach, when he became the head coach at the University of Michigan and decided to change the culture of the football program. He immediately saw nearly half his players leave the team prior to his first season, but in the end, his edict ran true - every player that stayed at Michigan and competed for Bo for four years during his 21 years as a coach won at least one Big Ten Championship.

Though the words don't directly apply to Daseke (DSKE), we think the idea remains the same: those that stay with the company, despite negative recent investor sentiment and the current price of the stock, will see their persistence and patience rewarded.

Daseke is the US's largest specialized/flatbed shipping provider with less than 3% market share in a $140bn+ growing market. We believe the company can continue to compound revenue at 20% (or more) per year well into the next decade, including through acquisitions, while increasing profitability at a faster rate. We simply don't believe that, in such a scenario, Daseke's valuation will remain sustainably depressed. It's hard to think of any company in any industry with such open road for ongoing growth with a similar valuation. We've previously written about Daseke here, here, and here.

After a strong performance in 2017, following becoming a public company via a merger with SPAC Hennessy Acquisition Corp II, Daseke saw its shares rise almost 45%. (As an aside, we note that Hennessy's 3rd SPAC (HCAC) has identified an acquisition candidate which appears to represent a compelling opportunity in a backstopped transaction). Daseke has seen a polar change in sentiment and its stock price in 2018 - down 38% year to date. This is despite the fact that the company hasn't had an egregious earnings miss, a delayed SEC filing, the loss of a meaningful customer (top-10 customers are just 28% of revenue) or experienced a discernible impact from uncertain US trade policy. This also stands in contrast to many comparables which are a stone's throw from 52-week highs - Echo Global Logistics (ECHO), Landstar System (LSTR), and XPO Logistics (XPO) would all be solid examples (although they are all primarily on the asset-light/logistics side - 50% of Daseke's revenue).

We think that Daseke's financial growth and long-term prospects, versus the stock's trading pattern, represent a serious disconnect - and an exciting opportunity. The stock price has taken a significant dip since its 2018-high of $14.48 in early January. It appears the company is still being penalized for its follow-on offering that was poorly executed in the middle of February. We

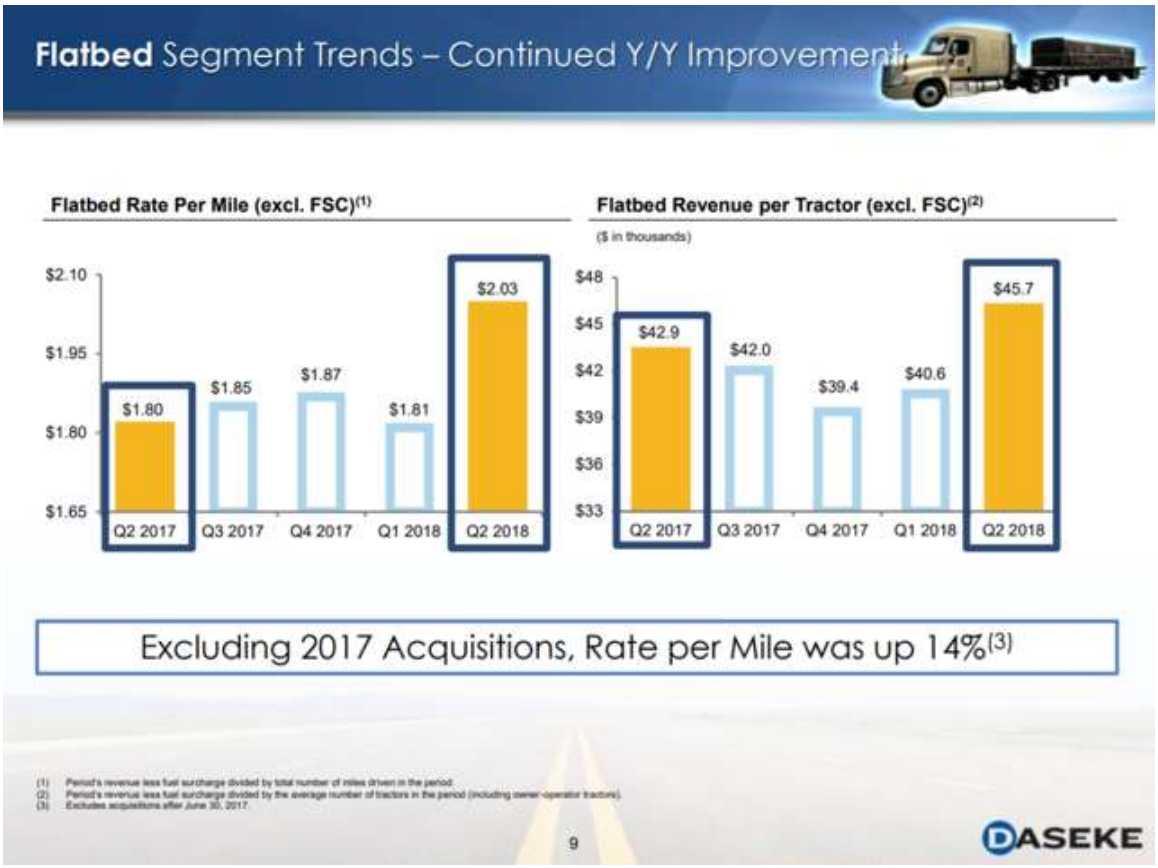
detailed the situation in a previous article, but in short, on Monday, February 12th, Daseke announced a follow-on offering of 7.4mn shares with proceeds to the company. By Wednesday night, the transaction had priced, but at roughly a 20% cut from the original deal announcement.

The stock soon broke deal price, a situation that was exacerbated by the April 16th announcement of the acquisition of Aveda Transportation and Energy Services at 8.1x 2017 EV/EBITDA, outside of Daseke's typical acquisition multiple of 5x-6x trailing EBITDA. Notably, given Aveda's business momentum and cross-selling synergy potential, we believe Aveda will ultimately fit well within Daseke's valuation parameters, if not look cheap. Moreover, it's worth remembering that in acquiring Aveda, Daseke paid $102mn for tangible assets that had recently been assessed at a value of $90mn. That, paying $12mn above book should result in the $60mn hit to Daseke's stock price experienced over the ensuing 2 weeks leading to a low on May 1st, strikes us as excessive and representative of Wall Street's frequent tendency to focus on the wrong things.

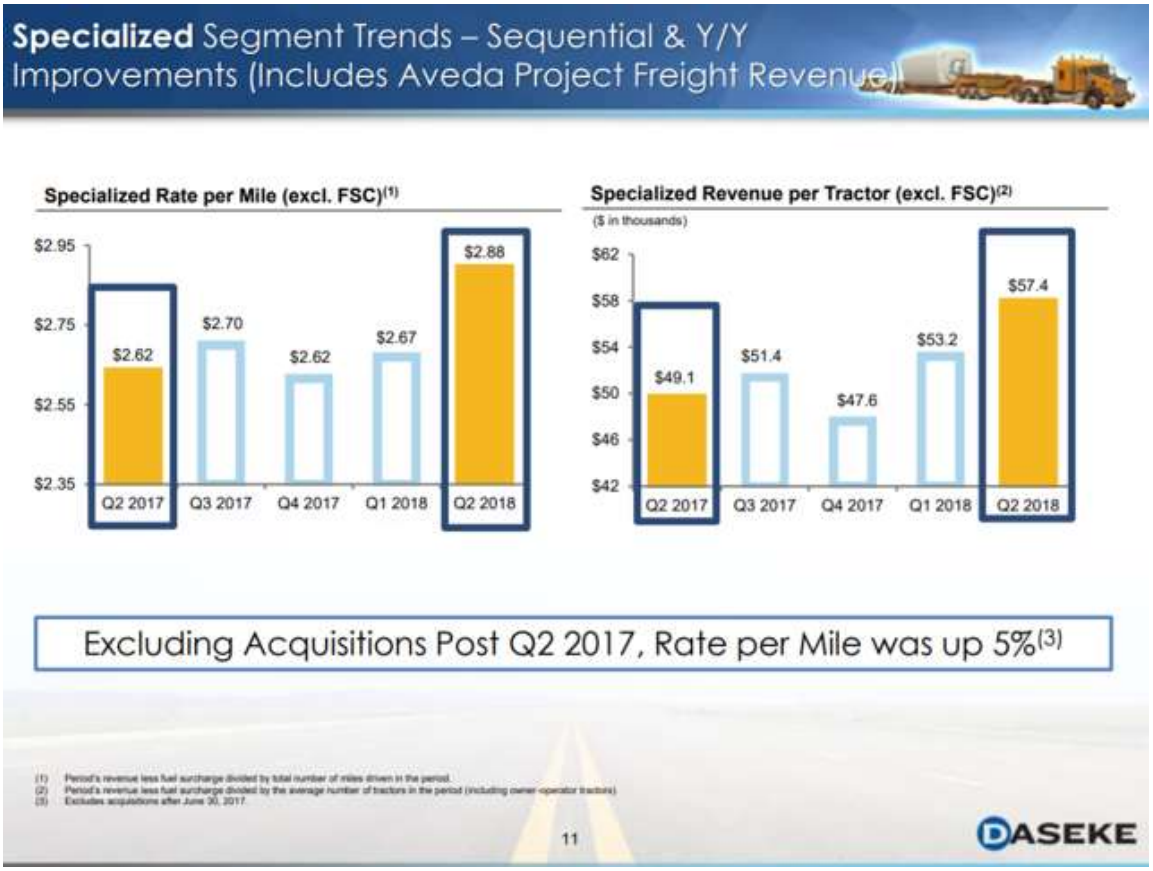
A long-term position of our Fund, Daseke has given us reasons to stick with them and remain confident in our decision. Most recently, they updated guidance for 2018 revenues and EBITDA to $1.55bn and $170mn, respectively.

Source: Daseke 2Q Investor Presentation

Operations continue to stay strong, and 2Q results were an encouraging sign. DSKE reported total 2Q revenues and adjusted EBITDA of $376.9mn and $46.3mn, respectively, both 91% increases y/y from 2017. Business is robust, and rates-per-mile continue to rise in both the flatbed and specialized segments, which is another positive sign for the future.



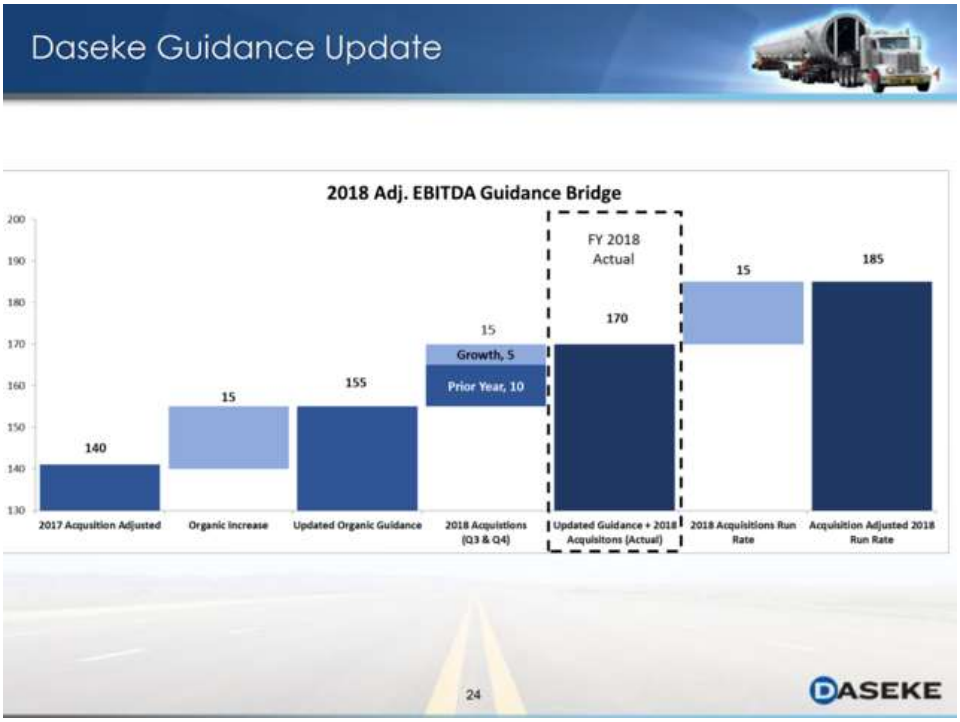
Source: Daseke 2Q Investor Presentation



Source: Daseke 2Q Investor Presentation

Many of the facets of the company that originally attracted us to DSKE are still there. First and foremost, the stock remains inexpensive relative to peers and on an absolute basis, with a projected 10%+ free cash flow yield in 2018. Their 2018E EV/EBITDA multiple is 5.5x, far lower than immediate comps and well below the industry average of 10.2x. With the company now generating 50% of revenue from higher multiple asset-light/logistics business (comps typically valued at 10x-12x or more), it appears to be getting no benefit for its mix shift. Secondly, management is still heavily aligned. CEO Don Daseke owns over 30% of the company and is in the middle of a 3-year lock-up that expires in March 2020. Thirdly, the industry remains highly fragmented with Daseke the acquirer of choice. We think there's substantial room for sustained growth.

Management's recent presentation provides a bridge to $185mn in run rate 2018 EBITDA.



Source: Daseke 2Q Investor Presentation

We suspect that with continued pricing improvement, increased efficiencies/synergies from acquisitions (management has previously commented on an expected 20% average EBITDA uplift within 2 years of an acquisition), and the benefits of the recently implemented Daseke Fleet Services team, 2019 EBITDA should approach $200mn, even in the unlikely event that Daseke fails to announce additional acquisitions. In such a case, between organic EBITDA growth and cash generation thereby reducing net debt, Daseke would be trading in the low 4x EV/EBITDA range in 12 months. We find such a scenario highly improbable and believe value funds will increasingly take note.

In our opinion, we don't think Daseke is any different than it was in early January, when it was roughly $14 a share, and if the EV/EBITDA multiple increased by 2 turns, it would be right back there. If anything, we think the company is in a much stronger state than it was back then - higher EBITDA, a more diversified customer and end-market base, and more robust organic growth have given us reason to expect increasing value for its shareholders. Though the impact of the follow-on offering has been frustratingly long, we believe this has created an opportunistic situation to buy into an exceptionally well-positioned company at a discount.

Though we are not sure we can uphold Bo Schembechler's ideology, that those who stay will be champions, we remain confident that if DSKE continues to perform to standards that it has projected, those who stay will be rewarded nicely for their patience and perseverance.