Some things and ideas: January 2019

Some random thoughts on articles that caught my attention in the last month. Note that I try to write notes on articles immediately after reading them, so there can be a little overlap in themes if an article grabs my attention early in the month and is similar to an article that I like later in the month.

Holding Companies and hedging

- One of my favorite places to invest is holding companies trading at a discount to their underlying asset value. One interesting thing about them is the come in a pretty wide variety of flavors. Let me walk through an example. Say Company A has an underlying net asset value (NAV) of $100/share. An investment in Company A can look different depending on the discount it trades at. Let me walk through two examples :
    - Narrow discounts: straight bets on underlying: If the vast majority of company A's NAV comes from one asset and company A trades at a reasonable discount (say company A trades for ~$90, so it trades for ~10% discount to its $100/share NAV), then buying company A is effectively a slightly discounted bet on the underlying.
        - A current example: Liberty Broadband (LBRDA, disclosure: long) trades at about a 10% discount to its underlying asset value, which consists (almost) entirely of Charter. There's really no reason to invest in Liberty Broadband unless you're bullish on Charter; while shrinking the discount would be nice, underlying moves in Charter are much more likely to determine the ultimate

outcome of an investment in Liberty Broadband

- Wider discounts: less about underlying, more about the discount. As the discount between NAV and the underlying value starts to rise, an interesting dynamic starts to happen where the investment becomes less about the value of the underlying asset and more about chance of successfully closing the discount. An extreme example will highlight this best: if company A trades for 10% of its NAV (so $10/share versus its $100 share NAV), you're much less concerned with the underlying moves in NAV and much more concerned with the potential for the NAV discount to collapse. If NAV declines by 20% (so from $100 to $80) but the NAV discount simply shrinks from 90% to 80%, the holdco stock will have gone from $10 to $16 and you'll be a relatively happy shareholder (if the discount completely collapses, you'll be an ecstatic shareholder).
    - A current example: Liberty Sirius (LSXMK, disclosure: long) trades at ~a 30% discount to its underlying asset value which consists (almost) entirely of Sirius (SIRI). That's a very wide discount for a straight bet on an underlying asset that's publicly traded, and it's starting to approach the point where you're less concerned with underlying NAV moves and more concerned with the collapse of the discount.
- An interesting thing about these examples: when the market prices in something with a wider discount, they're effectively adjusting for future management shenanigans / poor capital allocation. So, in many ways, investing at a narrower discount gives you more exposure to poor capital allocation because you'd get the double hit of a bad deal

diluting NAV and the market increasing its NAV discount to account for future bad deals. With a wider discount, you're less exposed, because the market has effectively already discounted bad future deals.

- That's an interesting thought to think about in light of the two examples used above. Liberty Broadband trades for a narrow discount, meaning the market isn't factoring in shenanigans / bad deals from management on the path to realizing NAV. Liberty Sirius trades for a relatively wide discount, meaning the market is incorporating some bad deals / dilution. As you might guess from their names, both Liberty Sirius and Liberty Broadband are controlled by the same management team / shareholders (Malone / Maffei). The two companies are in slightly different places (Broadband has a large but not controlling interest in Charter; Liberty Sirius has a controlling / majority interest in Sirius) and have different structures (Broadband is a separate company, while Liberty Sirius is a tracking stock still part of the Liberty Media holding company), so it's not a pure apples to apples comparison, but it is interesting that the market would assign such a wide discount difference to two pure play "holding companies" controlled by the same people.

- Of course, holding companies can get a lot more complex than just single asset companies (which both of the examples above were). A diversified NAV can create interesting opportunities (complexity can create opportunities / hidden value for people willing to do work), but it also makes an exact NAV much more difficult to estimate and makes it somewhat more dependent on the assumptions of whoever is building up the NAV. Consider:

    - Diversified public / private companies: Let's go back to company A. Their NAV is $100, but now it comes from three sources: an investment in publicly traded company B worth $20/share, an investment in publicly traded company C worth $30/share, and an insurance company they own that you think is worth $50/share. Suddenly you have some complexity. If company A is trading for $90/share, is it because they trade at a 10% discount to their $100/share NAV? Or is it because the insurance company you think is worth $50/share is actually worth $40 share?
        - A current example: As I write this, IAC (disclosure: long) trades for roughly ~$210/share. I estimate their underlying NAV at around $250/share, consisting of ~$220/share from their two publicly traded subs (ANGI and MTCH), ~$15/share in net cash, and ~$20/share from their other wholly owned subs (net of a corporate cost drag). So I have IAC trading at ~80% of NAV... but is it really? What if the wholly owned subs are near worthless (they're not, but humor me)? What if they're actually worth twice what I'm valuing them at (they might be)?
- So why do I mention all of this? One of the most difficult things I run into when looking at diversified holding companies is when / if to hedge the underlying holdings. It's a really tough call. Let me use a current example: Berkshire Hathaway (BRK) currently trades for ~$300k/share. Intrinsic value is probably somewhere in the range of $350k/share to $400k/share. Let's call it $400k/share to make the math easy. Let's say you want to take a 10% position in BRK. That makes tons of sense! It's trading for 75% of NAV and it's run by Warren

freaking Buffett.

- Here's the issue: about 10% of Berkshire's NAV is made up of its equity stake in Apple (AAPL), so by buying a 10% position in Berkshire you've effectively bought a 1% position in Apple. That's not a huge position.... but if you really wanted a 1% position in Apple, why didn't you just go buy a 1% position in Apple? And 1% might seem small but it's not nothing; if Apple completely crashed and burned (not unheard of for a large cap tech company!), it would certainly impact Berkshire's stock price and your investment in it. So what should you do? Hedge Apple to get a more direct bet on "core" Berkshire? Trust in Buffett that if he's investing in Apple, Apple is under or at least fairly valued (after all, all bets on holding companies at a discount are, to some extent, a bet that whoever is at the helm will do right by shareholders or, at minimum, can be replaced by someone who will)?
- Maybe that math seems easy currently.... but what if Berkshire traded for a 40% discount to NAV instead of a 25% discount? Would that make you more likely to hedge (so you could get a more direct bet on core Berkshire?) or less likely (cheap enough that you can stomach a wider drop in Apple)? What if Apple was a 20% position instead of a 10% position from Berkshire? What if Berkshire's 10% position wasn't in something stable-ish (like Apple) but was in something more cyclical (like the airlines)? Does that change the thought process?
- In general, I believe markets are mostly efficient, and you make investments when you have some sort of insight into something the market is missing. Let's say you're right that the market has mispriced Berkshire (which is why you're

buying Berkshire). That "mispricing" insight should be relatively rare.... how likely is it that you're going to have the same (relatively rare) insight to if the market is mispricing Apple? Apple is a completely different company in a completely different industry that you're only looking at because Berkshire owns them; it seems unlikely to me that you'd have any edge in determining if Apple is under or overvalued.
    - Also, what about opportunity cost? Let's say you're right that the market has mispriced Berkshire, but Apple is relatively fairly / efficiently priced (i.e. you agree with my point above / you have no unique insight there). Is it better to not hedge Apple? Or would it be better to hedge out Apple so your net long position is lower and you have more capital available to put into your other positions (which you ostensibly believe are mispriced / will outperform the market over the long run given you're invested in them)?
- I don't know the right answer to any of those questions. But as my portfolio has increasingly shifted to undervalued holding companies, almost all of which offer some type of "hedging" opportunities (the chance to hedge out a piece of their underlying asset value), it's a thought process I've struggled a lot with and I figured I'd throw out my thoughts on here.

Netflix’s tech advantage / Bird Box

- Netflix made huge waves around New Year’s when they announced Bird Box had gotten 45m views in ~1 week. That announcement immediately spawned debates around how similar a view was to a Box Office ticket (buying a ticket to see a movie in theaters) and if Netflix was taking over the movie industry.
    - I think it’s a crazy impressive figure and shows

the power of Netflix’s home screen / distribution, but the comparisons to box office views are obviously crazy. Going out and buying a ticket requires much more of a commitment than watching a “free” movie on the subscription, and while that level of views does show the power of Netflix’s home screen, Netflix clearly wanted to juice Bird Box and made it a prime location for all home screens. One big argument for traditional movies is talent doesn’t want to be lost in Netflix; if you’re pointing to Bird Box as a counter argument I think it’s a step in the right direction but I’d still want more proof that movies that Netflix doesn’t juice like Bird Box still can reach a wide audience consistently. For example, how many people actually saw Outlaw King? Or The Ballad of Buster Scrugs? My gut is awareness of both of those was way lower than if they had been released by a traditional studio with a marketing push behind a theatrical release. Bird Box was encouraging and the next few years will be interesting as all of the major studios launch their own DTC platforms, but I'd be really hesitant to call for the death of the way we currently release movies (big releases through theaters, some exclusivity window for the theatrical release, and then into streaming windows).

- One thing that I think is consistently underrated about Netflix is their tech. I was researching Lionsgate (LGF; disclosure: long a token position) over the holidays and subscribed / downloaded their Starz app. I got into Counterpart and downloaded an episode to watch on a plane. The download was horrible: for some reason, the first fifteen minutes of the episode were dropped, the closed captioning didn’t work, and the sound didn’t align with the video. Maybe my experience was anomalous, but I’ve never had the same issues with Netflix (and, in fact, I needed to switch to a Netflix show I had already downloaded because Counterpart was obviously unwatchable). It’s easy to say that other competitors are just going to go out and catch up to Netflix by buying content, but Netflix has an obvious technology lead that will take competitors years of focused effort and huge spend to erase.

  - Related: Netflix's Simplicity is its secret weapon
  - Speaking of Netflix tech, the Bandersnatch "interactive" Black Mirror episode is crazy interesting to think about. I've said a few times that I thought the future of entertainment was some type of interactive choose your own story programming, but to do it with live action is really impressive. I doubt the current effort is scalable (it seems like a one off, and there's no way you could apply a choose your own path to a live action TV series without huge restrictions or issues), but it's pretty cool. I'd recommend reading this: How the Surprise New Interactive 'Black Mirror' Came Together

- Last Netflix thing / speaking of Netflix tech- Vox / Recode estimate that most of Netflix's big shows are still shows owned by the legacy media companies / former cable bundle shows. Assuming the data is trustworthy / accurate (which is not a complete given), I find it pretty surprising and it speaks to a huge problem for Netflix. Netflix makes a clear push to steer people on their platform to Netflix controlled / pushed shows (whenever I load Netflix, their shows generally fill the first screen I load, and their 2018 earnings letter clearly states "As a result of our succes with original content, we're becoming less focused on 2nd run programming"). If most views are still for older licensed shows, it suggests Netflix is having some trouble building out enduring shows that reach a huge audience. There are a few ways you could explain this away for Netflix (people view the most popular Netflix shows, like Stranger Things, immediately when they come out, and combine that binging with those shows relative freshness (there's ~20 episodes of Stranger Things versus ~200 of Friends) and Netflix shows might be disadvantaged in this metric currently but they'll catch up over time), but you can also see a very easy bear case emerging from the data (despite Netflix's efforts, their most popular content remains stuff that began on legacy TV channels, and as that is pulled from Netflix viewers will follow it to other services).

  - On the other hand: 'You' is the latest beneficiary of the Very Real Netflix Bump shows the power of the Netflix platform. It's not exactly surprising that a show gets way more attention once it's on Netflix versus a small cable channel like Lifetime, but if the company can take a little watched Lifetime show and get 40m households to watch it in four weeks, it shows the power of the platform. (disclosure: my fiancee got me into You. It's good.)

- PS- Netflix is raising prices; its most popular plan is now $13/month. I continue to think that if you're valuing Netflix off their current pricing, you're completely crazy. The company clearly has significant pricing power. The legacy cable video bundle costs ~$100/month and includes ~15 minutes of ads for every hour you watch plus less choice / content than Netflix (given the legacy bundle only offers you the choice to watch what their channels show when they show it versus Netflix offering their whole library at any time). Yes, Netflix doesn't have sports or news, but Netflix is still significantly underpriced versus the cable bundle.
  - Very related: Steve Burke on NBCU's streaming plans, Fate of Hulu Stake and Winnowing direct reports and How Comcast's Wavering left an opening

for Netflix.

- Also related: The bundle strikes back: how steaming caught up to cable TV prices and Netflix's Strategy is growth, so it can't have growing pains

Update on FSK (disclosure: long)

- FSK was my third Christmas idea. The thesis was basically: FSK had been unfairly sold way below book value, and hidden in some recent filings are clues that book value hasn't deteriorated anywhere close to what the market is implying. Management is relatively aligned with shareholders and will aggressively buyback shares in the near future if they continue to trade at a big discount.
- So far, the thesis is playing out well. On Jan. 15, the company quietly filed an 8-K announcing prelim year end NAV/share of $7.82-7.86. With the prelim number filed, I believe the company is no longer in a "blackout window," and both insiders and the company itself can start to buyback shares. Sure enough, two days later, three insiders (the CIO, the CEO, and a director) bought shares on the open market (the director actually bought twice, and the CEO continued buying as it looks like the repurchases are part of a decently aggressive automated purchase program).
- I continue to think the company is going to be aggressive repurchasing shares, which should drive NAV significantly higher, and the insider purchases make me more confident in that suspicion.

Sports media update: A core tenant of the monthly update: continued highlights of the increasing value of sports rights (mainly because of my love of MSG (disclosure: Long)).

- Buzz is picking up ABC wants NFL rights
- NBA inks billion dollar deal with maker of 2K Videogame

(Take-Two)

  - One of the issues with anyone who makes anything that touches on the sporting ecosystem is it seems like, eventually, the leagues will extract all of the excess profit from them. So one of the tough things with looking at EA or Take-Two is that some of their biggest franchises are based on real life sports and it seems like the profits will always get extracted from them. Of course, those video game companies have other franchises that they can use to earn profits. I'm not sure the same can be said for broadcasters / the big 4 networks (ABC, Fox, etc.); it seems to me that most of their franchise is built on sports these days, and I think all of them will effectively spend every dollar of excess profit they earn to maintain their sports rights (if they don't, tech companies will swoop in and take them to build their own "networks" and the legacy networks will crumble). Look at ABC getting ready to bid for NFL rights; if they win, it by definition means one of the current rights holders must lose. I would guess the bidding will be ferocious as a big 4 network without the NFL is very vulnerable to pricing cuts as cable / satellite providers focus on managing programming expenses.

- NFL bullish about $25B revenue goal as Superbowl nears
- Lebron's move to Lakers is crippling NBA's TV ratings
  - A bit surprising to me that basketball ratings are down this season, as a variety of other metrics seem to indicate the league is at its all time highs. A lot of this seems to be related to TNT specifically (ESPN is down 5%, and ABC Xmas coverage was up), and it all needs to be considered compared to cord cutting that is ravaging the broadcast industry (most primetime broadcasts shows are down mid-double digits YoY).

    Still, I'm surprised it's down that much, and that a lot of the ratings declines can be traced to LeBron going from east to west shows the power of the mega-stars in sports and suggests that there could be a lot of upside next year if the East can get some star power (say, Kevin Durant going to the Knicks? The league should certainly be hoping for it!).

- ESPN in negotiations to extend MLB media rights
- Evaporating insurance market new threat to football
- How a deluge of money nearly broke the Premier League
- ESPN's EX-President wants to build the Netflix of Sports
- NFL Signs Caesars as Casino Partner, Inches Toward Betting Deals
- NY governor: let's legalize sports betting
    - Nielsen on how much revenue leagues will gain from sports betting
- MSG looks to move into sports betting
- MLB bid for Fox RSNs imminent
- NBC Sports Washington bets on interactive broadcasts
- Twitter to live-stream NBA games- featuring a camera of a single, fan-voted player
- Oracle pays more than $200m to rename SF ballpark
- NBA ends greatest sports deal of all time

Other things I liked

- Business Cycle (interview with Peloton's CEO, very interesting)
- Why some platforms thrive and others don't
- Should satellite companies be in charge of selling their 5G spectrum
- 5G: If you build it, we will fill it
    - From Wi-Fi to bluetooth to 5g all your wireless is about to change
- Terabyte-using cable customers double, increasing risk of data cap fees

- CBS Viacom merger talks drumbeat grows louder
    - CBS could end up with Viacom and Discovery
- The hit podcasters breaking down Harry Potter, Chapter by Chapter (disclosure: I'm a big fan)
- The 2 year old Instagram influencers who make more than you
- A farmer found a Trojan Horse inside an insurance contract; now he might bring down Canada's insurance industry
- Paramount was Hollywood's Mountain. Now it's a molehill
- The 20%-a-Year Stock Picker Who Wishes His Edge Would Disappear
- Bold Predictions for the Travel Industry in 2019
- Private equity firms create funds that are built to last
- 2019 Predictions from T-Mobile
- A peek at how Disney resort shows are made
- Is Liberty about to become the most powerful company in music? (disclosure: long a bunch of libertys)
- TV ratings way down over past two years
    - Apple CEO predicts cable bundle unravels in 2019
- Inside HBO's plan to win the streaming wars
- How Spotify is Trying to Take Over Nashville
- Rolling Stones Interview w/ Jack Dorsey (Twitter CEO, really enjoyed this)
- Can Chrome replace your game console?
    - This is interesting for a whole host of reasons, but here are the two things that pop into my mind. First, if games go completely streaming, then the opportunity to build out a Netflix-like game streaming service evolves. If that opportunity is there and a land grab forms, is the winner going to be someone who licenses games from a bunch of different studios? Or is the winner eventually going to be the person who follows the Netflix route and starts developing their own exclusive games to lure people on to their service? I suspect the later, and if that's the case the game

companies are all strategic takeout targets for the giant tech companies. Second, streaming games and stuff like this will require super low latency and massive internet upload / download speeds. Something to keep in mind when thinking about the future for broadband providers (speed / capacity / infrastructure will remain a critical advantage).

    - Still, I'm not convinced that gaming is going to develop a "Netflix" style streaming service for several reasons. First, games already monetize through subscription services (World of Warcraft monthly fees is a classic example) pretty well. Second, games are just tapping their in-game monetization potential (micro-transactions like buying cheap outfits on Fortnite); how would that evolve in a Netflix gaming subscrition? Third, gamers tend to focus all of their time in a handful of games, and the games can consume 1000s of hours of gameplay. If you're spending all of your time on two or three games, do you really need a "netflix of games" that offers you access to 1000s of titles? Probably not. So I can see the allure of comparing a streaming gaming service to Netflix / the upside if you could successfully create one, but I'm not sure its really viable or makes sense in the context of how the current gaming landscape looks.
    - Note that I'm just speculating / spitballing on the points above (this article dives a bit further into cloud gaming). I do think the game companies are takeout targets for a host of reasons (a media company could do wonders marrying their IP to other monetization avenues, and a microsoft / amazon would see huge synergies through the cloud offerings / data / userbase).
- Speaking of tech companies acquiring gaming companies, here's Barron's suggesting Apple should buy Nintendo

- Blackstone gets better as its business gets bigger
- Google leases One Westside (more here)
    - I've talked a few times about the potential for Class A Malls to be undervalued in public markets. In particular, I thought they had tons of optionality given they are generally really well located with lots of access to transportation (highways, parking, transit, etc.). This deal is "a first-of-its-kind", but I think it's emblamtic of the types of creative deals class A mall owners with really nice balance sheets should be / are considering.
- In New York, a Glitzy Mall Devotes a Floor to Online Retailers
- Yelp investor says shares could almost double; urges change (disclosure: long YELP)
- Inside the strange yet profitable world of retail arbitrage
- In Tokyo, These Trains Jingle All The Way