Some things and ideas: April 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.

Podcast and interviews

- Similar to March, the Rangeley Team recorded a podcast where we talked about some of the ideas and links in this post. You can find the podcast on Spotify or on iTunes (it should be on most other major podcast players, but please let me know if I need to get it uploaded to any others).
  - If the reception is good, our aim is to do a similar podcast once a month in advance of posting the monthly links. Feedback welcome!
- I also appeared (extremely briefly) on CNBC, where I managed to quickly mention positions in MSG (disclosure: long) and Charter through LBRDA (disclosure: long). Nothing new for anyone who follows this blog, though it can sometimes be nice to put a face (and huge forehead!) to an anonymous blogger so figured I'd share!
- I'll be on the scuttleblurb podcast at some point next month (it was supposed to be taped last week but we had some serious technical issues), so there's that to look forward to as well. I've been a subscriber to scuttleblurb for >1 year and really enjoy the product (I'm going on because I reached out to him and told him how much I liked the product!), so I'd highly recommend it if you're into in depth research of companies (generally more growth-y / SAAS focused), which I'm

guessing many readers of this blog are.

Monthly value theory ponderings: timing and luck

- Say you buy stock in company A for $20 per share. Your investment thesis plays out perfectly and the stock goes up to $40 over the next year, at which point you sell. 10 years later, the company goes bankrupt and the equity goes to zero.
  - I think it would be tough for anyone to hold that bankruptcy against you and say you got lucky in timing your trade. But where's the line between being "lucky" for selling early and just simple good investing. If you did the same investment and sold two years before bankruptcy, was that luck? One year? Six months? Three months? One week?
  - Obviously at some point on that time line, you'll have been lucky to dodge that bankruptcy bullet, but where is the line between "lucky to avoid" and "irrelevant"? And when does it start mattering if you sold because of a specific risk factor? For example, if you sell a stock today and tomorrow the company unexpectedly goes bankrupt and the stock craters, then you certainly got lucky, but if you follow an industry and company really closely and sell today because of a new risk you saw, and then the company's earnings crater from that exact risk sometime down the line (say three years later), was that lucky or skill? The classic example here is Warren Buffett selling all of his Fannie and Freddie stock in the early 2000s because of rising risks on their balance sheet; both companies had basically all of their equity wiped out a few years later during the financial crisis. It's tough to look at the sale Buffett made and say it was anything other than skill (he sold because he identified those exact new

risks!), but where's the line? How close to the crisis could he have sold his stock with the sale still falling into the "skill" category versus the "lucky he got out alive" category?

    - Related: I talk to a lot of other investors, and often when a company has some type of news that sends their price significantly up or down (like a really good or bad earnings report), I'll follow up with the investors I've talked to about that company. It's crazy how many times investors claim to have sold off all of their shares before a bad earnings announcement. Maybe they did (and good for them!), or maybe they're just trying to save face, but in general the people I'm talking to are fundamental, bottoms up, long term oriented investors, so it seems weird to be selling large positions before earnings because you've got a "gut feeling" they'll be bad. And if you're constantly "dodging bullets" by selling stocks right before awful earnings, it seems like that will eventually catch up to you in some form.
- Investing is a really difficult game, and it's near impossible to suss out luck from skill over a short period of time. But I increasingly wonder how easy it is to suss out luck from skill over what many of us consider longer periods of time. The holy grail for most value oriented active investors is outperforming over a full market cycle (i.e. a bull and a bear market). Is even that a long enough time frame? If you're running a concentrated portfolio, even over a full market cycle, your porfolio's return will only reflect the results of a handful of investments, and if you got "lucky" by dodging just one or two bullets or having invested in a sector that did better over that particular cycle (say, investing in tech at the beginning of this cycle, or avoiding tech in the late 90s / early 2000s time frame), your portfolio still might reflect a lot more thematic /

sector return than most professional investors would like to admit. Maybe that was due to skill in identifying sector, or maybe it was luck? Tough to say.

- Anyway, there are no real takeaways here. I've just been thinking a lot about luck and skill in investing, and the longer I do this (invest professionally, or at least try to!), the more I question how to measure the skill of an investor / assess the long term performance of someone / try to isolate the role of luck in investing.

Anadarko boosted CEO payout just before $33B Chevron Merger

- Earlier this month, Chevron (CVX) agreed to buy Andarko (APC; disclosure: long) in a $33B deal that valued APC at ~$65/share. It quickly broke that Occidental (OXY) had bid mid-$70s for APC and was surprised that APC had announced a deal with CVX (the CVX deal was announced Friday and OXY thought APC was going to take talks into the weekend, and obviously anyone would be shocked when a company agrees to a deal that's >10% below what you offered and you hadn't even been offered a "final bid" to try to bump your bid). OXY eventually came over the top and made a public topping bid for APC that valued the company at $76/share; the offer is notable because OXY's stock had already fallen a decent bit on rumors that they would bid for APC, so if you adjust OXY's price to the pre-APC price and back out the potential break fee APC will need to pay CVX, it suggests OXY would have had room to bump their offer to ~$80 (or even a bit higher) if APC had engaged with them before announcing the CVX deal.
- It turns out a few days before APC announced the CVX deal, they had bumped their executives' change of control agreements.
    - Normally I don't care about executives getting "golden parachutes"; in fact, I generally like companies I'm invested in to have them. If a CEO

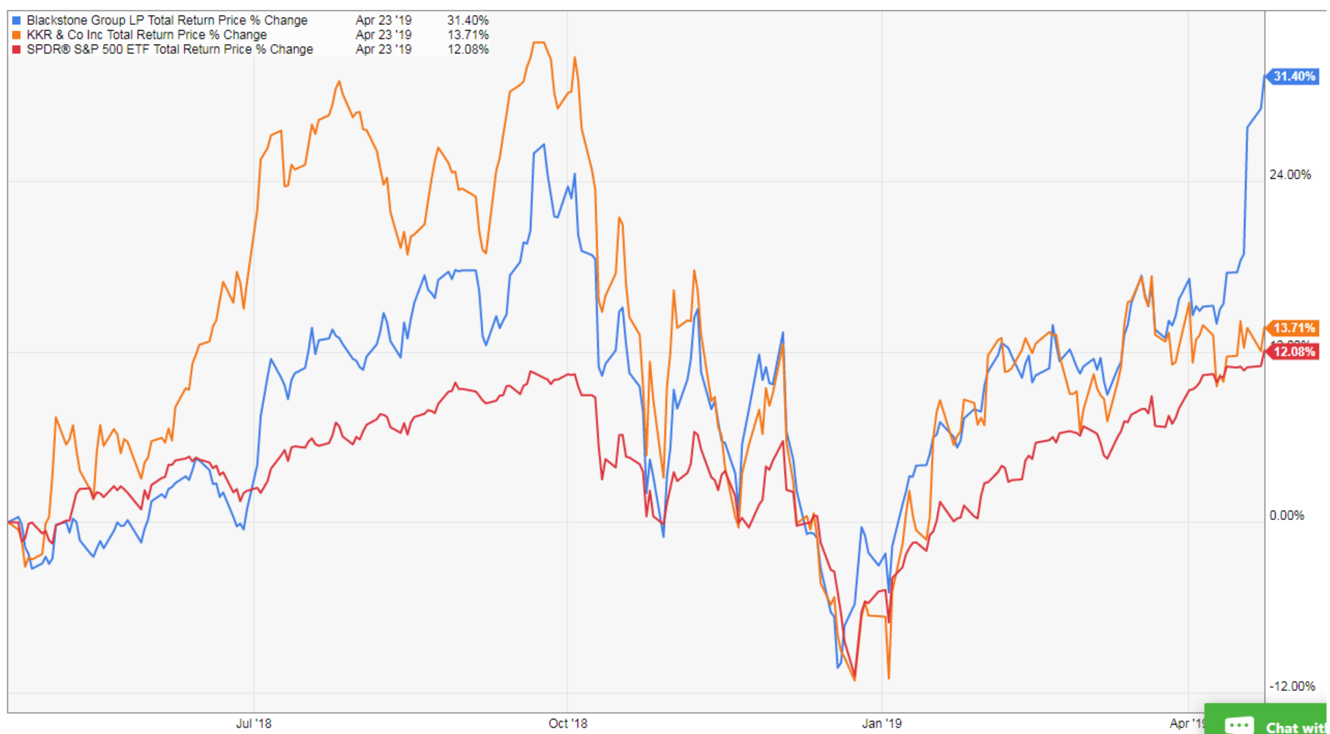
sells their company, I'll generally get a nice premium for my stock and they'll be out of a job. That's a real mismatch of incentives; a golden parachute helps encourage the CEO to sell if that's what makes the most sense.

- Still, I wonder if this shows the negative aspect of a golden parachute: managers might favor a "sure bid" over a bid that carries a larger premium but has a bit more risk. OXY's higher bid likely will require OXY's shareholders to vote on the deal, while CVX's deal does not. Is it possible APC management decided to take the "sure" CVX bid and guarantee their payouts versus a significantly higher OXY bid that may have had some risk of failing and not getting golden parachutes?
  - The risk of OXY's shareholders voting an APC deal down is no small risk. OXY shares fell 6% in the two days after the APC news was announced just on the news that they were considering an APC deal, and are currently down ~10% from their pre-APC deal price. If I was a shareholder in a company that announced a deal that sent my stock down 10%+, I would absolutely be considering voting that deal down!

- Note that I wrote this on April 28; on April 29th APC announced they would negotiate with OXY because the new OXY offer contained significant improvement to the prior offers. I actually think that announcement boosts the case I laid out above; why did management rush to take the CVX deal versus trying to get OXY to boost their bid and all of the conditions before signing a definitive deal with someone else?

Blackstone announces conversion to C-Corp

- Blackstone announced a conversion to a C-Corp, and the market cheered.
- I've said this before (and Matt Levine said it better than I can), but I find it interesting how much the market cheers these firms converting from partnerships to C-Corps. A conversion calls on the firm to willingly increase its tax rate, and yet investors cheer the move and bid the stock up. I'm not 100% convinced that's right or that a conversion is anything more than a short term sugar high. Consider Blackstone versus KKR (which I am long); KKR announced they would convert to C-Corp last year. In the wake of the conversion announcement, KKR shares initially outperformed both BX and the S&P 500, but they soon gave up those gains and had underperformed BX on a one year basis even before BX's recent C-Corp price bump. Obviously the KKR / BX comp is just one example, but it does strike me as surprising that the market is this excited for a conversion when there's limited evidence that it meaningfully improves a company's multiple / valuation.



- Another interesting thing about the conversion:

it's permanent. The private equity firms often point to the lower corporate tax rates from the tax cuts as a reason they think a conversion makes sense... but what happens if tax rates go up in the future? Then the firms will be locked into a C-Corp structure and their tax rates will be way higher than they would have under the old pass through structure. Again, I can't help but wonder if the private equity firms and the market are favoring a short term high over longer term value creation / tax minimization.

    - BX has argued that they are "managing for the long term" and this move works even if tax rates go higher, but I feel like there's a lot of slight of hand in their argument. Their argument is that if corporate tax rates move up to 25-28%, individual income tax rates will likely go up as well, so this move won't really be dilutive. That seems pretty specific; why would income tax rates go up? Why wouldn't corporate tax rates go back to their old 35% levels? I hope corporate tax rates don't go up, but it seems like firing a permanent bullet for a tax change that could be reversed isn't a "managing for the long term" type move.

- Below is what Apollo had to say when asked about converting late last year. As I write this on April 23, BX shares are up ~$4/share since announcing the conversion. Some of that is due to strong earnings and a strong market since announcement, but let's assume for a second that all of that share price increase is from the conversion. BX's LTM Distributable earnings per share (a metric I don't love, but it works for these purposes) are ~$2.20/share, so BX would have added a bit less than two turns of multiple by

converting. It will be interesting to see if APO looks at what happened to BX and KKR post conversion and decides a conversion is worth it or if they stick to the math laid out below and decide to maintain their current structure (FWIW, Apollo's stock was up on the BX announcement and has continued to rise since then (it's up ~10%, or almost as much as BX's!), so the market certainly seems to be thinking a conversion is likely!).

It is what it is. Now you can say this is because of the C conversion, but the last time I looked, Larry Fink has a C-converted company, and he's down 25% in the last five, six weeks. So I don't think you can attribute it all to C-corp. Having said that, I think C-corp is a very important issue. It's one we take extremely seriously. Frankly I would love to have a shareholder base which included a lot more long-only investors. I would love to get on an index. I'm the biggest shareholder in Apollo. Of course, I would like those things. The question is at what cost?

And there's a lot of tax leakage that's included to convert. The mathematics are pretty simple. It kind of says you have to make up 2.5 multiples, have an uplift, to come out and even. Now, I don't need [indiscernible] (00:33:03) get every penny of that back, but so is having a better shareholder base worth $50 million to us? Is it worth $100 billion? Is it worth $0.5 billion? So that's the judgment call.

- Related- Here's the WSJ on the conversion, here's an interview with Schwarzman discussing the C-Corp conversion, Blackstone raised alot of money during Q1, why they think their size is an advantage

The Smartest Guys in the Room

- Over Easter, I spent a lot of time travelling on trains, so I reread The Smartest Guys in the Room. This was my second read through; my first came when I was in college. I like to think I have just a bit more experience with business and investing now then I did then, so the reread was absolutely eye opening. Two things really jumped out at me: a lot of Enron's "hype" were based on businesses that are actually market / category killers today and Enron has a lot in common with the car company that must not be named (which, disclosure, I have a small short position in).
  - Enron hype / category killers: Enron was obviously a fraud, but it's crazy how many of the ideas

their fraud and hype were based on would become category kills. A lot of Enron's broadband vision was based on streaming video on demand (basically Netflix), and other pieces of the broadband vision were basically cloud computing.

  - That's surprising but not that crazy. Lots of the Dot Com bubble stocks were businesses that would eventually become some form of proven business; they were just way too early. For example, Kozmo.com was basically a grubhub or postmates. GeoCities was a webhosting service that seems awfully similar to something like godaddy (GDDY) or wordpress. Everyone remembers / mocks Pets.com and their sock puppet, but today online pet companies are all the rage (as they have been for ~the past decade). I'm not saying any of these are direct comparisons, but it's interesting how the successful busienss models of today are generally the highest flying / most mocked of the dot com era. The lesson? It's easy to dream up the future / ideas that will generate tons of consumer surplus. It's much harder to actually wait til the time is right (for example, Netflix always wanted to do streaming video, but they had to wait till broadband speeds were fast enough to handle) and then execute a profitable business plan.

- Comparison to the car company that must not be named: I try not to mention the car company that must not be named on this blog as there's simply no upside: people tend to fall into one of three camps (screaming bulls, raging bears, or people who just mute every hashtag associated with the topic and pray for the day the debate ends), and

it's so well followed there's not really any room for differentiation. I tend to agree with Bronte Capital; I'm short a very small amount and I'd like to be wrong on the short because the vision (a fully electric autonomous robotaxi network next year?!?!) is so amazing and so great for humanity. So keep in mind that this section may be me projecting what I'm economically motivated to see, but the similarities between Enron and the car company were really striking as I was reading the book (I'm far from the first person to point this out though!).

- Place would go wild to meet quarterly numbers, even at expense of long term health of business (Enron / car company Q1'19 and Q3'18)
  - Semi-related: end of quarter balance sheet window dressing (enron / car company quarterly cash balance and sale of regulatory credits to hit numbers)
- Reliance on customer deposits to finance business (Enron / car company)
- "Veritable sham" to pump stock / hype future business (Enron / so many examples for car company (the SolarCity Example is the best; possible / probably last month's Model Y reveal or the suggestion of launching an insurance business within a month would fit here too)
- Continued insistance that the company doesn't need to raise capital as balance sheet crumbles (Enron / car company)
- Allegations that a "cabal of short sellers and scoop hungry reporters" are to blame for the company's problems (Enron / car company (tweet on short sellers).

        - Related: short sellers initially "just think it's a bad business" and numbers don't make sense + continued insider sales (Enron / car company)
    - As share price declines, analysts ask harder questions and new pumps don't work for stock (Enron / car company)
        - Eventually, this leads to Insulting analysts on earnings calls (Enron (here's a bit more)/ car company)
    - Chairman / CEO heavily levered to stock price and surprisingly illiquid (Enron / car company)
    - Management has an.... aggressive way of dealing with employees and is known for mood swings (Enron / car company)
    - Company presents an initial idea that no insider believes is credible / close to where the company line says it is, but everyone is convinced it will work out because of company exceptionalism and size of opportunity (Enron / car company)
        - Bonus from that Enron clip: both companies seem more concerned with vision than actual execution (Enron "oblivious of the particular challenges of turning... latest grand vision into reality"; car company legendary for logistics / customer service issues that are basic blocking and tackling for normal car companies).
- Is everything above a perfect comparison? Absolutely not! Enron was pure hype whereas the car company, you know, produces cars, but I was certainly struck by just how much "history rhymes" I could see in real time as I read the book.

- Another interesting thing about Enron is that many of the products they claimed they were working would end up being true category killers. They owned a ton of pipelines, and Rich Kinder (who was COO for a long time) basically just took that pipeline business / vision and became a billionaire at Kinder Morgan. Enron's overall vision also included profiting from the privatization of infrastructure, which is huge among private equity funds now, and they even had dreams of a Netflix like app. The issue is that vision alone isn't enough to change the future; execution is significantly more important when it comes to successfully changing the future and building out a very profitable company. Obviously there was no attempt at execution in Enron; while I don't think it's fair to say there's no attempt at execution at the car company, I do think execution falls far, far behind vision on what the car company really cares about.
- I left plenty of other quotes that reminded me of the parrallels between the two companies on "the cutting room floor." The one I was saddest to leave behind was one I actually couldn't find; I remember a piece in the Enron book where they store a bunch of unused routers and one of them blows up / melts in a warehouse and causes a big fire (obviously car company is famous for cars catching on fire (and more)), but I couldn't track that down when I was searching my notes this morning. If anyone can find it, I will add it back here.

Extreme Due Diligence

- I love all stories relating to quirky / strange / extreme due diligence. I was reminded of that when reading this interview with KKR's "Next Generation Technology Growth Fund," where they mentioned launching a phishing attack on their own employees as DD for a cybersecurity investment.
    - My own personal extreme due diligence example? When we invested Bob Evans a few years ago, I ate their refrigerated mashed potatoes and/or mac and cheese with every lunch (and sometimes even breakfast) for ~two weeks. I also drove out to one of their stores, sampled basically their entire menu, including their candied bacon (delicious), and ordered around 50 cookies and other pastries to go from their bakery (the cookies survived maybe two days). My fiance came with me, and she still talks about the time we invested in the restaurant chain that served "literal bowls of gravy" because the biscuit and gravy came with one biscuit and a literal soup bowl of gravy. It was delicious. Long story short: by the end of our DD, I had easily put on five pounds (and I am more than happy to compare that DD to Ackman's work / Oreo eating when investing in Mondelez).
- Why do I mention this? No real reason except it cracks me up / to let my readers know that I welcome any and all examples of strange / extreme DD.
    - With a whole batch of publicly traded marijuana stocks making their way on the market, the potential for strange / hilarious DD continues to increase. Of course, I'm not sure anything will ever top the classic dating app / Ashley Madison extreme DD, but I am hopeful!

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)).

- Tsai in talks to buy Barclays Center, become majority owner of Nets
- Fox's MLB TV deal is much richer for team owners than you probably think
- FanDuel, DraftKings race to win $150B sports betting market
- The inside story of how the Ricketts family schemed and feuded their way to owning the Cubs
- Warriors make $2B from new Arena even before doors open
- Overwatch feels outdated in the era of Fortnite
  - Apex legends has lost its huge momentum
- NBC Sports interactive betting broadcasts head to Philly
- March Madness scores across all platforms
- The Athletic's next arena is podcasting (plus Athletic CEO's tweets on local sports podcasting)
- How hard a golf hole is does not depend solely on how hard it is
- Billionaire Bucks' Owner Says NFL's Revenue Reign Will End
  - NFL draft draws record numbers
- Fanatics has found a way to make itself effectively Amazon proof

Other things I liked

- Melon Tusk's comments to the SEC
- Making Uncommon Knowledge Common (On Rich Barton returning to Zillow)
- Buying Stakes in PE Firms, not just their funds, pays big
  - "Dyal and its chief competitors... have recently been paying prices that imply higher valuation multiples than the ones private equity firms trade at"
  - KKR Founders set sights on Japan Conglomerates

(disclosure: long KKR)
    - Rise of super carry unsettles PE investors
    - Private equity's unused cash hoard drives clients away
    - Colony Capital: the mixed investment record of Tom Barrack
- Bankruptcies test one of wall street's favorite trades
- DE Shaw: Inside Manhattan's 'Silicon Valley' hedge fund
- Youtube bows out of hollywood arms race with Netflix and Amazon
    - Why the clock is running out on big media companies
    - Disney / AT&T / Comcast versus Netflix / Amazon / Apple
    - After Autoplay: "Interactive, Personalize & Immersive" Entertainment
    - Netflix is still too cheap (the content, not the stock)
    - Netflix main rival is hulu
    - Why isn't Hulu better
    - How Netflix plans on owning your kids screen time
    - Love is fleeting, but Netflix passwords are forever
    - Cord Cutters savings shrink as online TV services raise prices
    - Leon Black (Apollo) is building a TV empire
    - Look what the streaming revolution did to your cable box
    - Netflix looks to keep its most popular shows: Friends and The Office
    - Let's watch netflix: three words guaranteed to kill a romantic mood
    - The whole process of creating a TV show, from pitch to pilot
- It's a short hop from fortnite to a new AI best friend
- The Hollywood fight that's tearing apart writers and agents, explained

- How Bioware's Anthem went wrong
- Hate your internet provider? Look to space
    - Altice thinks their deal is better for 5G than Sprint / T-Mobile
- A revolution sweeping railroads upends how America moves its stuff
- Blackrock sharpening focus on alternative investing to boost growth
    - Apollo to launch 7 funds in hot market for private capital
- Malls see tsunami of store closures as foot traffic declines further
- How a 119 word local crime post became Facebook's most shared story of 2019