Some things and ideas: November 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.

A request:

- I'm just going to start blanket including this request in each month's post. One of the reasons frequency of posts / podcasts / other public stuff can fall off is because I look at them and wonder: "Is it really worth my time doing these for this small an audience?" A lot of work goes into all of these, and I hope that the output is generally of interest / high quality. If it is and there's someone you think would like this blog / the podcast, please share it with them. It would mean a lot; positive feedback / increased readership is what keeps the public posts coming!
    - This isn't meant to be a threat or anything! It's just frustrating to spend lots of time on something that you think is decently high quality and consistently see viewership numbers that would rival a local high school's newspaper or a North Korea / South Korea soccer match.
    - And a big thank you to everyone who reached out expressing how much they liked the blog. Honestly it means a lot to me!
- One thing I realized this month: it's kind of rude for me to be asking people to share my blog without highlighting some other blogs I enjoy. So here's a special shoutout to some fellow bloggers whose posts I

enjoyed this month:

- Woodlock house on Medallion
- Bireme on Q3'19 investor letter ideas
- Non-Gaap thoughts on curious eOne insider buys (probably the best investing thing I read this month)
- A letter to the CLNC board
    - CLNY / CLNC is an absolute disaster. I took a small position in both a last year and fortunately sold at a small loss before the bottom dropped out; as one friend has told me, "it's almost a right of passage as a value investor to look at CLNY and say 'wow, there's a lot of asset value there; sure it's a mess but I'm more than getting paid for that,' and then buy the company and lose money because it's way worse than anyone could have imagined."
- My discovery while on vacation (not actually from my vacation! I don't take too many, though I will be going on a long honeymoon next month. From adventures in capitalism's vacation)
    - I'm not sure I 100% agree with this piece, but I do directionally agree with one point: the market appears to be responding later than it used to to new numbers. Take my largest position, Charter, as an example: I don't know anyone who followed the company who didn't believe in the "2019 will see a huge drop in capex as merger integration and DOCSIS roll out falls off" thesis. The company talked about it constantly.... but the market ignored that until the company reported Q4'18 earnings and gave a firm 2019 capex guidance number, and then the stock took off. I've been seeing that a lot lately: it's not until a number is fully

into the LTM numbers or explicitly guided by the company that the market adjusts to the numbers. Maybe that's because of increased reliance on computers / quantitative investors, or maybe it's a small sample set and I'm just cherry picking data points!

- While I'm on the subject and since the piece mentions the stock, I mentioned STNG (disclosure: I own a super small tracking position) in last month's post. The CEO continues to buy short term call options on the stock. If you're a bull on the stock, you think he's doing it because he thinks shipping rates are going to inflect up before year end and he'll make a fortune when these pay off. If you're a bear on the stock, you think he's doing it to pump the stock while the company pounds its ATM stock issuance program. There are merits to both those arguments, but I have a few other questions about those purchases. First, I don't think I've ever seen another company put out a press release about its CEO buying ST options; is this just a requirement because STNG is a foreign filer? Second, how is this not insider trading? I don't mean this in an accusatory way; I'm honestly asking the question of why this isn't insider trading. Let's assume he's doing the call buying because he talks to a bunch of shipping people as part of his role as CEO and he thinks rates are about to inflect upwards massively. How can he use that info, which he got as an officer of the company, to buy short term options? If I ran a public company and I got a buyout offer at a huge premium or my quarter was going really well,

I can't use that info to buy either the stock or short term call options; how is seeing a possible rate boom any different? Is it simply because this is a foreign company?

- Clark Street Value on Franchise Group (FRG; disclosure: long. I wrote it up here and here)
    - One small update on FRG. The company declared their first div this month; it works out to an annual div of $1/share. Normally I'd rather buybacks over divs, but given this is a low float company focused on buying concepts at very low multiples and cutting costs, returning a boatload of cashflow upfront through dividends probably makes the most sense from a capital allocation standpoint. If they keep executing / close VSI and cut the costs they think they can cut, I continue to think FRG is substantially undervalued even without benefit of future accrettive deals.

Programming note: I will be going on my honeymoon for most of the back half of December, so for the first time since November 2017 I'll probably be taking a month off this column. Look for a larger column in the new year!

- We're spending time in Tokyo, Hanoi, Da Nang, Phu Quoc, and Ho Chi Minh for the honeymoon; I've never been to that part of the world, so if you have any recs they would be much appreciated!

Podcast: Unfortunately, we didn't do a podcast this month; Thanksgiving came at the end of the month and I worked from the city for the last week of the month. Chris and I will hopefully have one final podcast for the year out next week (possibly discussing Berkshire bidding of Tech Data; guess whose 10-k I'll be reading this afternoon...). As always, you

can find past episodes on Spotify here.

- If you're looking for a replacement podcast, I can't recommend this invest like the best episode with Gavin Baker highly enough.

Monthly value theory ponderings: Management trustworthiness

- A frequent theme of this column is management trustworthiness. For example, last month's disclosures and guidance section mentioned Netflix and a few others habits of publishing internal guidance.
- Why do I care about management trustworthiness? I'm increasingly of the belief that investing with management teams you can trust / that treat shareholders fairly is one of the best edges in the market.
  - Look, I know the realization that investing with management teams who are not crooks is better than investing with crooks is truly revolutionary, groundbreaking stuff (insert sarcastic font here). Honestly, with insights this original and good, I should be charging a fortune for this blog.
- Anyway, why do I mention this? Well, I was flipping through the Mitek Q4'19 earnings call (disclosure: I'm bagholding a bit), and I was struck by how their earnings release failed to mention a $200m judgement against one of their clients using Mitek's app. $200m is no small judgement; even a mega giant like Apple or something would probably feel compelled to disclose some info on it. Mitek is not Apple; this is a <$500m market cap company that tried to bury a $200m legal loss. Incredible stuff.
  - Look, I'm not saying Mitek's management team are crooks. A lot of smaller management teams don't view their companies as something to be run for shareholders, but as a piggy bank to be looted as aggressively as possible. But Mitek trying to bury a mammoth award like that is indicative of a

management team that doesn't think of their shareholders as partners. Compare Mitek's handling of the lawsuit to how Grubhub responded when they had to take their guidance down massively due to competitive pressure in Q3'19; Grubhub wrote a detailed letter explaining why they were doing that and how they thought they'd benefit long term. One team laid out the bare facts, one team tried to brush a disaster under a rug.

    - Also, to be clear: it's not even certain if Mitek has any liability for that judgement, or if it will have any effect on the business! I'm more highlighting this because it was clearly a huge issue (MITK's stock is down 25-30% since disclosing the judgement) and Mitek clearly tried to bury it.

- Increasingly, I only want to invest in three types of companies.
    - Companies who treat shareholders like partners. I think you generally pay a premium for these companies, but the premium is often extremely small (or, if the controlling shareholders own enough to keep the company out of indices, I suspect this premium can often be dramatically outweighed by the "non-index" / illiquidity discount), and it's so much easier to sleep at night knowing that your management teams aren't actively working against you.
    - Companies who don't treat shareholders like partners, but where there's some catalyst that might change that. Often that catalyst is an activist, but there are a variety of others catalysts imaginable (for example, a company's controlling shareholder passing away and leaving a big tax bill to his heirs, forcing them to sell the company to get cash to cover the inheritance tax). Sometimes that catalyst has already happened

(a company announces a strategic process, so buying the stock is a bet on successful completion and/or a bigger premium than market expects).
    - MSG (disclosure: long), where James Dolan gives no fudges about shareholders and the team is horrifically mismanaged, but the assets are so good I can't help myself.

Bonus Pondering: timing, alpha, and luck

- I've mentioned this a few times on the blog, but one of the things I think about the most is how to separate timing / luck from actual alpha generation.
    - The simple example I give is this: say you buy a stock for $10 because you think it's too cheap and is a really good business. It reports a few good quarters, the market comes around to your thesis, and you sell about a year later for $25/share. Fantastic! Ten years later the company goes bankrupt and the stock goes to zero. No one would accuse you of luck there, right?
    - Where's the line though? What if, instead of the company going bankrupt ten years after you sold it, it went bankrupt one year after you sold it? Was that investment alpha or luck now? What if it announced awful earnings one week after you sold? Sure, you dodged a bullet, but the timing is really close... was the investment all luck or alpha now? What if part of the reason you sold was you saw increased risks to the business that made you uncomfortable holding? Really tough to say.
- Anyway, I mention it this month because BlueLinx (BXC) has crashed back to earth recently (see stock chart below). BXC was a popular long in the value investor community for a while because (among other reasons) they owned a ton of properties that were probably worth ~as much as their entire EV (perhaps more). The stock

skyrocketed when they announced a merger in early 2018 that had a mammoth amount of synergies, but this month the company has given basically all of those "merger gains" back as a disastrous Q3'19 earnings release and a subsequent shelf registration has caused investors to fear the company is on the verge of breaking covenants / facing a liquidity crunch that will cause mammoth dilution.

  - I've got no real views on the company. I had looked at them in late 2017 / early 2018 and constantly kicked myself that I had missed the big move. But I wanted to highlight it because it's such a clear example of the timing / luck thesis I think about so much. Investors who owned BXC before the merger made a killing (and I think it was a very good thesis), but in hindsight I wonder if the made a killing because this was a cyclical stock with a bunch of leverage and the market was strong versus the company actually generating value. Then again, is there really that much difference in stock picking between buying a company that generates value or being good at buying really cheap options on super leveraged companies that the market might warm up to really quickly? Yes, you can't buy and hold the later forever, but there are certainly interesting gains to be made there (I think this relates to the STNG stuff I talked about much earlier in the blog).

- No real takeaways here; just something I'm constantly mulling over, particularly as I try to think about my own track record / separate my "alpha" from leveraged beta and timing luck.

Podcast monetization / sports gambling advertising

- I was listening to the Book of basketball podcast (Bill Simmon's new podcast / audio follow up to his Book of Basketball book, which I loved), and in episode 7 I heard a really interesting ad. At ~the 40 minute mark, Simmons reads an ad for the Fanduel Sports book. What's so interesting about the ad? The fanduel sports book app is available in a grand total of FOUR states (Jersey, Penn, West Virginia, and Indiana). Obviously, there are going to be tons of people listening to that ad who don't reside in those four states (I live in NYC and listened to the ad in Louisiana), so Fanduel is paying national advertising rates to have their product pitched when they really only want to reach people in four states.
  - Yes, I understand Fanduel probably sees some brand building from having their product pitched in states where they hope to eventually expand, and I also understand that they offer daily fantasy sports generally nationwide so (again) there's probably some brand building value, but I think

it's fair to say the majority of the value of this ad was coming from the listeners who could actually.... use the product Fanduel is pitching.

- I mention this for two reasons
    - First, I think it clearly illustrates just how valuable cracking dynamic ad insertments for podcasting will be. What if, instead of being limited to one ad here, Simmons could sell dynamically inserted ads? So, for people who lived in the four states Fanduel is operational in, they would hear a Fanduel ad, and for anyone else, they could hear a more relevant ad (something like a razor pitch or Casper matress or something, or even just an ad for Fanduel that focuses on daily sports, not betting). That dynamic ad would be better for everyone: Simmons could charge a higher advertising rate, Fanduel would pay more per person but a lot less overall to target just the people they want, etc. Cracking that dynamic ad insertment opportunity is going to generate massive value, and the first company to do that is going to make a lot of money. From memory, I believe AT&T said at their Time Warner trial that dynamic ads carried ~4x the price point of normal ads.
        - I've mentioned this several times on the blog, but that's one of the reasons I find Spotify (disclosure: I own a tracking position) so fascinating. I think they are, by far, the company best positioned to crack the dynamic advertisement code, and if they do the monetization opportunities are huge, and I would think it could result in a really powerful flywheel for them where podcasters want to work with them because they offer so much more monetization opportunities, which leads more listeners to

hop on the Spotify platform, which increases their monetization and targetting opportunities, which attracts more pod casters, which.....

- I think you get all that potential call option (and a bunch more!) for free in Spotify's stock today. As I write this (November 20), Spotify's market cap is ~$25B (stock price = ~$135/share). They have ~$3.5B in cash and investments if you include their ~$1.6B in TME stock as an investment, so their EV is ~$22B. At year end, they'll have ~260m monthly active users and ~120m paying, so you're paying <$100/user and less than <$200/paying user.
    - Here's some anecdata: I probably listen to Spotify four hours a day. I tried to switch to Apple Music a few years back (I think because Taylor Swift's new album was exclusive to Apple for a while, and I'm not about to miss out on a new Taylor Swift album), hated it, and eventually switched back to Spotify. I can't imagine switching to anything else now: Spotify has too much of my liked music and knows me too well. Now, I realize I'm on the tail end of Spotify users for a whole host of reasons (I'm U.S. based, so probably their most valuable consumer, I listen more than the vast majority of consumers, and I probably still listen to more Fall Out Boy than is generally healthy), but it's tough for me to look at a dominant internet platform that I use that much and think that they

ultimately can't realize more than $100/user in lifetime value (where the market is currently pricing them).

    - I also think that anecdata broadly supports what Spotify says about their competitive positioning: that they're seeing lots of signs that their engagement / churn is much better than comps, and I'd guess that's because their product is simply better.

- Ok, last one on Spotify. I found this interesting from their Q3'19 call; they suggest their users were actually asking Spotify to provide them sponsored listings / advertisements. When your customers are actually asking you to provide them advertisements, your platform probably has a lot of monetization optionality going forward. Their CFO sees similarities between Spotify investing into podcasts and Netflix investing into content a few years back, and I think there's a good chance he's directionally correct (though i think NFLX exclusives will create more value than Spotify / podcast exclusives).
    - I'm not saying Spotify is a layup: someone else could certainly win (Apple music, Amazon, etc.), or it could turn out I'm wrong about the economics and all the value Spotify creates leaks to consumers and/or record labels (or perhaps whoever controls the device that plays the music (i.e. Alexa)), or it could turn out I'm right that Spotify wins but that "free" competition from services looking to monetize outside of music

(again, Apple music or Amazon Prime come to mind) prevents Spotify from ever delivering super financials, but I think Spotify has a great shot of winning the market and if they do the upside is mammoth. The market seems to disagree on both counts.

    - Second, Fanduel is paying national advertising rates for a product that people in only four states can use. I think that shows how profitable sports gambling can be. I tend to think excess sports gambling returns get competed away as all the sports gambling books compete for customers.... but I think it creates a potential bonanza for people who can offer sports gamblers opportunities to reach customers. Who benefits? My (somewhat educated) guess: networks with sports rights (who will make a fortune in advertising revenue) in the short to medium term and (eventually) the sports leagues themselves (if the networks are making a fortune in advertising revenue, they can pay even more money for sports rights in the next renewal talks).
- Right after I wrote this, I saw this article on podcasting advertisements in the WSJ. It's got some good statistics in there. I do think podcasters would be better sticking with live reads and just dynamically inserting advertisements based on what the listener likes, but programattic has some appeal as well. Either way, I would guess there's tons of money to unlock as the medium evolves.
    - Also after / as I wrote this, this Hollywood reporter article on SPOT's podcast ambitions came out.

C-Corp conversion for PE companies: did it work?

- Private equity firm stocks have been enjoying a fantastic 2019, and if you listen to their management teams / investor days, all of them think a big reason behind the big moves are their decisions to convert from partnerships to normal C-Corps has opened their stock up to a whole new world of buyers (index funds and vanilla long investors who were restricted from buying their stocks as partnerships for fear of getting a K-1 / tax complications). The private equity firms have also argued something along the line of "there's more to come from the conversion; right now we've only gotten a little of the benefit from it, but more and more investors will buy our shares over time as they get comfortable with us and it will lead to our shares continuing to grind higher over time." If the private equity firms are right, then that implies two things:
    - As investors looking for alpha, we should be devoting a lot of time to researching (and buying?!) stocks that currently aren't in normal C-Corp form, because the market is systematically undervaluing them (MLPs would be the most logical play here, though I can think of one or two other quirky candidates as well).
    - There's a lot of ineffeciency at play here: the cost of being listed and generating a K-1 (which incurs some tax complexity for the individual shareholder) mammothly outwieghs the tax savings the company generates / is much higher than I would guess most investors price their time (i.e. you may have to spend an extra couple thousand dollars on your individual taxes, but it's causing these multibillion dollar corporation to be systematically undervalued by 20-40%, so the overall deadweight lost valuation far far exceeds the incremental tax advisor cost even ignoring the fact that it causes the PE firm to save on taxes / reduces double taxation), but the market is so

inefficient when it comes to those costs that it doesn't immediately correct once the company becomes a C-Corp, which (again) presents a sustainable alpha potential for investors.

- Are the arguments above right? I'm not sure. I've posted four charts over on twitter (and I'll note here that I'm still long KKR): KKR versus the indices since it announced its conversion, KKR versus indices since conversion, BX versus indices since conversion announcement, and BX versus indices since converting.
    - It's tough for me to look at those and say "O yeah, these things have mammothly outperformed the index since converting!" KKR was worse than the index from both the conversion and the announcement til the end of 2018, and it's basically inline with the SPY since the conversion. KKR has outperformed since announcing the conversion, and BX has outperformed substantially since announcing the conversion, but nothing in their charts makes me think that the conversion is really responsible. The outperformance appears to be driven more by their underlying investment perform (their PE funds have done really well, and KKR has a huge piece of their balance sheet in FISV, which has been on fire this year) and the market rerating the PE space overall (BAM, which I am long, hasn't changed structures at all and is up 50% YTD).
    - Perhaps the private equity players would say the reason the space overall has rerated is because of the new attention from all of them going to C-corps. Perhaps it's not a coincidence that the performance started to accelerate after BX, the largest player in the space, announced their conversion. But that still implies a lot of market ineffeciency (the market wouldn't rerate till all, including the largest player, had converted, and

even then it was a grind higher).

What the heck is going on in the fast food space?

- Is it just me, or has the fast food space completely jumped the shark recently? I'm slightly tempted to quit my day job and just spend all of my time writing fan faction novels about bumbling fast food CEOs doing insane things.
- By far the headliner here is this batshit crazy interview from Papa John's CEO. Look, I've only listened to this 26 second clip, and trust me, that's enough. More than 40 pizzas in 30 days!?!?!?! How is this man still alive? He goes on to suggest some (former?) board members should be in jail, though I'm honestly not sure if he's suggesting they should be in jail for stealing the company or for changing the pizza formula. Just incredible.
- That's honestly the headliner, but the TAST story is pretty great from a pure business perspective. TAST is Burger King's largest franchisee, and last quarter they accidentally allowed "double discounts" on the Whopper that cost them almost $13m in a quarter is seriously insane.
  - I look at TAST once a year. Every time I look at them, I want to like the story. It's basically "we buy mom and pop franchisees for ~4x EBITDA (with about half of that in leverage), cut enough costs so that 4x becomes ~3x, and make a big profit (even bigger to equity given leverage)." But every time I look at it a see an organization that's a mess and that hasn't managed to sustainably grow earnings or cash flow despite making mammoth investments and acquisitions over the past few years. Honestly I think the "double discount" fiasco makes them basically uninvestable. It's not the mistake that matters; it's that it took them 3

full months and >$10m dollars to figure out the mistake. Any competent organization should have been able to look at a week of sales / profit numbers and realized something wasn't right.

- O yeah, and McDonalds' CEO resigned for having a relationship with a subordinate this month. The fast food space is so crazy right now that the CEO of, by far, the largest fast food company just resigned for having a relationship with a subordinate, and it was only the third most interesting story of the month.

Gold star continuation

- I introduced the "Gold Star" process in my August 2019 blog link and followed up on it in September. My goal is to continue to do this going forward: every month, I want to read 40 10-Ks and hit the most recent earnings call for those companies (if they have them). Many of these will be new companies, but some will be brushing up on old favorites. The hope is the process helps to me to maintain the balance of reading broadly while learning about new companies and ensures I'm a bit more structured in my work. Anyway, here are the 40 I read this month:
- If you have thoughts on any of the companies I mention in this, I'd love to hear them. Or if you have suggestions for companies I should look at next month, I'm always open to suggestions (I tend to hit ~75% of the companies people ask me to look at, and I'll try to get back to you with thoughts on them if I have any / if I remember or you remind me).
- I got through about 20 companies this month; however, I'm planning on wrapping more than half of them into a post I'm working on for the near future, so I'm actually not going to post this month's companies because the other ~10 are so small I don't want to publicize them. Hopefully I'll have a very long list for you in next

month's post, and look for a post wrapping the other ten in the near future!

Sports media update: A core tenet of the monthly update: continued highlights of the increasing value of sports rights (mainly because of my love of MSG (disclosure: Long)). (side note: I called this a "core tenant" instead of "core tenet" for almost two years until a reader pointed that typo out. Embarrassing! H/T Ryder)

- Blue Harbour says MSG worth $400/share
  - Bloomberg wants to save the world. He should buy the knicks (agree)
- Man City stake sale breaks valuation record for sports group
  - Three things on this: First, this makes me want to brush up on MANU. Their EV is less than $3B; substantially below this mark
  - Second, note that this deal is for a minority stake; I believe Forbes had their valuation at ~$2.7B. If a minority stake is going for $4.8B, imaging what a controlling stake would be worth... (I get that CFG, which is the entiry Silver Lake is investing in, controls more than just man City, but I'd be surprised if Man City isn't the overwhelming majority of the value here)
  - Third, Silver Lake is the minority investor. You know what else Silver Lake is a minority investor in? My favorite sports stock, MSG.
- Knicks, Devils Broadcasts get betting flavor with FanDuel Deal
- Superbowl ads give fox a pinch yourself moment
- Ballmer, Dolan in billionaire brawl amid sports arena arms race
- Comcast sued by RSN
- How Jeff David stole $13m from the Kings
- NFL and MLB players team up to start Jock Marketing

Venture (WSJ story on same topic)
- Snyder makes a bundle mismanaging Redskins

Other things I liked

- John Malone interview at Liberty investor day
  - Look, if you're interested in media or value investing, you're going to watch that interview. Required yearly watching; it's way more informative than any other billionaire interview out there (I'd rather listen to one of those than 10 Berkshire meetings).
- AQR says time to sin a little with value stocks
- Investors pay up to join the PE rush
  - When I mention my investment in alternative asset managers, most investors push back on the balance sheet valuation with something along the lines of "these are illiquid investment into their own funds; shouldn't you take a big haircut on them?" The private equity firms would argue that these are fee advantaged investments into funds that generally sell secondary stakes at or above NAV, so you should mark their book at a premium. I don't agree with either take, but I'd lean more towards agreeing with the later than the former.
  - A booming corner of private credit has some investors on edge
- Everyone gets paid in CBS Viacom merger... except for shareholders
- What do you fear
- The bus ticket theory of genius
- Kubernetes is the future of computing; that's bad news for one stock
- Netflix internal data suggests users aren't fleeing for Disney
  - IMO Disney and Netflix can co-exist; there's

probably room for a few others services but those are the two winners. I'm not married to that belief though (and it's not exactly controversial; Malone highlights the same thing in his interview).

- Bloomberg entering race is a huge windfall for TV stations
    - Ok, I'm linking to my own tweet. But political spend next year is going to be nutty!
- Chanos interview on Hedgeye
- 9 secrets I never knew about airports until I worked at LAX