Non-April Fools' post: some "shower thoughts" on the post-Corona investing environment

My wife and I have a joke about something we call "shower thoughts." Shower thoughts are thoughts that have some combination of complexity, deepness, and quirkiness; for example, yesterday her shower thought was "People under house arrest must feel so lucky right now; it's not even a punishment since it's what they'd have to do anyway."

Today, I'm feeling a bit reflective, and I decidedly do not want to do an April Fools' post (the world has basically played a big prank on us this year; I don't need to add to that fire). So I figured I'd post some investing "shower thoughts."

Before diving in, I want to emphasize I'm not saying any of these topics / trends are guaranteed to happen. Far from it. There's a lot unknowns right now, but clearly there are going to be some lasting impacts from the current environment. That could be bad for some businesses and great for others, and being early to recognize that trend could help you catch an OK business as it inflects to a good one or avoid a good business as it inflects to a bad one. So this is more about thinking through some possibilities than saying definitively any of this is right. That said.... investing shower thoughts:

- What are some businesses with network effects or consumer habits that could be broken by the current shutdown?
    - A network effect is something that gets more valuable the more people who use it. The classic

example (indeed, the example on wikipedia!) is a telephone network: if one person has a telephone, it's worthless. If everyone has a telephone, it's a valuable communication tool. The best current examples are the social networks like Facebook.

- A consumer habit is something a consumer does all the time that they eventually do without thinking. These can be pretty powerful (Buffett said the chains of habit are too light to be felt until they are too heavy to be broken; he was talking about work habits but the same applies to consumer habits). I think the best example today is google: when you want to search something, most people instinctively go to google to search. That's a very, very powerful habit that has turned google into one of the most successful businesses in history (yes, there's more to google's success than that, but a very powerful reason they're so strong is consumers habitually go to google for search).
- Huge swaths of the world are going to be stopped for the next ~6 months; that has the potential to break consumer habits and network effects, which in turn creates opportunities for start ups / emerging players and vulnerabilities for legacy players. Some potential examples:
    - Every morning on my walk to work, I open Spotify and listen to a podcast.... but I'm not walking to work right now, so my podcast listening has gone way down. The good news for Spotify is I still listen to music while I work, so I'm using the app all the time. But imagine a hypothetical user who listened to podcasts to Apple podcasts and used Spotify for their music. They're barely going to be opening up Apple podcasts over the next six months (if they're like me);

that would present the opportunity for Spotify to nudge into Apple's place as their preferred podcasting app

- Whenever I was looking for a local restaurant, my wife and I would search Yelp, but for the foreseeable future it's unlikely we're searching for new restaurants. Even once we do, a lot of those old Yelp ratings are going to be very stale (a lot of the restaurants will have closed, the staff will have had enormous overhaul, etc.). When we open up an app to look for a new restaurant six months from now, our habit of using Yelp will be broken. Will we just use Google Maps instead? Or will we grow frustrated with Yelp presenting us a bunch of highly rated but closed restaurants? Could be room for a new player or some other app (again, like Google Maps) to take their place.
- You could even paint a picture of how Uber will be decimated by this: when I was looking for a car in the past, I'd use Uber. Partly out of habit (it was just the app I opened) but also partly because they generally had the deepest network (most drivers = least waiting times = app of preference for users = more drivers on app = cycle). Uber usage is going to be way, way down right now, and a lot of those consumer habits are going to be broken. I don't think a new player necessarily steps in here, but it could present a lot of opportunity for Lyft to gain share.
- A mall is a network: buyers (customers) go there because all the stores are there, and stores fill in vacancies because they know there's lots of foot traffic / customers.

Once the network effect breaks, a mall can enter into something of a death spiral (a mall loses a few stores, which cause traffic to dip. Because traffic dips, a few more stores leave, which causes traffic to dip further, which.... and so on until the mall is dead). Every mall has had their network broken: they're shut for at least a month or three, and when they come back a bunch of their stores are going to be bankrupt / there are going to be a ton of bankruptcies. So what happens to malls? Do the old malls come back? Is there room for someone to build a new mall built more towards the modern shopper and steal the legacy mall's network? Does the pandemic simply accelerate the shift to online shopping so much that there's no room for malls?

- There's definitely real estate value underlying a lot of these malls. Malls are generally in fantastic locations with tons of access to transportation... but redeveloping a broken mall into something else (hotels, condos, apartments, etc.) takes a ton of capital. A lot of the mall companies were slowly redeveloping their malls into mixed use facilities (and realizing pretty nice returns on capital), but continuing to do that counted on cash flow from their current mall operations to fund that redevelopment. Suddenly, their malls are cash flowing nothing and have had their network effects broken. Can they restart that network effect? If not, how do they fund that redevelopment. And is there any equity value leftover at these malls after paying down their current mortgages and funding a redevelopment?

        - My personal belief here? Class A malls will be come through this; they're going to have a lot of vacancies, but they still have long term leases with really solid anchor tenants that drive lots of traffic (Apple, Tesla, etc.) and they're in great locations. It will be a rough few years, but the leases with great tenants + location should be enough for them to restart their network once everything comes back. Lower end malls are screwed (in other words... a continuation of the last few years!).

- Who stands to be a beneficiary of changing consumer tastes in response to Corona?
    - I would guess a pandemic like this one has long lasting effect on human behavior. Apparently the trend of Japan wearing face masks is a lasting remnant from 1918 pandemic. What are some other trends that could be started today, and who are beneficiaries?
    - The most obvious trend would be a decrease in travel for work. I would say, longer term, the vast majority of travel demand comes back. People aren't going to stop vacationing. People aren't going to stop going to big conferences and the like. But I do wonder if, on the farthest of margins, there are some travel trips that people look at now and say "meh, I can probably just teleconference that. Why risk getting sick and the expense of travel?"
        - If that's right, on the margin that would be

bad all sorts of travel companies, but in particular it would be bad for hotel franchisers (slightly reduced demand for business travel, which hits a lot of their loyalty programs). It would be good for teleconference companies and probably internet infrastructure (like cable) companies (since people would use more data / probably be willing to pay up for a bit more speed and reliability).

- It's possible that the demand for big cities could decrease as well. This decrease in demand could come from a few places: an increase in acceptability of remote working might lead more people to move to the burbs. Alternatively, people could look at how the places hardest hit by Corona tend to be large cities and say "you know what; the benefit of living in a big city doesn't outweigh the drawbacks of disease spread and the like."
    - This demand decrease would be negative for all sorts of things real estate related: big office buildings would see an increase in vacancies, apartment prices in big cities would come down from oversupply, etc.
    - I personally think demand for living in big cities is unlikely to change going forward. That said, I am an NYC resident, so it's possible I'm biased. I can tell you living in the city is not very fun right now: if you live in the burbs, you at least have a backyard to go to, and it's reasonably easy to go on a walk outside and avoid people. In NYC, you generally live in a small apartment, so you're trapped in a much smaller space and going outside while avoiding human contact is near impossible

(there are still people outside, and getting there involves using staircases and elevators that are used by the whole building).

- I would also guess that the demand for cruises is going to be smaller going forward. I don't know how much smaller, but going forward every time someone thinks about going on a cruise someone else is going to remember what happened to cruises during this cycle (sickness spreading like wildfire through them, boats stranded at sea, etc.). I'm not saying there's no demand for cruises, but on the margin I'd guess there's some shift to other vacations. In 2019 30.1m people went on cruises (per CCL 10-k), so even if just a small fraction of them switch to a different form of vacation that could create a pretty big boom elsewhere.
  - I'm not sure where that demand would switch. If it dissipates evenly across all travel options, you wouldn't really know it or see an effect for anyone else (i.e. a small fraction of those people go to NYC instead, some go to Miami, some go to Europe, etc.). But it's possible that it's more concentrated. What if the majority of people liked the all inclusive nature of cruises, so there's a big shift in demand from cruise companies to all inclusive beach locations?

- Does how businesses are financed change going forward?
  - Previously, if I looked at a business that had net cash, I would generally think their balance sheet was fine. Yes, obviously if it was something like a restaurant, I knew there were huge operating liabilities from their leases, but I wasn't buying restaurants for liquidations. I just wanted a cash buffer that would let them survive a couple of

months of sales suddenly dropping because of some big economic issue. The pandemic has made me reassess that: I honestly never factored in a "could this business survive if all revenues (not earnings; revenues!) went to zero for three months? What about six?" scenario. I wonder if business owners going forward readjust to the possibility that business can suddenly just freeze for six months.

        - I think this is unlikely; the changes you'd need to make are massive. Restaurants would need to start carrying ~6 months of all expenses in cash on their balance sheet. I think if businesses really started doing this, there would be a huge arbitrage / activism opportunity to buy companies and force them to take pursue "riskier" capital allocation.
    - But on the margin you could certainly see some effects:
        - Lower leverage for all companies
        - More hesitancy to buy back shares (if we do this, we'll be vilified in the press and excluded from bailouts)
        - Dropping downside cases lower (before, your downside case may have been revenues drop 30% instantly; now, downside cases might be revenues suddenly go to zero and stay there for six months), and paying more for financing that is more likely to be there in those downside cases (i.e. make sure your revolver has no covenants, because you'll blew through them in a "everything stops" scenario).
- Does society change going forward?
    - On the margin, I'd guess absolutely. There will be much more social acceptance of people calling in /

staying home when sick.

    - More germane to investing: I think people's hobbies are permanently shifting a bit here. In particularly, I'm thinking that the popularity of eSports and video games is exploding currently. eSports are pretty much the only game in town when it comes to watching "live sports" right now, and most of the options for leisure time (going to a bar, going to the movies, etc.) have vanished (in addition, with no commute time and a lot of businesses fully cut down, leisure time has massively increased). The combo of all the alternatives vanishing plus leisure time increasing has seen video game usage go up dramatically. While some of that probably pulls back when the alternatives revive, I would guess that eSports popularity has significantly accelerated and video game usage / time dedication has permanently increased.

- What are the knock on effects from movie releases and TV pilots shifting?
    - Basically every studio has cancelled their slate this year. It seems for movies that were not already released, the studios are simply planning to release them next year. But that has a bunch of knock-on effects: the box office next year is probably going to be crazy crowded. Do studios look at a crowded box office and say "you know what? Rather than releasing this movie into theaters and running a huge marketing budget to promote it, I'll just release it straight to my streaming service?" And, once that cat is out of the bag, do we see more and more movies go straight to streamers until eventually the box office isn't big enough to support movie theaters in their current form (most movie theater companies are probably going bankrupt or through

some type of restructuring because of the current shut down, but I more mean movie theaters in their current form as a smaller box office means we get smaller movie theaters with less screens (because they handle fewer movies) and those screens are more catered to a luxury experience).

        - Also, the marketing budget piece is interesting. A big piece of TV advertisements are advertising for upcoming movies. What happens if and when more movies are released directly onto streaming services? Does demand for those ads go down?

    - Also, every movie and TV production is in hiatus right now. Most likely, there aren't any new TV pilots to air this fall. Does that have knock on effects for how networks air pilots (i.e. instead of airing all of them in the fall, maybe they just start immediately airing shows once they get new inventory)?
    - What about Netflix? Right now, they're seeing a huge usage boom, but new shows are huge for them in terms of drawing in new subs / retaining old subs. After a few months of not releasing new shows, does that have any impact on Netflix
        - I would guess the answer is no here; it's not like Netflix will be the only service without new shows.... but it certainly could have an impact (maybe after a month of nothing new on Netflix, I think to myself "you know what? I've watched everything I want to watch on Netflix. Maybe I cancel Netflix until they get some new shows and go watch a bunch of HBO shows I've been meaning to watch).
- Sports leagues: do they take advantage of any silver linings here?
    - The current environment is an absolute disaster

for sports leagues. But they'll come through it; the demand for sports will always be there (and I would guess it's a little elevated once the country re-opens as people are desperate for something that makes them feel normal).

- The bigger question to me is if the sports leagues take advantage of this stop to do common sense things that would help their league longer term. For example, basketball season currently starts around Halloween. That means the first two months of basketball are almost an afterthought for a bunch of sports lovers because the NFL is in mid-season. Why does basketball do that? Why not use this stop to reset the schedule so that the season starts just as football as ending and then ends right before football starts? That would let basketball take a bunch more mind share.
- There are plenty of other examples (for example, why does hockey season wrap up in summer?), but that's just the one that comes top of mind since basketball is my favorite sport. Smart commissioners and leagues will be looking to take advantage of the hand they've been dealt to make common sense changes that will improve the league going forward.