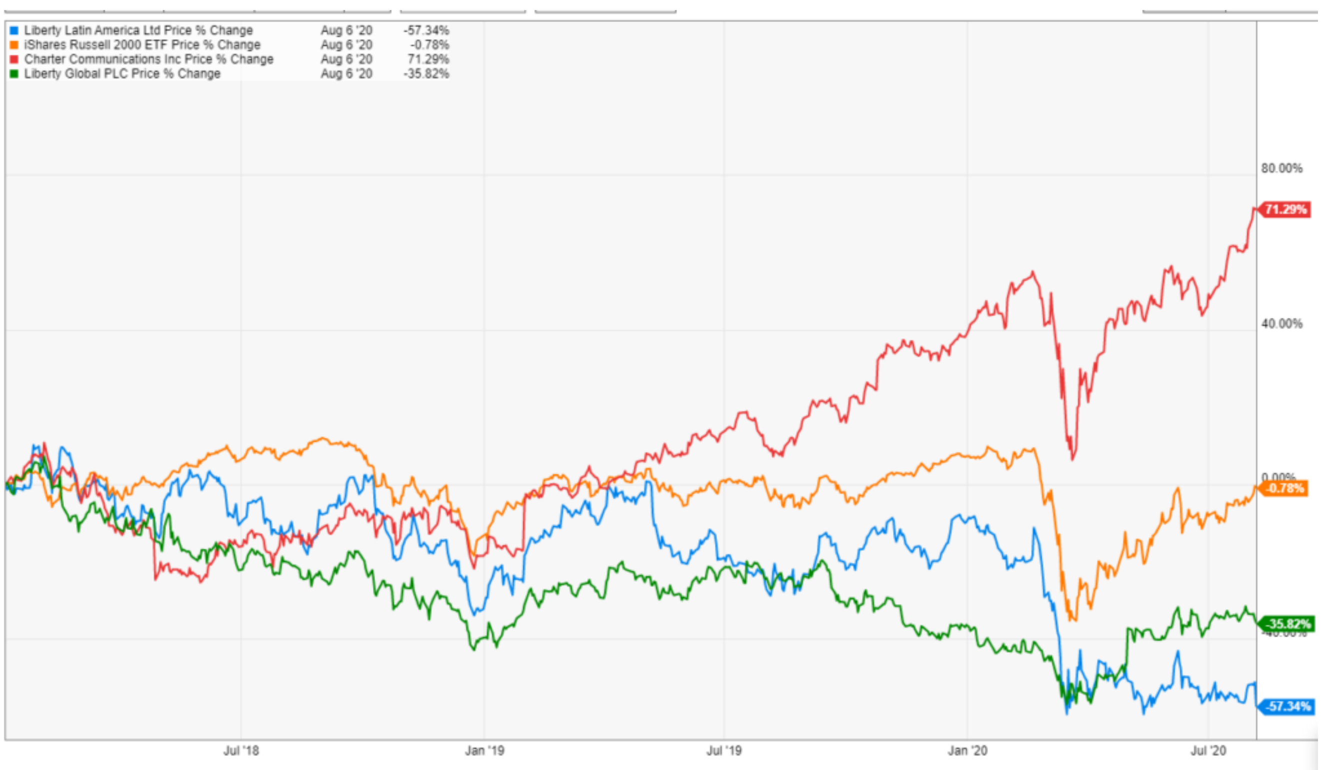
Malone's perplexing rights offering spree $LILAK $LSXMK

Something I've wondered about a few times: what stock has burnt the most value investors (had the most value investors invested into them but ended up exploding)? The most likely candidate is probably Valeant (now Bausch / BHC), which burnt Ackman and almost destroyed Sequoia. Perhaps the biggest destroyer is one of the pre-financial crisis bank stocks. I'm frequently surprised Sears and JC Penny didn't burn more investors. If we turned to the short side, Tesla may have blown up more investors than every long company put together (though Netflix might be up there too).

Off the top of my head, those are the big value destroyers. But what about among smaller cap names? I would contend that if we ignored the larger cap names and focused more on the smaller / more event-y names that I (and I suspect most of my readers) tend to focus on, perhaps no company has burned as many investors as Liberty Latam (LILAK); my friend scuttleblurb has called the company "the widow maker" and a core holding of "Generic Value Partners," and I am envious of his wit for that.

The thesis for LILAK has always been pretty simple. It's a John Malone controlled cable roll up. Those tend to work out well. You could paint a picture where LILAK worked out better than normal: with plenty of potential secular growth, a super fragmented ecosystem, and some weaker regional players, LILAK presented white space for growth and mergers that Malone likely hadn't encountered since the early days of cable.

The results have not been in line with what the bulls expected. LILAK spun off from Liberty Global right at the start of 2018; it was actually publicly traded as a tracking stock before then and I believe its performance as a tracking stock was quite bad as well; however, I can't easily find the data and it's not super relevant to this thesis so you'll have to take my word on that! Still, even ignoring that tracking time, LILAK has been an absolute disaster almost from the moment of the spin. Investors who bought into the the spin at the beginning of 2018 saw a fair to cheap valuation and a huge growth runway versus U.S. peers like Charter. It turns out they would have been better off just sticking with the O.G. and buying Charter!



Some of LILAK's woes have been outside of their control. Hurricane Maria hit in late 2017 and absolutely devastated Puerto Rico (a major LILAK market). Puerto Rico's ongoing budget woes don't help, and Latin America has been particularly hard hit by a double whammy for COVID (they're the "most impacted by the pandemic globally," and the drop in tourism has demolished a huge piece of their economy),

So a lot of LILAK's woes have been outside their control. But that hasn't stopped them from shooting themselves in the foot a few times. LILAK bought CWC from Malone in 2015; it appeared an expensive and conflicted deal at the time and hindsight has not improved that perception! LILAK's accounting is hopelessly complicated, with lots of different debt solos, operating companies, and noncontrolling interests, and it changes slightly every year as the company buys in minority shareholders or pursues some other acquisitions.

Anyway, a full background of LILAK is a bit beyond the scoop of this post; if you're interested, findmevalue has an old deck from 2016 that covers the company well, and scuttleblurb put a piece out in April on the company. I'd encourage you to read each of those for more background (and just generally to read everything the two of them do, as they're always good!).

Instead, what I wanted to talk about is their recent announcement of a rights offering.

On the one hand, the offering makes some sense. Latin America is getting rocked by COVID, and often the best acquisitions present themselves in times of turmoil. LILAK has not been shy about taking advantage of the environment, having struck a ~$2B deal to buy AT&T's Puerto Rico operations late last year and a $500m deal to buy Telefonia's Costa Rica Operations a few weeks ago (yes, I know the AT&T deal was pre-covid, but in general it's best to assume that AT&T is perpetually both a distressed seller and eager overbidder when it comes to M&A). So LILAK is putting money to work, and given their core operations are not immune to the general COVID environment and that their balance sheet is already pretty maxed out, a rights offering makes some sense.

On the other hand, it's strange timing to do a rights offering now. In mid-March, LILAK announced a $100m share repurchase program. In the past, I've accused many Malone controlled entriprises of being momentum buyers of their own stock. QRTEA had a voracious appetite to buyback stock when their stock was in the mid-$20s, but after it missed earnigns a few quarters and collapsed to <$10, suddenly the company was focused on debt paydown. Charter slowed down their buyback program during COVID despite their core business accelerating while their share price cratered, but a few years ago they felt confident accelerating their share repurchase program as their stock rose into rumors that Verizon / Softbank / Altice were considering buying them (to simplify: Charter bought more stock when there was an acquisition premium in the price, but dialed purchases back when the market was weak). So when I saw LILAK was actually repurchasing shares during a crisis, the hairs on my neck stood up a bit. Malone tends not to buyback stock when the market is panicking; if LILAK was pursuing a repurchase, perhaps the company was doing better than the market thought or there was some other angle to value creation LILAK was driving? Plus, the CEO was buying LILAK shares on the open market; exceedingly rare for a Liberty entity. Put the two together and I thought the market might be over-discounting LILAK.

Alright, that was a little long winded. Let me sum it up here: I'm rather surprised by LILAK's rights offering. The company seemed prepped to buyback shares (indeed, they bought back ~$9m since announcing the repurchase in mid-March through the end of Q2). It just seems weird to me that LILAK would start to dab their toes into a small repurchase program and then would pivot to issuing equity when a small-ish acquisition came along. Why bother? They had to know there were acquisitions out there; why not just go all one way (preserve capital for acquisitions) or all the other (eschew acquisitions for a while and focus on integrating your current acquisitions while buying back your own discounted stock)?

Anyway, I'm all over the place here but the LILAK offering has me really confused. I consider You Can Be a Stock Market Genius the bible of modern value investing, but Malone has now done two rights offerings this year: first at LSXMK in a deal that I think was hopelessly conflicted, and now today at LILAK. Both have left me cold. It seems like bad capital allocation to me; combined, the two rights offerings seem like the capital allocation strategy of a group that's more focused on treading water than playing offense in an environment that should present a lot of opportunity for value creation.

Again, I can hear the protests from the Liberty Stans who support everything they do: it's a rights offering; current shareholders aren't diluted so it's a cheap form of capital! (semantics; I still have to put more money into the company). It's an accrettive deal; shareholders should be happy to fund it (everything has an opportunity cost; the companies could have temporarily increased leverage a bit to pursue these deals or chosen not to do it and just bought back their discounted stock).

There are no answers here. It's just a little baffling to me. Rule #1 of modern value investing might be to follow Malone into rights offerings, but it's tough for me to get excited about this one (or the Liberty Sirius offer). True, per the press release, both Malone and the company insiders will exercise their full rights here, but Malone and insiders did that for LSXMK as well and both Malone and some other LSXMK officers exercised their rights and immediately sold the stock (or sold more stock than they bought!). That seems more the action of a man who wanted to lend the air of confidence to a deal but wanted nothing to do with putting more capital into a company. Who's to say he doesn't do the same here?

I don't know. My priors are saying a Malone rights offering is an opportunity. But my heart and my head are telling me something is off.

One last thought before I wrap up: GLIBA and LBRDA announced prelim talks to merge. I tend to agree with my friend Clark Street on that deal; it's fairish and probably both parties do well since it cleans the structure up and gets them one step closer to the endgame of a merger with Charter. So from that perspective the deal is pretty unremarkable. But when you look at the deal with the backdrop of two strange rights offerings across the Liberty empire, it starts to paint the GLIBA / LBRDA potential deal in a bit of a different light. Why do the deal now, when both stocks are trading at record discounts to NAV? Why not attack the discount now and merge later?