# Graham & Doddsville

FALL 2022

An investment newsletter from the students of Columbia Business School

## / Inside this issue



## / Editors


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Matt Keating, MBA 2023

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# Welcome to Graham & Doddsville

**Meredith Trivedi**, Managing Director of the Heilbrunn Center. Meredith leads the Center, cultivating strong relationships with some of the world´s most experienced value investors and creating numerous learning opportunities for students interested in value investing.


**Professor Tano Santos**, the Faculty Director of the Heilbrunn Center. The Center sponsors the Value Investing Program, a rigorous academic curriculum for particularly committed students that is taught by some of the industry´s best practitioners. The classes sponsored by the Heilbrunn Center are among the most heavily demanded and highly rated classes at Columbia Business School.

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CSIMA Columbia Student Investment Management Association

We are pleased to bring you the 46th edition of Graham & Doddsville. This student-led investment publication of Columbia Business School (CBS) is co-sponsored by the Heilbrunn Center for Graham & Dodd Investing and the Columbia Student Investment Management Association (CSIMA). In this issue, we were lucky to be joined by three investors who have plied their craft across geographies, asset classes, and market cycles.

We first interviewed **Jacob Rubin,** founder of Philosophy Capital. We discussed Mr. Rubin's path to investing, key mentors, how principles from philosophy inform his investing approach, and go over several notable investment case studies.

Next, we interviewed **Connor Haley**, founder of Alta Fox Capital Management. We discussed Mr. Haley's experience launching a fund, evaluating management teams, and dig into his long idea on IDT Corporation.

Finally, we interviewed **Christopher Bloomstran**, President of Semper Augustus Investments Group. We discuss Mr. Bloomstran's investment philosophy, views on capital allocation, and dig into his long idea on Paramount Global.

We continue to bring you stock pitches from current CBS students.

In this issue, we feature the winner of the 2022 Kawaja Growth Stock Pitch Challenge, Shalin Doshi ('23), for his long thesis on Contemporary Amperex Technology [CATL] (SZSE: 300750)

We also feature the winners of the 2022 Chicago Booth Investment Conference & Competition, Alan Leite ('24), Thomas Schlabach ('24), Cheng Jiang ('23), and Matthew West ('24) for their long thesis on Planet Fitness (NYSE: PLNT).

You can find more in-depth interviews on the *Value Investing with Legends* podcast, hosted by Tano Santos and Michael Mabuoussin, Head of Consilient Research on Counterpoint Global at Morgan Stanley Investment Management and adjunct faculty member at Columbia Business School. The new season of the podcast will launch on December 16th.

We thank our interviewees for contributing their time and insights not only to us, but to the whole investing community.

***G&D Editors***

# 32nd Annual Graham & Dodd Breakfast

Todd Combs '02 with breakfast guests

Todd Combs '02 and Michael Mauboussin

Mario Gabelli '67 and Marc Mayer '83

Bill Ackman asks a question

# Value Investing Program Welcome Reception

Tano Santos and Matt Keating '23

Value Investing Program Students

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# The 26th Annual

# *CSIMA Conference*

**Date: February 10, 2023**
**(8:00 am to 5:00 pm EST)**

**2920 Broadway (115th Street)**
**Alfred Lerner Hall,**
**Columbia University,**

**www.grahamanddodd.com**

**Featuring:**

***Cliff Asness, AQR Capital Management***
***Thomas Gayner, Markel Corporation***
***Mason Morfit, ValueAct Capital***
***Jeff Mueller '13, Polen Capital***
***David Samra '93, Artisan Partners***
***Lauren Taylor Wolfe, Impactive Capital***

***Best Ideas panel***

For inquiries, please contact: valueinvesting@gsb.columbia.edu

# Jacob Rubin, Philosophy Capital

**Jacob Rubin, Philosophy Capital**

**Jacob Rubin is the Founder and Managing Member of Philosophy Capital Management LLC. Philosophy invests long and short across the capital structure with a value-oriented approach targeting securities with asymmetric investment returns.**

**After graduating with a BA in Economics-Philosophy from Columbia University (2006), Jacob began his career with three years of banking (JPMorgan, Macquarie) followed by an MBA at Stanford (GSB 2011). During those years, he raced bikes and accumulated a unique collection of jerseys as a reward for his efforts (the GFC-era Merrill Lynch-sponsored amateur kit is a gem). He briefly returned to finance at Goldman Sachs only to veer off course to further scratch the academic itch. He earned an M.Phil in Economics at Cambridge University (2013) while rowing Bumps for his college in the M1 boat. Upon his return to the States, Jacob found his calling at Lonestar Capital, where he spent six years getting at-bats, cultivating a network, and developing pattern recognition. Jacob hung the Philosophy shingle just as Covid hit and spent the past few years weathering endless "tail" events while growing the team and capital base. He traded bikes and boats for trail running shoes and lives with his wife and three children in the Bay Area. When not behind screens, Jacob can be found running ultramarathons on trails or guest teaching at Stanford on subjects like game theory, event-driven investing, and negotiations.**

***Editor's Note: This interview took place on September 29th, 2022.***

**Graham & Doddsville (G&D):**

I'm grateful you're taking the time to speak with G&D. It would be great to learn about you, your background, your upbringing, and how you became interested in pursuing a career in value investing.

**Jacob Rubin (JR):** Thanks for having me on Graham & Doddsville. As a Columbia alum, I'm familiar with the publication and it's an honor to be a part of it. My upbringing had nothing to do with investing. I grew up in California as a sports and math kid. I had a lawyer dad who worked for the government and a CPA mom. My life was all about competition in sports, but tempered by parents who had a clear understanding that academics was the ticket to a better life. My first exposure to stocks was ironically my dad losing all my Bar Mitzvah money in the Dot Com crash. That didn't have any profound impact on me, but it's a funny place to start. My dad, an assistant Attorney General for California, had a poker group of guys who worked a range of professions, doctors and lawyers and accountants. At the table, they would trade jokes – "have you heard the one about the…" – and then they might mention a stock tip. None of them knew what they were talking about, nobody had training, it was just a social thing. Who knows, maybe that put a kernel in my head about the stock market being like poker. Aside from that, the only part of my childhood that proved relevant was the focus on math, which was driven by my mom, who once tricked me into thinking algebra was fun with a game called Algeblaster. I was always a couple grades ahead and did math summer camp for three years; my parents made a deal with me that if I wanted to go to tennis or soccer camp, I had to do math camp. Later, this evolved into Mathletes and the American Invitational Mathematics Exam. The relevant connection to investing was just building confidence in math and creating an identity as a numbers guy.

**G&D:**

Looking through your background at Columbia, you were an economics and philosophy major. It'd be interesting to

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# Jacob Rubin, Philosophy Capital

learn more about how you shifted from math expert to liberal arts.

**JR:**

I started at Columbia in the economics department in 2002. This was the result of a lack of imagination. Economics was a popular major, I was in New York City, business was exciting, and I went with the flow. In fact, the first time I used my brain for myself was when I pivoted from economics. I noticed that the assumptions underlying the models in lower-level classes were not realistic. I recognized that people act emotionally, inconsistently, are prone to bias or impulse, and have blind spots. I was preoccupied with the applicability of classroom learning and the predictive power of models. If something was strictly academic, that only went so far. I wanted to ask questions and poke holes. That led me to the fields of decision theory, behavioral economics, and game theory. Curiosity helped me veer into the philosophy department. Ultimately, I wrote a dissertation on violations of rationality. The focus was looking at examples of seemingly rational human beings making irrational decisions. And the point of my paper was trying to redefine experiments to better explain results without resorting to the idea that people are utterly unpredictable.

**G&D:**

Can you help translate that for the philosophy newbies?

**JR:**

Sure, though it's been decades! One example I recall involved a fruit bowl. People may state explicit rank preferences of certain types of fruit over others, only to violate those preferences in a seemingly inconsistent manner. But rather than concluding irrationality, it may be that the description of choices in the experiment doesn't capture an additional, relevant factor (such as etiquette). Assume there's a bowl of fruit with oranges and pears and assume I prefer oranges to pears. In a normal scenario, I'll take the orange over the pear. But if it's the last orange, and it's your fruit bowl, maybe I'll take a pear to be polite. A more fulsome description of the choice (I prefer oranges to pears, unless it is the last one, in which case I'll take a pear) preserves rationality and enhances predictability. I also remember an example with a cocaine-addled neighbor offering tea, but I'll stop here. Suffice it to say, I had no idea this background would result in a fund name.

**G&D:**

Maybe to fast-forward a bit, you've now spent some time in finance and then you decide to attend business school. You're combining math, economics, and philosophy, which feels as if this is the beginning of a true value investor education. How did that shape your business school experience and inform your career path post-graduation?

**JR:**

The business school path was boring: I was following a plan I laid out for myself years before. If you rewind the tape, my parents grew up with little and used education to achieve graduate degrees and provide a better opportunity for their kids. My parents wanted their kids to keep pushing forward and this emphasis on progress entailed planning. Coming out of college, I had a five-year plan: three years of "boot camp" banking, then a two-year MBA. I was fortunate to get into Stanford and returned to Northern California.

For MBA students with my background, the next step was presumed to be the buyside, but the fact is I didn't have a new five-year plan yet. I showed up with an open mind, perhaps buoyed by the idea that my acceptance had guaranteed a decent worst-case outcome. The primary effect of my two years on campus was not tied to any particular profession, but instead much more general. A great way to describe what I got from business school is to think about that section in Us Weekly called "They're

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Just Like Us!" If you've ever been in the grocery store and seen celebrity magazines, there is a section with photos of Ben Affleck grabbing Dunkin Donuts or Brad Pitt taking out the trash. The message to the non-famous public is "Look, they're just like us!" Stanford gave us a parade of portfolio managers and Fortune 500 CEOs. Burbank talked about commodities, Chanos spoke about short selling, and Mary Barra discussed the future of automobiles. Part of the

***"But you see that in place of magic, it's a cocktail of hard work, a bit of luck, and long years dedicated to a craft. Stir it in a pot and voila, they're speaking as a CEO."***

allure of a Columbia or Stanford MBA is that these institutions pull in such successful leaders. After class, you have lunch with them, they're hanging out, they're feeling nostalgic and telling you stories from when they were students, and you realize, "Oh my God, there's no magic here." I mean, don't get me wrong, these are impressive people. In place of magic, it's a cocktail of hard work, a bit of luck, and long years dedicated to a craft. Stir it in a pot and voila, they're speaking as a CEO at Stanford Business School. For me, this was an 'aha' moment. If I went for it, worked hard, had my eyes open, and caught a couple breaks, I could become that person.

**G&D:**

In past interviews, you've mentioned that you began life as a risk-averse person, which is a part of your brain you've had to rewire. How did you go about this transformation, and do you think this rewiring process is replicable?

**JR:**

Yeah, that's true. For me, it was a conscious choice. It wasn't happenstance and, to answer the last question first, I do think it can be replicated.

There were three big moments. First, my dad got sick and passed away during business school. There's something about being confronted with mortality that is eye opening. You realize you're on this planet for a while, run around, do some things, then you die and the world moves on. A life takeaway is that the most important thing is who's around you at the end. But beyond that, his passing made me want to swing the bat harder because "why the hell not?" At the end of the day, who is going to care if you fall on your face? If you put in honest work, what do you have to lose? That realization hit me like a ton of bricks and I made a few concrete goals on the spot. The second moment happened a year later. After Stanford, I was at Goldman, the fog was lifting, and I could tell banking was not right for me. I needed advice and two friends offered an idea and perspective, respectively. The first guy, Tyler, had done a Gates Fellowship to Cambridge. He and I are close; he lost his dad young, we both raced bikes, yadda yadda. He said, "go to Cambridge and mix it up. Maybe join the rowing team." The second guy, a much older mentor figure, was an early partner at Montgomery Securities. He broke it down like this: "Say you have a 40-year career. Consider two scenarios. Scenario one, you spend 40 years cranking and retire. Scenario two, you spend 39 years at work, but somewhere in there you spend a year on an adventure. Which life sounds more interesting?" My decision was made and I sent in my acceptance to Cambridge that day.

After Cambridge, I came back and didn't have a job. I found my way to Lonestar Capital, where I worked for Jerome Simon. It was my dream gig. But after a year in the seat, and despite doing solid bottom-up research, Jerome said to me, "You know Jacob, maybe you're really supposed to be a consultant. Or in research." I'm not trying to throw shade, but for me, personally, I took it as an insult, and I'm pretty sure it was

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## Jacob Rubin, Philosophy Capital

meant as an insult! His point was that I was so task oriented performing analysis that I wasn't wired for the goal, which is to compound the pile. I was going to lose my job if I didn't figure this out, so with my head on the chopping block I had to figure out what to do to stay. This was the final straw; out of desperation, I had to take calculated risk and find the ability to pound the table.

At this point I figured out a useful formula for success as a hedge fund analyst. It's a three-legged stool. Leg one is goal orientation and recognizing that investing is a commercial endeavor. Though it's fun, money management is neither a hobby nor an intellectual exercise. We aren't teaching. We are doing this to grow a pile of capital. This entails finding things to invest in. For an analyst, this means getting efficient with your time and quickly determining the probability of actionability up front. Then, you have to repeat the process again and again and never slow down. There's a phrase, "keep pedaling the bike." You get kicked in the face? Keep pedaling. You have a homerun and feel like doing a victory lap? Keep pedaling.

Leg two is that you need to learn to speak the PM's language. The PM is like Congress and you need to pass some legislation. If you want names in the book, if you want your PM to go down the sheets and attribute names to you, you have to communicate effectively and figure out how to get the decision maker onboard. For me, I'd go into Jerome's office and would have ten seconds of his attention. I would need to turn those ten seconds into two minutes and then get him out of his chair to the white board for thirty. Then you got to know it cold – no notes, no equivocations – and turn that white boarding into a starter position and the PM's commitment to read a full memo. A benefit of this flow is that you learn what matters and how to get to the good stuff fast.

Leg three is simply your track record. Either you're making money or you're not. You can see the inherent bias to do something in those first couple legs. But for me at Lonestar, if there were too many losers, I'd be gone. I needed a legit batting average (or slugging percentage) to survive, but to get there I first needed conviction, that's what I figured out to keep my job.

> ***"I figured out a formula for success as a hedge fund analyst. It's a three-legged stool. Leg one is goal orientation and recognizing that investing is a commercial endeavor…Leg two is that you need to learn to speak the PM's language…Leg three is your track record."***

One final note on Lonestar. Before this stop, when I was a banker, if the MD messaged on Friday night, I'd be annoyed. Like, "where is your work-life balance?" But with Jerome, he'd message all day, anytime, every day of the week. But it never bothered me! Jerome is obsessed, addicted, totally wired for investing – and it turns out I am too. If I'm at the airport and it's full, I ping our team about Dufry ("DUFN SW") between changing my kids' diapers. If that bothers you, if you're not obsessed, this job is not for you.

**G&D:**

This sounds a lot like the 'What Matters' framework that Kian Ghazi teaches at Columbia Business School, which is an efficient way to boil down the thesis into what actually moves the securities. The goal is not to write a book report, it's to figure out what the variant view is and figure out what we need to know to make it a long or a short. It would be helpful to hear how you've taken getting pushed as an analyst working with Jerome to becoming a PM and implementing that process within Philosophy.

**JR:**

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First, any discussion about 'what matters' should start with the question, "is this actionable?" It's annoying when people on FinTwit or Substack pitch incredible opportunities that don't trade. If there is no borrow, has a crazy rate, is super illiquid, or has a sky-high short interest, don't bother researching the short. Waste of time. That's a big difference between trading a personal account and running an investment business.

Second, we start with wondering, "does this opportunity represent a serious mispricing?" To answer that, we look for a few things. We might think about abnormal upside (75% or higher) with reasonable assumptions. You might react skeptically, saying "if those only grew on trees, right?" But they do exist. You don't find them often and it's not without risk, but you can find things that look like they could double if things break right. We also think about asymmetric skew. Think about, say, the 'net net' concept by Benjamin Graham, where something looks like it's covered by current assets less liabilities. Theoretically you make money in liquidation, so it feels like covered downside. Of course, you find this with elevated uncertainty, so on a related note, we hunt situations with ambiguity. No sell-side coverage, obscured assets, complex financials, litigation, or political risks. If there isn't any uncertainty, it's probably not a major mispricing. If there is no potential misunderstanding, it's probably not in our wheelhouse at Philosophy. There are great, fairly priced businesses that could deliver an adequate compounded IRR over time with steady execution. But that is not what we do.

Third, if it's actionable and we think there's a mispricing, we now ask, "why is this mispriced?" and "will this mispricing persist indefinitely, or can it be corrected?" That is the crux of our work. We are good at finding things that look cheap with explosive upside. But the area where we sharpen our pencils is differentiating between CFAR (cheap for a reason) and TCTI (too cheap to ignore). Is it a value trap? Maybe it is cheap merely because it is a dicey, commodity-driven cyclical – a low multiple is justified. If you can actually determine why it's misunderstood and that there's a credible path toward fixing the disconnect, if you can forecast a changed narrative, you have something.

> ***"We are good at finding things that look cheap with explosive upside. But the area where we sharpen our pencils is differentiating between CFAR (cheap for a reason) and TCTI (too cheap to ignore)."***

Finally, we've got to be able to make objective and measurable predictions that we can track over time. This is important because if we violate the predictions, I know to sell. That's our framework for individual ideas. There is another dimension when it comes to portfolio construction, how the pieces fit together, factor exposures, etc. But that's a different puzzle.

**G&D:**

You've touched on this in past interviews, but you mentioned Philosophy likes to invest in broken markets. It would be great to hear about which markets you're focused on, and maybe a few examples.

**JR:**

We like investments to fit into a fact pattern with which we are familiar. Examples include 'survival bets,' 'free call options', 'broken tech M&A'. Not to mention the omnipresent leveraged packaging company. Beyond familiarity, we typically aim for significant or inflecting free cash flow. If cash flow is missing, it is likely a distressed situation where we're thinking about underwriting through bankruptcy and thinking through asset values. A final component is catalysts; mis-pricings don't tend to correct out of thin air. Usually

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there's an event path for an about-face. As you might imagine, efficient markets have lots of eyeballs, smart people with strong incentives, combing over the opportunity set. The good news, though, is that markets break down all the time. Elections in Italy and Colombia are scaring the market, we'll see what happens here in the US with midterms and then 2024. ESG is massive and not exactly perfect fundamentally. The spirit might be good, but folks are taking advantage of it, puffing up bad companies and harming some good ones. I'd also argue small caps are becoming broken because they're not investable for the increasingly large institutions that drive flows. In credit markets, there are all sorts of technical issues. Whether it's CLOs who can't hold stressed paper, or real money PM's needing to offload stressed paper to distressed guys, these situations trade with 10- or 20-point gaps in pricing, not point-by-point. Oh, and tax loss selling; it's October as we're talking, we're entering prime tax-loss selling season. For tax-paying investors, you can have big losers that get to a point where you can make 100% return on a realized tax loss. Even if you think the stock's a double, the benefit of the tax loss is certain. That quirk is tied to the tax code.

> ***"We like investments to fit into a fact pattern with which we are familiar. Examples includes 'survival bets,' 'free call options', 'broken tech M&A'. Beyond familiarity, we typically aim for significant or inflecting free cash flow."***

**G&D:**

You mention in other interviews how important it is for investors early in their career to "be wrong" and to "feel wrong." I'd be curious to hear how you've translated that into your success in your career. Could you walk through an experience that you had early on in your career, with an investment that made it through all your criteria, but didn't work out, and what you learned from that?

**JR:**

I can give a couple examples, both mistakes and then successes.

Back at Lonestar I invested in a couple air freight businesses, Air Transport Service Group ("ATSG") and later Atlas Air ("AAWW"). It was a classic levered value investment. This was 2017/2018 and the thesis was that AAWW's bad FCF was the result of elevated capex tied to the build-out of Amazon's fleet. Atlas claimed this cycle would die down and the company would gush free cash flow and de-lever by half a turn a year. Atlas was benefiting from secular tailwinds like e-commerce and just-in-time delivery. It had ACMI business (aircraft, crew, maintenance, insurance) with guaranteed minimums, lending stability to the downside. A clear thesis overall: capex cliff, de-lever 0.5x per year, stability to the downside, and a cheap multiple. Fast forward to August 1st, 2019 and AAWW, the largest position in my sleeve, which was a trial balloon to see if Jerome would back me. Atlas whiffed hard, with EBITDA -31% year-on-year and below consensus by -17%. The stock fell 25% and kept falling. Management blamed tensions in trans-pacific relations, but this kind of result wasn't supposed to happen with ACMI contractual minimums. Moreover, they didn't de-lever at all and when I asked them about it, they said the company did pay down debt. I was confused because the metrics didn't change, but they said, "well, we drew the revolver to pay down the bonds." I had to sell because that was disingenuous and my understanding of the business was proven wrong. A small lesson I learned is that guaranteed minimums are not a panacea. Oftentimes, guarantees are priced well below normal run rate, so spot

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dries up completely and the contractual bit falls to the minimum and earnings get smoked.

Sadly for me, the AAWW mistake doesn't end there. It gets worse! During COVID, passenger flights were decimated, which killed nearly half the air freight capacity that flies in the underbelly. Ships were backed up at every port and supplies were needed everywhere. Atlas was in the perfect place at the perfect time – and I completely missed it. I didn't revisit it, I didn't get any dollars behind the trade, and the stock went from $20 to $100. This ties in another Jerome-ism: "never take your eye off a ticker." Once you've learned it and you've put in that time, you can't forget about it. The world is dynamic.

One more mistake. Avaya ("AVYA") is a communications company that ran into big trouble. After the stock plummeted, we identified a trade tied to an impending convert maturity. There was a small issuance due in 2023, but after that it had four years until a mountain of secured debt in 2027-2028. The company was in the market raising $500 million to take out this $300 million convert. The books were covered and even got upsized. The explicit use of proceeds in the marketing of the deal was to take out the convert. We bought converts at 88 cents thinking that when they closed the new money deal, the converts were good. Avaya closed the deal, the converts jumped to 95, and we felt smart for about five seconds. Unexpectedly, a couple weeks later, the CEO was fired, the word "removed" was in the press release, and numbers were slashed and abandoned. I felt physically ill and immediately realized we were screwed. Thankfully, it was sized small and we took our medicine fast. But it was painful!

> ***"This ties in another Jerome-ism: "never take your eye off a ticker." Once you've learned it and you've put in that time, you can't forget about it. The world is dynamic."***

In hindsight, I made three mistakes here. First, this was asymmetric the wrong way; we could make 12 points or lose 88, which is awful unless the odds are nearly certain and I'm not someone who underwrites to certainty. Second, we made money on our core prediction – job done – and yet we decided to hang on for five more points. The math was even more asymmetric the wrong way and we should have called it a day. Finally, I had not adequately scored the downside case. If things fell apart, our convert was unsecured and the fact it was first in time would not protect us. We were below $2 billion of secured debt. While the events that occurred were somewhat hard to predict, this was not bad luck but, rather, a series of mistakes.

**G&D:**

That's a helpful overview. The Avaya trade reminds me of an experience I had where I've learned to not buy 2nd liens because of a similar dynamic. I'd be remiss if I didn't give you an opportunity to talk about a successful investment.

**JR:**

For symmetry I'll give you two. We had a good investment in Bombardier ("BBD/B CN"), which went from 27 cents CAD to about $2. In 2020, the stock got killed on Covid and kept falling without respite during tax loss selling season. It was just getting slammed every day. But we realized that Bombardier had a catalyst on the immediate horizon. Namely, the company was selling its trains business to Alstom. With the sale, Bombardier would shed a complex minority interest, a bunch of debt, and pension obligations. Plus, there would be a sizable cash infusion and the creation of a pure-play private aviation business. This catalyst would change the narrative and buy four years for optionality. We ran a Black-Scholes model where we looked at in-the-money call

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value for six months versus four years and sixth months. Four years of runway was worth almost the entire stock price. (And yes, I used the "runway" joke many times in LP meetings. Sue me.) We bought the stock as a survivor bet, but also picked off front end debt in the 70s. And then the fun part was as we moved past the trains sale, we realized Bombardier was a secular winner in a world where commercial travel felt unsafe. Sure enough, they boosted orders and people got excited about the optionality.

Another fun one was shipping broadly. I remembered that in my banking days from 2006 – 2008, shipping was fantastic and every bank had its own shipping teams. But good times led to oversupply and decade-plus period of nasty supply/demand. Everyone invested lost their shirt. I read a fun book about a hedge fund PM risking everything on shipping, The Shipping Man. But in 2019, I realized that there was nobody to talk to about shipping. It was dead. No more banking coverage, nothing. These ships have 20 year lives but tend to float even longer. Excess supply loitered on the water, just wouldn't clear out, and every investor in the space sounded suicidal. But we discovered one of the cheapest stocks anywhere, well before COVID-19, called Danaos ("DAC"). It was 0.7x PE. I remember seeing that multiple and feeling giddy. It had chartered business, asset value covered by scrap, and management that seemed better than others in the space (low bar). We had a small position before COVID-19 and thankfully, unlike Atlas, we put the pieces together fast. We made the position bigger post Covid and the stock shot from $3.60/share to over $100. We didn't hold it all the way, but suffice it to say we did well. Interestingly, in January 2021, an Israeli shipping company called Zim ("ZIM") IPO'ed. Danaos had a large stake in Zim, which caused us to take a look. When the IPO broke price, we built a position which also had a meteoric rise. Colored by the horrors of the past, both fictional and real, we erred on the side of caution and sold our positions at the end of 2021. I had this mantra that the number of folks who have done well in shipping is "not many" and, well, this was art versus science, and "art" told me to get out.

***"I had this mantra that the number of folks who have done well in shipping is "not many" and, well, this was art versus science, and "art" told me to get out."***

**G&D:**

You've discussed investing in businesses with different 'grades' of management, splitting between 'A Team', 'B Team', and 'C Team' performing players. New investors who can be great at business and fundamental analysis might be missing this part of their skillset, which is an ability to evaluate the performance of management teams. What's your criteria in weighing that?

**JR:**

The first ingredient is access to management. At Philosophy I am trying to instill a culture of not being shy. My guess would be that if you talked to the management teams we've invested behind, they would probably laugh and make a joke about how persistent (annoying?) we are. We have lots of calls, lots of meetings, we share our work to let them know what we're thinking, and we offer "suggestivism." We're not afraid to go into boards or executive teams and we try to do so intelligently. For example, junior analysts need to learn that if you write cookie-cutter messages like, "hi, I'm from so and so, a fund that manages X dollars, this is our mandate, can we please have a phone call?" then management will ignore you. They are human beings and that's what human beings do to boring emails. Instead, make it more casual, to the point, and ideally have something that is in it for them. Then, boom, a meeting. Also, this is way better than using an expert network. I went away

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from those services because the serendipity in the process of getting to people is so valuable. You just don't know where it's going to go, but all those calls usually produce something unexpected, and if you just lazily have someone scheduling expert calls for you, you miss out on that element.

Once you have access, it's just reps, at-bats, and years in the seat to help you distinguish between good and bad. At first, all managements will sound compelling but over time you appreciate the difference. In addition to how they sound and what their background is, you can look at incentives. You want alignment from an ownership perspective. You can do checks on them and ask around to find out if they are well-regarded. Listen to see if they sound capable, they're articulate, they don't repeat themselves, they don't resort to generic language but instead get right into specifics. A mistake I've made is overlooking problems with management. If there's a governance problem and management is not trustworthy, if you get checks saying they're crooks, get out. Crooks gonna crook. They know how to do it and if they're an executive at a publicly traded company, they are probably good at it. You need to respect that reality and get away from it. It's too unpredictable.

**G&D:**

You've mentioned Philosophy looks at the hairy stuff that's out of favor potentially for a reason. How do you go about determining which investments should fall into the too-hard pile, versus digging in and really trying to do some creative work? One example is an Engineering & Construction ("E&C") business like a McDermott. This was not a good business model, and it was going through a tough time of overruns and delays. It wasn't bankrupt yet, had runway and liquidity, and the debt looked covered on asset value and was yielding a juicy coupon. It became clear the business was going bankrupt. I did a ton of work to underwrite owning it into bankruptcy, but it proved to be a gigantic waste of time. I'm curious how you all think through that process and what makes you decide it's not worth the brain damage?

**JR:**

Part of this process is accumulating battle scars. You say McDermott and I recall Chicago Bridge & Iron, Babcock & Wilcox, and a few other E&Cs. At some point, trying a cheap E&C feels like a right of passage. You get killed on spiraling cost overruns; you see management teams confidently stand behind increased cost estimates – "the last time, we promise" – and then they blow past them the next quarter. You learn these are bad businesses and once you learn that, it goes in your toolbox. Going forward, the bar to convince me of an E&C long is going to be awfully high. Another consequence of this learning would be that if something looks like an E&C business, and is cheap as a result, but in reality is not such a business, then that is a reason for cheapness that could pique my interest.

> ***"Part of this process is accumulating battle scars…As far as deciding if something is uninvestable broadly, we always ask the question, can this be corrected? Can what everyone is seeing today be flipped around…We get it right some of the times, wrong other times, but when we get it wrong, we ask ourselves why and fill up our 'Lessons Learned Scar Tissue' bucket."***

As far as deciding if something is uninvest-able broadly, we always ask the question, can this be corrected? Can what everyone is seeing today be flipped around? What you described with McDermott was clearly cheap for a reason – nothing about it was a

(Continued on page 14)

## Jacob Rubin, Philosophy Capital

mispricing. It's cheap for clear reasons. We get it right some of the times, wrong other times, but when we get it wrong, we ask ourselves why and fill up our 'Lessons Learned Scar Tissue' bucket.

**G&D:**

Coming off the tech bubble boom and bust between 2000 - 2001, many investors swore off investing in technology. That myopic view was obviously proven wrong. Do you think there are similar sectors where the market is meaningfully mispricing risk today?

**JR:**

I can think of a couple. When you're doing a top-down analysis, you're looking for a paradigm change, for multi-year trends that reverse. You try and think "what are the implications?" One area of change today is energy transition. We think about the proliferation of ESG funds and what that means for longs and shorts. We think about the dynamic problems that are being tackled from governments and businesses globally. Power demand is only growing, with both demographic trends as well as the need to digitize developing economies. Meanwhile, classic fuel types are killing our planet. So a wave of fund flows flood the market trying to find clean energy solutions. But you need to think about complex scientific problems, like distribution, transmission, energy density and the full impact of supply chain ecosystems. Everyone points to solar, wind, and batteries, but they neglect the rare earth mineral mining or how you tackle the waste or old panels or turbines. Anyway, the place that feels interesting and early, to me, is nuclear. But we also look at LNG as well as the fat tail of classic oil and gas. Traditional oil and gas companies are so unloved, they trade at 1-2x cash flow.

Another area of change is that we just had a decade-plus of falling interest rates or interest rates pegged to the floor, not to mention negative in Europe. Now, rates are rising and regardless of when the Fed pivots, or to what extent they turn dovish, the fact remains that rates are off the floor. What's more, Quantitative Easing is turning hard into Quantitative Tightening. It's not just coasting in neutral; it's actually reversing 180 degrees. When you jam the brakes and throw it in reverse and interest rates rise, what happens? We are asking ourselves these questions all the time and we've uncovered a few interesting investment opportunities.

For example, there's a factoring business in Italy, BFF Bank ("BFF IM"), where the Italian political backdrop and what's happening in European equities has punished stocks and hidden a few gems. BFF is triple-exposed to rising rates: 1) the factoring business benefits from spreads blowing out due to increased time value of money, not to mention the benefits of factoring in a more uncertain world; 2) BFF has a 6 billion EUR loan book tied to Italian sovereigns where 5-yr spreads are blowing out and they have near-term and floating exposure that is going gangbusters; and, 3) BFF charges late payment interest at a statutory floating L+800 rate. So, BFF is triple-exposed to rising rates and as long as the entire country of Italy can fund hospital bills and the like, it will be a major beneficiary of this environment. That's just one example of Philosophy looking around an area of change and not knowing what we'll stumble on.

**G&D:**

In the Winter 2009 Graham & Doddsville edition following the Great Financial Crisis, Bruce Berkowitz stated he believed investors were "focused on most of the ways in which you can die, which is a great signal for the future. What is happening today, as in most bear markets, is that people either don't have the cash or they don't have the stomach – hence the low valuations." The draconian risk during the GFC was the potential for total collapse of the capital markets, but the fear in markets today appears to be a scenario

*(Continued on page 15)*

## Jacob Rubin, Philosophy Capital

where high inflation and slow growth create a decade of stagflation. Layer in a growing lack of confidence in central banks and sovereign debt issuers, and it's a nasty cocktail. At the same time, sentiment across retail, business leaders, and investors is quite poor. Do you see any corollaries between the post-GFC era and today? Are we closer to the 'Roaring 20s,' the 1970s, or the Great Depression?

**JR:**

One of the most important risk management priorities right now is understanding your factor exposures. And not just Fama French stuff. If Putin is taken out tomorrow, how is your book going to perform? If escalation happens with China and Taiwan, how are you positioned? Corporate leverage? Wage inflation? You need to think about if you are balanced or imbalanced on all these dimensions. If you are imbalanced, you have to know whether that's something you want by design because you believe in it. If not, how can you achieve better balance? Philosophy has a lot of tools we use to think about hedging and we tend to find creative ways to offset all sorts of risks. Peace might ding our energy book, but travel stocks probably rip. Etc. etc.

As far as facts on the ground, two things are true simultaneously. One, it's a bad macro setup. Geopolitics is a mess, we have social efforts distorting markets, we are coming off free money fueling idiotic bubbles, we have a brutal combination of high inflation with strong employment, which gives the Fed cover to jack up rates. We have the reversal of globalization, which is inflationary. It's a tough backdrop when you add it up. This is consensus, but that doesn't mean

> ***"One of the most important risk management priorities right now is understanding your factor exposures. And not just Fama French stuff. If Putin is taken out tomorrow, how is your book going to perform? If escalation happens with China and Taiwan, how are you positioned? Corporate leverage? Wage inflation? You need to think about if you are balanced or imbalanced on all these dimensions."***

it's wrong. Two, there are businesses generating cash that will prove resilient. I think the idea of capital allocation is front-and-center, more than it has been in the past. You can find management teams that appreciate the importance of capital allocation that have cheap multiples and copious cash flow.

This sounds self-serving, but if you add up the two facts I mentioned – the existence of cheap securities tied to businesses that make cash and want to give it back, against a tough macro-environment with lots of risks looming – I think you need a long/short strategy. Further, you want a low net, you want some cash on the sidelines, and if you want to make it really interesting, you want the ability to go after distressed credit if we're heading into a cycle.

**G&D:**

I couldn't agree more. I think that's probably a great place to leave it. Jacob. Thank you so much for your time.

**JR:**

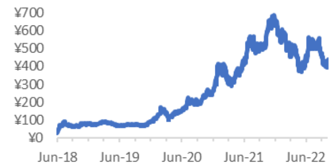
You're welcome, thanks for having me.

# Contemporary Amperex Technology Ltd. [CATL] (SZSE: 300750) - Long
## First Annual Kawaja Growth Stock Pitch Challenge (1st Place)

**Shalin Doshi ´23**
SDoshi23@gsb.columbia.edu

Shalin is a second-year MBA student at CBS and part of the Value Investing Program. He started his career as an Equity Research Analyst at JP Morgan, covering Consumer sectors. This summer, he worked with Whale Rock Capital, a Boston-based long-short equity hedge fund. Shalin graduated from the Indian Institute of Technology Madras with a Bachelors and Masters in Technology, and is a CFA charterholder.

| Period end: | Dec-18 | Dec-19 | Dec-20 | Dec-21 | Dec-22 | Dec-23 | Dec-24 | Dec-25 |
|---|---|---|---|---|---|---|---|---|
| **Financial Summary (RMB M)** | **2018** | **2019** | **2020** | **2021** | **2022E** | **2023E** | **2024E** | **2025E** |
| **Net Revenue** | **29,611** | **45,788** | **50,319** | **130,356** | **301,474** | **409,449** | **524,903** | **648,891** |
| *% growth* | *48%* | *55%* | *10%* | *159%* | *131%* | *36%* | *28%* | *24%* |
| *% vs consensus* | | | | | *1%* | *7%* | *10%* | *28%* |
| **Gross Profit** | **8,978** | **12,538** | **13,345** | **32,378** | **69,026** | **100,369** | **130,394** | **163,344** |
| *% margin* | *30.3%* | *27.4%* | *26.5%* | *24.8%* | *22.9%* | *24.5%* | *24.8%* | *25.2%* |
| *% vs consensus* | | | | | *6%* | *12%* | *14%* | |
| **Adj. EBIT** | **3,602** | **5,320** | **5,327** | **16,207** | **34,629** | **57,831** | **78,761** | **104,060** |
| *% margin* | *12.2%* | *11.6%* | *10.6%* | *12.4%* | *11.5%* | *14.1%* | *15.0%* | *16.0%* |
| **EPS (¥/share)** | **¥1.64** | **¥2.09** | **¥2.48** | **¥6.84** | **¥12.57** | **¥19.26** | **¥26.16** | **¥34.53** |
| *% growth* | *-18%* | *27%* | *19%* | *175%* | *84%* | *53%* | *36%* | *32%* |
| *% vs consensus* | | | | | *20%* | *21%* | *26%* | *67%* |
| *Current P/E* | | | | | *34.4x* | *22.4x* | *16.5x* | *12.5x* |
| Free Cash Flow | 4,687 | 3,845 | 5,128 | -860 | 1,793 | 23,355 | 31,065 | 42,342 |
| Current FCF Yield | | | | | 0% | 2% | 3% | 4% |
| Net Debt/EBITDA | -3.7x | -2.5x | -4.2x | -1.6x | -1.7x | -1.4x | -1.3x | -1.3x |



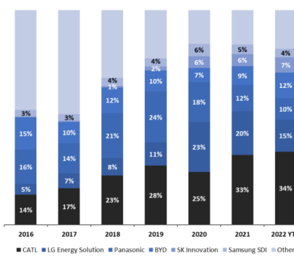

| Price Target | per share |
|---|---|
| Current Price (13-Oct-22) | ¥432.00 |
| **Target Price (31-Dec-24)** | **¥863.35** |
| Total Upside | 100% |
| IRR (to Dec-24) | 37% |

**<u>Recommendation</u>:**

Long CATL with a Dec 2024 price target of ¥863, representing 100% upside or an IRR of 37%.

**<u>Background</u>:**

CATL is a manufacturer of lithium-ion batteries for electric vehicles (EV) and energy storage applications, and is the leader (33% share in 2021) in a concentrated EV battery market (top 5 players hold ~80% share). EVs represent a majority of global lithium-ion battery demand, with a large, growing TAM driven by increasing global EV penetration, which is expected to rise from 8% in 2021 to 23% by 2025. I believe <u>CATL is the best way to bet on the EV growth curve</u>.

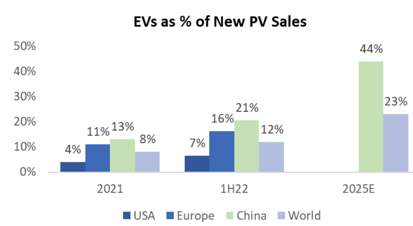



**<u>Investment Thesis</u>:**

### 1. Underappreciated growth levers and market-leading positions

*Expect ~10% pt. upside to Street's FY22-25 revenue CAGR estimates*

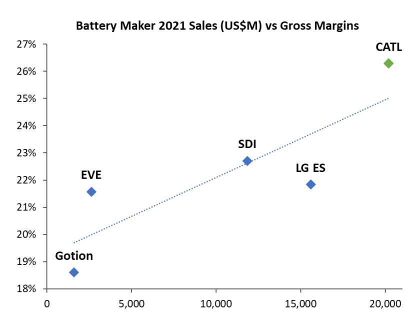
- Supplies nearly every OEM across all regions, standing to win irrespective of which player gains share
- Retains 50% share in China, which <u>will remain the largest + fastest growing EV market this decade</u>
- Well-positioned to grow ex-China share, the next lever of growth, with plants in Europe, Asia, Mexico
- Pack innovation leadership (CTP) allows multiple chemistry use-cases, <u>growing both NMC and LFP</u>
- ESS represents a call option, with <u>sodium-ion a potential accelerator</u>; low street expectations




### 2. Unique competitive advantages allow industry-leading margins

*Expect ~250bps upside to Street's FY24 EBIT margin estimates*

- Benefits from economies of scale clearly exist in battery manufacturing, with CATL also benefiting from <u>large govt. subsidies, no longer replicable</u>
- Strong negotiating power vs supplier base, steadily built over a decade, allows superior cost profile, with <u>feedback from multiple suppliers indicating favorable fee structures</u>; CATL represents >50% of revenue for many of its suppliers
- Shrewd investments in critical raw material supply (lithium and cobalt mines, cell components) removes bottleneck to expansion, with <u>research indicating persistent lithium undersupply till 2030</u>
- OEM <u>contracts were renegotiated to favor battery makers</u>, with OEMs having high switching costs



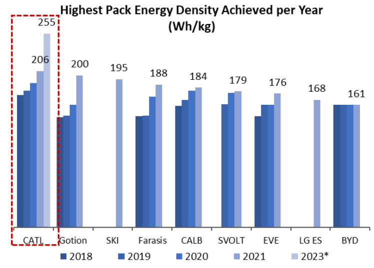

*Sources: Company Reports, Bloomberg, CapitalIQ, EV-volumes, GGII, Broker Research, Expert Network Transcripts. Pricing as of 13-Oct-22.*

# Contemporary Amperex Technology Ltd. [CATL] (SZSE: 300750) - Long

### 3. Product innovation leadership ensures CATL remains ahead of the curve

*Key driver against substitution risk in a rapidly evolving industry*

- Highest R&D spend (another scale benefit) + top talent allows best product quality every year; <u>expert feedback suggests quality gap keeps increasing</u>
- Ability to get a new product to market as quickly as within 2 years is well above peers
- Encouraging chemistry development pipeline, with progress being made in LMFP, Na-ion, cobalt-free, and silicon anodes; <u>represent optionalities</u>
- <u>Well-regarded management</u> with expertise, relationships, and skin in the game - the Chairman/CEO is the largest shareholder with a 25% stake




**<u>Valuation</u>**: 67% upside to FY25 consensus EPS; cheap P/E given growth

- Expect volumes, gross margins, and operating margins to be above consensus estimates for FY24-25
- CATL offers the best value for growth among battery comps (see table below)
- Assuming a <u>conservative 25x P/E multiple on base case FY25 EPS</u>; multiple should arguably be higher given 40% EPS growth CAGR expected over FY22-25
- Stock has historically traded in a wide band of 30-100x NTM P/E; current multiple (22x FY23) is near all-time lows since IPO
- <u>Reasonable downside protection</u> in the event of weaker-than-expected volumes and margins, with the current share price implying persistently low multiples and much lower EPS growth

| | | FY25E |
|---|---|---|
| P/E multiple | | 25.0x |
| Adj. Net Income (2025E) | ¥ | 80,483 |
| **Equity Value (RMB mn)** | | **¥ 2,012,069** |
| FDSO | | 2,331 |
| **Value per Share ($)** | **¥** | **863.35** |
| Implied upside/downside | | *100%* |
| IRR (to 31-Dec-2024) | | ***36.6%*** |


**<u>Risks and mitigants</u>**: Concerns around margins, oversupply, geopolitics

- <u>Geopolitics to limit global expansion</u>: Plausible risk, not in company's control. Recent contract wins in US (Ford, Tesla comments) suggest OEMs have bigger issues. CATL's Mexico plant could technically be eligible for IRA benefits. But US is a small part of CATL's story, with no US contribution at worst a 10% hit to EBIT. Strong relationships with European OEMs with large capacity expansion projects in Germany and Hungary suggest Europe will ensure international remains a key driver by FY25.
- <u>Margin weakness due to high raw material costs</u>: Starting from Apr/May 2022, raw material costs have been completely passed through to OEMs, with EV makers confirming this in subsequent earnings calls.
- <u>Market oversupply & competition from Tier 2 players in China</u>: On the contrary, EV makers have struggled with battery shortages since last year. Conversations with battery heads at OEMs suggests they prefer battery makers with scale, high utilization, access to raw materials, and best-in-class tech - for all of which CATL is a league above its peers.
- <u>EV (and battery) demand falls off a cliff in a recession</u>: EV adoption could slow temporarily, but the structural trend is unlikely to change on a medium term time frame. Demand outlook in China remains robust, supported by favorable regulations.
- <u>OEMs start making batteries in-house</u>: Battery manufacturing has huge barriers to entry from capital requirements, chemical engineering expertise, and different manufacturing capabilities vs car-making. Product cycle development takes years.
- <u>Substitution risk from new battery technologies (read: solid-state)</u>: Any groundbreaking technology is unlikely in the near term, as per numerous industry experts, with solid-state particularly unviable. Product innovation is likely to come from CATL itself than any other player given its massive R&D spend.
- <u>Low utilization rates given expected global lithium undersupply</u>: CATL's investments leave it better placed vs other battery makers in securing lithium supply.

| Ticker | Name | LCL Price | $B Mkt Cap | $B EV | ND/EBITDA | Gross Margin 2021 | P/E 2022E | P/E 2023E | P/E 2024E | EV/Revenue 2022E | EV/Revenue 2023E | EV/Revenue 2024E | Revenue Growth 2022E | Revenue Growth 2023E | Revenue Growth 2024E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| <u>My Estimates</u> | | | | | | | | | | | | | | | |
| **SZSE:300750** | **Contemporary Amperex Technology Co., Limited** | | | | | | **34.4x** | **22.4x** | **16.5x** | **3.2x** | **2.4x** | **1.9x** | **131%** | **36%** | **28%** |
| <u>Consensus Estimates</u> | | | | | | | | | | | | | | | |
| SZSE:300750 | Contemporary Amperex Technology | ¥432.00 | $147.0 | $137.5 | NM | 24.8% | 41.2x | 27.1x | 20.7x | 3.3x | 2.6x | 2.1x | 128% | 29% | 24% |
| | **Peer Average:** | | | | **4.7x** | **15.6%** | **60.1x** | **30.0x** | **21.6x** | **2.8x** | **1.7x** | **1.3x** | **91%** | **36%** | **26%** |
| SEHK:1211 | BYD Company Limited | 191.50 | $91.8 | $91.1 | NM | 12.7% | 53.9x | 35.4x | 26.7x | 1.8x | 1.3x | 1.1x | 72% | 34% | 22% |
| SZSE:002074 | Gotion High-tech Co.,Ltd. | 33.68 | $8.4 | $9.3 | 10.2x | 17.0% | 113.8x | 41.9x | 28.8x | 2.9x | 2.0x | 1.5x | 119% | 46% | 38% |
| SHSE:688567 | Farasis Energy (Gan Zhou) Co., Ltd. | 26.81 | $4.0 | $3.9 | NM | -8.5% | NM | 25.5x | 13.1x | 2.1x | 1.2x | 0.8x | 286% | 78% | 46% |
| SZSE:300014 | EVE Energy Co., Ltd. | 91.30 | $24.2 | $26.0 | 6.0x | 20.9% | 54.2x | 29.7x | 20.6x | 5.3x | 3.1x | 2.2x | 108% | 70% | 44% |
| KOSE:A373220 | LG Energy Solution, Ltd. | 477,000 | $78.1 | $78.6 | NM | 21.8% | 110.3x | 71.0x | 52.3x | 4.7x | 3.5x | 2.7x | 33% | 36% | 30% |
| KOSE:A006400 | Samsung SDI Co., Ltd. | 596,000 | $27.9 | $29.8 | 0.8x | 22.7% | 23.8x | 19.7x | 16.1x | 2.2x | 1.8x | 1.5x | 44% | 21% | 20% |
| TSE:6752 | Panasonic Holdings Corporation | 1,022 | $16.2 | $20.6 | | 29.5% | | 10.1x | 8.7x | | 0.4x | 0.4x | 9% | 8% | 3% |
| KOSE:A096770 | SK Innovation Co., Ltd. | 151,500 | $9.0 | $19.0 | 1.9x | 8.9% | 4.4x | 6.9x | 6.5x | 0.4x | 0.4x | 0.4x | 59% | -2% | 0% |

| P/E \ 2025 EPS | ¥21.08 | ¥26.27 | ¥34.53 | ¥41.01 | ¥47.99 |
|---|---|---|---|---|---|
| 18x | ¥368.87 | ¥459.79 | ¥604.34 | ¥717.61 | ¥839.82 |
| 20x | ¥421.56 | ¥525.47 | ¥690.68 | ¥820.12 | ¥959.79 |
| 23x | ¥474.26 | **¥591.15** | **¥777.01** | **¥922.64** | ¥1,079.76 |
| 25x | ¥526.95 | **¥656.84** | **¥863.35** | **¥1,025.16** | ¥1,199.74 |
| 28x | ¥579.65 | **¥722.52** | **¥949.68** | **¥1,127.67** | ¥1,319.71 |
| 30x | ¥632.34 | ¥788.20 | ¥1,036.01 | ¥1,230.19 | ¥1,439.68 |
| 33x | ¥685.04 | ¥853.89 | ¥1,122.35 | ¥1,332.70 | ¥1,559.66 |

*Sources: Company Reports, Bloomberg, CapitalIQ, EV-volumes, GGII, Broker Research, Expert Network Transcripts. Pricing as of 13-Oct-22.*

# Planet Fitness, Inc. (NYSE: PLNT)
## 2022 Chicago Booth Investment Conference & Competition (1st Place)


**Alan Leite, CFA '24**
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Alan is a first-year MBA student at CBS. Prior to business school, he worked as a Proprietary M&A/VC senior associate at Nubank in Brazil. Before that, Alan was as a private equity associate at Carlyle. Alan graduated in engineering at the University of Sao Paulo.

**Thomas Schlabach '24**
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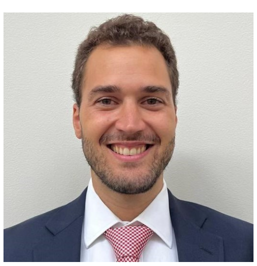
Tommy is a first-year MBA student at CBS and AVP of CSIMA Conference. He served for 12 years as a US Navy veteran. He is now a large cap strategy intern at Diamond Hill Capital Management.

**Cheng Jiang '23**
ChJiang23@gsb.columbia.edu

Cheng is a second-year M.S. Financial Economics student at CBS. His previous experiences were in FOF research and business analytics. Cheng graduated *magna cum laude* from Rensselaer Polytechnic Institute with a B.S. in Computer Science.



**Matthew West, CPA '24**
MWest24@gsb.columbia.edu

Matthew is a first-year MBA student at CBS. Prior to business school, he worked at Becton Dickinson as a senior internal auditor. Matthew graduated *summa cum laude* from Rutgers Business School with a bachelor of science in accounting and finance.


**Recommendation**

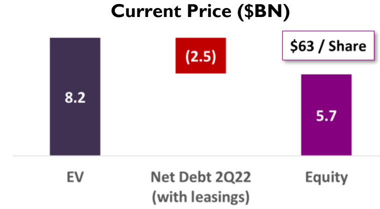
Long PLNT with a 3-year target price of $102, representing an IRR of 18%

**Company Overview**

Planet Fitness is the largest gym franchisor in the world, with 2,324+ units, where 90% are franchises and 10% are corporate owned gyms.

- Founded by the Grondahl brothers in 1992 in Dover, New Hampshire
- Chris Rondeau started working at the front desk of the first ever Planet Fitness and became CEO in 2013.
- Planet Fitness present in all 50 states in the U.S., and started to expand to Canada (~50 units), Mexico (~16 units), Australia (~8 units), Panama (~6 units), and Puerto Rico (13 units).
- Planet Fitness has a market share of 9% in the U.S. in terms of net revenue, and international sales account for 3% of Planet Fitness' net revenue.

**Current Price ($BN)**




**LTM 2Q22 Net Revenue Breakdown**

| Franchise Royalties and Fees | Corporate Owned Stores | Equipment Sales |
|---|---|---|
| 42% | 36% | 22% |

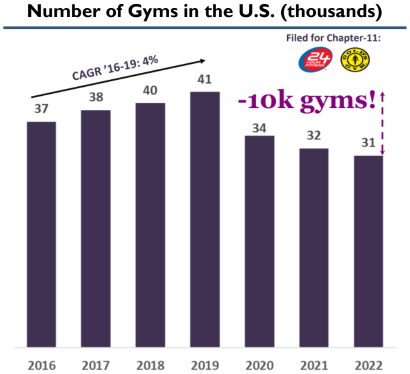
**Investment Thesis**

Planet Fitness is well-positioned to drive significant growth beyond current market expectations, and it is trading at an attractive valuation

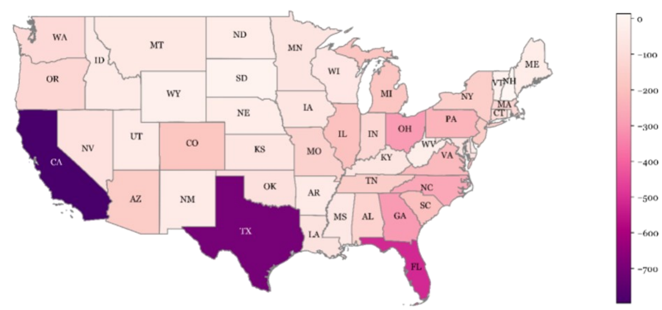
**I. Favorable Industry Tailwinds:**

- U.S. gym market is large ($37 billion) and is growing at 4% per year.
- The COVID-19 pandemic resulted in the closure of about 10k gyms (~25% of total number of gyms in the U.S.), and during this time PLNT did not have any store closures.
- International markets are an opportunity of more than $9 billion, with similar trends to those of the U.S.
- Strong performance during the 2007/2008 GFC shows Planet Fitness as a recession proof business.

**Number of Gyms in the U.S. (thousands)**




**Change in Number of Gyms by State (2019 - 2022)**




**II. Strong Business Model with Competitive Advantages:**

# Planet Fitness, Inc. (NYSE: PLNT) - Long


**II. Strong Business Model with Competitive Advantages (Continue):**

- We ran a survey and discovered that, when looking for a gym, clients value location, price, and cleanliness, and Planet Fitness offers great values in these criteria. They have an extensive footprint, with 2,324+ locations. In addition to the $10 entry price, clients can get access to every Planet Fitness locations with the Black Card at $25. Black card memberships account for >60% of total memberships. Planet Fitness also holds a high standard in terms of cleanliness, as verified by site visits and a word cloud from 50 randomly selected Planet Fitness locations and reviews from across the US.
- Planet Fitness also has a strong value proposition to franchisees which includes great unit economics (ROIC of 17%), thus aligning interests for expansion.
- Planet Fitness's scale provides great competitive advantages which differentiates the company from competitors. This includes a large national advertising campaign, discounts on gym equipment, better relationship with real estate agencies and network effects.

**III. Attractive Valuation Caused by Overlooked Sales Growth:**

- Market's overreaction after PLNT's 2Q22 guidance created a great entry opportunity as long-term fundamentals were unchanged. After the earnings release on August 9, PLNT declined 23% while the S&P 500 declined only 9%. In addition, PLNT is trading at –1 standard deviation of its 5-year P/E NTM average.

**Variant Views:**

- Number of stores: Management provided 4.0k stores in the U.S. prior to COVID, and the street still uses the number as a target for U.S. (+0.2k for international). However, the street fails to incorporate what COVID caused in this industry (10k gyms closing doors). Thus, due to its strong competitive advantages and best-in-class value proposition, we believe Planet Fitness is poised to capture more market share, reaching 4.6k stores in total in 2032.
- Average Revenue per User (ARPU): Prior to the pandemic, equipment revenue per franchise was around $140k, but COVID compressed this number to $80k, and the street still forecasts a slightly higher value going forward. However, franchises have the obligation to replace their equipment every 5-7 years. Therefore, we believe equipment revenue per franchise should return to pre-COVID levels.

**<u>Valuation — What You Need to Believe to Reach Our Target Price in 2025</u>**

- Stores: 3.0k in 2025 (vs. 2.4k in 2022) / 4.6k in 2032 — A larger opportunity due to COVID outcome (-10k gyms)
- ARPU: $69 in 2025 (vs. 55 in 2022) — Mainly due to higher equipment sales
- Net Margin: 19% in 2025 (vs. 15% in 2022) — Back to historical levels (pre-COVID)
- 2025 Exit P/E NTM Multiple: 25x (vs. 30x entry and 23x of the street) — Higher growth until 2032 (vs. the street) and supported by trading comps

| 2025E | Street | Bear | Base | Bull |
|---|---|---|---|---|
| **Number of Stores in 2025** | **3.0** | **2.7** | **3.1** | **3.4** |
| *CAGR 22-25* | 9% | 5% | 9% | 12% |
| **Number of Stores in 2032** | **4.2** | **3.3** | **4.6** | **5.5** |
| *CAGR 22-32* | 6% | 3% | 7% | 9% |
| **Members in 2025 (M)** | **22** | **20** | **23** | **24** |
| **Net Revenue ($M)** | **1,307** | **1,238** | **1,520** | **1,665** |
| *Net Revenue per Member* | *61* | *62* | *69* | *72* |
| **Net Income ($M)** | **258** | **214** | **296** | **325** |
| *Net Margin* | *20%* | *17%* | *19%* | *20%* |
| **Exit P/E NTM** | **23x** | **19x** | **25x** | **29x** |
| **3-Year Target Price** | **86** | **58** | **102** | **139** |
| *Total Upside / (Downside)* | 37% | (8%) | 63% | 121% |
| **IRR** | **11%** | **(3%)** | **18%** | **30%** |

**In summary, we see PLNT as a highly asymmetrical opportunity and recommend long PLNT with a 3-year target price of $102 and an IRR of 18%.**

**<u>Risk and Mitigation</u>**

- **Slower Expansion:** If Planet Fitness or its franchisees are not able to continue to expand, our these would be broken.
  - Planet Fitness already signed ADA to expand +1,000 stores with current franchisees. Also, the COVID-19 pandemic created a great opportunity for expansion.
- **Competition:** If other fitness competitors start to aggressively enter Planet Fitness' market, the number of members per gym would be affected and returns would be lower. Also, price competition could hurt Planet Fitness' margins.
  - Planet Fitness has the best value proposition among current competitors (and other relevant competitive advantages). Also, according to a former board observer for a franchisee at PF, because around 50%-65% of members don't show up often, members do not go to competitors when they arrive.
- **Cannibalization:** If Planet Fitness opens too many units, one unit can steal members from the other. Thus, number of members would be lower per unit, which can hurt growth and margins.
  - Planet Fitness still has a vast opportunity to expand nationally and internationally. Also, if 20k square feet units have no larger space, Planet Fitness can reduce to 10k square feet and expand to places where the 20k square feet unit would not be viable.
- **Recession:** In case of a recession and/or a high interest rates, people could stop spending and franchisees could halt expansion due to high cost of debt.
  - Planet Fitness has the cheapest product in the market, so people would be attracted to it. Fitness is not discretionary, and PF performed well during the financial crisis in 2007-2008 and during COVID, whereas other gyms did not. This could create even more opportunities for PF. Lastly, Planet Fitness' unit economics are already attractive even without leverage.
- **Lower ARPU:** Planet Fitness' value proposition is low price for a quality gym. This can result in lower pricing power with consumers; Planet Fitness is not able to return equipment sales to pre-pandemic levels.
  - Planet Fitness recently increased its Black Card price from $23 to $25 but didn't see churn increase. Also, Black Card penetration is still ramping-up, so this would increase ARPU.
  - Franchisees are obliged by contract to renew their equipment every 5-7 years. This was postponed due to the COVID-19 pandemic but is returning to normal levels.
  - Contracts of franchisees are converging to new 7% royalties fee (from 6.38% LTM), so this will increase ARPU over time.
- **Disruption:** Work out at home companies (such as Peloton) could steal members from Planet Fitness and decrease PF's growth.
  - Planet Fitness targets a different population from traditional fitness centers and has a much lower pricing point. Also, the value proposition of Planet Fitness is attractive due to the low price, and members can have both subscriptions.

# Connor Haley, Alta Fox Capital Management

**Connor Haley, Alta Fox Capital Management**

**Connor Haley founded Alta Fox in 2018 and is responsible for managing all aspects of the firm's investment process and strategy. He has over ten years of investing experience and a passion for investing in small-cap and under-the-radar opportunities. Before founding Alta Fox, Connor was an Analyst at Scopia Capital Management LP in New York (2014-2017). Connor is an active investor on MicroCapClub.com and ValueInvestorsClub.com (since 2016). Connor was an active investor in college—he founded TheVariantView.com and was the President of Harvard's largest undergraduate financial club, which he led to its highest ever annual return. Shortly after founding Alta Fox, Connor won the 2018 Texas Hedge Fund Conference Emerging Manager Pitch Competition. Connor received an A.B. in Government from Harvard College (magna cum laude).**

***Editor's Note: This interview took place on October 20th, 2022.***

**Graham & Doddsville (G&D):**

Connor, thanks for joining us. We're really excited to talk with you today. It would be helpful for our readers if you could walk us through your background and how you first became interested in investing.

**Connor Haley (CH):**

Thanks for having me. I've always been pretty analytical and into strategy games. I caught the investing bug when I was a freshman in high school. I took an economics elective, and we had sort of a stock market game where we'd compete against local schools through virtual stock picks. It really sparked my fascination and I started reading everything I could about investing. In high school, I created a website to generate Peter Lynch style "invest in what you know" insights. The idea was to aggregate consumer insights from high school and college students into investing insights while teaching a younger generation about investing. It was a fun idea with very little demand. It turns out that most high school and college students really don't care much about investing.

In college, I was highly active in investing. I ran an investing blog called thevariantview.com and participated in numerous investing competitions while part of Harvard's Financial Analysts Club. I also sought out several great investing internships where I continued to further my knowledge of investing. I was trying to get better every single year. My goal was to get into a risk-taking seat as early as possible and catalyze my own learning. There are so many resources available today for investors to learn from the greatest investors of all time, and I tried to take advantage of those resources.

**G&D:**

Who are some of the investors that you think have made the biggest impact on your investing philosophy? Who have you looked up to and has that changed over the course of your career?

**CH:**

There's a common perception that investing is an apprenticeship business. You hear a lot of people say that. In my view, that's a bit of a pessimistic notion because the odds that you land in a seat where you are working directly for someone who is a top tier investor who not only has a style that resonates with your personality but is also willing to teach you everything they know is extremely unlikely. If you ended up working for Julian Robertson in the early days, that's fantastic, but it's just very unlikely. Fortunately, there are more resources than ever both online and in print to learn from the greatest fundamental investors in history. My greatest influences have been reading everything I could from investors like Joel Greenblatt. I think I've read everything he's ever put out there, including his

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## Connor Haley, Alta Fox Capital Management

Columbia Business School notes, frankly, which is one of the things I always recommend to investors.

Same for Buffet, Lynch, et cetera. I think you just really need to read and reread the greatest investors of all time and ultimately find a way to incorporate some of their principles into your own process, which is important because there are many styles of investing. There's no one size fits all, and it's important that you develop your own framework from first principles so that you know and have confidence in your own style in times of market turbulence because the market will inevitably test you. And if you're uncertain about how you want to invest, you're likely to make costly mistakes.

***"I think you just really need to read and reread the greatest investors of all time and ultimately find a way to incorporate some of their principles into your own process."***

**G&D:**

Anything in particular that stood out about Joel Greenblatt?

**CH:**

A lot of things, but if I had to say one, what I think is exceptional about Greenblatt is his ability to take very complicated situations and simplify them into their most essential elements. I think he's excellent in that regard and it explains a lot of his success.

**G&D:**

Shifting gears, walk us through the period shortly before you left your previous fund to launch Alta Fox. What gave you the confidence to go out on your own and what was the opportunity that you saw in the market that you wanted to capitalize on?

**CH:**

I've always been entrepreneurial by nature. It was always my dream to move back to Texas and launch a fund with a flexible mandate and long-term capital. I had been fairly successful investing my personal account for many years, and I had a strong desire to implement my investing philosophy at an institutional scale.

**G&D:**

You launched Alta Fox in 2018. What are some of the takeaways from that period? Anything that surprised you, things you would do differently, things you'd do the same?

**CH:**

I knew launching the fund would be an enormous amount of work and very stressful. This was not lost on me, but it was probably even more stressful than I thought, to be honest. Managing the fund, as a one-person team, alongside all of the operational aspects that go into a fund while trying to raise capital, is all consuming. Unfortunately, getting off to a good start is even more important than it should be, in my opinion, in terms of determining your long-term success in this industry. In terms of things I did well, I spent several months studying the operational aspects of hedge funds before launching Alta Fox. I knew what I wanted to do and was well-prepared on the research side, but from an operational perspective, I'd never worked on that side of a hedge fund. But when you launch a firm and you're doing it as a one-man team, you must study that. I spent several months prior to launch really studying that aspect seriously. That knowledge helped me make informed decisions that I think put Alta Fox in a better position today than if I had solely relied on external advisors like I see many people do. You really have to own every aspect of the process if you're going to launch your own fund. I see a lot of aspiring fund managers gloss over this detail. It may not be fun or sexy, but it can be the difference between success or failure because if you overlook some of the operational aspects, you can have

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## Connor Haley, Alta Fox Capital Management

costly, unforced errors. I've been very blessed with supportive and long-term focused LPs and people who believed in me early, and I'm very thankful and certainly will never forget that.

In terms of mistakes, I think I would've benefited from developing ways to de-stress and remove myself from the day-to-day strains of the job. Today, I have a tremendous team that I can bounce ideas off of and share the day-to-day grind of managing a fund. But when you are a one-man investment team, it can be very lonely. And I think that's something that if I had fully understood, just the level of stress, especially early on, I would've wanted to develop, in advance, ways of managing that.

*"You really have to own every aspect of the process if you're going to launch your own fund. I see a lot of aspiring fund managers gloss over this detail. It may not be fun or sexy, but it can be the difference between success or failure because if you overlook some of the operational aspects, you can have costly, unforced errors."*

**G&D:**

What are some of the ways that you found helpful to de-stress?

**CH:**

There are a lot of things. I mean the biggest thing is just having a team, being able to talk through things, having people who are aware of what you're dealing with that share the highs and the lows. I think that's really important, and we've got a great team culture at Alta Fox and tremendous individuals that comprise the team. But when you're managing it by yourself, you've got so much in your head and you're dealing with all these other things, even outside the portfolio, it can be really daunting. And I think I manage that reasonably well. But if someone were launching a fund by themselves, I would encourage them to have contacts that they're checking in with on at least a monthly basis and chatting through their own highs and lows. You can share some of that journey with someone else.

**G&D:**

You mentioned studying the operational aspects when starting your own fund, and we wanted to double click into that. Could you talk a little bit more about what you were studying and what your learnings were on the operational side of things. Any advice there?

**CH:**

When you launch a fund, there are a thousand different decisions you have to make. Many of them are operational and if you've never worked on that side of a hedge fund (which basically describes everyone who's trying to launch a fund) you will have no expertise in that area. Many times, you won't even understand the question that the lawyer is asking you. The lawyer may not even be asking you the question because they have a default and they're just kind of answering it implicitly for you. I think it's important if you're going to launch your own fund to own all aspects of the fund and that includes operations. You should not take for granted the default answers that 99% of investors will go with. You really need to ask those questions starting from a first principles basis.

I spoke to a lot of other people who had launched funds. I tried to learn from both their successes and their mistakes. And while this was a very fruitful process, I also did a lot of research myself. I read about fund operations, I built decision trees around whether to structure the fund this way or that way. What are the pros and cons? I forced myself to ask these questions, which then led to more questions, which led to greater discovery of the process. I had an end goal in

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## Connor Haley, Alta Fox Capital Management

mind for what I wanted Alta Fox to look like. I think understanding those operational aspects from the beginning allowed me to make the right choices on vendors, for example. Depending on where you want your fund to be five and ten years from launch, you're going to make different choices about which vendors you choose on day one. That can be a big mistake I see people make.

There are difficult trade-offs. If you launch with a relatively small amount of money and you have to balance the budget plus the long-term growth, these are difficult decisions. However, if you fully understand the pros and cons and have studied the operational questions sufficiently, which I see very few people launching do, frankly, I think you're in a better position to make those decisions.

**G&D:**

Give us an overview of Alta Fox. What's your investment philosophy and investable universe? And is there anything else that you think is unique about your firm?

**CH:**

Alta Fox has a flexible mandate by design. We invest globally. We invest in both public companies and private companies. We invest as passive holders, activists and everything in between. Nothing is off limits if the business is in our circle of competence, and we can develop a strong view of the risk and reward. That is not always the sexiest pitch in a world where many allocators want increasing levels of specialization, but it has benefited returns. I think our LPs understand that I've got the vast majority, 90% plus of my net worth, in the fund. I eat my own cooking, and we are going to go where we think the best risk adjusted returns are, even if it doesn't fit a pigeonholed marketing narrative.

Searching for good businesses with competitive advantages and long growth runways is not particularly unique among fundamental investors. We're cognizant of that. What I think Alta Fox has done well since inception is having the ability to go both very wide and very deep in our research process. This is difficult to do, but every single aspect of our investing process is designed with this goal in mind. For example, we have a very high velocity of ideas, but we kill ideas very quickly. For every analyst that has joined our team, this has been quite an adjustment. We are not a firm where you get one idea and you come back two weeks later and tell us whether you think it's interesting or not. It's more like, here are six ideas and let's talk about them two days from now, for an initial level of analysis.

Once we identify a business that potentially fits our criteria, we have a very systematic process for analyzing the risk / reward. It would not be unusual for us to drop everything and take as long as it takes to get clarity on the risk and reward. So, we can go very wide and very deep. Across our four-person investment team, we look at about 25 companies a week. It's a KPI we track religiously. I am very much a believer of the Peter Lynch view, that the person who turns over the most rocks is likely to win the game. We turn over a lot of rocks at Alta Fox and once we find one that fits what we're looking for, we have the ability to go deep.

***"Across our four-person investment team, we look at about 25 companies a week. It's a KPI we track religiously. I am very much a believer of the Peter Lynch view, that the person who turns over the most rocks is likely to win the game. We turn over a lot of rocks at Alta Fox and once we find one that fits what we're looking for, we have the ability to go deep."***

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# Connor Haley, Alta Fox Capital Management

**G&D:**

An analyst at your firm gets assigned a name or comes across a company that seems potentially interesting. What does that one- or two-day initial research process look like?

**CH:**

Well, we have a very high bar for what IRRs are interesting. So, we're typically looking for 25% plus on a three-year IRR basis. There are a lot of businesses, even high quality businesses with good management teams, that you can quickly eliminate in the first couple of hours of work if the setup does not exist to potentially generate a 25% IRR. On the first level of analysis, the analysts are trying to put guardrails around what is reasonable from a revenue perspective, a margin expansion perspective, a multiple perspective, and a balance sheet utilization perspective. The various levers to generate an IRR, what are reasonable, and is there the potential to generate a very attractive, 25% plus IRR over the next three years? If the answer is no, then we'll file away that information. It doesn't get lost. We have software that captures all of this information and will alert us to when these companies are approaching price targets that start to get interesting. So, we don't ever lose that information, but we quickly kill the idea in terms of our research process, and we move on to the next. Once we find something that is potentially interesting within those guardrails, again, we'll drop everything and sharpen our pencils.

***"There are a lot of businesses, even high quality businesses with good management teams, that you can quickly eliminate in the first couple of hours of work if the setup does not exist to potentially generate a 25% IRR."***

**G&D:**

For your idea funnel, are you using screens? Or is it sort of a bespoke process? How do you typically find most of your interesting ideas?

**CH:**

We source ideas through a combination of methods. Screening is an important part of the process. A strong network of contacts and boots on the ground research is also important. However, probably our favorite method of generating ideas is talking to companies and industry experts and then having that organic process lead us to other leading companies. It could be a competitor or a supplier. We often find that is one of the most organic ways of researching ideas, whether it's in the same industry or in an adjacent industry. So, we try not to get pigeonholed by dictating "we're looking for this." For every company we research, there are dozens of companies that interact with it in some way as suppliers, competitors, etc. We will hop from one company to the next, wherever our research leads us.

**G&D:**

You made an interesting observation in one of your quarterly letters that Alta Fox had done better in the small cap space versus the micro-cap space. Many investors are under this impression that the micro-cap space is the most inefficient of any market cap bucket. Can you talk about why you moved away from micro-caps and into bigger names and why you think that's a better hunting ground for Alta Fox?

**CH:**

Well, I do believe that micro-caps are inefficient as is the entire Small-to-Mid cap space. However, at Alta Fox we often like to cut our losers quickly and let our winners ride. I think that is a difficult approach with micro-caps because even the most successful micro-caps inevitably run into various bumps in the road; they're less diversified businesses. It happens. So, if you are cutting exposure during that time, it's challenging to generate

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## Connor Haley, Alta Fox Capital Management

the long-term results that we are targeting at Alta Fox. As a result, for our own investing process, we have found it more fruitful to focus on high growth companies in a slightly more mature phase of their growth. You might miss the first double or triple, but in many cases the business has been significantly de-risked, so you have higher conviction to hold the business for the long term.

**G&D:**

Maybe we could touch on the private side of the book as well. Is every analyst looking at private ideas as well as public? What does the time allocation between those two books look like?

**CH:**

Not every analyst is looking at both. Some are. However, every analyst is having conversations about what we’re seeing as the most attractive returns on the public side versus the private side. And that’s important. And so, we’re sharing insights across the team and we’ve found significant synergies. Being a public investor makes it easier for us to diligence private companies, and diligence in private companies often yields insights valuable on the public side. So we found it helpful in both directions. But we do have some analysts that are focused more on the private side than public and vice versa.

**G&D:**

We spend a lot of time at Columbia Business School thinking about security selection, obviously very important, but as you know, it's only half the job. As portfolio manager, you have to size the positions as well. How do you approach that aspect of investing and what's your framework for position sizing?

**CH:**

I believe investing is both an art and a science. In my opinion, position sizing should be much more of a science than how most investors approach it. We use software that we have customized over the last four and a half years that takes our projected IRRs as well as our quantifiable scores across several important investing criteria that we've identified to generate optimal position sizing. There are obviously top-down constraints as well, married with our bottom-up qualitative decisions. While we do not follow this process religiously, we do have very high correlation. So, roughly 80% plus. It is a forced check on our analysis. It instills position-level discipline, and it allows us to track hundreds of ideas on our watch list in a very efficient manner. Investing is both art and science, but I think this is a particular area where a lot of fundamental investors kind of shoot from the hip, if you will. And I think that's a significant mistake.

***“In my opinion, position sizing should be much more of a science than how most investors approach it. We use software that we have customized over the last four and a half years that takes our projected IRRs as well as our quantifiable scores across several important investing criteria that we've identified to generate optimal position sizing.”***

**G&D:**

You've written publicly about several long ideas, but you also short. Could you talk about your overall framework for shorts? Any common short setups that you could walk us through?

**CH:**

We tend to be risk averse on the long side, but extremely risk averse on the short side. As a result, we typically avoid high short interest or otherwise crowded shorts. Typically, we're looking for structurally challenged businesses, cyclical peaks or fads, as an example. Our underwriting process for

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shorts is similar to the underwriting process for longs, but our sizing and trading around the positions is a bit different primarily for risk management purposes.

**G&D:**

In 2020, you initiated two notable activist campaigns, Collectors Universe and Enlabs AB (NLAB SS). What were some of your takeaways from that period? And how do you decide when to go activist versus when to just pass and maximize your return on time?

**CH:**

I'm passionate about corporate governance. I think it's extremely important and bad corporate governance hurts everyone except a small few; typically entrenched directors or members of management. I think it's actually a real societal concern and an issue with market integrity. We always strive to engage in a constructive manner with management teams and have excellent relationships with the vast majority of our portfolio companies. Unfortunately, there are instances in which management teams and boards are unwilling to do the right thing for shareholders. But the value that can be unlocked is tremendous. In these situations, activism is a valuable tool that can benefit all stakeholders. I do not particularly enjoy activism. It's a lot of hard work and expensive from a capital perspective and even more so from a time perspective. However, I do think it fulfills a necessary role in the market to combat entrenched directors looking out for themselves instead of fulfilling their fiduciary duties.

In terms of whether it's worth the time and how we think about that, we try to find good businesses that should be great rather than looking for bad businesses that could be okay. It would be very unlikely for you to see us involved in an activist situation that involves some massive turnaround in operations. I think Collectors Universe is a great example. It was a really good business, but they were paying out most of their cash flow as dividends instead of reinvesting in their business around their core competencies and competitive advantages to unlock additional shareholder value. So, it was sort of this mindless capital allocation policy.

I think activists often get a little bit of a stigma of "they just want to cut costs, they just want to fire people", etc. In many of our cases, it's the exact opposite. We want to invest more, we want to unlock higher growth, and, ultimately, that rewards all stakeholders. But you sometimes have entrenched directors or management that have very little skin in the game to take on that capital allocation thoughtfulness, even when it is likely to unlock significant shareholder value.

We typically do not screen for activist ideas. We try to approach everything from a constructive manner alongside management teams and boards. It's only when we identify a really exceptional opportunity where the only way to unlock the highest possible return is through change that we would consider engaging from of an activist perspective.

> ***"I'm passionate about corporate governance. I think it's extremely important and bad corporate governance hurts everyone except a small few; typically entrenched directors or members of management. I think it's actually a real societal concern and an issue with market integrity."***

**G&D:**

What are some examples of typical capital allocation mistakes that management teams make?

**CH:**

Well, I think a lot of management teams and

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## Connor Haley, Alta Fox Capital Management

boards do not understand how public securities are valued. For example, if you're just thinking about growing your profits but you don't understand across various segments that some segments will be valued higher than others, it can lead you to make bad capital allocation choices. I think even great operators of businesses do not necessarily have that investor mindset, which is really important because if your goal is to increase shareholder value, you need to understand how shareholders value your business. Many management teams and boards do not understand this, and it leads to serious capital allocation errors.

> ***"I think even great operators of businesses do not necessarily have that investor mindset, which is really important because if your goal is to increase shareholder value, you need to understand how shareholders value your business. Many management teams and boards do not understand this, and it leads to serious capital allocation errors."***

**G&D:**

Do you typically have this engagement mindset before initiating a position?

**CH:**

It can be both. We don't go looking for fights. In the case of Collectors, for example, we invested in the business because we thought it was a good business that would generate attractive returns even on a standalone, no change basis. We also thought it could generate extraordinary returns with capital allocation changes, and we started to engage with the company about how they could create more value, not in a hostile way, but in a collaborative way: "we own a lot of shares, we want to see your company succeed, and here are some of the ideas we have". In those situations, we hope that the management team and the board will interact in a collaborative manner for the benefit of all shareholders, as they are supposed to do in the spirit of their fiduciary duty.

In the case of Collectors, unfortunately, the Chairman of the company basically questioned why he should listen to us and told us to stop bothering him and that we could sell our shares if we disagreed with his decisions. The Chairman owned very few shares of the business (so it was really more our business than his), but that was an unfortunate situation and it never needed to lead to activism. Additionally, the company tried to sell at a very low price, which we then had to oppose. We are confident that our involvement helped lead to a much better outcome for shareholders than would've come to pass otherwise. In the case of something like Enlabs, the fight kind of found us. We were big fans of the management team, but the company accepted a takeover offer that was completely inadequate.

The circumstances around that acceptance were questionable in our view, that this might have been best for some particular individuals, but not for shareholders. And we had to take a stance as a large shareholder that had the capability of blocking the deal to say we're not going to allow this to happen. Within a couple days of their initial lowball offer, we had drafted a press release announcing our public opposition alongside other major shareholders, which collectively represented a blocking vote. We told the buying group to come back with something that represents closer to fair value or this deal will get blocked. Our actions manufactured a much better outcome for all shareholders. But I think both of these examples and many others illustrate that if activism

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is done in the right way, it does not deserve any sort of stigma. In fact, it should be celebrated. It requires extraordinary effort, time, and cost for a single shareholder to create positive outcomes for all shareholders. And that is extremely beneficial to the market ecosystem. I think it's very much needed today because corporate governance is in such a bad state in the US.

**G&D:**

You wrote in one of your past letters that Alta Fox was in the process of compiling this wall of fame of successful capital allocators. Could you share any of the names on that list that you think readers and investors out there should be following more closely?

**CH:**

There are some that would be well known by your readers that are extraordinary value creators, but I'll give a couple off the beaten path exaples. Ryan Pape, the CEO at XPEL (NASDAQ: XPEL) is one who comes to mind. He's done an extraordinary job. XPEL has had some of the highest value creation of any public security in the markets during his tenure. And he has the right capital allocation mindset. He's fully invested in his business with a majority of his net worth. He has been rewarded, as have investors, for his excellent leadership. So, I think he's one to study and he is certainly on our wall of fame. Another would be Howard Jonas at IDT (NYSE: IDT). IDT is a conglomerate, but it has had 20% plus annualized share returns for the last decade inclusive of all spinoffs. They've done an exceptional job of incubating businesses with their legacy cash flows and then spinning off those businesses to investors. We have great respect for that management team and the leaders inside their respective businesses.

**G&D:**

What are some of the things that stand out about Ryan Pape and Howard Jonas? Are there certain tells that you see when you're reading about them or speaking with them that make you think that these guys are great capital allocators?

**CH:**

The first thing is that they're all-in on their business. They're not there to just collect a salary. They have the majority of their net worth invested in the business and every single day they're fired up to create shareholder value. XPEL is a business that doesn't issue shares. It's very easy to forecast their shares outstanding for the next quarter because it's the same every quarter, every year. They treat shares like gold, like a valuable currency. That behavior is rare in an era where stock-based compensation and rampant dilution is quite common. Ryan Pape treats it that way because he is a shareholder himself. There was even a time early on where he had to put some expenses on his own personal credit card for the business.

You don't see that level of dedication from most executives who are getting paid millions without really taking on any personal risks. So, I think he's been all in alongside shareholders and he's really focused on the long-term value creation and that's refreshing.

In the case of Howard Jonas, he is incredibly thoughtful about capital allocation at IDT, the parent company that he founded. It's a relatively small market cap today, but that's only because they have spun off multiple businesses successfully that they've incubated over time. There are a lot of empire builders in corporate America today that want to have their business be bigger and more noticeable and collect a bigger salary, as a result. At IDT, they've sort of done the opposite. They're extremely frugal on costs. They don't have any sell-side coverage, and they don't particularly care. They just want to compound value per share at attractive rates over time. And they're very thoughtful about how they allocate capital, whether it be for acquisitions or spinoffs, and it shows up in the long-term results.

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## Connor Haley, Alta Fox Capital Management

***"The first thing is that they're all-in on their business. They're not there to just collect a salary. They have the majority of their net worth invested in the business and every single day they're fired up to create shareholder value...They treat shares like gold, like a valuable currency. That behavior is rare in an era where stock-based compensation and rampant dilution is quite common."***

**G&D:**

That's a good segue for us to dive into IDT. Could walk us through the thesis on IDT?

**CH:**

Sure. IDT is a small cap conglomerate that lacks any sell-side coverage or a natural investor base. Historically, the company has used their legacy business cash flows from their telecom business to incubate businesses and then spin them off. The strategy has been extremely successful as IDT has compounded inclusive of spinoffs value per share in excess of 20% over the last decade. We believe this story is about to repeat. IDT has one business in particular, NRS, National Retail Solutions, which we believe is spectacular and, on our numbers, is worth substantially more than the entire enterprise value of IDT today. NRS is a point-of-sale system for individual convenience stores. It is essentially a monopoly and has 90% plus gross margins on non-hardware revenue. In the last two years, the business has gone from negative EBITDA margins to over 36% in the last quarter.

In a couple of years, we believe this will be a 60% EBITDA margin business. It is also currently growing revenue in excess of 130% year-on-year. We are unaware of any asset in the public markets that has such an exceptional combination of top line growth and profitability. We expect NRS will be spun off to shareholders sometime in the next two or three years and that investors at today's prices will be greatly rewarded. There has been some concern over a pending lawsuit. Our diligence suggests that you are being more than compensated for this risk at today's prices. But as for any position with a left tail risk it is important to size the position appropriately.

**G&D:**

Do you have any advice for undergrad or MBA students that want to break into the investment management business? And when you're hiring an analyst, what are the things you're looking for?

**CH:**

In terms of advice, I would say start from first principles. Don't assume you will find the world's greatest mentor who will teach you everything they know. Study the greatest investors of all time and weave in their many teachings with your own personality to find what makes sense for you. Really take control of your own investing journey. There are many ways to make money but having a defined process that you can personally rely on in times of market turbulence is essential. So, that would be my advice on the investing side.

In terms of what I look for when hiring analysts, first and foremost, I look for people who are highly passionate about investing and who are ultra-competitive. I want people who eat, sleep and breathe investing and recognize it as the greatest game in the world and have a deep desire to win. Second, they have to be team players. We win and lose as a team at Alta Fox, and having that team approach with competitive individuals can yield incredible outcomes. I'm very blessed to have an extraordinarily talented team at Alta Fox.

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**G&D:**

Do you have any advice for young people looking to become better investors? What are the things that you did that you think really accelerated your learning curve?

**CH:**

I would read everything Joel Greenblatt has ever put out. I'd read everything that Peter Lynch has ever put out. I'd read the old Warren Buffet partnership letters as well as all of the Berkshire Hathaway annual reports. Read everything that investors with exceptional long-term track records of alpha and outperformance have put out there. And try and really understand how those principles resonate with you. You'll take the best of each of them and weave them in with your own personality and style.

In addition to reading, I think it's important to be a practitioner. Start a small personal account. Start investing on your own. If you can't do that, start a virtual account, but take the positions seriously, manage it as if you are managing a fund. Get on the quarterly conference calls, have a model that you compare your own expectations versus reality and sort of recognize what you're good at and what you're not, and make mistakes over time. There's no substitute for that. I think you've got to read everything and develop a really good baseline. Once you get a good baseline, you need to start really practicing and developing models and get out of the theoretical world into the practical world. From there, I think you'll learn with every investment you make or pass on.

**G&D:**

You mentioned first principles a few times and we were wondering if you could talk a little bit more about how you incorporate first principles into your process and your thinking. Additionally, could you provide some advice for students on how to develop mental frameworks around first principles?

**CH:**

I'm a big believer in having clear outlines. Anytime I wrote a paper, I had a really detailed outline going from the first thesis to the sub bullets to the next. I think it's important to develop an outline, a detailed framework for how you hope to outperform in the markets. And that should be a living, breathing document that changes over time and incorporates all your experiences and your learnings. I started with one when I was in high school and it wasn't that good, but it got better every single year. It is still something that I think about, analyze, and tweak. When I think about my role at Alta Fox and how to position the firm for long-term outperformance and where we should be investing our resources, the many iterations from that first document are still highly relevant.

I think it's really starting from there. Don't have any preconceptions about how you should invest. Go look at who has succeeded in the past and how they succeeded. What lessons are still relevant today? Who is the most forward thinking today? What can you learn from them? What strengths or weaknesses do you have that you can bring to the table? So, it's really starting with a blank sheet of paper and saying, how do I hope to outperform? Then, iterating on that over time based on your practical experiences and implementing that in a systematic, scalable, and repeatable investment process.

> ***"I think it's important to develop an outline, a detailed framework for how you hope to outperform in the markets. And that should be a living, breathing document that changes over time and incorporates all your experiences and your learnings."***

**G&D:**

There's this ongoing debate in the investment community, whether it's better to be a generalist

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## Connor Haley, Alta Fox Capital Management

or whether it's better to be a very focused specialist. Depending on who you talk to, they'll have very different opinions. What is your take on that debate?

**CH:**

I don't think it's black or white. There are merits to both. I think either can be successful and I think it would be wrong to come to any other conclusion because there are obviously numerous examples of success in both camps. I think it also varies by sector. There are some sectors that lend themselves to specialization more so than others. I think if you're a generalist, you need to really think about how you can maximize the value of being a generalist by having a really systematic process to compare the relative investment merits across very different industries and geographies. If you develop that really clear approach, you can consistently put yourself in interesting positions. You can be successful in either camp. However, I think the issue that generalists sometimes run into is when they don't have a defined process to make sure they're maximizing their return on time by focusing on really interesting things that are likely to be mispriced by the market in a variety of industries.

**G&D:**

Last question before we let you go. What do you like to do for fun when you're not investing?

**CH:**

I have an 18-month-old daughter who takes up a lot of my extraneous time, but beyond that, I love to compete in pretty much anything. Strategy games, sports, video games, ping pong. I'm currently the Alta Fox ping pong champion. I play something called Bughouse, which is like a 2v2 fast-paced chess variant, which is very niche but fun. On the sports side, I enjoy golf and pick-up basketball. Video games, I enjoy playing Apex Legends with friends. It's a fun way to stay in touch with friends, but also has skill, strategy, and teamwork elements. I'm usually game for any type of competition, and that's certainly a consistent theme at Alta Fox.

**G&D:**

Thanks Connor, this was great.

**CH:**

Thanks for having me.

# Christopher Bloomstran, Semper Augustus

**Christopher Bloomstran, Semper Augustus**

**Christopher P. Bloomstran, CFA, is the President and CIO of Semper Augustus Investments Group LLC. Chris has three decades of professional investment experience with a disciplined, value-driven approach to fundamental equity and industry research. Semper Augustus manages concentrated equity portfolios of well-run, well-capitalized businesses with share prices trading below conservative appraisals of intrinsic value.**

**Prior to forming Semper Augustus in 1998, Chris was a VP and Portfolio Manager at UMB Investment Advisors where he managed the Trust Investment offices in St. Louis and Denver and the Scout Balanced Fund from the fund's inception until he left to found Semper Augustus. Chris received his Bachelor of Science in Finance from the University of Colorado at Boulder, where he also played football. He served as President of the Board of Directors for the CFA Society of St. Louis from 2006-2007 and as a Director on the Board from 2001 to 2021. He has also served on various not-for-profit boards in St. Louis where resides with this family.**

***Editor's Note: This interview took place on October 28th, 2022.***

**Graham & Doddsville (G&D):**

Could you walk us through your background and how you first got interested in investing?

**Christopher Bloomstran (CB):**

I was going to be a mechanical engineer. Lots of my family were engineers of sorts, mechanical and petroleum, and I was going to mesh engineering with football. I was a football player in college and never enjoyed the engineering classes. I'd taken a business class in high school that had the students track things like the DOW and the S&P and the price of gold and interest rates and all the big stocks like Coca-Cola and IBM. I found myself looking at the financial pages and back then you had all the daily changes in stock prices listed in the local newspaper. As a kid I was always as fascinated with the stock tables as I was the baseball statistics and other sports lines. I found myself reading the Wall Street Journal in the engineering school library and ultimately moved next door to the business school where things seemed more interesting.

When the football career ended with a broken foot and knee surgeries in my junior year I saw the light and the wisdom of applying myself more in the classroom. Grades always came easily but I was an effort minimalist in the classroom. Back then the finance curriculum was all academic. It was very Chicago school efficient market hypothesis. You had finance classes, but they were all taught from the corporate finance side. If you were doing DCFs, they were all project related. There was no investing angle. You had nobody breaking down financial statements. Your accounting classes were cost accounting and financial statement prep, not use. None of it applied to how to analyze or value a business, how to invest and allocate capital. I came to that on my own and was reading all the investing books that I could find and just fell in love with investing. I knew I wanted to make money by investing. I was counting cards in blackjack so thought with a system you could probably have an advantage in the stock market like you can at the blackjack table. Only later did I come to appreciate how much of a casino the market is to speculators or the uninitiated but how it's not at all for investors.

Investors Business Daily's founder, Bill O'Neal, had this CANSLIM system which was an acronym that basically meant buy stocks when earnings are breaking out, when sales are breaking out, when the stock is breaking out. It's a very momentum-based

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application. And so I was tracking and charting all these quarterly earnings numbers and sales earnings numbers and overlaying it with technical analysis doing candlestick charting, none of which had to do with actually understanding or valuing a business. I got to the point where I thought I knew what I was doing. I had some money saved up from college summer jobs, high school jobs and some scholarship money and wound up putting all my money in on a stock on a tip in an article I'd read in the Heard on the Street column of the Journal, a Norwegian very large crude carrier business that was essentially a self-liquidating structure.

The company had very old vessels that were going to run for a few years, distribute all the cash flow to the shareholders and then scrap the ships at the end for whatever they could get, all at a profit of course. It was going to wind down and everybody was going to get rich. Well, it didn't work out that way, and six months or so after I bought the thing, it was bankrupt. And I thought, geez, this is a really bad hobby - you put all your money in something and it goes to zero. You're going to need to figure out what happened, or you need to find a better hobby, so I wrote over to Norway to get the financial statements. It hadn't dawned on me to do that before investing. I didn't really know what I was doing, but you could see with declining cash flows and just lousy assets and depreciation charges didn't match the life of the ships. I learned right there to read the financial statements before you invest!

The thing was so levered. It couldn't withstand any kind of an economic downturn and was going to go to zero regardless.

So that kind of lit my fire to figure out how to read financial statements, which I started doing in earnest, all the time. I wound up writing up a business idea involving commercial paper for an entrepreneurship class the final semester of my senior year. Chrysler was being downgraded again and with a recent SEC ruling 2a-7 which limited money market funds to owning no more than 5% of their assets in less than top rated paper, Chrysler Finance was essentially being booted from issuing commercial paper. I theorized they could co-issue with top rated issuers and pick up the lines of credit cost for those guys, lowering their cost of issuance and also allowing Chrysler continued access at a cheaper cost than bank lines. The project evolved and ultimately had Jerry York at Chrysler on board. We ultimately couldn't get any banks to do the lines or letter of credit. However, I'd met some bankers in Kansas City and the head of the bank said, "We don't do anything in commercial paper, but we think you're a smart kid. If you ever wanted a job, let me know." And I said, well, I really want to manage money. At that point I'd signed up for CFA Level 1 exam, and I thought that the coolest thing in the world would be to run a mutual fund. When the commercial paper venture stalled I called back the CEO of the bank, Crosby Kemper, who said, "let me put you on our investment operation of the trust company and if you work out we'll get you a fund within a couple of years."

Which they did. I was running one of the mutual funds and working with pension systems in the state and all kinds of wealthy families. It was great and a great learning experience. Got to wear a lot of different hats. Learned about trust law, trust tax, employee benefits, 401k design, profit sharing, defined benefit design, a lot of things that wouldn't have interested me as a young, very wet behind the ear investor, but turned out to be a great experience. They gave a young investor a lot of authority, or rope. And I pushed and had assignments delegated to me just because I was energetic and on a learning curve and loved what I was doing.

**G&D:**

You started your firm in late 1998 in the midst of the technology bubble, what are some of the learnings that kind of

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stick with you today in the current market environment?

**CB:**

Well, you've got to seize opportunity when it comes. That's no different in managing an investment portfolio. It's through the lens of opportunity cost that you allocate capital. If you can be rational and understand when the herd has gone off the rails, that's when there's enormous value to be added. You've been trending for several years toward a secular peak. I think 2021 is going to wind up being on par with 1929, the late 1960s and 2000. But these secular tops don't simply emerge overnight. You just don't go from, well, everything's fairly valued to all of a sudden, things are overvalued. You're usually very early to figure it out as the crowd comes in and pushes things to excess, which can be very painful.

Ignoring the macro and the herd most of the time serves you well. But understanding when you're at an inflection point, I think you can do things very opportunistically. I tried to weave the story of our anchor client and what he did at various secular peaks and troughs with what Warren Buffett did at others into my letter this year in a chapter titled "Benign Neglect" that talked about his pivot in 1928, getting out of the market entirely, but a year and a half early, and then getting back in at 1932's lows with what Ben Graham ultimately called net-nets. Then later Warren Buffet closing his partnership to new capital in 1966 and eventually closing down and giving all the money back in 1969. Between those two points, he'd already, in 1965, gotten control of Berkshire Hathaway but bought National Indemnity in 1967. So he had a platform now that had the float derived from premiums and investment reserves to invest and took advantage of the brutal 1970s when the market traded sideways with tremendous volatility until 1982. He had a chance to buy the Washington Post and Gillette and GEICO and General Foods and a bunch of other things at rock bottom prices.

Then in 1998 our client, Bob Smith, and I joined forces and tax efficiently sold very expensive shares at secular high prices and reinvested in undervalued smaller and mid cap businesses at fire-sale prices at the same time Warren Buffett was pivoting away from a heavy concentration in stocks by buying bond-heavy GenRe and using Berkshire's very overvalued shares as currency in the deal. We pivoted from all of those blue chips at 40 times to 50 times earnings, many of whom were no longer earning their cost of capital, into better balance sheets and better businesses. We sold overvalued assets like the GE bought at the low in 1932, which was the core of the portfolio. GE is still down 80% from where we sold it, into things that from a value perspective were really cheap, and that bifurcation in the market fixed itself from 2000 to 2002. There are a lot of parallels today with that period. You are seeing much of the speculative excess and overvaluation beginning to be cleansed from the system.

> *"Ignoring the macro and the herd most of the time serves you well. But understanding when you're at an inflection point, I think you can do things very opportunistically."*

**G&D:**

That was super helpful and maybe this is a good time to step back and just talk about your firm at a high level. Could you tell us a little bit about your investment philosophy and the investible universe that you look at and what your stock selection process is?

**CB:**

We're very eclectic. Having worked in a bank trust environment, we were running a lot of defined benefit money for the big state pension

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systems in Missouri. I got to see the encroachment of the consultant industry which wedged itself between the pension systems and the investors, the money managers, and they carved everything up into style boxes, which have now been carved up further and allocated into more and more asset classes. You didn't have a lot of venture cap, you didn't have a lot of private equity, but now you've gotten myriad asset classes on the efficient frontier.

When we started the firm, I don't want to get pigeonholed into being a small cap value manager or midcap or whatever. You really need the flexibility to go buy things where they make sense. We do get pigeonholed as a value investor. But we love growth as much as anybody but recognize it as only part of the valuation equation. In our world, price is the paramount driver of what we do. We approach investing with a dual margin of safety, which is business quality and the price you pay for that business quality, which kind of goes without saying, right? That's what you guys do at Columbia. Without intent, we've always run a very concentrated portfolio and that's an evolution of position sizing.

You don't get that many good ideas. We've never had more than 30 stocks in the portfolio at any given time. Again, not by design, but on average, I'd say over the 24 years that we've run Semper and my 30 plus years as an investor, I'm only getting two or three, four names that are worth bringing into the portfolio on average in a given year. Brand new names. Typically, when I bring something in, it's offsetting something that's fully gone out that's been sold completely or acquired, which happens a fair amount.

***"You really need the flexibility to go buy things where they make sense. We do get pigeonholed as a value investor. But we love growth as much as anybody but recognize it as only part of the valuation equation. In our world, price is the paramount driver of what we do."***

We run a very low turnover portfolio. 15% on average over time, but the majority of trading is not bringing in the new name. If we bring in two new names at position sizes of 2% or 3% a year each, that's 4% to 6% of capital. The majority of trading, maybe 10% or more of the portfolio value per year is among existing holdings. Some years it's a lot more, some a lot less, but it's shifting capital around the companies in the portfolio opportunistically for valuation reasons where a lot of value is added.

I'm of a mind that if you assess the profitability of the companies that you own properly, you should earn the earnings yield of the companies. In a classic Graham & Dodd sense, if you're buying dollar bills for some fraction of a dollar, if you're paying 66 cents on the dollar, you've got 50% upside. If you're capable of finding businesses that trade for less than what we'd all call intrinsic value, it can take a bunch of years for that discount to accrete, or sometimes it happens suddenly. I've always said, take the earnings yield and generally add 2% or 3% to it, and you get the expected return over time. I think the best way to look at that dynamic, if you're not a hyperactive trader, is to start with the expectation of earning the earnings yield.

You're going to get the dividend portion of the yield paid to you as cash. In my world, we've got about 18% of our profits today earned by the collection of businesses that we own coming to us as dividends. Meaning I've got 82% of profits that are retained by the companies that we own. And my job, essentially a large part of what we do, is to discern how well the managers of the businesses we own invest retained earnings. If most of profits are retained, a long-term owner will see returns

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gravitate to the underlying return on equity of the business. What kind of opportunities do they have to invest in growth capex, growth R&D, bolt-on acquisitions? Do they understand the value of their share? If they're conducting share purchases, are they being done at intelligent prices or are they simply offsetting dilution? How do they utilize the balance sheet?

Our businesses return almost as much on capital as they do on equity at about 15% as a group. A Costco or a Dollar General that are retaining fair amounts of capital every year and have opportunities to open new stores that generate over 20% returns on those units, that's a brilliant use of capital. A lot of businesses don't have the ability to reinvest. And I've got some companies that pay most of what they earn as dividends because they don't have an opportunity set to reinvest but recognize that. If you can figure that out, it's a huge advantage. Costco only opens 20-25 new warehouses per year. The stock is rarely cheap so as the proportion of retained earnings needed to grow each year dwindles, they pay special dividends when cash builds up. We've earned as much in special dividends since we bought the stock initially as we paid for the shares.

Return on reinvested capital means a lot because not that many places can do it well sustainably and durably. And a lot of times the opportunity sets will change to where now you've hit a point where you can't continue to reinvest, and you either pivot and get into different business lines or you've got to change your capital allocation strategy. And so that's at the core of what we do by recognizing where it's done well and where it's not. Not many public company executives get it. We seek the ones that do.

I also own cyclical businesses, which are a totally different animal. There I've lived long enough, in the energy patch for example, to know that if you're going to buy an asset, you've generally got to sell it at a point. We got a lot of money invested in energy in 2020. I bought refiners for the first time in my career, never thought I would ever buy a refiner, but realized scarcity was developing because of the world's green energy shift. We were closing net refining capacity in Europe and North America, despite population growth and growing demand for much of the products that are refined from crude. During the pandemic, capacity was taken down and some was converted to making renewable diesel, creating shortages in much of the stack. If you believe that Europe and North America are not going to build another refinery, you've got a durable long-term advantage here.

We'll do some merger arb and occasionally special situations come along where you can't help but make money and take no risk doing so. Those are rare but fun. If you don't live in a style box and you just try to go find places that you understand where you can make a bunch of money and take very little risk in doing so, that's our investment philosophy. Just be an aware generalist, I guess, is a decent way to describe it.

> ***"And my job, essentially a large part of what we do, is to discern how well the managers of the businesses we own invest retained earnings. If most of profits are retained, a long-term owner will see returns gravitate to the underlying return on equity of the business."***

**G&D:**

Given that pretty broad mandate, could you talk about your approach to position sizing?

**CB:**

I think about the portfolio in terms of number of bullets and each point of capital

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being a bullet. If something new was coming into the portfolio, I'd bring it in at one bullet, especially early on. If I really liked it, my hope was that it would get cheaper and take it to two. As long as the fundamental case was intact, you wanted to get it cheaper and buy it at three. So if you're starting off buying something at 80 cents on the dollar, I'm going to add to the position at 70 or 60. I've gotten a lot better at getting more capital working early because often you'd get 1% into something only to see it run up to fair value.

In the first two years of the firm, oil got down to 10 bucks. The deep-water drillers were in trouble, nobody was making any money, assets were cold stacked. I spent a couple weeks in Houston and discerned that if the depressed oil price were to last another month, companies like Rowan were going to go out of business. And so having done all that work and knowing the high-quality assets at that time were Transocean and Diamond Offshore, I got 1% of our capital in each and didn't expect that the oil price was going to recover quickly. We wound up tripling our money on each of those positions, but I did it with only 2% of our money, which barely moves the needle. We're a lot better now about getting more money in early. You know the business. You know the valuation. When the two mesh and it's the best idea in front of you, don't screw around with 1%. There's no rule, but I like to at least get at least 2% in general with a new idea.

We're happy investing up to 3% or 4% very quickly, oftentimes in the first week of trading, because now I've spent 30 plus years doing this. And we've got a pretty good sense about the investment universe. There are a few hundred companies that we follow pretty closely. We're obviously going to follow any of the competitors of the businesses that we own. I've got a wish list of companies that we'd always like to buy at certain prices. Oftentimes what happens is you get a March 2020 or you get a 2008-2009 when everything gets cheap. There you've got to figure out if you really want to bring in a wish list company or are you good with what you've got. And more often than not, you're good with what you've got because you've done all the work on the portfolio names and especially the ones you want to own forever.

But we will bring names in during those periods because rarely do you get a chance to buy a Costco or do you get a chance to buy a great business. They're just never on sale. Often it takes an overall market selloff to give you an opportunity to buy a great business. Sometimes an industry is down and priced in as though it's dead forever. You are seeing that with media content today and an expensive scramble to change distribution.

> ***"You know the business. You know the valuation. When the two mesh and it's the best idea in front of you, don't screw around with 1%. There's no rule, but I like to at least get at least 2% in general with a new idea."***

Berkshire sits at the top of the portfolio. It's grown into that a bit. I try to bring clients into Berkshire at 20%, but only when it's cheap. I was buying the heck out of it two and three and four weeks ago. With a lot of new clients here in the last six months, this downturn in Berkshire has given us a chance to get them fully invested. It's still so sufficiently undervalued to intrinsic value and so conservatively run. The earning power is so predictable that I almost look at Berkshire as though it's a fixed income holding that happens to yield 10 to 12% when bought intelligently. The business earns 10 to 12 on equity and trades at a nominal premium to equity. It's got the ability to reinvest. It's got the ability to buy shares back, but only when they're cheap. The capital allocation levers

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inside of Berkshire are as well executed as they are anywhere. Most CEOs ought to pay more attention to what Berkshire does and how they allocate capital. The energy and the railroad bear most of the company's debt, but with those two groups their debt is non-hypothecated to the parent. If you look at how Berkshire termed out its debt, when interest rates were low over the last few years, they're huge beneficiaries of very low-cost financing. Compare that with companies utilizing a lot of commercial paper or floating rate debt, with a lot of paper coming due in the next couple three years. A lot of businesses are going to be in trouble because they're going to have to refinance what was low-cost debt. The way Elon Musk just financed the Twitter deal with $13 billion in high-yield floating rate debt is a disaster. Interest expense, which will grow, is chewing up a quarter of revenues on a business with an EBITDA margin less than 25%. Think about that. If interest rates stay high and inflation stays high, who knows what's going to happen on the inflation front, lots of companies will be in trouble.

I have a lot of names in the portfolio that run between 3% and say 6%. That's where a core of our capital shakes out, I've always tended to have the majority of our capital in our top 10 holdings We've been running 75% in the top 10 on average, plus or minus 5% for a long time. Again, none of that's methodical or by design, it's just the way the process works. You have your two or three percenters outperform for a while, they get to be bigger, or you like something a lot and you get 4% or 5% in it and now all of a sudden it's 15% and you've got to scale it back. We just did that with Olin. The advantage of living in the world of intrinsic value, if you have a good sense of what's undervalued and what's less undervalued and what's working, is the ability to move capital around. What it's allowed us to do is generally keep the overall portfolio valuation at a fairly low price to value regardless of overall market valuation.

Today the portfolio trades at nine times earnings, which is absurd. I've only had a portfolio this cheap on a handful of occasions in the last quarter century. March 2020 and the lows in 2008, 2009. You have a stock market that's rolled over a bit, but at year end 2021 was very expensive. Lots of parallels between end of 2021 and 1999, but an enormous amount of value under the surface. You've got a whole bunch of the market that's still very, very dangerous and expensive, but a lot of companies are really cheap. Any value investor is going to know the term value trap. Part of the key is avoiding the traps, but there a number of gems to be had despite what remains an expensive market.

> ***"The advantage of living in the world of intrinsic value, if you have a good sense of what's undervalued and what's less undervalued and what's working, is the ability to move capital around."***

**G&D:**

You have previously talked about "Learning the lesson of being able to pay a much higher price for something that you bought recently." I think this is a really important lesson, but just one that's really hard to implement. Could you talk a little bit more about this? And then maybe if you could provide an example of where you implemented this.

**CB:**

That's a very important question. It took me a while to get to this because as human beings, we anchor. If you've paid a price for an asset and you can't get it for the same price six months on or 12 months on, more often than not, you're going to want to get it back to that price. Or if you've missed something at a price and you're

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frustrated because you didn't get it bought, you wanted to buy it, you might anchor into that price. I think about Bob Smith's philosophy of benign neglect and how that served him so well, and I also think about my history with Ross Stores.

I've written and talked about Ross, as one of my biggest mistakes. I bought the company in the late 90s period of bifurcation. Paid 10 times earnings for a retailer that I knew very well that had terrific unit economics and a very long runway to open new stores that then were already earning high teens returns at the unit level.

During the bear market that took the S&P down by half, we made two and a half times our money with Ross. The overall portfolio was up when the market was down, but companies like Ross led the charge. All of a sudden, I had this problem of Ross now not trading at 10 times earnings but somewhere in the mid-20s. I was still grounded to classic fundamental price to earnings, price to sales, price to cash flow, dividend yields. And my God, if you've paid 10 times for something and it's now at 25, I've got to get out of this thing and into things that are cheaper, right? So I sold one of the best businesses that I'd ever found knowing it was going to be a much bigger business, knowing that they had the ability to retain capital, knowing that they had a perfect balance sheet that was unencumbered by debt with the exception of capitalizing the operating leases, which we did before it became a mandate here a few years ago under GAAP accounting.

I thought, "Well, it'd be easy to come back and buy it again when it gets cheaper." Well, it never traded again at 10 times. I don't think I was necessarily anchored to 10 times, but I never came back to it. And if you look at the stock chart, it's been one of the best performing stocks in the market since I sold it in 2004. It's more than a 20 plus bagger after I sold it. I've done the math on the dollars not gained after sale relative to the little bit that I made and its painful. Shame on me, but that was an important lesson. With the businesses that I want to own for 20, 30, 40 years, I've gravitated to trimming them in the portfolio but never eliminating them from the portfolio.

I took Nike down to one half of 1%, I've taken Costco way back. But those names exist in the portfolio because I will come back to them opportunistically when they get cheaper. A tiny overvalued position can't kill you.

You've always got to adjust your intrinsic values. I adjust all values quarterly, not that I'm trying to do it with precision, but it forces me to look at what's changed in a quarter, what's the change in the share count. Has capital moved around? Has the balance sheet changed? Working capital changes? Where's our profitability coming from? What do we think the business is supposed to look like a year out, two years, three years out? Were we right or were we wrong? So I'm updating intrinsic values and that allows a calculation of discount or premium to intrinsic value and then apply that discount around the portfolio opportunistically. I've become comfortable paying higher prices for companies over time when the value of the business grows.

***"A tiny overvalued position can't kill you. You've always got to adjust your intrinsic values. I adjust all values quarterly, not that I'm trying to do it with precision, but it forces me to look at what's changed in a quarter, what's the change in the share count. Has capital moved around? Has the balance sheet changed?"***

When you get away from price anchoring and you can really think opportunistically about

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upside, downside valuation, relative strength, position sizing, it all comes together and it becomes very easy to look past the fact that you've sold something, or you made a mistake, "It's a business I still want to own or I was wrong on some fundamental concern," and it makes it easy to buy at any time if we know it well and if the valuation discount gives us some margin of safety.

**G&D:**

Yeah, that makes a lot of sense. And I think even what you said at the end there, buying what you know well and having the competence in that valuation, and you know if the underlying factors change and the valuation change, buying again, I think that's a really important lesson.

Switching gears a little bit, what do you think about the state of stock-based compensation today? And how do you recommend investors think about stock-based compensation when attempting to value high tech or human capital-intensive businesses? And maybe any examples along those lines that you might be able to share.

**CB:**

Silicon Valley learned how to use stock options in the 1980s. Options weren't really a compensation tool prior to that. I've got a history in one of my older letters on the evolution of how stock options and share-based compensation came into being and evolved. In the 80s and 90s option comp was not expensed. It was contentious, I saw the harm in dilution, and eventually Warren Buffett railed against it. Ultimately the accounting profession saw the light that if you're giving away shares, whether valued under Black-Scholes or if you hypothetically run all your expenses, not with cash by paying but by issuing new stock to pay your vendors, there is a cost. So now it's an expensed item.

The number of shares outstanding drove materially higher during the 1990s. The majority of that was Silicon Valley giving away huge percentages of the company each year to the employees and executives. Only later did they get around to masking dilution with repurchases.

Done right, if you're buying your company shares back and you don't have a better use for the capital and the stock is trading at a discount to what we'd all call intrinsic value, that's a great capital tool to be able to shrink your share count accretively.

You're adding value and not taking advantage of anybody or anything, but if you're using the share repurchase to offset the dilution that comes from giving away the company and you have no regard for the price that you're paying, well that's a destruction of value, you might as well take a giant pile of money, put it on a table and light it on fire. And that's what most companies have done over the last decade or two because we've not had an undervalued stock market. If you're the CEO of a public company, you're on the job for four or five years, you have a window to get rich, you may have come out of engineering or marketing, you don't come out of the capital allocation department thinking about how to optimize the balance sheet, what the share is worth, whether you should issue, whether you should buy back.

You're not trained in the art of business valuation so you lean on your bankers to tell you if it’s a good or a bad deal to go into an acquisition, but generally it's going to be a good deal for them because you’re paying them a fee, and it’s a good deal for you because it makes the top line bigger and that makes your compensation bigger. Too often, share based comp is now done through a lens that incentivizes short term thinking. I think far too often, especially in the tech world, Silicon Valley, some of these folks running these businesses still have a venture cap mindset where they're thinking about funding rounds and they don't have a regard for what the share actually represents, which is the ownership of the company by all of your shareholders and what

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the business is worth.

They think about ownership and how easy it was to have been given shares to be the CEO of a private business before it went public. Giving the ship away is just commonplace in that world.

Here we have Facebook blowing up and so...yesterday afternoon, I looked at Facebook's share repurchases over time. I wanted to see how much they've given away and bought back despite little change in the share count over time. It turns out they started buying the stock back at the beginning of 2017. From their first share repurchases through Q3 here this year, you've got $112 billion repurchased against $144 billion in profit. They spent 78% of their profits buying the stock back and 50% of their cash flow from operations. Now, when you get on most companies' calls or you read their adjusted EBITDA disclosures in their press releases or investor decks, not in the Qs, but in the press releases and decks, they'll tell you that share based compensation is not a cash item, so you really ought to ignore it. It makes my blood boil.

Well, Facebook winds up paying something like 250 bucks a share for their average repurchases. The repurchases in 2021 were done at $330 vs. $97 today. That's share based comp done badly with an eye toward getting yourselves rich, no regard for the shareholder and really no regard for the price you were paying for the stock, "Hey, we don't need the money in the business. We're cap light." What do you do with it? Do you pay a dividend? Do you go invent a bunch of stuff with R&D?

***"Done right, if you're buying your company shares back and you don't have a better use for the capital and the stock is trading at a discount to what we'd all call intrinsic value, that's a great capital tool to be able to shrink your share count accretively."***

Very few contemplate how disastrous a repurchase is when it's undertaken at a price that far exceeds the underlying value of the business, and so who knows what the value of Meta or Facebook's going to wind up being. You guys tell me if there's a moat in the business, I've never found the moat, I get durable advertising revenues, but I'm not sure I get the platform.

Now I don't mind a business paying me profit as dividends. I don't like paying taxes on dividends in taxable accounts. But if you don't have a better use for the money, I'd rather you not create a use for it by making bad acquisitions or simply buying the share back even though it's not cheap but because some consultant told you it is returning money to stakeholders. Give me the money. I'll take it and I'll find places that make more sense, right?

**G&D:**

That is a very pertinent example, especially over the past few days here with what's been going on. And I think tying that into the share base compensation is really helpful in terms of informing our readers along the lines of how important capital allocation decisions are. I think that that's really enlightening and really timely right now.

So, I'm going to jump ahead a little bit here, and maybe we could talk about one of the positions here, Paramount Global, and get your thoughts on that name.

**CB:**

Paramount is the old Viacom, which merged with CBS four or five years ago. You have these streaming wars going on and you've got the content guys going over the top with distribution, which Netflix really drove. It's a combination of cord cutting and younger generations leaving traditional consumption of content (cable, free TV, or satellite). We're

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now getting our content now through apps, certainly my kids are. Netflix decided they wanted to compete in the content creation world. Disney realized that no longer was Netflix just a pipe, but a content competitor, and so they said, "Whoa, we're going to pull back all of our content from you guys and take it back inhouse, and we'll create our own apps and we'll go over the top." In the midst of all that, we've got this free for all, because you've got a declining set of eyeballs through traditional cable and a growing amount of expensive to produce content that's looking for whichever outlet winds up winning in terms of how you view your content.

Thus you've had an ongoing nuclear arms race on content spend. I sent a letter to the Disney board a couple years ago suggesting they not necessarily reintroduce their dividend at the pre-pandemic rate because they'd taken on a bunch of debt to finance their own acquisition of all the 21st Century Fox assets. My suggestion was, "Look, you guys make better content than anybody. Out of your movie studios, you put out fewer films per year, but they're all blockbusters." There was a push by other investors that were more activist in nature that were encouraging Disney to spend essentially everything they had, making more and more content so there was more stuff on the Disney+ app, on the Hulu app, and on their ESPN+ app.

My suggestion was, don't necessarily listen to the investment community as what you ought to do with capital and what you ought to do with spending. You guys do a good job and are the pros. You might think about not paying a dividend at a regular rate and paying specials like Costco does, but beyond that, I wouldn't get caught up in the arms race because the last thing you want to do is make a bunch of crap that's going to sit there that nobody's going to watch and diminish the value of the brand.

I equate high level of great content coming out of a Disney or coming out of a Showtime, which is Paramount, to a high-end watch. You might pay $22,000 or $300,000 for a watch, and the company's got a 65%-70% gross margin. You're not paying for the jewelry content or the diamonds. You're paying for the scarcity of the watch and the brand, the creation by hand, the artistry. Well, Showtime's a brand. Your viewers know you're making great shows. If you're Disney, you know your kids' content is great. ESPN is great. Don't diminish the brand by overbuilding. Rolex now might be making too many watches, right? You're starting to see some weakness in the secondary market for watches.

In the world of all this overspending on content, it opened the investment community's eyes to Netflix as to whether they were actually going to get a return on a lot of the ephemeral content that they were putting out. How many series on television, like a Cheers or a Seinfeld, that get into syndication, are going to be seen for decades? Well, if you're spending a mountain of money making a mountain of content, some of it doesn't even get through even a season, and very, very little of it's going to get into the repeat of a second, third, fourth, fifth, where you're going to watch it again and again and again. You're not going to get paid for syndication. Too many shows. Not enough eyeballs and a race to sign up subscribers.

Now you're in a place where a lot of what had been content that came as a byproduct of content... If you think about all of the old Viacom assets managed under Sumner Redstone, well, there was a lot of milking of the cash flow cow. I would say under-investment in some of their properties like MTV and maybe Nick, BET... They didn't maintain the spend on those properties at a high enough level and the brands there got diminished.

But lo and behold, you get this merger with CBS before the pandemic, and I don't know, they were doing $14 billion in revenue, so combined they should have done

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double that. You've now got the business only doing about as much profitability as Viacom was doing alone prior to the purchase of the CBS assets, even though the business size doubled. The profit margin is down from 10% to 5%. You're bringing on a lot of subscribers, but a lot of the value of those subscribers is back-end loaded. You're not going to see really high durable cash flows for a couple, three years.

But the question comes down, who's making the best content, and who survives all of this, and who are we all going to pay for? As we consolidate the apps, you're going to probably have consolidation of the industry. Any business growing customers in a subscription world needs to watch churn. I'm here to say the Paramount movie studio, Showtime, CBS, particularly with CBS Sports, those are trophy assets and you're going to get paid for them. In my world, I've got revenues growing from today's $28 or $29 billion to $33 or $34 billion. You're going to get mid-single-digit growth on top line, you'll get price. But I've got profits which are depressed at a 5% net today. I've got the margin doubling back up to where they were pre-pandemic, so 10 to 12%. You're looking at $3 or $4 billion net income, and as we do the math, and think where everything shakes out in four or five years, we have a market cap today that's 12.5 billion. You capitalize that on $34 billion in revenues at a 10 to 12% margin, you can get to a $50 billion market cap, four times where you are today.

If we're wrong, and we simply muddle along and margins are permanently depressed at current levels, the stock's at eight times earnings. Recapitalize it at double the multiple and contemplate the business throwing off a lot of free cash.

I like the management team. I like the CEO, Bob Bakish. Since the acquisition, net debt has come down from $20 billion to $13 billion. A lot of the free cash has gone to repairing the balance sheet. Wall Street's looking at the current quarter, they're looking at the projection six months out. They're not looking at where this is going to wind up. This looks a lot to me like Nike, which is in the midst of doubling their margins because they're taking more and more of their business direct to consumer through the apps. Investors hate it. Well, they hated Microsoft at 10 times earnings after the stock fell 75% over six or seven years.

I would never buy a business for likely consolidation, but I think these assets belong with the top content producers in some format. It's worth way more than the current bid, but you just don't see it during the period where they're fixing the business, repairing the balance sheet and transitioning the customer base. Now, it could take longer and there may be so much spend that nobody gets a return on forcing the consumer to the app that we think they're going to get, and we could be wrong, but we have a margin of safety with price and a margin of safety with the repair of the balance sheet. And who would've known that two quarters after we came into it, Berkshire would come into it.

> ***"But the question comes down, who's making the best content, and who survives all of this, and who are we all going to pay for? As we consolidate the apps, you're going to probably have consolidation of the industry. Any business growing customers in a subscription world needs to watch churn."***

**G&D:**

Do you have any advice that you would give to younger investors or MBA graduates who want to learn more about value investing?

**CB:**

I get asked all the time,

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what one book should I read that's going to make me a great investor? My answer to that is there's no book. I'd read The Intelligent Investor, no doubt about that. The light went on for me when I read it. But just turn over rock after rock after rock. Read as many Ks and Qs as you can. Continuously add to the arsenal of companies that you know well and get deeper and deeper understandings of businesses. There's no substitute for reading about companies, and I think too many investors don't get to that.

I don't want to do a commercial for Value Line, but one of the most valuable things that I do, and I've done for my entire career, which I started doing in college, and which I didn't realize would become a lifelong discipline, but I get the large cap and the small cap print editions of the Value Line. I've always gotten the hard copies. And I read them every week.

The discipline of looking at the data, you're not reading the Value Line page for their summary of what's going on, but you're looking at 10 to 15 years of figures on a per share basis, on a dollar basis. You're looking at the share count change, you're looking at how returns on equity and capital change over time, current snapshot of working capital. You can see when businesses are increasing leverage, you can summary one-off charges against earnings, you can see where an acquisition was done and how it was financed, spinoffs, all in just a handful of numbers, and in a format that you can orient yourself with in a short period of time. There's no getting around dissecting a 10-Q or a 10-K. It's a great starting point for the research process having all of that that data all on one page. When you get oriented to the format and you condition your brain, you start thinking about where are returns on equity being driven? Is it coming from leverage? Where's my cash going? Is it building up? How are working capital components changing?

***"I'd read The Intelligent Investor, no doubt about that. But just turn over rock after rock after rock. Read as many Ks and Qs as you can. Continuously add to the arsenal of companies that you know well and get deeper and deeper understandings of businesses."***

Whether you do that using the Value Line, or whether you have access to platforms like Bloomberg or FactSet or Sentio, create your own templates where you can look at a lot of years of data and be able to see how the balance sheet, income statement, and cash flow statement figures all interact with each other. You can't invest based on a tear sheet, but when I'm going to go analyze a business and break something down, especially when I was younger, if I didn't really know a business that well and I wanted to get myself oriented in a hurry, I'd spend 5 or 10 minutes with the Value Line page and pages for the industry, then I would read several years' worth of annual reports and Ks and Qs. But I'd start with the tear sheet and then I've got a better long-term sense about where this business has been.

It's allowed me to maintain a universe in my head of a lot of different industries and a lot of different businesses. And then, when you start investing more and more abroad and you don't have the Value Line page, now I can pull up a company on the Bloomberg and I've got some templates where I get 10, 20 years' worth of data and figures, and I know what's important from a high level to be able to generally discern in just a few minutes whether you've got a decent business or a bad business, at least historically, based on how it's evolved. It doesn't tell you how it's going to change over the next five or ten years. That's where your analysis comes in and

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that's where you're going to do the work, when you really get into the business, do all your reading, talk to competitors, talk to managements.

But I would say get a lot more of your daily calendar oriented toward turning over as many rocks as you can and reading about as many companies as you can, and read them in depth. If you're just starting out, for the first ten years of your career, you have to live in the footnotes. I live in the footnotes. But read all the footnotes. All the new accounting pronouncements that are coming. Read the definitions of how revenue recognition takes place, boring, pedestrian stuff. But then when you get a GAAP or an IFRS accounting change, and you've got six or seven companies talking about the same change, and "We're going to implement it now," "We're going to do it in a year," then some of these nuances really start to make sense..

I don't have to read as much boilerplate now, because I've done it for so long, but it was advantageous to me, big time, to have taken my time, not going as fast as I could but spent a lot of time, company by company. And if you're reading a lot of books and listening to a lot of podcasts, nobody's drilling into that kind of minutiae that you can, because it takes time to do it. It takes a lot of time to do it well.

*"But I would say get a lot more of your daily calendar oriented toward turning over as many rocks as you can and reading about as many companies as you can, and read them in depth. If you're just starting out, for the first ten years of your career, you have to live in the footnotes."*

**G&D:**

That's super helpful, and I think our readers will really appreciate that. It's different than what we've heard, but it's a good reinforcement of you've got to put in the work, you've got to learn about the history of companies, in a sense, and really see a lot of pitches. And I like maintaining a universe in your head. I think that's really helpful.

All right, wrapping up here. What do you like to do for fun outside of investing? Any hobbies or passion projects or things you're involved with that you want to enlighten our readers on?

**CB:**

Well, as I mentioned earlier, when I was in college, I got into counting cards. Ed Thorp had a book called Beat the Dealer. There was a guy named Ken Uston that had a book out called Million Dollar Blackjack. Uston was the president of the Pacific Stock Exchange and was banned for counting, skill in a game of chance, but sued and settled for a large undisclosed sum. Counting cards is easy. You have a count system where you're assigning a positive count to your low cards and a negative number to your high cards. And so, two through six could be a plus one, seven through nine would be neutral, they'd be a zero, and your 10 and all your face cards and your aces would be a negative one. You keep a running count. And you could get into a lot of decks by using a divisor. Essentially the way counting works is you want to know when the unplayed deck is rich in high cards, because you don't ever want to hit your hand and bust if the dealer's going to draw a card or cards and bust. You get more money out when the odds are in your favor and change your play based on the count. It's easy but incredibly boring.

I would play a bunch of poker, especially when I was in my 20s and 30s. Then I was trying to play golf once a week, sometimes twice a week when not on the road. I had a regular golf game on Saturdays at my club with all the older guys and had a lot of fun. It was competitive and enjoyed the camaraderie.
When my kids came

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along, I scrapped the golf and poker and basically lived my non-investing life through their lens. My hobby for all those years that the kids were under the roof was them... We just went empty nest this year. So far the silence is deafening. They say you eventually relish it. My baby boy is a freshman in college, my daughter's a senior, so that changed the dynamic.

A reflection on what I learned was important was give your children time. They grow so quickly it's a blur. Think back to when you were 15 or 16 and started driving. How much time did you hang out with your parents? You didn't. So you don't have 18 years with your kids. It's a short window.
I coached a bunch of their sports teams – basketball, softball, baseball. Coaching my son's football teams from 2nd to 8th grade was a joy and privilege. I loved that. If you look at the Semper website – I know some of you read my annual letters, you'll see a window where I did not write a big, long annual letter. It was more important to run the portfolios but to be there for the kids. For a time my priority in January was not writing a big annual letter. I have no regrets about doing that whatsoever. I'd add that as you have a family your friend group will evolve around their school and activities. But professionally it's mission critical to choose your friend group carefully. Find those smarter than you, some older, some younger, but above all else find good people with moral compasses. Outside of kids and family, there is no more fun than having a group of colleagues that you enjoy spending time with, on the phone and getting together. Thirty of us are getting together for three days next week to talk stocks. If you like investing, hang out with great investors. When you meet bad people, unethical or who treat others badly, you should know who they are and get rid of them. Bad people can drag you up. Good ones lift you up.

***"But professionally it's mission critical to choose your friend group carefully. Find those smarter than you, some older, some younger, but above all else find good people with moral compasses."***

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