THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

Announcer: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks Over a Beer, hosted by hedge fund veteran and newsletter writer Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street to help you focus on what really matters in the markets. Now, here is your host, Mike Alkin.

Mike Alkin: Welcome. It is Monday February 25th, 2019. I hope you had a good weekend. I must say after 20 ... it's my 25th year of marriage, my wife and I. My lovely wife and I. Our anniversary is in July, we'll be married 25 years. After 25 years I think you feel like you know them. You have a rhythm and you know each other's strengths and weaknesses. My wife did a really ... she got me this weekend. She got me good. In a good way, it was kind of funny. When we built our house, a couple of things that she insisted on and this is some years ago. She said, "I love you, you're my husband and all that stuff but, you're kind of a gross guy in terms of men and their bathroom habits and you're a little messy." She said, "I'm gonna give you your own bathroom." For me and my son. We have our own bathroom. One of them is off the master bedroom. That's where my son and I use that and we just do our stuff. That's our bathroom.

The other thing she said ... there's another room upstairs. She said, "We can turn that into a man cave for you. You can watch your games and do your work." Because what I like to do is if I'm watching a ballgame, I'm reading something. I'm reading the 10K, I'm reading a book, I'm doing something. I'm multitasking. She said, "You have that area. You just chill out, relax, and it's your man cave." Over the years it's just not been decorated to the way I really wanted to. It was just bland. When I say decorate, I pay no attention to this stuff. She's been on me for a little while now. She said, "Why don't you do what you want? Turn it into the colors you want, do whatever you want. I'll get some furnishings and all that stuff." "Yeah, yeah, yeah." One year leads into the next and I just go in there and I watch my game and I read or whatever. But recently, she said, "I really think you should start thinking about what you want to do." This was a few months ago.

I said, "Okay. You know what? You're right." I got to thinking. I'm gonna turn this into a New York Islander man cave. It's going to be that royal blue and orange. I'll paint the walls and I'll get some pictures of the cups. The four cups they won and maybe half the room will be jet green. J-E-T-S, jet green and I'll have some Joe Namath stuff. Now, keep in mind, I have some stuff downstairs where I go to, but this is more upstairs. But she said, "Do what you will." Last week she said, "Have you ever decided on what you want to do?" I said, "Yeah, actually I have. I'm gonna turned it into an Islander and Jet man cave. It's gonna be half Islander colors and half jet green. She said, "You're joking?" I said, "No, why?" She said, "You can't have those colors around the house. That's fine where nobody can see it, we have guests or something and that's ridiculous." I said, "No, we're gonna go with that."

She didn't give me a hard time. Normally I could tell but, she just dropped it. I thought, "All right fine. I'll just start to do that." Then during the week, I had said, "Hey listen, I think I'm just gonna get going on this stuff." This was about maybe a week and a half ago or so. I said, "I'm gonna get going on getting this stuff. I'm gonna order some stuff and just paint." She's like, "Oh, great." Sure enough, Saturday she was gone in the morning and she had disappeared for a few hours. My daughter said, "Yeah, Mommy went shopping." I said, "Okay." She comes home and she has a big area rug with her and I bunch of pillows. She comes in, my son and I go up and help. We bring stuff in and next thing I know, in my man cave, she's putting out their area rug. It was a [foo-foo 00:05:35] area rug. I said, "What is that?" She said, "Oh, I thought it would look nice in here." I said, "I don't follow."

She said, "No, I thought that it would be a nice touch." I said, "How does a ..." Persian or a Persian rug they call them I think. I said, "How does that fit with the Jets?" She said, "I don't know but it might look nice." My daughter then comes in and she starts talking and I think it was a tag team actually because she said, "Oh Dad, that's kind of a nice rug." I said, "Come on, but I'm gonna paint it Islander blue and orange." She said, "You can't." I said, "What about jet green?" She said, "You can't do that." Next thing you know, she happened to have paint from ... we painted my daughter's room and next thing you know, within 30 minutes it happened. I'm all of a sudden lifting up the carpet in the room and when we built the house, the beautiful wood floors were finished but, for some reason she had put a carpet in that man cave. Next thing you know she's suggesting that I just look to see underneath the carpet.

Next thing you know I'm pulling up the whole carpet. Next thing you know my son's bringing up the paint and all of a sudden I have rollers and everything ready to go. All of a sudden, within the course of one hour, my entire man cave life changed. It went from Islanders royal blue and orange and jet green, to a navy walls all over it with a ... with the carpet pulled up with the nice wood floors, and now an area rug. The couch happens to be coming too, the nicer one. My man cave that I was so excited about is now an extra sitting room for the family and that was my weekend. I spent pulling up carpets, painting. She knows I like to do that stuff. I enjoy that. That's cathartic. I didn't realize that I got played. It was so smooth because she realized, if she went at me on the Islanders and stuff, I'd probably ... and I normally don't but my Islanders and Jets, I might dig in a little bit.

But she was so good and so smooth and I tipped my cap to her and I told her that. She smiled and that was her plan and here we go. We have a new ... I can't call it a man cave though. I've got to take my sign down that says Mike's man cave when you walk in. Anyway, last night we watched the Oscars at a neighbor's house. I can't stand the Oscars but, they had a little get together. An Oscars party and a dinner. A barbecue and brought some stuff in. I can't handle them. I like movies, I appreciate the craft. Really, I can't act. I like all of that stuff. I can't watch people in the self-adoration and this holier than now, and my God we're so special.

I suggested to people last night, I want to have a neighborhood Oscars and I want us all who go to work every day for a living and all who try, and perfect our craft and who are good at it to have an awards dinner for ourselves, so that we can all stand up and make statements and celebrate ourselves just like every other person who gets up in the morning and gets into the car or goes to work and puts in a hard day's work. Do that because it annoys the crap out of me. Call me grouchy, call me grumpy, call me a killjoy, but enough. Just stop. I know it's history and it's the big screen and all that stuff but, I can't even watch it. Instead, I just sit there and take cheap shots and poke fun all night. I got few chuckles. That was that.

Friday, I don't know if you saw but Kraft Heinz, the stock was down 28% or so. Think you know their brands. Kool-Aid, Jell-O, Oscar Mayer. It's Kraft. It's Kraft Heinz. I shouldn't have to list the brands. Turns out they reported the quarter, sales grew a little bit. Missed the estimate six times in the last eight quarters. Organic sale is up two and quarter percent. Earnings fell seven percent. EBITDA fell 14%, missed the estimates for the seventh time in the last nine quarters. But that wasn't why the stock went down 27%. Stocks' down 27% because they reported a 12.6 billion dollar net loss for the quarter including a whopping 15.4 billion dollar write down. Primarily related to the Kraft and the Oscar Mayer brands.

Consumer packaged goods. If you go on the internet, you'll see a talk I gave in January of 2018, where I talked about consumer packaged goods getting crushed. Where I think they will get crushed because of changing consumer preferences. Consumers today, they're not buying sugary foods. They're not buying processed foods. Of course, some are when you put up those kind of sales, but the trend is clearly in the healthy, natural, organic direction. There's just no mistaking it. That trend has been going on for a while, that trend is not going to change, and it's important as an investor that you recognize that. Because a lot of times, like for instance, Warren Buffett's involved in Kraft Heinz. As is the private equity group 3G, which is also a major investor in Anheuser-Busch. The playbook has been with these consumer products companies to cost cut. The problem they face is a volume game.

If you are a monster company and you've merged and bought other brands, and the reason they do that is, because over a period of time, as these trends that I'm talking about, no sugar, less less-healthy food and more towards local, organic, smaller, more regional brands. More things that are local. That's been a ground swell that's taking place for a while. It didn't just happen, it's been going on. The millennials don't buy what their parents bought, it's just the opposite, but it takes time. Through the playbook for 3G and for these big other ... they're an investor in these brands, but these brands, the playbook has been as this is going on, to cost cut. Because what they really have been doing is your volumes when you're seeding share to competitors and new entrants, your volumes will start to suffer. What they've been able to do because these companies have so much footage in the stores, so much shelf space, that they've been able to take price. They have leverage. Big companies have leverage over their customers.

Their customers being grocery stores, the Targets, the Walmarts. What they've been able to do is take pricing because they're not selling more of the stuff they have. How do you create revenue? By volume or price. If volume is declining a little bit, you've got to take your pricing higher. The funny thing about that is you would rather have a point of price. All things being equal, one percentage point growth in price means more to your operating profit. It's all things being equal than a percentage point in volume. If you think about it, the reason for that is if I'm selling another percentage point in volume, I've got to buy the raw materials, I've got to make it, I've got to ship it. I've got to send it to the store. There's a lot of stuff involved. There's fluctuating raw material costs, labor costs. If you're taking a point of price, that's having your sales team negotiate with them and with your customer and the price goes up.

Your margin should be much more meaningful on a point in price. That works for a while but then the volume starts to decline and decline. You see it across the board. Volume struggling, pricing going higher. At a certain point you price yourself out of the market because there's these tiers and what you're seeing is there's private label brands that come in. This isn't like 30 years ago where the generics were the yellow and black packaged goods in the generics aisle saying, "Hello, flashing lights. You want the cheap stuff, here it is." Store brands are competing with them, and the other brands are competing with them. The different, organic, local, all that stuff. If you're selling sugary stuff, if you're selling snacky stuff, you've got a challenge.

Think about beer. Think about 15 years ago when you went to a barbecue. You had Bud, Miller Light, whatever you had. Bud Light. Today, I'm pretty sure you don't see that. You see the craft beers. Now, that's become saturated too but, when your Budweiser and your Bud brand has been down for 20 years plus in a row and Bud Light is struggling and Miller Light. Same thing with those brands. They're struggling, and they're struggling to the more hip, local, cool brands. Again, there's only so much price you can take. But, these companies now are massive enterprises. What do you do when you can't take your price higher because you have tiers? You have your base level, your mid-tier and then your premium. If you can keep a 25, 30% gap in that range that's great, but then, when volume starts suffering, you gotta keep taking more price. It just gets out of whack and that makes it challenging.

What these companies did is they went on massive cost-cutting sprees. All these major consumer packaged goods companies. They have programs. They come out, and they march out a new cost-cutting program, and they call it project X. They come up with these great names, and they have sales meetings and rally the team around it and everyone gets excited. Then they go out and have an analyst day, and they tell investors, "Here's what we're doing. Here's all the cost cutting and here's how the margins are gonna improve. We're getting back to purchasing and do better purchasing and better more operational efficiency." It's a consultant's dream because they bring the consultants in, and an army of consultants tell them how to get better, and they get very excited. Then the Wall Street analysts say, "We just came back from the analyst day, and we can see a pathway to steady EBITDA growth. Because of project, we're getting better."

Sure enough, everyone jumps on board and there you have it. That too, runs its course because you can't cost cut your way to prosperity. What I'm talking here, this has been going on for a decade. We have the initial, the volume hiccups. Taken by pricing and then pricing hits the ceiling. Then you get the cost cuts but, sooner or later you have your come-to-Jesus-moment where the rubber hits the road. Where you don't have any more cost cuts, you can't take anymore pricing power, and now you gotta rely on the power of your brands, or you could go out and buy another company. The problem with that for many of these consumer goods companies is the challenge they'd faced is because they didn't have any of this stuff. They didn't have the revenue. Natural, organic revenue growth. They cost cut their way to the extent that they could. But then because the Fed degrades down to nothing for a long time and many of these companies, the general nature of them is cash-generative machines for decades, and unlevered balance sheets, meaning not a lot of debt.

What did they do? How else can you juice your earnings? Pricing. Check, did that. Cost cutting. Check, did that. Aha, we got good balance sheets. Let's go out and borrow. Let's borrow money at really low interest rates. Thank you Federal Reserve. With that, we're going to add debt to our balance sheets, but we're gonna go buy back stock. When we buy back stock and reduce the share count, all things being equal, we'll get an actual lift to earnings. The evolution of this has been make up for volume with pricing, tapped out. Make up for when pricing taps out, and it starts to go the other way, you've got to do cost cutting. When cost cutting goes away, you buy back your stock. You know what happens when you buy back a lot of stock over a period of time with many of these companies? You add a lot of debt to your balance sheet.

Eventually you're gonna pay the piper. When you add a fair amount of debt to your balance sheet, your leverage ratio goes up. Your net debt to EBITDA. Just think of it, rather than get technical if you don't know what that is, it's how much debt do you have? Take all your total short-term, long-term debt, back out your cash. How much debt do you have? For EBITDA let's substitute cashflow. When you start getting into three and half, four times, you're starting to be what's called levered. Then you want to look at your interest ratios. Can you cover that? Yeah, most of these companies can but, the point is they trade at very rich multiples and have. Why? Because, a lot of these stocks are considered safety stocks. They're considered stocks you go to when the market is uncertain, when you're not sure about where the market is. Let me go buy me a packaged good company. I need some equity exposure. They're stable, they're good, they're fantastic. They're cash generative machines.

I talk a lot about things that are hiding in plain sight and how the narrative of industries and groups catches on and continues and gets stuck in people's psyche. Professional investors have playbooks. Mental playbooks. Where did they rotate into at certain times? Individual investors, especially a little bit those who are little bit older or older. They think of brands that they knew, and they grew up with. Good companies, solid companies and they'll own the stock. But changes happen. Things occur, and they don't happen overnight. These are behemoth companies. Shifts in consumer preferences, they've become really apparent because they've been happening for a long time. Then you wake up one day, and you get a 15 billion dollar write-off.

[inaudible 00:23:07] in this sector, Warren Buffett, huge shareholder of Kraft Heinz. World's greatest investor. A couple weeks ago one of his other big holdings, Coke, got hammered. Same thing, people really aren't drinking as much Coke now. Coke has other brands and stuff but, the core products are struggling. Investors tend to rely upon the past. Changes are happening underneath the surface that don't always get noticed because of financial engineering. Add to the mix when a guy like Warren Buffett's involved, my God for 20 years maybe longer you've had a cottage industry of fund managers who like to emulate Warren Buffett. Wouldn't we all? Genius talent. The thing is when Buffett was younger and Buffett didn't have as much capital, he had some monstrous returns. He's buying stressed companies, tremendous deal maker. Unbelievable and then, as you start managing hundreds of billions of dollars, the opportunity set shrinks dramatically.

That beaten up, left-for-dead industry or company, you all of a sudden can't buy because it's too small. Now you're buying these big behemoths. You take Buffett, drinks his Cherry Cokes and likes his consumer-packaged goods companies and absolutely, and for decades that worked. But things are changing. Consumer preferences are changing. But this cottage industry of fund managers ... I say cottage industry because every year Berkshire Hathaway has its annual meeting and people descend on Omaha.

15000 people fill the arena and he and Charlie Munger stand up there, and they're brilliant. Their investment principles and their way they go about life. Treat people fairly, you want honest people running your company. All that stuff is phenomenal. In the last 20 years if you read annual letters from fund managers, you see so many of them taking the sayings of Buffett and applying them. These are the rules we live by. There's so many books written about them. There's one Warren Buffett. If it was that easy, then all you had to do was be one of the 15000 people who would go there and read his books, everyone would do it.

It leads me to this whole thing of narratives and how they get formed and how they get shaped. Consumer products companies are great companies. They're cashflow machines. When the market's getting bumpy, let's go buy a consumer product's company. Good dividend yield. Fund manager. It worked for Buffett. He's really smart, he's great. Let's live by those principles. There's one Warren Buffett and Charlie Munger. My point is, is individual investors don't get sucked into the narrative. You've been hearing me say for a year now, "Know what you own." Don't own something because someone else owns it. You don't know why they own it. Earlier last year we were short Budweiser in my newsletter. Budweiser and Kraft and Goodyear Tire. Consumer products companies that were struggling. Goodyear more tied to the autos cycle but, Budweiser and Kellogg, for these same reasons. But know what you own. You have to know what you own. Don't own it because someone else does.

Rather than listening to this podcast or any other podcast or CNBC and Bloomberg, hoping for investment ideas, what I think is, would behoove you is to listen to these podcasts to learn how to become a better investor. To beef up your investment toolbox. What are the things ... take the lessons that people are teaching you? Not telling you what stock to own because you don't know why they own it. Is the guy on CNBC or Bloomberg, does he run a 30, 50 billion dollar fund that he only has a limited pool he can buy for a 20 billion dollar ... whatever. Just because he likes it, doesn't mean it's right for you. Just because you're familiar with the company by name, or you use their products. The old Peter Lynch thing, "Buy what you know." God, that worked then, it doesn't mean it's gonna work now.

Geez, I like Oscar Mayer bologna. Geez, I love Jell-O. Velveeta cheese, fantastic. Let me go buy it. You just got crushed. Understand whatever you're investing in. Know the history. Where did this company come from? How did it get here? What are the expectations? The expectations are based on what. What's the competitive set? I could go on and on and on and on and I have. I'm not gonna do that now. I think Kraft Heinz is a good example. Just because Warren Buffett owns it, just because it's a really good set of brands ... old brands ... understand how the sausage is being made now. I think it's an important lesson. The YouTube video that I did a year ago where I talk about the autos ... type in on YouTube, Mike Alkin ... I think it's auto crash sector or something like that, and the second half of it has the consumer staple stuff. You can see, and I walk you through the story there.

Anyway, speaking of folks ... thinking about things differently, I'm gonna bring a guest on today who's a hardcore short seller who I've known for ... I don't know, 20 plus years. He looks at the world a little bit differently. He doesn't take things at face value. Let's spend a little time seeing about how somebody who lives on the other side of the world lives. Not the other side of the geographic world, but the other side of I don't think stocks are going up all the time. We're gonna bring in Rob MacArthur. Rob MacArthur, how you doing buddy?

Rob MacArthur: Good morning.

Mike Alkin: Rob, I was just talking before I brought you on here. I was talking about the Kraft Heinz blowup on Friday and how who would have thought? But, if you take a different approach to the narrative and you do your work, there are certain things you could find. I wasn't sure of Kraft Heinz, I was sure of some other stuff earlier in the year on this stuff in the consumer staples space. It just sparks the whole conversation about how to do deep dive research and how to think about things a little bit differently from the narrative and folks who are listening, I've known Rob over 20 years. More than 20 years now.

Rob and I met in prior lives where we were both short sellers working on the for-profit education space. Rob has been in for-profit end a couple of times. He's even written a book about it. Rob was on the sell side for a number of years. Meaning he was selling his research to hedge fund. I was at a hedge fund and we would talk to Rob on a regular basis and Rob just lives in the weeds and doesn't believe what Wall Street is telling you.

Rob MacArthur: Never [crosstalk 00:32:17].

Mike Alkin: He doesn't believe what companies are telling you and more often than not, he's a fairly normal guy like we all are, we think. When we talk to people on the outside, and they say, "Oh, I like this and this company." When you've been doing this as long as he and I have, you're like, "That management team is full of shit," or, "this one's full of shit," and after a while, people think, "God, you guys are curmudgeonly bastards. Do you like anything?" That's what you're talking to, short sellers. Cynical, skeptical and you're gonna listen to a real skeptical, cynical guy for the next 45 minutes to an hour. It's not what you think because you hear, let's take Tesla. This isn't a Tesla conversation, but I think you all know that I'm not a fan of Tesla. I am not a fan of Elon Musk. I won't get into it, I've gotten into it a lot. You think that the Tesla bulls will come out and call it FUDD. I even forget that it stands for. Fake, made up stuff and all this from the bad short sellers. Nothing could be further from the truther.

If there weren't short sellers, you would have less market efficiency. They hold to task, the management teams of companies, and they bring out an example. It is Kraft Heinz where there are guys digging deep in the weeds maybe on this one or other companies across the board that one day blow up, and they see this stuff. They question, and they don't take management's word for it. That doesn't mean you're a bad guy, it means you have a different view of the investment set of the opportunity. The board is so tilted in your direction because the scale serves ... 90% of the analysts have buys on stuff and people want to buy stuff. If you're a management team, it's easy to just play into that. Now, the hard part about being a short seller is you get run over most of the time until you don't. The market, a strong market, it's tough. It's tough, but eventually if you've managed the position sizing and you scale into your positions, it's possible to have a good at it.

But, the work of a short seller, and shorts in portfolios have a position. You may not make money on some of your shorts because the market's just going up, or the company had a good quarter a couple of quarters ahead of time. But, if you're sizing it appropriately, there's a great role for it. Rob and I are gonna talk a lot about it but, first I'm gonna ask him to give his background. MacArthur, tell people where you come from, what you do and all that stuff. How you got to where you are.

Rob MacArthur: I have a funny beginning. Certainly didn't go through traditional channels. I do not have a finance degree, I don't have an MBA [crosstalk 00:35:23].

Mike Alkin: That's a good thing.

Rob MacArthur: But I did study a lot of philosophy in college and that has served me very well in terms of developing my own critical thinking skills.

Mike Alkin: By the way, that and a fourth grade math education is what you need to be a good investor.

Rob MacArthur: That'll do it, right?

Mike Alkin: Yeah.

Rob MacArthur: I remember distinctly, my father worked on Wall Street for 25 years. He was at Goldman Sachs and he retired in his mid-50s. I had never shown any interest in the investment business. I was sort of a hippie who was pissed off at the world but then-

Mike Alkin: Yeah, you Connecticut guys, real hippies.

Rob MacArthur: I was. I don't know ... but certainly not the general population. Anyway, I lived in Europe for a while and I came back and I finally said to my dad one day to his dismay, "Hey, can you teach me this Wall Street stuff." He succeeded in giving me lessons in accounting and finance and just about everything. For a couple of months. As I said, he was already retired and I wasn't working at the time. But he was like, "You'll never make it because you don't have a decent MBA." I was like, "Well, I think I can work my way around it in some way, in some fashion." I started learning about trading stocks and I had $5000 in a bank account and I started trading with it like a wild man, and doubled it and then lost it all. That was my first lesson in how not to be a reckless wild man. It's not supposed to be a casino and I treated it like it was. I was even borrowing money off of my credit cards at 25% of whatever to buy stocks.

I rolled it up to a pretty good amount but, I really wanted to be in the business. I met a portfolio manager of a 300 million dollar fund and he interviewed me and he was shocked at how many stocks I knew about. One of which was a stock that he owned and I had done some digging on that, and there were a couple things that he was not as aware of as I told him. He said, "You know what? You're great at this. I'm gonna get you a job." He picked up his phone to all of his direct wires to all the brokers on Wall Street and said, "You will give this kid an interview. Otherwise, I'm gonna stop doing business with you." Making this horrific threat to them, I had been trying for months to get one interview and I couldn't and all of a sudden I had six of them lined up. One of the guys really fell in love with me. A very entrepreneurial type of guy.

I worked for him for a couple of months but, let's just say I got a little too entrepreneurial myself because I was calling on the West Coast to all the small hedge funds that were out there. Sometimes within the large mutual fund complexes, they had small 50 million dollar funds or whatever. Apparently the institutional sales department didn't appreciate that because I was "stepping on their toes" and in their territory. I had to turn over the contacts that I had made which were not easy to find at the time and give them my leads or else. I refused and they pretty much fired me for that. I was like, "Okay, I'm not gonna give up my sources that I've been working hard on for the last month or two." I actually went over to your building Mike, 237 Park Avenue, which used to be called the Hedge Fund Hilton-

Mike Alkin: Yep.

Rob MacArthur: To look for leads. I went into the lobby back in the days when you could do that and just wrote down all the names of the [inaudible 00:39:42] on the wall and walk out to the telephone before cell phones and started dialing for dollars and saying, "Hey, I'm right outside. I could be there in 10 minutes if you want." Sometimes hit that eighth or ninth floor and visited 10 funds [inaudible 00:39:59]. I became friendly with this gentleman, Richard Fine, Dick Fine. He became my mentor for the next two or three years. I was at his office on weekends and he was telling me how to do research and how to throw out the bath with the baby water when it came to street research. "Do you believe this guy could write this?" I was like, "Yeah, of course. He's a street analyst." He tore me down as far as having any kind of faith in the street and over time, you can see patterns of how these street analysts could work.

Mike Alkin: Hey Rob. I want you to do that because it's an important point. You say street analyst and again, the listeners here, we have some institutional listeners, but we also have a lot of retail investors trying to learn their whole thing. When Rob's talking about street analysts, he's talking investment bank analyst guys, and I'm not picking on anyone but, JP Morgan, Goldman Sachs, Morgan Stanley, that type of stuff. What Rob's talking about is saying, why listen to this research? Rob, talk about why one might not want to pay attention for their stock recommendations. Not necessarily their industry overviews or their company breakdowns, but in terms of how they're making the sausage in terms of recommending the buy and getting to the earnings. Talk about that.

Rob MacArthur: That leads me to a good point as well. I quickly learned that there was an anomaly within Wall Street that the brokerage firms could recommend their stocks long. Often these companies wanted to maintain or begin an investment banking relationship with those companies. They had to play nice with the companies in order to get paid or get a new relationship, or if they said the wrong thing in their research reports, they might lose the investment banking relationship. There's theoretically a wall between research and investment banking, but nobody believes that, that wall's very thick. Let's put it that way. The analysts almost becomes slaves to the management. The anomaly there is even though the analyst may think the company is a piece of garbage, politically it's incorrect to recognize them as a short. The anomaly is that everybody's drinking the same Kool-Aid, but the real story is that the stock is a short.

When I got into the business, I thought, "Well, here I am trying to be an entrepreneur. Let's find a demand and fill it and see if there are people who want to buy short ideas after I look at the street research and go, "How are they getting these estimates? What are their assumptions?" You could find huge leaps of faith in terms of operating expenses and revenue growth and so forth to make their numbers work. Sometimes they would even go by the guidance of the management for the following year earnings and then reverse back into the operating expenses in revenue. They were severely tainted and they still are. Again, a structural issue in the investment business that's politically driven, not fundamentally driven.

Mike Alkin: Was that hard for you to ... because so much of what you read when you get the research you watch the NBC or Bloomberg, you for a while ... you're being told something and you mentioned earlier like your dad was saying, "You don't have an MBA, you don't have this, you don't have that." You look at the pedigree of so many of these people and it's off the charts.

Rob MacArthur: Yeah.

Mike Alkin: Top business schools, and the smartest guys in the world and they come in and my God, they sound so convincing. If you think about being a short seller, you gotta step back and say, "Okay, this is the machine. The machine being the companies, the machines being the analysts. This is the machine and they say it's going to be so." Where do you even begin? Because when I first started, it was all about ... you knew the guys I was with. A bunch of curmudgeonly old guys and sit around and ... not necessarily old, but at that point older in their career and they'd be like, "This guy's full of shit, that guy's full of shit, this guy's full of shit." You'd be in there and you'd be like, "Holy cow. Everyone's full of shit." But, you start to realize, they're not all full of shit but, even the best of them still spin things. Once you start to get that rhythm, you know what to look for. Talk about how you'd think about it. We go back to our days with the for-profit education space and computer learning centers.

Me, going around to all the schools and posing as a student, and you doing the same and talking to people all over the government and doing that. But yet, the stock going higher and higher and higher and higher, until it didn't. Until, it went bankrupt. When you're looking at a company or an industry, what are the things that you're looking for that make up a checklist or a playbook for you to determine whether or not the story makes sense or not?

Rob MacArthur: I have two general comments on that. One is a story, and I'll tell the story first. In the very beginning of my career, I worked at a large retail brokerage firm. They would have morning meetings where the analyst would come in who was treated like a God and then all the retail brokers would come in and coffee and donuts and blah, blah, blah. The analyst would speak for 15 or 20 minutes about why a particular stock was a buy or whatever. I had already had a lot of those thinking skills innately in my body just because I was a skeptic, and I was an investigative journalist in school at times. I've always had that skeptical mind well before I got there. I couldn't believe that all these stock brokers were taking the analyst as solid gold. We were covering a company called ... what was it? Scoreboard, which was a baseball card, hockey card, the memorabilia type stuff company. To me, I was like, "That makes no sense whatsoever. That doesn't sound like something a public company can survive doing for any period of time."

Mike Alkin: That's a lot of baseball cards you have to sell.

Rob MacArthur: Yeah, they sell baseball cards. At the same time, I'm visiting all these funds and I took a very entrepreneurial approach to these guys when I first met them and they said, "Give us your first idea." I said, "Well, I really don't have one." I said, "Find a demand and fill it, that's what an entrepreneur's supposed to do." I said, "Tell me what you want for a short and I'll go get it and bring it to you. I wrote down the various parameters that they look for and usually a weak balance sheet was right off the top the first one or high level of debt, and so on and so forth. I began to have these different types of views and tried to mush them all together to come up with a list of things to look for in a short, which I did do. I was looking more at financial statement analysis than I was a qualitative aspect of a company because I didn't know anything about baseball card sales or anything like that.

But, another day I walked into ... I probably shouldn't say his name, but I visited a hedge fund manager and he said to me, "I want to thank your analyst at your firm for recommending Scoreboard as a long because I'm short a ton of it and I needed the uptick. The stock to be going up while I execute my short sale position." That was another aha moment where I got hit in the head and I was like, "Here's the professional and here's the retail, and here's the incongruence that's going on here. The hedge fund manager is using high-level thinking and the retail guys are in 10th grade.

Mike Alkin: That's a good point Rob. You're going to be way early. If it's a good short, you're early. You're two quarters, three quarters, four quarters early, sometimes more. Because if it was obvious, it would be priced in and you wouldn't have the opportunity. Really what I've always found is the beginning challenge or the thing you're really wanting to wrap your head around is when does it become obvious? Because, you're seeing something. Like you and I do, is you're looking at the numbers. You're looking at trends that are starting to develop over a period of time so you may start to see margins. Sales growth may be slowing a little bit or, gross margin is starting to slow down on a year over year basis. Or, sales are growing rapidly and margins are going down, you try, and understand why. Or, you're looking down the profit and loss statement. Are they making their bottom line because they're cutting costs that are unreasonable?

You're looking at all these things but really, what people tend to focus on is the headlines and what the numbers are and where the company guided them. Then, all the other stuff that gets lost in the mix, but that doesn't become obvious right away. One of the things you do and it's how I've made my living for a lot of years and how you do, is you ignore all that Wall Street stuff and go out and find the story because you can see it in the numbers, but it doesn't mean anything until you're actually out there talking to people trying to see how that sausage gets made. Talk about the experience that you've had and what you do to actually put the numbers and the story together. Not the story you're being told, but the actual story in the field.

Rob MacArthur: It's interesting. I think a little bit differently than you do I think because I gave up the goat on trying to scale into a momentum stock slowly and still hang around. I got killed in one or two stocks years ago and it tarnished my reputation. I vowed that I wouldn't recommend a stock like that until it had at least one missed quarter. I may be missing the top 10% of the short, but I'd rather make another 40 or 50 by having successive quarters that continue to miss earnings.

Mike Alkin: By the way, I don't short momentum stocks. Most stocks like the crazy ones, you don't want to deal with those. I completely agree with you. You wait until those are done. I'm talking about a typical short where even the ones that miss a quarter can still come back and rally a little bit because they got stuff going on. How do you try, and find your catalyst then?

Rob MacArthur: I'll give you a good example that I'm working on right now and I worked on in the past very successfully. In 2015, I recommended Sam Adams at 215 and then, it had several dips of 30 or 40 points where there were decent trading opportunities to book at least a 20% profit. The stock rallied all the way back on some takeover speculation but, the story is very easy because Sam Adams owns 25% or whatever it was at the time of the craft brew market and there were thousands and thousands of these micro brewers opening up left and right. In 2015 there was 2500-ish. Today there are 7000 and Sam Adams' core product, the Sam Adams beer is going down and has been going down and will never recover.

Mike Alkin: But that's a good example. Use that, because I saw your work back then. Use Sam. Tell people what you did on Sam to be able to get comfort with that.

Rob MacArthur: I love going into the channel and asking. I generated a list of micro brewers across the country. I think my list was 900 of them. I developed a group of survey questions and hoped for the best that I would get some responses. Unfortunately, I didn't get a ton of those responses, but the ones that I got were actually very sophisticated people who were owners of these micro brewers and they could tell me about the channel. I stayed in contact with them since 2015 to see how their businesses have changed. I can talk detail on that, but maybe I should hold back on it.

Mike Alkin: Yeah.

Rob MacArthur: Immediately, the thesis was easy that Sam Adams could be getting killed by the growth of the micro brewers, which they did and continue to be. The stock ultimately went to 135. We wrote a cover down from 213 and we were like, "Let's get away from this for a while because if they come up with a set of new products or something that's good, then we will get killed." Shortly after that, the stock went from 133 to 330 over the next nine months. We thought, "Well, glad we got out of the way of that freight train." But, more recently I've become far more interested in this thing as a short, and they reported the other day ... I'm a big technical chart guy too as you know. If anybody looked at the chart of Sam Adams reported last week, it looked like it was a massive short squeeze. The stock could have gone down 30 if they had terrible earnings and gone up 30 if they had great earnings. Not only that, but 20% of the float is short and it only trades by appointment only. It trades less than 100000 shares a day but almost two million shares are short.

I told clients, I said, "Maybe short just a little in case it blows up, but rather see what kind of picture we get after they report. If it runs the stock way up and we think the fundamentals are bad or going to be bad, then let's think about an entry." Subsequently, it went up like 38 points and it went from ... I don't know, 260 to 310 or something like that. It said 303 today but-

Mike Alkin: You say you put a little bit on because you don't know if ... I actually find when you have some on, you pay more attention to it also when you have a little bit on. Now the stock had a big rally, right? It rallied hard and how do you think about it now?

Rob MacArthur: Sam Adams proper is down and the "non-beer categories" are up, which consist of hardened apple cider. Now we're doing a whole analysis of the competition and the size of the market participants and so on and so forth. In this case it's not that there are 7000 of these micro brewers but, in this one particular product category called the rosé, Pepsi owns one of the best products and Coke owns the other best product. Then, there's a family business that has been doing cider for 100000 years or whatever. They've got 55% of the market already. Sam is gonna grow into that market and people are already talking about it getting saturated. If it works out that the non-beer category in Sam Adams doesn't work, or it doesn't work a year from now or six months from now, the stock will be more than cut in half. Just a quick comment, there are in my mind, very serious things that the management of these companies do in order to make their earnings report.

For example, in the case of Sam Adams, they've got five new products which they should've been marketing the heck out of from last year. Now, we're looking at the growth of this company heading into that market share and really pounding the table on their rosé products, but we're already found that the incumbent competition is substantial. Oh my God, and the operating expenses. In the third quarter, the sales and marketing expense was up 38%. Then, for the fourth quarter, they slashed it and it was down I think like 15% for the quarter while sales were only up 9%. They made their quarter because of lower sales and marketing expenses. To me, if you're promoting five new products, you don't just cut your marketing expenses in order to make the quarter. Sam Adams, years ago, used to give you the sales breakdown by beer versus non-beer. Now they just tell you percentage growth rates or declines, making it almost impossible for you to guess what their revenues are.

Mike Alkin: It's interesting. Not to pick on Sam, but with a lot of companies, what I tend to find is as their challenges increase, the disclosure decreases.

Rob MacArthur: Yeah.

Mike Alkin: Which, makes it more difficult to analyze. But to your point, with any company Rob, when you're going through a growth phase or products launches, typically as an investor, you would expect to see sales and marketing expenses accelerate because the cost to go out and generate the buzz and generate the launch of a product. A company like Sam, one of the things you always run against were these ... good brand. People are well-known, have done a phenomenal job over the years getting to where they have. One of the things from a short perspective is you worry about is takeout risk. How do you think about that? When you're looking at any company that you're short, and sometimes it's just gonna happen. There's always somebody willing to come in and pay a multiple for something sometimes and you just say, "Oops." How do you look through? What's the work you do to get your head around how much risk you have to a company being taken out that you're short?

Rob MacArthur: I've only had one company taken out that I was recommending a short and it was embarrassing because it was an all-cash deal. But it was in the second year of my tenure in the business. I hopefully eliminated that. I think if it's gonna be a good short in the first place, nobody's gonna want to buy it. As you know I was recommending Allegiant for a while. We wrote a cover recently of 105 or something like that. Anyway, I'm not worried that it's gonna be bought out because it's such a badly run company. Who in the right mind would want to buy this? I think everybody who was in the industry would much rather develop their own company and just put Allegiant in bankruptcy but, as the competition grows. The CEOs, just like the CEO of Sam Adams. They're both from Harvard Business School and they both just think nothing about walking over the rules or bending rules in order to make themselves look better.

As Maury Gallagher from Allegiant says, "I'm going back to the good ol' days," or stuff like that. When you could really run your company fraudulently. I don't think a company like Allegiant could be bought out because there are several competitors and he was such an idiot. He fired his top management. Several people within a week and they all went to the competitors who launched a new business getting into the short range markets for an airline. One guy went to a Canadian, ultra-low-cost carrier. Another guy went to Delta and so on. He's created more competition for himself by firing his best guys who were scooped up by the competition. Hopefully nobody in their right mind would think about buying a company like that. That way I have some insulation. A rule of thumb that I use is that what is the multiple of EBITDA and when I got in the business overall, looking at all the stocks, the average EBITDA was probably on the order of 10 to 1. That was considered expensive.

Today though, I think if you look at the average stock, they're all 15, possibly even 20 would be the top tolerance level. Anything beyond that is serious. Sorry, I'm trying to look at some of these numbers at the same time. Not at risk of getting bought out because their equity value is so high. Sam Adams have a 20 times EBITDA evaluation. Even if they were to get bought out at 15 times and still ahead of the game, it would be a take under.

Mike Alkin: I tell you, and I think a lot of that too depends on the industry, the sector and the competitive set. I'll never forget, I think it was my third year in the business. It was a medical device company in the heart sector. We had done just a massive amount of work on it. We were speaking to doctors and we were speaking to them and this company was growing like a weed but, it had very little penetration. It was young and it was in a more mature sector, but it was growing and taking share but from a very small base. But the more doctors we spoke to, the more we realized this product wasn't that great and that it would have a limited life of growth like this. It was trading a ridiculous multiple of sales and they didn't even have cashflow at the time.

We thought, "Okay, it really started to get excited. A young dynamic, according to Wall Street, growth company that was growing like a weed. We were able to speak to the people using this and they said they weren't impressed and it would not continue to grow like a weed. You never know what the next guy's willing to pay for something. But, when you can combine it with fundamentals, that's great." What winds up happening, come in one day and we had done so much work on this and we were convinced that we were gonna miss a quarter. It got taken out at like a 60% premium. 6-0.

Rob MacArthur: Wow.

Mike Alkin: We thought, "You've got to be kidding me." The biggest lesson that I took away from that was the competitors. The market share that they were seeding to these guys was nothing. It didn't really matter. But, the competitors were mature and they were slowing and they had a big multiple too, the big guys. They were willing to pay up because they just needed growth. As you mature in the industry and you look and you say, "Oh wait, yeah. Sure, grow heals. It heals Wall Street's concerns." For me, the takeaway was always, okay yes, I can see this individual company's gonna struggle, but how bad are the big guys struggling? How desperate are they willing to use elevated stock.

This was during ... you're probably talking during the internet bubble when stocks were just elevated. They had goofy multiples, these stocks and they were willing to exchange their stock for something that they could get people excited about. It does become tricky in terms of that front. How much short interest? Folks, by short interest I mean stock has a certain amount of shares that are in a free float that are trading at any one time. The amount of shares short as a percentage of that flow to something a short seller needs to pay attention to. The more shares that are short as a percentage of the float, the more the risk is that if something goes against you as the short seller, that people are gonna go out to try, and cover the short. Very simply the process is you borrow stock you don't own, you sell it in the market and then at some point in the future, you take cash and at some point in the future you have to replace that stock to the broker who lent it to you.

When things go against you and your loss could theoretically be unlimited because there's no ceiling as to how high I stock can go, people get scared and they go out and cover and it causes unnatural buying. For me Rob, as a stock, short interest starts to get into the 10, 12, 15% range. I'm starting to think, "Okay, how many shorts are in here that could cause some risk here if there's some good news for the company?" How do you think about short interest?

Rob MacArthur: Let me prep this by saying that in the last couple of months I've been trying to raise money to start a short fund and one of the things that I have developed over the years is a series of screens on the Bloomberg. I run this different screens of which there are ... I don't know, about 19 or 20 of them. They work in different sets of scenarios. For example, if they miss the quarter and the stock market's going down, and the beta volatility is high, do I want to be there? How many people missed what happened in December because they just couldn't get their hands around shorting the stock without being solid with the fundamentals? By the time you do that, you've missed it, sorry. You've got to be prepared to be really nimble.

One of mine is high, short-interest ratio. I will go there and I will try to find companies that ... let me see. My parameters are now is, two billion to 15 billion dollar market cap and short interest ratio greater than 12. 12 is just a number that I massaged in there to generate a list. The list could be quite small. I want 40 or 50 hits to pick out. I don't do natural resources for biotech, so I kicked those out of the screen. But, you never know. It might come up with something that's really good to look at. There could be a short and then, the next question becomes, do I want to short a stock that is heavily shorted? Or, is the reason why it's heavily shorted really good and I should just get in even if the borrow's hard or the short interest is-

Mike Alkin: Oh, this is going to lead exactly to my next point. You just said something really interesting. Is the heavily shorted stock something that's really good? When you and I started in this business a long time ago, there were not a lot of hedge funds. When the stock had a lot of short interest, that means were was some really smart guys doing their homework and making a bet that the stock was going to go down. Fast forward all these years and the number of hedge funds, when you and I started, there were probably 500? I don't know, 1000 maybe?

Rob MacArthur: Yeah.

Mike Alkin: Now there's 10000. With that, you didn't all of a sudden groom 20, 30, 40, 50000 really skilled short sellers because it's a hard gig. There's a lot of hedge funds that just put on short exposure because they know the institutional investors placing capital with them want to know that they're active short sellers. Not just shorting as a market hedge, but shorting to get what you would call alpha, which would be out-performance on the short side. Now, you and I also know that a lot of that is window dressing.

What a lot of guys do is they ... most people are wired to want to own stocks. They go out and subscribe to some accounting services or however they come up with their ideas, but they're not doing the deep dive work on it. You've seen I'm sure hundreds of guys and I could point to a two where the shorts are there because they need to be. Not because that's their vocation and what they want to do.

With that, the advent of the idea dinner where in big cities, guys get together and talk about ideas that they like and the short idea. Next thing you know, 10 guys go to a dinner and they talk about companies and they just share their views and thoughts and next thing you know, it's a network effect. 10 of those people who were at dinner and they talk and they each speak to 20 people throughout the week. Next thing you know the guy who has a ... he has a good short idea, he puts on the portfolio but he's not done any work on it, and it's eight removed from the work that was done on it, but it had a good thesis and he might put it on. When something goes against you, stock beats a quarter and the stock's up 10%, all of a sudden they're out. They're like I don't need this.

Rob MacArthur: Yeah.

Mike Alkin: Right? I've seen it change dramatically over the years. That's why it scares me sometimes, where those really high short interest ones. Because 20 years ago Rob, you know if something had 25% of a float short or 30% of a float short, you'd be like, "Oh, somebody's got something here. You just gotta wait it out a little bit." That game's changed a little bit.

Rob MacArthur: Yeah. If I propose an idea of a 20% I'd be shot.

Mike Alkin: Yeah, exactly. Exactly.

Rob MacArthur: From your previous employer by the way. Back in those days, 15 plus years ago, a 10% short interest ratio was considered high and people really wanted to be there when it was under 10. That ruled out a lot of stocks but, now everybody ... two things on your comment there. First of all, we have this huge proliferation of hedge funds and just not enough people who know how to get short. I run into a lot of that. That's why my business model is not my favorite anymore. Where, at 50, I'm an old guy because they've got these young MBAs who come in from the Ivy League schools and whatever. But they're young. They're 26, 27 years old and they just don't know a lot about short selling. The worst thing you can do is try to re-engineer your long theories and how you play it alongside and just reverse it into a short methodology. That is just the worst thing you can do to yourself.

Mike Alkin: It doesn't work.

Rob MacArthur: I interviewed with a guy and the analyst said, "Well, did you call the management about these account irregularities?" That's the best one. It's like, go, because these are corrupt management. As you know when we did the for-profits, I said to several people, you have to throw out all of the numbers that the University of Phoenix is reporting, because they're made up. No wonder they're so good. I can show 10 ways how they make up their revenue.

Mike Alkin: I'll never forget Rob, this was during the time the second wave of for-profit eds. This was the mid-2000s. Our first wave was the late '90s and folks, what we're talking about is for-profit education schools. The ones that are not traditional schools. What these schools typically did they went out and would try and go after students through a very aggressive internet marketing. Even before the internet with ... the first were in the late '90s, it was more just telephone marketing, and they would go to bus stations and try, and bring people in. With the internet marketing, just get them in and sell them on a dream. First in your family to go to college and they jam them down egregiously expensive programs. Crappy educations, promise job placements, they wouldn't materialize. A lot of kids thought they were getting grants, they were in fact getting loans. It was just a mess.

But one of the things they did by doing that because the return on their marketing dollar was so high, what would happen is it was a Wall Street growth investor's dream because the returns on investing capital would go through the roof. The cash flows were just stunning, but they were BS because they were not providing the education promise and kids were getting left holding the bag with massive amounts of debt. Many of them dropped out. I'll never forget Rob, I was ... I won't say the name but you'd know who they were. I was at a lunch that was set up by somebody who knew I was shorted and they said you should come to lunch with one of these big funds that owns this company. I said, "Okay, the work we had done had been in the field. We were talking to former employees. We were talking to students, we were talking to ... just the core of what this was with the information that we could find that proved that these guys were full of crap.

At this lunch, this pompous, arrogant, large fund manager telling me how stunning the returns on capital were and the cash flow and the growth rates and how many schools these guys were gonna be opening and that you'd be silly to be short something like that. Said to me, "Well, guys like you and me, who are privileged, we can't depreciate the opportunity that these people are getting to go to school." First of all, I come from lower income and I put myself through school. A, don't start there with me. And secondly, had you ... and said, a lot of my points to your point, kept saying about, "Yeah, but if you speak to management," what they'll tell you.

I thought, "Okay, here you are in your ivory tower. You have no effing idea what you're talking about. These kids, who you think are getting a great opportunity, they're the ones getting sold a bill of goods and they're the ones getting hammered. If you really gave a shit about them, you'd go out and talk to them. Instead, you turn around and talk to management who's telling you why things are so good and all the good things they're doing." Sure enough, you know how this ended. The stocks eventually got destroyed. You do run into that. You do run into that ivory tower mentally and this elitist mentality, and it does create opportunities, but it takes a while for that to happen.

Rob MacArthur: I went exactly through the same thing. One of my clients basically asked me if I would take the train with him to Washington DC because there was a for-profit education [inaudible 01:19:18] conference. I got to see Todd Nelson and David [inaudible 01:19:22] or whatever. The guys from ESI and all the managements were there. Before the speeches began, I was standing in a crowd and one of the companies standing right there owned 8% of Corinthian College, which was at about 15 at that point. I said to him, "You don't know what you own."

Mike Alkin: Yep.

Rob MacArthur: He says, "Who are you?" I said, "Never mind who I am. Let me tell you about what you own."

Mike Alkin: Yep.

Rob MacArthur: I started blurting off numbers and he was like a deer in the headlights. I don't think I ever told you this story. We sat down at round tables. I can't remember the guy's name. The former CEO of ITT Education was at my table. One of the guys, he got taken out in handcuffs. All these analysts were from like Fidelity, and they were looking at him like he's a God. I was standing right across from him and as he was talking I said, "How did it feel the day they took you out in handcuffs?"

Mike Alkin:	That's-
Rob MacArthur:	He was like, "Who the hell are you? Why would you say that to me? We had a good company." I said, "You were total fraud. You were the better at it than the other guys."
Mike Alkin:	Yep.
Rob MacArthur:	"You were the worst ones. Come on." Anyway, back to your comment about the dinners and sharing of ideas, in the job function for Alternative Research, my company, I've always had a relatively small number of clients. Maybe four, five, six. I can take on as many as 10. I've got three right now but, they're very large hedge funds. They would think nothing of putting on a 500 million dollar position for a year and a half. I try to hit that sweet spot for them more than trying to be a jack of all trades for everybody. My competition, which is off Wall Street, their problem is that they have too many customers. They've got like 30 customers I think. When they publish a report, everybody wants to get into the short idea at the same time. They knock down the stock 15 or 20% just trying to get into the position. Some of them are hot money and they end up turning around and covering the stock at higher prices or whatever. But, it ends up being like 0% of the float is short to 20 in like a week. I don't think that's a good business model for him, but Mark's been around forever so I can't knock him. But as far as the dinners and sharing ideas, I rarely share and if I do its older existing data, not some of the proprietary stuff that we're working on.
Mike Alkin:	For listeners who are ... it doesn't mean they're gonna go out and short a stock. Before you came on, I talked about Kraft Heinz and it's not a stock you'd expect to be down 28% in a day, but I had given a talk a year ago and it's up on YouTube, about the auto sector and the consumer staples sectors imploding. I laid out the reasons why. If you had to say, okay, you're not gonna want short stock, but if you own stuff, here's what you need to be looking for. What are guys like you or me ... I talk a lot about what I'm looking at, but what is it that triggers these thoughts for you? It's not just valuation. Somebody's feeling comfortable, they own a stock and then all of a sudden a guy like Rob MacArthur comes along and it's like, "Oh, here comes a story." What's your core tenets if you will? Your investment philosophy?
Rob MacArthur:	I have a pattern to what I'm doing.

Mike Alkin: The method to your madness?

Rob MacArthur: The methods of my madness, sure. As I mentioned I developed a whole bunch of proprietary screens. I run those screens ... I play around with them, or I run a different screen to get what I'm looking for. Then, I take ideas from that screen, which might have 25, 30 hits. I'll start to look at the chart and go through some of the Bloomberg metrics and the forward earnings expectations and so on. Then I immediately start reading both the SEC filings, the 10Qs, the 10Ks and I also go through the transcripts for the conference calls for the last year, sometimes more. That gives me a pretty good foundation and I'm very quick to discount an idea as something like a recurring revenue stream is apparently. I just refuse to short companies. Maybe Sirius is a good idea or something but I'm not gonna ever do that. Quant guys are looking at future value of forward cash flows and if they can model that out, they will buy tons of stock regardless of whether it's a fraud or not.

Then I begin to follow it. I look for its competitors, read up on those a little bit. For Allegiant for example, I casually [crosstalk 01:25:44]-

Mike Alkin: What is the Allegiant story for those who don't know?

Rob MacArthur: Allegiant is a discount airline, and the CEO is the same CEO who was in charge of Value Jet. As you recall, Value Jet crashed in the Everglades and kills a whole bunch of people because there was a fire in the rear compartment because some oxygen canisters blew up and kills all these people.

Mike Alkin: Yep, I remember that.

Rob MacArthur: Later, it was exposed that the maintenance for those planes was not very good. The maintenance personnel were not well-trained. When I started looking at Allegiant, there was an article I picked up on the wires I think that a guy who was at Continental Airlines for 30 years, said that he ... he retired and worked at Allegiant for two years. He said, "I fired Allegiant because their maintenance is so dangerous [inaudible 01:27:01]." That's a pretty strong statement. Thereupon, I sought out to find other mechanics. I spoke to five or six of them. One guy said, "Yeah, all of the maintenance records are falsified. A lot of times that work doesn't even get done. Maury doesn't care about safety and so on, and so on."

They had a really old set of airplanes that were beyond their useful life but they put scotch tape and so forth to make these things work again [inaudible 01:27:43]. They have like a hundred emergency landings in an 18-month period. Each one of them was pretty dangerous. One of them had ... an aileron was frozen by rust and it caused the airplane to take off on the runway before they were at the proper speed. That was obviously really difficult. Another one, the tires all exploded when the plane landed. Another one, the pilot declared an emergency landing because the hydraulic fluid was leaking. He landed and they just refilled the hydraulic fuel and went up in the air the next day and the same thing happened. Clearly maintenance was lazy and just didn't want to look for the look.

This went on and on and management's saying, "Okay, we are going to get rid of those planes and buy Airbus A319s and A320s." They tried to raise cash and nobody would take it. Nobody would buy the bonds ... or the equity rather. They had huge amounts of cutbacks to the tune of $500 million per year to buy all these new ... really used, A319, 320s. Since then, he's been telling everybody that there won't be any maintenance issues with those planes. But, I became friendly with a chief negotiator for the pilot's union and he really knows the company and the industry. He said, "There's no way that they're doing all the maintenance on the Airbus planes like they're supposed to be." There's already been a couple of incidents. We shorted it through the transition and bad things are happening already but, we started to recommend it as a cover I think around 112 or something like that, 110.

It had taken several falls and now that they completed the transition, I wanted to wait a quarter to see how far this thing can go down. We started at 170 and it had gone all the way down to like 110 and then back to 170 and then back to 100. There was plenty of opportunity to make good money on this thing.

Mike Alkin: What are you doing now business-wise?

Rob MacArthur: I'm looking to raise the money from either family or a hedge fund or something like that. I think after what happened in December, especially the fund-to-funds because the performance of the hedge funds has been so poor even though there's a lot of them. I think I can provide a lot of value added to [inaudible 01:31:06] individuals and institutions because I think with all the methodologies that I have, I can really manage risk and so forth. I just mentioned the one thing using the screen, but I also look for IPOs that don't behave well. Typically, when an IPO breaks through the price it came public, that means there's something wrong with it and it usually goes down.

Mike Alkin: Yep.

Rob MacArthur: I like doing a lot of balance sheet analysis of companies that have high receivables or inventory, or low cash and lots of debt. I pick from that category and then, there's things like where there's a transition going on in the industry like the Sam Adams has the micro brewer thing. There's a change in the industry and Sam probably can't compete by turning themselves into something else [crosstalk 01:32:09].

Mike Alkin: How many stocks are you typically short at a time?

Rob MacArthur: About three.

Mike Alkin: Yeah? You're highly concentrated?

Rob MacArthur: If I have three ideas and three customers, definitely I'm highly concentrated. Unfortunately, my clients are so big, in several cases north of 10 billion under management, that they can't do a lot of stuff. Nobody could do the Allegiant that I recommended. I had a small hedge fund like 250 million at the time and he made a lot of money in Allegiant, but if you want to short two million shares of it, you're not gonna like it if you have a volatility between a 100 and 180 two times during that period. As you know, I'm more of a trader than a lot of people?

Mike Alkin: Mm-hmm (affirmative).

Rob MacArthur: I don't mind suggesting to my clients even if they're not trading-oriented, take some off right here or back up the truck up here or something like that. I have a lot of different methodologies to look for ideas. The thing is I haven't been really marketing my service because if I raise money or get a job with a hedge fund, then I have to break that contract so I don't want to do that. But, I'm focused on seeing if the family offices or fund-to-funds are interested in being short given what happened in December when pretty much all the hedge funds missed that downward move. I don't think I know very many people who were up. It was up 20% in December, just not there because they can't pull a trigger first and figure out the rest later. You know what I mean?

Mike Alkin: Yep. How do people get ahold of you?

Rob MacArthur: My phone number is 203-244-5174. My email, if you want that, is MacArthur, M-A-C-A-R-T-H-U-R, @altresearch.com.

Mike Alkin: All right man, it was good catching up and talking short selling.

Rob MacArthur: Yeah, I appreciate it. If there's anything else I can do, let's do it.

Mike Alkin: Great man. All right, buddy. Thanks.

Rob MacArthur: Thanks.

Mike Alkin: You just got to listen to a hardcore short seller. Rob's been doing this for a really long time. He has three ideas at a clip. When you consider many portfolios will have 40, 50 stocks, Rob's highly concentrated, does really deep-dive due diligence on his names. Rob's one of other guys that are out there doing stuff like that. That's what you get on the short side where guys are gonna dive deep and take a different view of it and it's not a different view based upon their hunch or an instinct or a gut feel, it's a different view based upon work that they do. I just wanted to bring that to you, let you see what the other side is, how they think about the world. I hope you enjoyed it and next week, I've got a pretty cool guest actually coming on. I'm pretty excited. He's a former pro football player in Canada, wrote a great book, his names Angus Reid. Wrote a great book that caught my attention called, Thank You Coach.

He was a 13-year CFL player with great experience able to translate learnings from a life of professional football and even before what football did for him. But, how he translated it into life and work and management and just great stories. I've gotten to speak with him a few times. Really enjoyed it, really smart guy and he's gonna be on the podcast next week. Hope you have a good week and we'll talk to you next Monday. Thanks.

Announcer: The information presented on Talking Stocks Over a Beer is the opinion of its hosts and guests. You should not base your investment decisions solely on this broadcast. Remember, it's your money and your responsibility.