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listeningin

A Wealth Of Values

Mark &Jon Boyar On the Upside of the Downside: Opportunity, Cheap

Make no mistake about it, the scale of the wealth evisceration visited on the U.S. stock market in the first half's almost all-encompassing retreat was prodigious, ($9 trillion by the FT's reckoning), with only a few inflation/commodities-linked securities eking out gains over the six months. And the unsparing downslide, as is the wont of such ursine beasts, was as precipitous as it was sickeningly severe.

Is it over? No one knows. But experience tells me that's a poor bet. Bears are expert at applying just enough balm of higher prices to lure investment naifs back in for the kill.

Jon Boyar Mark Boyar

Yet Mark and Jon Boyar — respectively, the founder, and a principal — of Boyar Value Group, aren't wasting time debating bear or bull, recession or no. Their firm's efforts remains focused — as they have been since Mark established his research boutique in 1975 — strictly on bottom-up financial analysis of individual stocks to find "value." In their case, high-quality businesses whose shares — because of the vicissitudes of the market — are currently selling at a significant discount to what a private equity acquirer would pay — over a reasonable horizon. In other words, the Boyars' patience isn't infinite; they insist on finding a catalyst for surfacing under-water value within a few years. It has worked splendidly for them and their clients.

The good news — and we all need some these days — is that Mark and Jon's work is now turning up a cornucopia of highly investable "value" stocks for their clients. Ones that — even if the broad market continues to be mauled — have already been through their own private investing hells and come preloaded with substantial upside. Hope? Nope. The ideas the pair generously shared with me recently are very much by the numbers. Listen In. —KMW

Welcome, Mark, and Jon. I understand you

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two had a big celebration last night. Yet you don't sound any worse for wear.
Mark: Not at all. Though it was my wife's birthday — and I pulled off a surprise.

Amazing. That's usually pretty impossible.
Mark: Particularly for me. But it worked. She was absolutely surprised and delighted. She told me afterwards that she'd been a bit disconcerted when she caught a glimpse of "someone" who looked exactly like our grandson as we entered the restaurant.

Little did she know —
Mark: Exactly. I trust you are well, as well.

No complaints here. Are you broiling in Florida or NY this summer?
Mark: I'm back in New York for summer, on hot, hot Long Island. In Old Westbury.

So we're sharing the same island, albeit on opposite ends — separated by gridlock. At least Covid didn't stop you from traveling this year.
Mark: Right. Once June comes, Florida is a terrible place — unless you're a glutton for punishment. And I'm not!

Glad you clarified that, Mark. Considering that you've been managing money for almost 50 years, there are those who might wonder — especially when the bear is on the prowl.
Jon: Haven't you heard? The stock market is all fun and games. Seriously, we have to stop meeting this way. Every time we sit for an interview, the world is coming to an end.

Isn't that a bit dramatic, Jon? I'm hearing this latest bear is already kaput. The indexes have been up — what? Two or three days in a row.
Jon: Yes. Yes. We've got almost a 3% up-day. *"Happy days are here again."*

Not exactly subtle satire, but I'll take it.
Mark: It's extraordinary, how — these days you just don't know until the last hour and a half of trading if the day's action amounts to a bear market rally, or if whatever upside you're seeing is even going to hold. It's, "Uh, we've got all these algorithms kicking in. It's uh, it's anybody's guess."

I don't know why traders even show up for work before 3 pm, Eastern.
Mark: Yes, it really doesn't matter.

Jon: No question these are "interesting times." But our research team now is busily working to take full advantage of the market decline. We're about to come out with something new — a mid-year opportunity issue. We have no shortage of ideas — But I can say that it won't be a list of 40, because our longstanding yearend publication is the "Forgotten Forty."

You could easily find 50 at this juncture.
Jon: Exactly. Although the time we've taken to really vet these opportunities and pare the list to just 10 or so has really made it interesting. Ironically — or tellingly — the last time we scrambled to put together a special research issue was shortly before the last interview we did with you, our coronavirus opportunity issue back in 2020. Our new one is significantly more detailed. But I have to say, the performance of the stocks we spotlighted back then was fantastic, at least on a one-year basis.

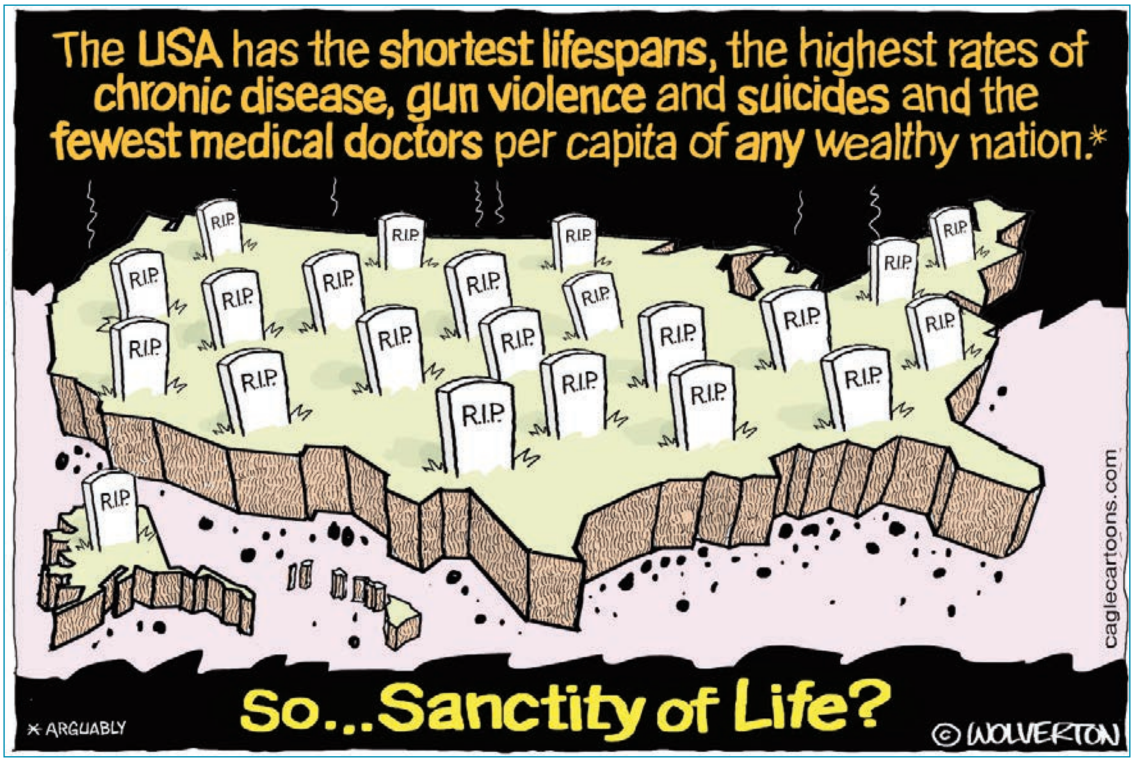
"With the benefit of hindsight, all bubbles have the same characteristics. When you step back and look at — think about — any of the historical bubbles, you have to wonder, "How can anybody have bought these things at those prices?" — Mark

That sort of "instant" gratification isn't normally your thing —
Jon: Right, it "never" happens to value investors like us. Our picks more often retreat some more before they go up. I have to say that one thing that has gotten me really excited here — I don't know if you saw it today (July 19) — was that Bank of America

fund managers survey that came out.

I've seen the doom and gloom headlines —

Jon: It was great because it gave the market a contrarian reason to mount today's rally. The survey showed that in some respects sentiment is worse now than in 2008. Investors reported they have slashed their exposures to risk assets to levels even lower than they did at the worst of the GFC. And people are holding more cash than at any time since 2001 — *since the 9-11 attack*, in other words.



So...Sanctity of Life? by Monty Woverton, *Battle Ground, WA*

Basically, since forever, then.

Jon: Exactly. According to survey, recession expectations are at their highest since May of 2020. Investor allocations to stocks registered their lowest level since October 2008. And 58% of fund managers surveyed said they were taking lower-than-normal risks, a record level of caution that surpassed what the survey reflected at the worst point in the global financial crisis. Not to mention that the most-crowded trades are long the U.S. dollar, long oil and commodities, long ESG assets, long cash and short U.S. Treasuries. Meanwhile, the biggest tail risk cited by investors surveyed was inflation, followed by global recession, rising rates and systemic credit events. So yes, the B of A survey is the most bullish thing I've heard in a while.

It sounds like the market's downside — the pain — is really registering, even with that typically bullish contingent. But I doubt we're going to get much of a reprieve.

Jon: True — especially after the first half, in which there was no place to hide. I love how now everyone wants to own commodities. When I went on my computer today and checked prices, I saw that in the last three months, aluminum prices have retreated 26%, copper has tumbled 28%, iron ore is down 25%, cotton is off 27%, and corn has dropped 25%. So, commodities don't seem to me like a great place to be — but who knows?

They are reinforcing their reputations for volatility, that's for darn sure.

Jon: Yes. My Dad could speak to this better — but they've been horrible investments, historically.

They had a relatively brief but spectacular reign in the sun amid the late 1970s inflation — and have done essentially nothing ever since.

Mark: Yep. People forget. Everybody's now talking — about some guy from Goldman Sachs predicting that oil is going to $150 a barrel or whatever. I still remember, in the 1980s, hearing Goldman talking about $200 a barrel oil.

Oh, the dangerous allure of round numbers —

Mark: Oil is absolutely a cyclical commodity. It periodically has a run-up, and then it gets clobbered. This time, they say, "it's different." But I'm scarcely original in noting that those are very dangerous words for investors to utter.

I hear your skepticism.

Mark: Yes, been a professional investor for 50-plus years, I am a skeptic. With the benefit of hindsight, all bubbles have the same characteristics. Whether you were talking the blue chip bubble of the 'Sixties, whether it was the bubble that preceded that 1987 crash, whether it was the internet bubble, or the real estate bubble that preceded that Great Financial Crisis — when you step back and look at — think about — any of the historical bubbles, you have to wonder, "How can anybody have bought *these* things at *those* prices?"

Jon: You can ask the same thing now when you look at the WFH stocks, or the meme stocks.

Not to mention crypto —
Mark: Going back to 2020, I've started every Boyar Asset Manangement board meeting with my little song and dance about, "Look at the overvaluations in telecoms. Look at the overvaluations in memes, in Work From Homes." I'd go through five or six of the most excessive every quarter. And every quarter I said, "They're still likely overvalued." But it wasn't until the first half of this year that we saw many of those stocks melt from hundreds of dollars to single-digits a share. And there were lots of them.

Lots of crushed dreams.
Mark: Obviously, they'll never get back to those price levels. Their high-water marks likely will prove just as durable as those of most of the internet bubble stocks. Even most of the companies that survived that one have never seen their stocks rebound to anywhere close to those bubble highs. And the majority either went out of business or were absorbed into another company. The same thing happens in every bubble cycle. Look up the history of Polaroid in 1969 or 1970. It sold at 100 times earnings. But it didn't survive. And there were a lot of Polaroids.

Xerox and Eastman Kodak are just two names of that era that leap to mind.
Mark: Exactly. Most of the Nifty Fifty never came close to returning to the heights they scaled during that roaring bull market. And this period is not going to be any different. The market leadership will change. People will take a break from growth for a while. They'll wind up buying — gasp — value stocks instead.

Not to be too cynical, but that's every value guy's perpetually fondest hope.
Mark: You are right. But we put up our best absolute performance numbers back in the 1975 -1982 stretch — and also in the period right after the internet bubble burst. I think the same thing is going to happen now. Investors are going to gravitate towards value stocks, like they always do after a speculative bubble bursts — at least for a relatively short period. I don't know how long it'll last. But after the internet bubble imploded, value's run of outperformance lasted for five years.

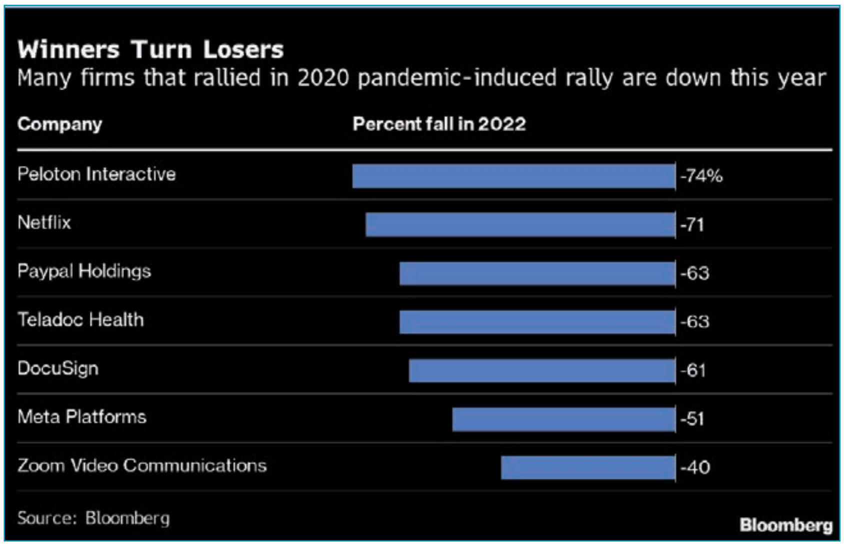
An eternity to most investors. What's seared into my mind is how excruciatingly long it took — after 1974, when the bear market brutally extinguished any remaining vestiges of the Go-Go Years just as I was learning the ropes at Dow Jones — for stocks to gather any semblance of bullish momentum. The better part of a decade.
Mark: I started on Wall Street in 1968, right near the top, so I got a taste of the upside. But I was working at Price Waterhouse — and hated it. Then I met Stanley Nabi and told him I really wanted to work on the investment side.

That led to your first break on the Street?
Mark: Well, Stanley said, "We're not hiring anybody." He was a general partner at Schweickart & Co. back then; this was long before he went to Lazard or Bessemer Trust, much less Silvercrest. Anyway, Stan added, "About the only way I can hire somebody is if somebody else leaves." Then, luckily for me, one of his analysts decided to go elsewhere. Stanley called and said, "You've got a job if you want it." I jumped at it — and really started on Wall Street at the top of the market. I remember the Dow first hit 1000 in late 1972 — then plunged to 600 — before spending "forever" bouncing between those levels for a decade.

Creating opportunities, as well as lots of frustration —
Mark: Yes, during that period, you could have made a great deal of money.

In fact, great investment fortunes were amassed.
Mark: Yes. If you look back, in '69, Hilton Hotels sold for $50 or $60 a share. It eventually traded down under $10. At that point it was yielding, like, 12% — then it subsequently tripled in price during those years of "sideways" markets. The averages didn't do well at all over that span. Continued to trend down, by and large. But that doesn't mean that individual stocks didn't do extraordinarily well, based on value fundamentals.

They did. The seesaw market persisted until halfway through '82, creating a lot of angst and frustration about if/when it would ever break decisively through 1000 — much less hurdle 2000. But savvy and flexible investors made gazillions over that span.
Mark: No question. I remember, I met [legendary value investor] Walter Schloss — probably in 1977. I went to an annual meeting for a company called Lightolier, which made lighting fixtures and had a great consumer franchise — but was trading at a price that was less than the value of the cash and



All graphics courtesy of Boyar Value Group

equivalents on its balance sheet.

I had no idea who Walter was. There were only four or five investors at the annual meeting. Walter asked me, "Why is a young guy here looking at a stodgy company like this — when everybody is still pulling for the Nifty Fifty to revive?" I told him I couldn't resist. "My father was an accountant. I was weaned on this." That's how I was fortunate enough to find out about value stocks. Lightolier was trading for less than half of its book value. But those were the kinds of opportunities you could find: Lightolier as a $6 stock, when it had sold in the 20s and the 30s prior to 1969. It ultimately ended up being acquired —

At a price you were more than happy to accept, I'll bet.

Mark: Well, we held it, and did extraordinarily well when it was acquired. Those were the days you could literally buy a dollar's worth of cash for 30 - 40 - 50 cents in the stock market.

But the investment style was never as sexy as loading up with any stock with "tronics" or ".com" in its name.

Mark: Not at all. That's why Walter was so surprised to see a young guy at that meeting.

Not to mention one who'd evidently read the balance sheet and income statement — even back in those days when book value meant something.

Mark: Well, I'll just say that as we honed our skills, we decided that we didn't only want to buy something trading at 50 cents on the dollar or less. We also wanted a catalyst or something that's going to surface that value during our lifetime.

Wisdom hard won in long dry stretches for value performance, no doubt —

Mark: That's for sure.

Jon: The good news is that *now* we are coming across a lot of names like that. Good businesses —

But not many yielding 12% —

Jon: No.

Mark: You have to remember that back then, interest rates were significantly higher.

True, as was inflation.

Mark: Then too, New York City was going bankrupt and, we had chaos in the streets. I think this is the 45th anniversary of the big NYC blackout and the riots it spawned across the city. And of course, we had the Vietnam War. It wasn't a very pleasant period. A lot of stocks *deserved* to sell where they were trading, particularly when you could get a significant return on a bond or a Treasury bill.

The credit markets *were* significant competitors for investors' dollars.

Mark: Now, we're at 3% on the 10-year and some people consider that stiff competition for stocks. But if you're happy with a 3% return when inflation is running significantly higher than that, fine. Buy the bond.

You're clearly not. When you reflect on previous cycles you've lived through, which reminds you the most of our current experience?

Mark: The dot.com boom and bust. The parallels are very striking. At that time, you had the day

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traders. This time, you have the stay-at-home guys, the Work From Home crowd, and young speculators congregating on Robinhood or Reddit. It's all very similar. They were all buying the same stocks, driving them to valuations that were just stupid. And I think it's going to play out exactly the same way. In the 2000 bear, many former market leaders lost 75% - 90% of their value, never to approach again their previous highs.

Jon: It's sobering to recall, in that context, that after the NASDAQ peak in March 2000, the index didn't surpass that high for fully 15 years. So when I've lately heard some pandemic darlings being referred to as "bargains" down 60% or 70% from their peaks, I can't help saying, *"caveat emptor."*

Mark: I remember when this all started — in this cycle — people were talking about this new class of investors being a great thing for the markets. That same song was sung during the internet craze. That time, a whole bunch of new investors came in and got their heads handed to them — ultimately abandoning the markets for a very long time. This time, the newbie investors who came in — whether to crypto, whether to Work From Home stocks or to memes — are already gone. They've been lost to the markets.

We've all read horror stories about what has happened to crypto investors — Forget about crypto going from what — $60,000 — to $17,000. What about all of the places — in the private markets and through dealers — where newbies were buying, selling, and borrowing and lending that purported but ultimately ephemeral "store of value" — that already have gone out out of business?

Clearly, there was an element of Madoff, or Ponzi finance, in some of crypto's once-glittering prospects.

Mark: The newbies were accepting, Kate. They leapt at posted interest rates of 17% being offered on crypto deposits. They fell for promises like, "Give us your money, and we'll give you a 17% return."

But now they've mostly been wiped out and it is going to take years and years for them to come back into the marketplace — if they every do.

I reiterate, every bubble, with the benefit of hindsight, shares many characteristics. The longer you invest, the more you just scratch your head and say, "How does anybody pay X amount of dollars for a business that has no earnings." Yet the stocks defy gravity for longer than you think possible.

The greater fool theory works — until it doesn't. What do the kids call it now, Jon — FOMO? Fear of missing out?

Jon: FOMO. Yes, absolutely. It's a very serious disease.

SPX Drawdown Analysis Starting in 1939 with a Minimum Decline of -20%

Start Date	End Date	Duration (Mo.)	Drawdown (Peak to Trough)	Trough Forward P/E	Forward P/E at -20% Drawdown	Peak CPI	Recession/Non-Recession	Additional Drawdown After -20% Decline	Months from Trough	Forward Performance following -20% Drawdown* 1-YR	3-YR	5-YR
10/25/1939	6/10/1940	8 Months	-32%	8.5x	9.7x	2.2%	No Recession	-15%	1 Months	-4%	11%	13%
11/7/1940	4/28/1942	18 Months	-34%	7.0x	9.6x	12.7%	No Recession	-18%	5 Months	9%	19%	16%
5/29/1946	5/19/1947	12 Months	-28%	8.1x	10.4x	19.7%	No Recession	-11%	8 Months	2%	6%	17%
6/15/1948	6/13/1949	12 Months	-21%	5.7x	5.7x	9.9%	Recession	-1%	0 Months	59%	32%	25%
8/2/1956	10/22/1957	15 Months	-22%	13.5x	13.6x	3.7%	Recession	-2%	0 Months	34%	14%	11%
12/12/1961	6/26/1962	7 Months	-28%	14.1x	15.0x	1.3%	No Recession	-10%	1 Months	25%	19%	13%
2/9/1966	10/7/1966	8 Months	-22%	13.8x	14.0x	3.8%	No Recession	-3%	1 Months	28%	12%	10%
11/29/1968	5/26/1970	18 Months	-36%	13.3x	16.7x	6.2%	Recession	-20%	4 Months	15%	14%	1%
1/11/1973	10/3/1974	21 Months	-48%	8.0x	10.5x	12.1%	Recession	-35%	10 Months	-24%	7%	5%
11/28/1980	8/12/1982	21 Months	-27%	7.7x	9.0x	12.6%	Recession	-9%	6 Months	37%	23%	26%
8/25/1987	12/4/1987	3 Months	-34%	9.4x	9.5x	4.5%	No Recession	-17%	2 Months	7%	9%	13%
* 7/16/1990	10/11/1990	3 Months	-20%	18.5x	18.5x	6.3%	Recession	0%	0 Months	34%	20%	18%
3/24/2000	10/9/2002	31 Months	-49%	15.9x	47.8x	3.8%	Recession	-36%	19 Months	-3%	-1%	3%
10/9/2007	3/9/2009	17 Months	-57%	11.1x	99.3x	5.6%	Recession	-46%	8 Months	-28%	5%	8%
2/19/2020	3/23/2020	1 Months	-34%	23.8x	26.4x	2.3%	Recession	-17%	0 Months	48%	N/A	N/A
Average		13 Months	-33%	11.9x	21.0x	7.1%		-16%	4 Months	16%	13%	13%
Median		**12 Months**	**-32%**	**11.1x**	**13.6x**	**5.6%**		**-15%**	**2 Months**	**15%**	**13%**	**13%**
Avg Recession		15 Months	-35%	13.1x	27.5x	6.9%	60%	-19%	5 Months	19%	14%	12%
Median		**17 Months**	**-34%**	**13.3x**	**16.7x**	**6.2%**		**-17%**	**4 Months**	**34%**	**14%**	**9%**
Avg No Recession		9 Months	-30%	10.1x	11.4x	7.4%	40%	-12%	3 Months	11%	12%	14%
Median		**8 Months**	**-30%**	**9.0x**	**10.1x**	**4.2%**		**-13%**	**1 Months**	**8%**	**11%**	**13%**
Current Period												
1/3/2022	6/16/2022	5 Months	-24%	15.5x	15.9x	8.6%	N/A	-4%	0 Months	N/A	N/A	N/A

**The 3 and 5 year returns reflected above are annualized*

***The 1990 bear market fell -19.92% vs the typical definition of a -20% drawdown which we believe should qualify as a bear market and is therefore included in the analysis*

Source: Miller Value Partners, Bloomberg, and Birinyi Associates

Source: Miller Value Partners

Highly contagious, sometimes fatal.
Jon: And don't forget it's cousin, TINA. There is no alternative.

How could I? TINA is usually first to arrive at the party. Then FOMO gets it rocking.
Jon: It's fascinating, if you can look at the cycles in a detached fashion. One value investor I admire a lot — though he definitely runs hot and cold — nonetheless has a very good long-term record. I'm referring to Bill Miller and the folks at his Miller Value Partners.

Bill is an esteemed WOWS client. Great fun to interview.
Jon: I don't know if you saw his long-time partner Samantha MeLemore's recent piece about extreme times in the market. She's Miller Opportunity Equity's PM, alongside Bill. She did a really did a good job of looking at market's very challenging first half — and then examining what happened in the one, three, and five years *after* previous bear markets started. She incorporated quite a few insights into the article, but if investors glean nothing else from it, they should take away the conclusion that despite how bad the macro picture looks here, they should really be *buying* compelling fundamental values now. But, of course, most investors won't.

You've got to admit, that takes a bit of courage, as well as solid research. Especially after a bear market has just vaporized an estimated $9 trillion in stock market value in the year's first half.
Jon: I do. Going through a bear market is painful, both financiallydf and psychologically, but investors should remind themselves that *periods of substantial declines have historically been followed by outsized gains.* Investors who have the patience, and the financial strength, to stick with their positions during difficult times (and the cash to add to existing positions or initiate new ones) have typically been handsomely rewarded.

While each bear market is difficult in its own way, we see no reason the next three-to-five-year period should differ substantially from previous bear markets. Remember—the most dangerous words in investing are "It's different this time."

True, but staying invested amid a bear is harder than it sounds.
Jon: I agree. But it doesn't require some unobtainable state of Zen. One of the things I like to think about in that context is that in almost every case — after every bear market since 1939 — the market's one-, three-, and five-year returns were significantly above the "average" long-term return of the stock market. In fact, according to Miller's research [table, page 6], the median one-, three-, and five- year returns after bear markets that coincided with recessions were 34%, 14%, and 9%, respectively. When the bear market did *not* result in a recession, the one-, three-, and five-year median returns were 8%, 11%, and 13%, respectively. So the one- and three-year median returns were higher in recessions, but those bear market periods also experienced deeper total drops (in percentage terms) in the market (34% vs. 30%) and took longer to bottom.

The good news is that, if history rhymes again, this should be a really good time to be buying stocks. Now, as of July 12, the S&P 500 was down around 18.5% from its high, so we may very well have significant downside still to come. However, many stocks in the S&P 500 and Russell 2000 are down 40% or more from their all-time highs —

Meaning stock-picking skills are relevant —
Jon: You're preaching to the choir. Although the overall market might not have bottomed, many individual stocks might have already done so. That's the opportunity. But I also recognize that patience will be required. Timing is always a question. And it's very much worth reiterating here that the NASDAQ didn't surmount its 2000 peak until 15 years later.

Not only was it a long wait, the constituents of the NASDAQ index were scarcely the same 15 years later.
Jon: Absolutely, and that's a matter of great import to investors in individual stocks, rather than index investors.

Can I assume that Boyar Asset is buying selectively here, but keeping some dry powder?
Jon: I think you make those decisions on a stock-by-stock basis. I'm of the belief — and I learned this from my Dad — that you should invest slowly over time. You're never going to pick the bottom, so investors should not waste effort trying. Just pick stocks to research and then to buy — *when they are cheap* — and keep adding to that position prudently and opportunistically. There's a long list of stocks in our universe that already have been unfairly punished in this downturn, in our opinion. And they range from names like Hanesbrands (HBI) — a provider of consumer necessities —

Couldn't be more basic —
Jon: Exactly, but the stock is down 32% year to date. It has a 5.3% yield with a payout ratio of 40%.

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An easily digestible $7.2 billion enterprise value. So, if things don't improve, there could be a change of control. It's always been our theory, and this is something else I learned from my Dad, that if the public market doesn't value a stock correctly, an acquirer will come along who will.

Bargains get snapped up.
Jon: Especially where, like at Hanes, there is no controlling shareholder. The board has finally brought in good management. They used to promote solely from within. Recently they've installed some Walmart veterans who are doing a fantastic job. The business is no longer dominated by namesake Hanes lines. Champion is now 30% of sales and growing rapidly. Our estimate of Hanes' intrinsic value implies that the stock could more than double from here, without using any heroic assumptions. This is not the greatest business in the world, but it's a good one; management is finally doing all the right things. But those things take time to be reflected in results. Meanwhile, the stock is trading at roughly six times earnings. There are lots of way for Hanes to unlock value, or for an acquirer to do it.

What else beckons?
Jon: If you go in a little bit upmarket in this sector, Levi Strauss (LEVI) is another name we've recently profiled in *Boyar Asset Analysis Focus*. It's not yielding as much as Hanes, but LEVI does yield about 2.6%. The stock is down 26% year to date. Trading at 11.5 times earnings. They're doing a fantastic job of improving their direct-to-consumer business. Its balance sheet is great. Leverage is only 1.2 times.

And at least some folks are no longer working from home in their pajamas.
Jon: They might not be working from home in their pajamas, but more and more businesses are accepting casualization. You can wear jeans to work. And my favorite factoid about Levi is that 40% of consumers experienced a waist-size change during the pandemic.

Another dividing line in society —
Jon: Right, but whether up or down, that much change should help sales. This is a smart management. They've diversified to meet their consumers wherever they are. I mean, they own Dockers, which is about 5% of sales. But they also went into the athleisure game, acquiring Beyond Yoga, which describes itself a "body-positive premium athleisure apparel brand focused on quality, fit, and comfort for all shapes and sizes from XXS to 4X." Athleisure is a much bigger apparel category than jeans. At $50 billion a year globally, it is five times the size of the jeans market.

Meanwhile, Levi is far and away the category leader in denim, and a number of their competitors didn't survive COVID, particularly the highly indebted ones. I'd also mention that the controlling Strauss family — the descendants — have been pretty consistently selling their shares. We don't consider this a red flag here, because it is essentially increasing Levi's public float.

It's a dual-class structure, isn't it?
Jon: Yes, and the vast majority of the super-voting B shares are held by members of the Strauss family. However, when those folks sell — ostensibly due to diversification considerations and the like — their shares convert to class A publicly traded shares. In that way, the liquidity of the public share class has been steadily improving. In fact, around 25% of LEVI's total shares are now publicly traded, up from only about 11% at the company's 2019 IPO. As a result, bigger institutions can get involved in the stock. At any rate, LEVI is another company that isn't sexy, perhaps, but that should be very rewarding to investors going forward. It's trading around $18 a share and our estimate of its intrinsic value, with a 2024 horizon, is $33.

Cheap enough to nibble on?
Jon: I would hope so. It always amazes me how cheap these things can get. I didn't think Hanesbrands would break below $10 — in the 2020 pandemic crash. We originally started looking at LEVI, I think, at $12. It then went up to $30, but now it's back down to $18 — even though the fundamentals of business have actually been pretty strong, and its fortress balance sheet gives investors a fair amount of protection. The biggest risk in LEVI here, I think, is that it could be more dead money than anything else for a bit.

How ironic was it to you that actually bankrupt companies often topped the speculative leaderboard during the now-deceased bull market? For a while there, all a stock needed was a household name for meme traders to run it to absurd valuations. Hertz, Kodak…
Jon: What was *really* eye-opening was that the trading got so egregious that the SEC actually put their foot down and blocked Hertz from raising $500 million by selling vastly overvalued shares.

Right, the cops normally show up only

after the damage is done.

Mark: It was entertaining, on one level, to watch a company like Revlon file for Chapter 11 protection with its stock languishing at couple of bucks a share — then see those same shares almost instantly triple to $6 a share. Largely because of buying by that crowd of Reddit and Robinhood traders. Look, they didn't care about the fundamentals. They just wanted to see if there was a huge short position or anything that could supercharge a move to the upside. Those traders probably had no idea what the company does, or about its fundamentals. They just talked with one another, incessantly, bulling the stocks to absurd valuations.

Creating digital boiler rooms.

Mark: Yes. Until the bear appeared. Hopefully, the upside of this market downside is that the bear is ushering some sanity back into the marketplace. Valuations will matter and many companies the likes of a Levi or a Hanesbrands will probably catch people's eyes as they search for returns on their money that might beat inflation.

Mark: Another interesting company, though more highly leveraged right now because they merged with Warner Bros., is what's now called Warner Bros. Discovery Inc. (WBD). It is the old Discovery Communications, post its merger with AT&T's WarnerMedia. After the transaction, Discovery's old shareholders control about 30% of the combined company, and AT&T shareholders, maybe 70%, but it is Discovery's old management and CEO, David Zaslav, in the driver seat.

I hate to play the skunk, but Warner Communications was an albatross for AT&T from day one. What makes you think this M&A deal will do any better?

Mark: For one thing, Zaslav and his team have done this before. They are really good deleveragers.

Jon: They bought Scripps Networks Interactive a few years back and did a fantastic job of deleveraging the acquisition. We expect them to deploy the same playbook to extract more than $3 billion in cost savings from their Warner acquisition — which isn't much of a leap because media mogul John Malone, who controlled a significant chunk of the old Discovery stock, is on record saying the combined companies will produce cost and revenue synergies "easily" exceeding $3 - $4 billion a year. And the fact that Malone and Advance/Newhouse — both of which have been quite successfully involved in the media industry for many decades — were both willing to collapse their voting stakes in Discovery as part of the merger agreement tells us just how much they believe in this merger.

But the most amazing thing about Warner Bros. Discovery is that they did the deal right at the exact right time. The financing terms — 80% fixed rate, a 4.5% cost of debt, the weighted average maturity is 14 years — for a deal like this are pretty remarkable. Zaslav and company already have done a fantastic job with this.

Mark: If you go back and you look at the history of Discovery, you'll see that when they bought Scripps Networks, they were throwing off enormous amounts of cash flow, they were buying back their stock. But they decided Scripps was a once-in-a-lifetime potential acquisition for them. So they did the deal, even though the institutional investment community was absolutely, completely, against it. As a result, the stock sold down to a ridiculously low price. But a number of years later, after Discovery deleveraged the acquisition, it was a great stock again.

Then last year, this opportunity arose where they could buy Warner from AT&T — which never knew what to do with it. I think Zaslav and team will be able to orchestrate the same kind of deleveraging and restructuring with it. Remind me, Jon, what the deal has done to Discovery's stock?

Jon: When the acquisition was announced, it was 36. It dropped down to 24 - 25 while the deal was pending — and one of the main reasons was that the AT&T shareholders who would be getting shares in the deal essentially had an allergic reaction to holding a stock that wasn't paying dividends and would be highly levered. So institutions basically threw it out. Then too, the deal was closing just about when Netflix reported their horrible results. That basically created a perfect storm of forced selling in bad market.

So, yes, this thing has fallen to $15 or so. At these levels, WBD is just unbelievably inexpensive and it has lots of opportunities — not only for cost synergies but revenue synergies. In our view, this could be a 40-odd-dollar stock in a couple years.

That's nice upside.

Mark: This is a real opportunity at a fantastic price.

If I'm not mistaken, you've followed this company's various incarnations for years —

Mark: This is the third time that I have owned Warner Brothers. The first time was when Steve Ross wound up buying it.

Now you're talking ancient history!
Mark: I suppose. It was in 1969. The Warner Bros. - Seven Arts movie studio was ailing and for sale — along with its television and record businesses, as it turned out. As I recall, Allen & Co. was the investment bank. And Steve Ross agreed to pay $400 million for the Hollywood icon.

Raising some eyebrows on Wall Street, I believe.
Mark: Steve Ross, the son of Jewish immigrants who lost everything in the Great Depression, wasn't exactly a member of the club. He'd gotten a start in New York as a funeral director at his in-laws' funeral home. His first business coup was convincing his father-in-law's partner to let him rent out funeral limos that weren't being used in the evening. That morphed into an expanding car rental business, which Ross merged within a few years into a parking lot operator, Kinney Parking. After adding an office cleaning outfit to the mix, Ross took Kinney Parking public in 1962 at a valuation of $12.5 million.

A very 1960s success story — except, didn't Ross have some "unsavory" associates?
Mark: There were always questions. When he merged his rental company with Kinney Parking, it was owned by a couple of characters known as underworld crime associates.

That would do it. And years later, as I recall, a couple of senior Warner executives, though not Ross, were convicted of racketeering involving a mob-connected theater in Westchester County.
Mark: Those stories and innuendo dogged him throughout his career, but his dealmaking was legendary — and he made a lot of money for shareholders. It didn't take long after he acquired Warner, in 1969, for Ross to discover that he'd only paid about half of what the company was really worth. Warner's accountants had been ascribing virtually no value to its record division.

Quite a gift.
Mark: What do they say, better lucky than smart. But Ross was smart. I owned Warner then and I owned it again, 20 years later, in 1989, when Ross merged his Warner Communications with Time Inc. in a $14 billion deal that created the largest media and entertainment company of that era. It actually became a ten-bagger for us over the subsequent decade. Then, when the AOL - Time Warner deal was announced — when was that Jon?

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Jon: That news broke on Jan. 10, 2000 — a merger valued at an astounding $350 billion.

One destined to become *the* fiasco capping the internet bubble. I remember that day well. We were recording *Barron's* annual roundtable when the news came out — so we captured our panel's astonishment in real time.
Mark: Well, because it was a ten-bagger for us, Time Warner had grown to 10% of our portfolio by the end of 1999. So as soon as the AOL - Time Warner news hit, I said to the team, "Let's sell 30% of the position right now." This *never* happens, but we caught the high tick in the stock.

Sweet.
Mark: It was, but then we held the rest of our position all the way down amid the popping of the internet bubble — and then all the way back up again — before we finally sold it. Now we own it again, so this is my third foray into the company now known as Warner Bros. Discovery — or whatever they're calling it this week. And it's probably a better company, now that it owns HBO, than it ever was when I owned it in the past.

Jon: It will be. What people don't really talk enough about is how mismanaged Warner has been over the last few years — ever since AT&T paid a total of $102 billion in cash, stock and debt to take it over in 2018. Actually, Warner wasn't particularly well-managed for a few years even before that, when its primary focus was on gussying itself up to appeal to the next sucker at the poker table.

They found one in AT&T, certainly.
Jon: The phone company simply had no idea how to run a media company.

Zilch.
Jon: But all of that means there's a lot of opportunity in it for Zaslav to exploit. One of the things that could also provide a boost for the new Warner Discovery — assuming Amazon and Apple don't go crazy — is that it looks like content costs may moderate, now that everyone has seen what runaway costs did to Netflix. Obviously, it won't be ideal if the new company runs straight into a recession. But I have a lot of confidence in Zaslav and his team.

This is a shameless plug, but he was a great guest on my podcast. A really smart guy who has done a really good job, even if Warner Bros. Discovery's stock has yet to reflect it.

Mark: Another thing about Zaslav is he's disciplined. He has said numerous times that he's not going to make zillions of movies just for the sake of making movies, or pay absurd prices to do it. I think that bodes well for the entire industry. He wants to make good movies that become a valuable part of his film library — have residual value.

Jon: One thing that's not part of our investment cases for Warner Discovery or for Comcast, either — but wouldn't shock me, is something that John Malone has hinted at. As you know, Comcast (CMCSA) right now is an unbelievably cheap stock. It gets absolutely no credit from investors for owning NBC Universal — which they bought for practically nothing from GE back in 2013. It was a great deal for Comcast.

But if Comcast shareholders don't at long last get rewarded for that deal within a couple of years, I wouldn't be surprised to see [Comcast Chairman and CEO] Brian Roberts try to surface that value by spinning out NBC Universal and merging it — perhaps with Warner Bros. Discovery.

Why would he do that deal?
Jon: Because if you do that, you'll essentially create another Disney. You'd have the theme parks. You'd have the intellectual property. You'd have the movie studio. You'd have a network. I think, under the right circumstances, Brian Roberts would be amenable to that.

Mark: He *did* try to buy Disney, after all.

I forgot that —
Jon: It was an unsolicited bid back in 2004. At this point, as a Comcast shareholder, I'd hope that Roberts would be a seller, not a buyer. More precisely, if he were to spin out NBC Universal, he'd create a tremendous amount of value for Comcast shareholders. What people don't appreciate is that the broadband business part of Comcast's cable franchise is extremely valuable. And when I look at how NBC Universal could best be monetized, spinning it out to Warner Discovery to create a "new Disney' just leaps out as something that would attract Roberts.

Mark: That's what nice about having a CEO with a lot of skin in the game like Roberts. He's not just going to do something for the sake of doing it. He owns a lot of stock. And he's an opportunist. I mean, when he bought the studio from General Electric, it was almost incomprehensible to me that he was able to buy it at such a friendly price.

It helps when the other guy at the table has no clue what he's holding in his hand —
Mark: Correct, absolutely correct.

Jon: That deal was a home run for Roberts. Anyway, the stock has been knocked down, roughly from 60 to 40 this year, and we think represents real value.

Cable hasn't been an exciting business for decades. But you think it's undervalued?
Jon: Let me outline our case for Comcast. First, the company's cable unit, *which includes broadband*, is its crown jewel — currently generates two-thirds of revenues and about 80% of profitability.

Second, what's weighing on the shares at the moment — they're down about 30% from recent highs — is that its broadband operations have reported a slowing in their growth rate.

That doesn't worry you?
Jon: We expected it. There was a significant pull forward in broadband demand during the pandemic, so comparisons are out of whack, but will normalize given a little time. Third, Comcast has whittled its leverage back down to management's comfort zone, following its 2018 acquisition of Sky — which leads us to believe that outsized share buybacks are likely. The company increased its share repurchase authorization to $10 billion earlier this year.

Go on —
Jon: Fourth, Comcast continues to increase its payout to shareholders (14 straight years of dividend increases) including an 11% increase in 2022 (current yield: 2.6%).

Fifth, Comcast boasts a hidden asset in Hulu. The asset is likely to monetized in the coming years and we would not be surprised if proceeds were returned to shareholders as is its wont, via dividends, repurchases or even a special dividend.

Sixth, Comcast's fledgling Peacock streaming service holds a great deal of potential, which should become more obvious as it reclaims key Universal content from rival streaming services.

Seventh, Comcast's theme parks have recovered — even though international tourism remains depressed. A recovery in international travel should go a long way toward sustaining the momentum in the theme parks business — as should a new park in Beijing ("opened" last September) but still held back by Covid restrictions.

Our eighth reason comes down to dollars — and

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sense. The market is currently applying a "conglomerate discount" to Comcast shares, with investors able to acquire the Company's attractive cable communications business at a discounted valuation — and receive about $35/per share in additional intrinsic value *for free*.

Finally, as I think we've made clear, if Comcast shares continue to languish, we would not be surprised to see Roberts pursue more aggressive actions than the outsized buybacks/dividends, etc. he usually employs to unlock value. A separation of the content business from the cable business could go a long way toward narrowing the valuation gap.

Fine. Where do you spy value away from the communications/entertainment sphere?

Jon: Well, the banks are cheap. Bank of America (BAC) is probably our favorite, and a great way of playing a rise in interest rates, as the most interest-rate-sensitive major bank. There are lots of ways in this market to make money, if your time horizon is not tomorrow.

Can you be more specific about B of A?

Jon: Sure. I'll summarize the key points of our investment case. BAC is enjoying the fruits of having instituted a "responsible growth strategy" over a decade ago, which has resulted in excellent credit quality across all business lines and driven its charge-offs almost to historic lows.

What's more, it is seeing strong year-over-year loan growth of 13% in combined business segment loans. It boasts the leading U.S. retail deposit share with over $1 trillion at the consumer bank and over $2 trillion companywide — a "cheap" funding source, with around 40% of all deposits non-interest bearing.

I wonder how long that can last now —

Jon: We think Bank of America is very well-equipped to compete harder for deposits when it has to. It simply has the leading technology position in consumer banking. In fact, it is a leading fintech company:

• No. 1 in online banking and mobile banking functionality, according to Keynova's Online Banker Scorecard)

• No. 1 in customer satisfaction with merchant services, according to J.D. Power

• Ranked as best consumer digital bank in the U.S. and best bank in the U.S. by Global Finance

• It had 55 million verified and 43 million active digital users in the second quarter of 2022

•While recent Fed stress tests are expected to push BAC's CET1 minimum capital ratio requirement from 9.5% to 10.4%, effective October 1 (the Fed's final determination is due in August), B of A's ratio was already at 10.5% at the end of Q2. And, despite the increasing capital requirement, the bank increased its dividend 5%. So its 2.6% dividend yield and even share repurchases (unlike some rival major banks') are expected to continue (at reduced levels).

Isn't that a tad aggressive, considering that minimum capital ratios are supposed to keep rising?

Jon: You're right, in the sense that on January 1, 2024, the bank's CET1 minimum capital requirement will go up to 10.9%. But while in the past, BAC had maintained a 1% cushion over the minimum, it plans to reduce the cushion to 50 basis points going forward. That doesn't seem excessively aggressive to us.

•Especially because the extent to which higher short-term interest rates will benefit BAC (because of its low funding costs) is being underappreciated by the market, as investors focus instead on the flat yield curve. Some 90% of BAC's interest rate sensitivity is to short-term rates. In other words, it benefits when rates rise. A one-point parallel rise in the yield curve would result in a $5 billion net benefit to BAC's net interest income. In fact, the bank has said its net interest income should increase by $900 million to a $1 billion in Q3 — and by that much or more in Q4.

You do get into the nitty-gritty. What's the upside in B of A?

Jon: Our current price target is around $45 a share, which would be 1.8 times our estimate of its 2023 tangible book value of $25. But, should the economy *not* go into recession and the yield curve steepen —

You cockeyed optimist, you!

Jon: Let me dream. In that case, 2 or even 2.2 times tangible book is likely. Banks have been, we believe, unduly punished by recession fears and the flat/slightly inverted yield curve. And, IMHO, Bank of America's CEO Brian Moynihan is one of the best bank CEOs — one of the best in *any* industry.

Mark: But if you'd prefer to own a sports team than a bank — and also want to buy your trophy for around 50 cents on the dollar — take a look at Madison Square Garden Sports (MSGS).

If you say so —

Mark: Really. Look at the enterprise value of Madison Square Value Sports relative to what the

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Knicks and Rangers would command in a private market transaction. The disconnect is enormous. We currently estimate MSGS is trading at a 50% discount to private market value, meaning we see a potential for 100% upside from the current stock market valuation if a private buyer were to emerge for the teams — which, let me remind you — are the epitome of trophy assets with storied histories and rabid fan bases in one of the nation's largest media markets. Yet, at recent trading prices, you're essentially getting the Rangers for free — in one of very few securities that allows investors to take an ownership stake in professional sports franchises.

They're not exactly the best teams in their leagues — or most profitable —

Jon: The operating performance of both teams was impacted during the pandemic, but prospects are improving with the leagues returning to full seasons and stadiums operating again at full capacity. The Rangers even reached the eastern Conference finals last season, which bodes well for future MSGS operating profits as they increase ticket/suite prices and the cost of sponsorship deals, etc.

Granted, MSGS was positioned as a return-of-capital vehicle during its 2020 spinout from MSG Entertainment. But those ambitions were put on hold as the company increased borrowings to navigate the pandemic. The good news is that a significant amount of debt has been repaid and we would not be surprised if significant returns to shareholders are forthcoming.

MSGS management is clearly acutely aware that the value of sports franchises has increased markedly in recent years, and that their own shares have lagged. And we actually see further upside in the team's intrinsic values as media rights renewals kick in over the next few years. The NBA deal ends with the 2024/2025 season and the new NHL deal currently being implemented (the Rangers are direct beneficiaries) is pulling down $625 million a year in revenues, versus about $300 million under the prior contract.

Big numbers. But it seems like you've been talking about Dolan stocks forever, Mark —

Mark: We have been long-term holders — going back to Cablevision. We made so much money in Cablevision — and got so much more for it when he ultimately sold it. It took patience, yes. But the Dolan family has done all of the right things, eventually. You probably remember that Charles did try years ago to use super-voting shares to take it private at an extremely advantageous price — for him, not public shareholders. But he ended up agreeing to abide by a vote of the minority shareholders, who gave the deal a thumbs down, and it wasn't taken private. He kept the business public, ended up paying out a special dividend and started buying back public shares.

Then, back in 2010, James Dolan spun Madison Square Garden Corp. (MSG) out of Cablevision. A decade later, he spun out its non-sports assets (real estate and entertainment venues) to MSG Entertainment (MSGE) and renamed the sports franchise company MSG Sports (MSGS).

It can be head spinning.

Mark: But in all of these deals, we made a lot of money — and we're going to make a lot more money with Madison Square Garden Sports — and MSG Entertainment, too. I'm actually surprised that nobody has made an offer to buy the Sports business — yet. I know the Dolans still control the company through their super-voting shares. But if someone were to come in and offer to pay more than fair value for it, I believe the Dolans would sell their franchises.

There's even a relatively new private equity firm, Arctos Sports Partners, specializing in professional sports team investments now. Recently, the NHL voted to allow PE firms to get involved in financing hockey teams. The NBA has allowed it for a while. So, there's definitely growing liquidity in the sports franchise market and it wouldn't shock us — at least as a first step — for a company like Arctos to take a minority stake in the Knicks and/or the Rangers, which would be a start in establishing the teams' valuations. MSGS could then use that liquidity for a large share repurchase.

Why not just sell the whole thing and mercifully end the soap opera?

Jon: Look, for the last 10 years, everyone on the Street has been saying, "They need to sell the teams to unlock value." And to be clear, we've been guilty of that, too.

But *the best thing* James Dolan could have done was keep those teams. They just go up in value. That's been because of the revaluation of sports media rights up until recently. But the next thing that is going to propel MSGS's valuation to new heights, is online sports gambling, which was recently legalized in New York.

Pardon me if I don't think that's the best thing since sliced bread —

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Jon: Perhaps not, for society at large. But it's a tremendous opportunity for franchise owners to increase their profits — especially through increased advertising revenue. In fact, online sports wagering firms are now MSGS's largest advertising source. As you know, there seem to be certainties in life, and that the Knicks will be awful seems to be one of them. But people will still watch the games because they are betting on them.

Mark: The reality is, cities and states are running out of ways to increase their revenue, and falling back on sin taxes to fill their coffers. So we'll have more legal online gambling and legalized marijuana, too. When you go into an arena, you will find some sort of handheld device at every seat. You're going to be able to make bets from your seat. On everything from, "Will this guy make this foul shot?" to "How many points will so and so score in the game?" There will be an over and an under. All kinds of things. That is the future of sports teams over the next decade. And it's one reason that franchises have sold recently at absolutely huge valuations.

Jon: I really think it's only a matter of time before someone makes the Dolans an offer they can't refuse. I don't understand why James Dolan still wants to own these teams, considering the amount of public abuse that is heaped on him about them, and not just in the sports pages. Life is too short to be the man everyone in New York loves to hate. Some of things said online when he caught Covid — they were pretty awful. So it just seems like he'd be a seller of Sports at the right price. He'd probably be happier focusing on the Entertainment business — doing more things like opening for the Eagles with his little rock band.

I'm not sure he can ever top that.

Mark: No matter. It's more important to note that Charles Dolan is still very much alive and in the picture. And there's a whole family dynamic that James Dolan has to consider. It is Charles Dolan, his wife Helen, *and their six children* — including James — who own the controlling stakes in both Madison Square Garden companies, as well as in AMC Networks. At some point, I would think, there will be some event that causes the Dolan family to sell the teams.

Okay, but isn't MSG Entertainment making an outlandish bet on some new mega glitzy concert venue in Vegas?

Jon: Sphere, that's what they are calling it.

Mark: That's a big reason the stock is under a cloud and the "Dolan Discount" has been resurrected in the case of MSGE — with the shares down more than 50% from the recent highs. Their huge "next-generation" Las Vegas construction project definitely is *not* without risks. But if James Dolan pulls it off, it will be an incredible money machine. It's not really surprising, given what has happened in the last few years, that they have encountered costs overruns on the project. But time has a way of taking care of those things. If it works, the Sphere will become as iconic as the Garden, Radio City Music Hall and the Christmas Spectaclar starring the Rockettes.

Jon: MSGE probably has higher upside than MSGS. Both stocks are unbelievably cheap, but if you look at the Dolans' track record for investing in major construction/rennovations to upgrade their real estate assets — and in targeting underserved concert markets, you can't miss that they've consistently hit home runs. Look what they did with the Garden — probably 15 years ago. They spent maybe $1 billion — what everyone said was a crazy amount at the time — but it turned out to be a fantastic investment. They did the same thing with the Forum in LA, and ended up selling it to Steve Ballmer for a huge slug of money. My point is, they have a very good track record.

But this is "wildly ambitious" new construction, not a rehab project, one that in all likelihood will cost more than $2 billion before it opens. Maybe it already has —

Jon: I'd prefer if they had never started the Sphere project, because it *is* a lot of money. Or if they had brought in a substantial partner. Clearly, MSGE is assuming a lot of risk. But it should be a grand slam — eventually.

Meanwhile, its core entertainment business is "thriving" and delivering results at or above pre-pandemic levels in many categories. The Garden, particularly, is benefitting from significant pent-up demand for live entertainment and in calendar 2022 is expected to generate significant growth versus pre-pandemic levels. The high-tech Sphere — its exterior will function as the world's largest LED screen — is now scheduled to open towards the end of 2023. And it should be poised to generate a significant amount of revenue from advertising (given the uniqueness of its venue). Plus, a recently inked partnership with Formula 1 should go a long way toward achieving its profitability objectives. I'd be remiss, too, if I didn't mention the bright prospects of MSGE's underappreciated Tao unit.

Never heard of it. Please enlighten me.

Jon: See? It is a bit under the radar. Tao is an operator of premium nightclubs/hospitality venues across the country, but with a particular concentration in Vegas — especially since its recent acquisition of a popular Las Vegas rival Hakkasan. The combined company is poised for strong growth in the year ahead with a solid pipeline of new venue openings slated. And MSGE expects Tao/Hakkasan's meaningful presence in Las Vegas to go a long way toward ensuring the success of their Sphere initiative.

Let's turn to another idea —
Jon: My Dad mentioned marijuana a few minutes ago. Are you up for talking about ScottsMiracle-Gro (SMG) as a company that should benefit from the legalization of cannabis?

Sure, even though it doesn't literally grow grass, as we called it when I was in college.
Jon: They're not growing the grass. Like Levi's, this company uses more of a picks-and-shovels-for-the-goldminers approach. They have one of the best consumer franchises out there, in ScottsMiracle-Gro (SMG), which is a great lawn and garden care business. It has dominant market shares in key product areas, including lawn fertilizer, growing media and controls (for weeds, insects, etc.). Their second business unit, Hawthorne Gardening Equipment, is a leading supplier of hydroponic growing products and supplies — most prominently, to marijuana growers. Both divisions were meaningful beneficiaries of the pandemic, and yet the company's shares have come under a cloud as the world — and the stock market — struggle to readjust to the new normal — or whatever this is.

Only temporarily, you think?
Jon: Precisely. The pandemic should have favorable long-term impacts on the U.S. consumer business because it produced a mass migration of millennials from urban locations to the suburbs. Notably, millennials over index to gardening activities, which is expected to position the business as a mid-single-digit grower (vs. low-single-digit pre-pandemic) going forward.

What about the pandemic's impact on the long-term outlook of the pot industry?
Jon: Hawthorne is not without near-term challenges, but it is very well-positioned as a supplier to the emerging cannabis industry — which should continue to be the beneficiary of increased legalization of cannabis, state by state, across the nation. If cannabis banking reform ever manages to make its way through Congress, it will likely be a boon for the industry — which now is forced to do business on an all-cash basis — even in states where the trade is legal — because federal banking regulations ban banks from servicing the industry.

How did a company like ScottsMiracle-Gro happen into selling pot growing supplies?
Jon: Glad you asked. If you'll permit another shameless plug, Scotts' chairman and CEO, James Hagedorn was another great guest on my podcast, not long ago.

Jim helped orchestrate, back in 1995, the merger of Scott's dominant lawn care business with consumer gardening powerhouse, Stern's Miracle Gro, which had been founded by Otto Stern and Horace Hagedorn (Jim's father). By 2001, Jim was running the combined company as CEO and he was named Chairman in January 2003.

Fast-forward to 2014. That's when Jim, along with his son, Chris, started Scott's second operating business — from scratch. The idea was for Hawthorne to focus on supplying hydroponic growing supplies and equipment for growers working in greenhouses, in indoor gardens, and even doing urban gardening.

In less than a decade as executive vice president of Scotts and as division president of Hawthorne, Chris has built the Scotts subsidiary into a robust portfolio of hydroponic supplies businesses — mostly by acquiring leading hydroponic brands in categories like nutrients, growing media, ventilation and lighting. And, in the process, Hawthorne emerged as the leading supplier of hydroponic supplies to the cannabis industry — which heavily utilizes hydroponics — as well as to other hydroponic growers, generating about $1.5 billion in revenues in fiscal 2021. So Hawthorne easily stands out as the No. One supplier, by far, to hydroponic cannabis growers.

That distinction was evidently recognized during the pandemic by a lot of WFH investors (and gardeners?) who drove Scotts' shares, which had traded in the $100 range, pre-pandemic, to a peak just over $250 in the spring of last year. Now, however, the shares have fallen back down to around $80.

Dare I suggest that it was great high while it lasted?
Jon: Pun intended, I hope! But let me talk about what broke the spell. One, cannabis shares as a group have fallen unbelievably out of favor, mostly as a result of significant oversupply issues facing growers in key California markets. While painful, that is literally a crop issue that will work itself out

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over time. Two, there was excessive excitement in the industry a year or so ago that a "Democrat-controlled" Congress would assist the industry with a national legalization of weed, or at least, by easing the federal banking prohibition and IRS rules that work against growers. Obviously, that has not materialized.

To make matters worse for the Hagedorns and their company, Scotts, their traditional lawn and garden business, wasn't immune to commodities and supply chain headwinds — and turned in a horrible spring season this year, mostly because of cold, wet conditions in key markets. And it is essentially a two-season business. The stock just cratered, as I said. But in buying it around 80 here, we are essentially getting the cannabis business for free *and* buying the core consumer business at a discounted valuation.

What do you figure it's worth?

Jon: The Hagedorn family controls about 26% of SMG and has demonstrated a flair for capital allocation, creating significant shareholder value using M&A to build Hawthorne's business from scratch. They are also shareholder friendly — pay regular dividends, special dividends and repurchase stock. All in all, I'd say it's probably a $160 stock, so it's probably a double from here.

Now, at some point in time, they're going to split the cannabis business from the traditional business — and it wouldn't surprise me if they sold Scotts-Miracle-Gro, because it seems like the family's passion today is really the cannabis supply business. But either way, separating the businesses, perhaps relatively soon, would go a long way toward unlocking the shareholder value we see.

Mark: It's also worth noting something we haven't worked into Jon's valuation work at all. Another structural negative holding back the cannabis industry now is the way it is taxed on the federal level. Because current regulations don't allow them to deduct any business expenses, they essentially get taxed on their revenue, not income. In effect, they are prevented from generating profits — until the business is, someday, legalized nationally. (Needless to say, the states legalizing the cannabis business don't have any sway with the IRS.)

How is that impacting SMG's supply biz?

Mark: It's not. But the Hagedorns haven't been expressing their enthusiasm for the cannabis industry only by building their Hawthorne supply business.

How else then?

Mark: Scotts has been establishing another beachhead of sorts in the industry by making deals with cannabis growers and people who own cannabis stores — deals that essentially amount to long-term equity investments — though they are structured as loans, on which the cannabis companies pay interest. That way, SMG isn't taking equity stakes in businesses that aren't yet legal on a national basis. In the loan agreements, Scotts agrees not to swap its loans for equity in the cannabis businesses until the industry is fully legalized. But in the meantime, it is financing and cementing relationships with key players. At some point, I think, they're going to be perhaps the biggest cannabis company in the world — assuming federal legalization.

Jon: Just as clarification, cannabis doesn't necessarily have to be fully legalized for Scotts' debt/equity swaps to be activated. The trigger is actually Congressional passage of a law permitting the industry to use banking services. The bipartisan Secure and Fair Enforcement (SAFE) Banking Act has actually passed the House seven times (in varied forms) but consistently has stalled in the Senate, mostly due to Sen. Cory Booker's long-standing opposition to facilitating cannabis banking without also addressing social justice in marijuana reform by enacting comprehensive federal legalization at the same time. But at some point, it will happen. And when it does, Scotts will be a primary beneficiary.

Mark: Then they can sell their cannabis position to one of the major liquor companies. I suspect they will be the ultimate acquirers of cannabis businesses. They took booze out of the Prohibition era. They know how to do it.

Jon: Well, that's what Jim Hagedorn is talking about. He basically wants to create Seagram's. He knows brand marketing. He might actually have a fighting chance of doing it. And with the stock at current levels, you're not really paying for that option.

What's another stock you're accumulating?

Jon: I haven't mentioned our health sector ideas. CVS is the first, and pretty self-evident, down it its stock symbol, (CVS). Does anyone in America not know on some level that the ubiquitous drug store operator is the leading, and uniquely-positioned, omnichannel vertically integrated healthcare company (because the business spans retail pharmacies, pharmacy benefit management, health insurance plans (Aetna), retail clinics —

The whole nine yards.

Jon: Exactly. What investors may not realize is that Aetna has the fastest growing Medicare Advantage plan business (and the nation's third-largest) and will inevitably benefit from the surge in the senior population. And they likely don't appreciate that the fact that 85% of the U.S. population lives within 10 miles of a CVS store gives the company strong advantages in implementing its strategy to broaden its delivery of healthcare services — likes its growing business of operating primary care clinics.

And it's doing all this profitably?
Jon: No question. Trading down around $94 of late, the stock's current dividend yield of 2.3%. The company's net debt/EBITDA — which climbed to 4.7 times as CVS swallowed up its Aetna acquisition — is back down in the low two-times range.

What's your upside calculation?
Jon: We value CVS at 15 times our estimate of 2023 earnings per share — which is $9 — for an intrinsic value per share of $135. That represents 43% upside from current levels. And our 15 times P/E multiple is conservative, I think, representing a mid-level between rival Walgreens and CVS's insurance peers.

Okay, you have another health care idea?
Jon: Absolutely. It is LabCorp (LH), which we think is significantly undervalued at recent levels around $240 a share.

You're begging the question, why?
Jon: For starters, take the fact that LabCorp shares peaked at the end of 2021 at $317.17 and are down 24% through yesterday's [July 18th's] close ($240.88). Then consider that LabCorp's valuation now is approximately equal to Quest's —

They *are* rival lab operators —
Jon: But valuing LabCorp on par with its main competitor, Quest, makes no sense because Quest is basically a pure-play lab business that, with the COVID pandemic receding (we hope), should return to around the 11 times valuation level that it has typically averaged over time. And, while LabCorp and Quest dominate, and basically split, the independent clinical lab business, with a combined market share of about 50%, LH has another, faster-growing and very undervalued operating business, in the pharmaceutical development arena, LabCorp Drug Development. Based down in North Carolina, the subsidiary provides nonclinical, preclinical, clinical and commercialization services to the pharmaceutical and biotechnology industries.

That does sound more buzz-worthy.
Jon: It is. Drug Development's expected long-term revenue growth rate is 6% - 8.5% versus low-single digits for the lab diagnostics business. Valuations in the drug development industry tend to center around the 20 times EV/EBITDA level (and that number includes multiple 2021 transactions) while the lab business, as I said, historically garners an 11 multiple. And the disparity has been noticed.

How do you know?
Jon: Jana Partners, last spring, took a position in LabCorp, seeking the sale of the Drug Development unit and other moves to try to unlock shareholder value — and LabCorp agreed to do a strategic review.

Typical stall tactic. Has anything come of it beyond the run-up in the stock last year?
Jon: LabCorp reported in December that the review concluded they should keep the Drug Development business, but that they were also initiating a 1.2% dividend (in line with Quest's) and had authorized a $2.5 billion share repurchase plan, $1 billion of which would be implemented on an accelerated basis. What's more, they said they were embarking on a $350 million cost-reduction program and committing to providing additional business disclosures.

Was that sufficient to pacify Jana for a bit?
Jon: Well, LH's shares have certainly backed off. Which just makes it more undervalued in our view. We think it's reasonable to apply an EV/EBITDA multiple of, say, 18 times, to LabCorp's drug development business, while using 11 times for its more quotidien lab operation — and that gives us a blended intrinsic valuation of $400 a share. That works out to 66% upside from here. So we are willing to wait.

Great. Got it.
Jon: Can I give you one more idea, really quickly? It's from our Micro Cap Focus publication, which I've been doing for better than a decade now, using our same research methologies to focus on companies with market caps of $500 million or less — which have been essentially abandoned by the Street. We think the micro cap space is one of the best places to invest in terms of risk/reward in the market currently — provided you can stomach the lack of liquidity.

A critical proviso, but go ahead quickly —
Jon: The company is Townsquare Media, Inc. (TSQ), trading around eight bucks. Here are my bullet points:

• Under current management, TSQ has been transformed from a traditional radio company to a digital media operator with high margins, meaningful growth opportunities and significant free cash flow. Over 50% of TSQ revenues are now from digi-

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digital advertising or subscription website services and it has a long run way for growth from both sources. Notably, the company's TSQ Interactive business (the recurring subscription business) generates around 20% of TSQ's overall revenue with profitably on par with the company's average of about 30% EBITDA margins.

•Shares have declined by about 40% from recent highs despite strong operating performance.

• TSQ's traditional radio and digital advertising business has benefited from the closing of about 1,800 local newspapers in the U.S. since 2004. In many instances, as a result of TSQ's primary small-market presence, it is the only source of local news in its communities.

•Although operating results were impacted by the pandemic, management took the opportunity to rightsize its cost structure, finding $20 million in annual expense reductions about half of which are expected to be permanent.

• In typical "Outsiders" fashion, In March 2021, Townsquare repurchased about 12.6 million shares and warrants (almost 45% of its then total outstanding) from Oaktree at around a 39% discount to the prevailing share price and a 19% discount to the price the shares were trading at prior to the buyback announcement. We saw this capital allocation move as extremely favorable and believe it will ultimately prove instrumental in unlocking meaningful shareholder value.

• TSQ's balance sheet is improving with net debt/EBITDA currently at 4.7 times, down from a pandemic high of almost 8 times. Leverage is expected to decline to about 4 times by the end of this year, which could set the stage for a refinancing to will lower annual interest expense

•Digital revenues were $206 million on a trailing 12-month basis as of March 2022. Management expects digital revenues to exceed $275 million by 2024.

•Applying a 3 times multiple to TSQ's expected 2024 digital revenues and factoring in the value for the company's slower growing, though still highly profitable traditional radio business at a depressed 5 times EBITDA — which is below precedent transactions — we value TSQ at $23 a share representing 181% upside from current levels.

I'm impressed. Concise and cheap. Just to be clear here, guys, whether we're in/heading into a recession isn't really entering into your investment decisions here?

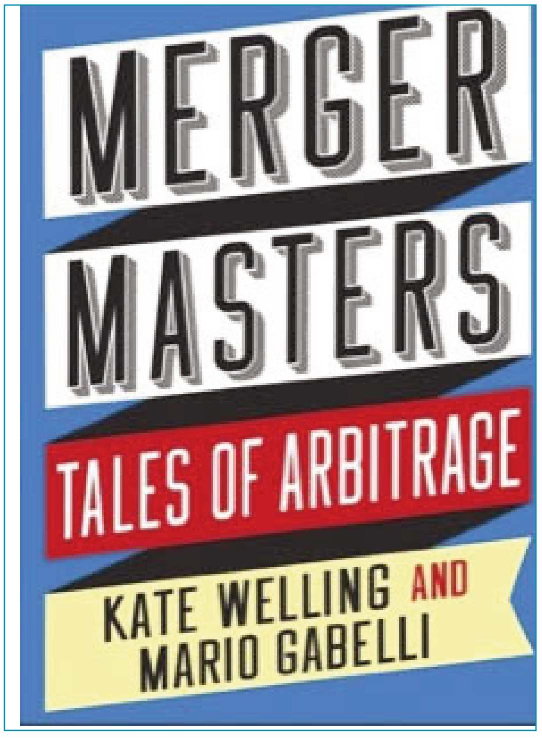
Mark: Recessions come and go. They end. And, a lot of these companies have already predicted a recession by collapsing 60% or 70% from their highs. Some of which were obviously ridiculous. Take a stock like Bank of America. We started buying it after the Great Financial Crisis, so we have a very low cost basis in it. Single digits. But our work indicated then that at some point, BAC had $2.15 in earnings power. Well, fast forward. Now, they've reported more than $2.50 a share, and the stock got up to 50. Last week, it got down to 29 again, which is now book value. And I can make the case the next time we have an up-cycle in banks, BAC could have $4 in earnings power. So it could sell for $60 a share.

My point is that a lot of these companies are already discounting a recession, and even if they prove to have a bit more downside, it's probably only around 10%. But meanwhile they're offering you more than double that in upside. I like those odds. Even it it takes five years to double, that's not such a bad return on investment.

Jon: Don't forget, you're also getting a decent dividend while you wait.

Mark: A new bull market will start at some point. When? Who the heck knows? Forecasting is a loser's game. Buying into true bargains, as they become available, isn't. The cycle will turn.

I'll second that article of faith. Thanks for sharing all your valuable work, Mark and Jon. And stay well.



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