Why I'm Cautious, A Stroll Down Memory Lane, and My Favorite Long and Short Ideas

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Robin Hood Investors Conference

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Why I'm Cautious

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My Portfolio Is Currently Positioned Very Cautiously With Low Gross and Net Exposure

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For only the third time in my nearly 18-year investment career, I've positioned my portfolio very cautiously

- The other two times were the peak of the internet and housing bubbles

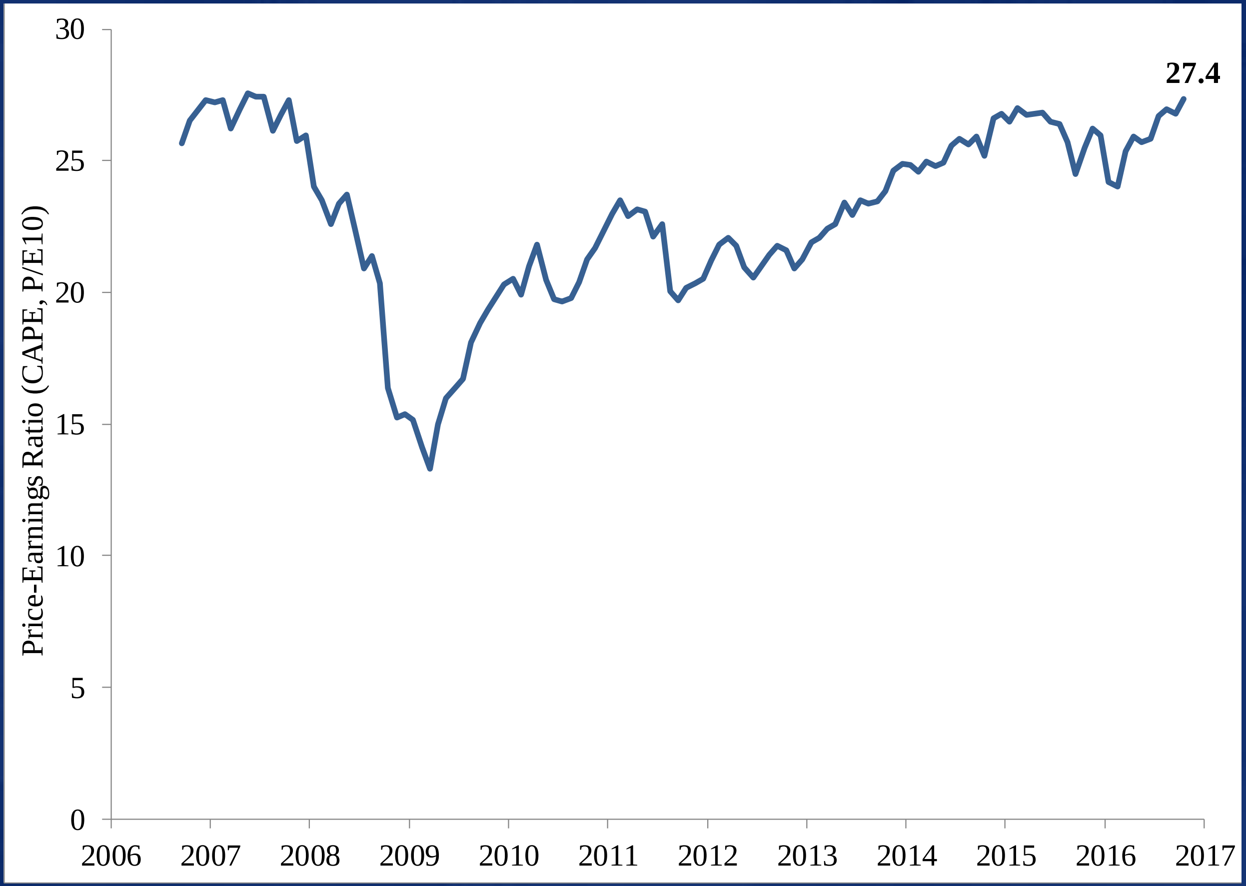
My portfolio today is only 37% long and 20% short (57% gross, 17% net) exposure, for three primary reasons:

1. My bottoms-up research is yielding few interesting long ideas and many excellent short ideas;
2. My top-down analysis is that the high valuations and complacency in the U.S. market is inconsistent with the uncertainty and wide range of potential outcomes that exist today; and
3. I expect significantly more volatility going forward, which creates abundant opportunities for stock pickers like me

The S&P 500 Today Is at a 10-Year Valuation High According to the Shiller PE Ratio

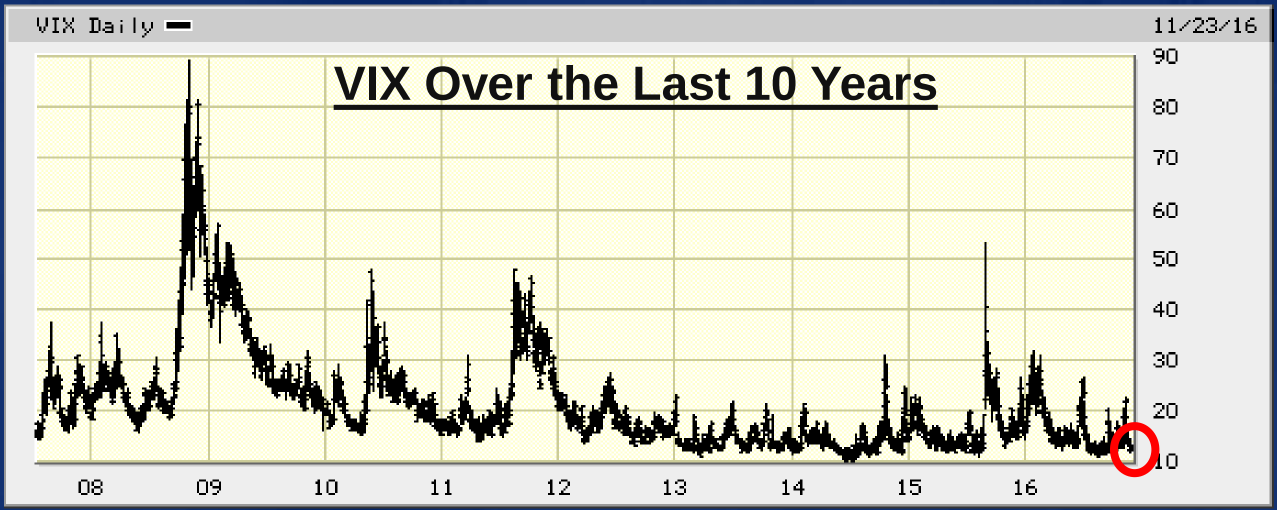
The major U.S. stock indices are at or near all-time highs and valuations are rich

- The Shiller P/E Ratio now exceeds 27x, the highest since the market peaked in 2007



The VIX (Fear Gauge) Is Near Its Post-Financial Crisis Lows

The CBOE Volatility Index (VIX), also known as the "fear gauge", is near a decade-long low, indicating a high degree of investor complacency



We Are in a Period of High Uncertainly, With a Wide Range of Possible Outcomes

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Interest Rates Rising

- After an unprecedented period of extremely low (even negative) interest rates, they have risen sharply since July, especially in the past 3 weeks
  - Rising interest rates have historically not been good for stocks
  - Ray Dalio said yesterday that another 1% rise in yields could result in a bear market

Brexit

- The world's 5th largest economy is withdrawing from the EU, something that has never been done before
  - Could lead other countries to withdraw, even to the breakup of the EU

Rising Populism

- Rising populism in the U.S. and Europe is leading to threats to the post-WW II world order characterized by reasonably free trade and movement of people

There Is a High Degree of Uncertainty Around Donald Trump, Who Takes Office in 7½ Weeks

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- This is not a typical Presidential transition: in many ways, Trump is the most unusual President in history. This might turn out well (I hope it does!) – but might not…

Trump's promise	Upside	Downside
Characteristics		
Business, not political experience	Bloomberg	Berlusconi
Have an open mind	Better, non-ideological decisions	Decisions based on the last person who had input
Go with his gut	His gut in some areas has been very accurate	Bad decisions
Be unpredictable	Keeps enemies off balance	Uncertainty/chaos
Policies		
Shake things up, drain the swamp	Washington needs shaking up/draining	Political turmoil
Renegotiate trade agreements	Better trade agreements	Trade war(s)
U.S.-first foreign policy	Benefits U.S.	Breakdown of post-WWII order
Reduce regulations	Unleash economic growth	Businesses running amok
Cut taxes & invest in infrastructure	Stimulate the economy	Higher deficits, inflation and/or interest rates

Summary of Why I'm Cautious

- What happened three weeks ago was, by all accounts, an *earthquake* – but the U.S. stock market doesn't reflect this…yet
- The range of outcomes is wide, and investors would be foolish to assume that only the upside outcomes are possible/likely
- It's possible that Trump is good for stocks in the short term, but not in the long term
    - This would be consistent with his business career, which has been characterized by many booms and busts
    - This was a widespread view in an unscientific survey I did of some of my friends who manage hedge funds
- I'm not predicting calamity, but I am predicting volatility
- As an investor, I like certainty
- I'm perfectly happy to invest in times of great uncertainty – for example, late 2008/early 2009 or even as recently as January/February of this year – but only when I'm being compensated for it in the form of low valuations
- I'll conclude with Buffett's famous maxim: "Be fearful when others are greedy and greedy when others are fearful."

An Update on the Dozen Ideas I've Pitched at the Last Three Robin Hood Investors Conferences

- I have low portfolio turnover, so I still hold and like some of them
- I've pitched 12 ideas (LL twice), 11 of which are up; the average gain is 43%
- Lesson: Robin Hood is good mojo for any stock I mention, so I'm going to talk about a lot of stocks!

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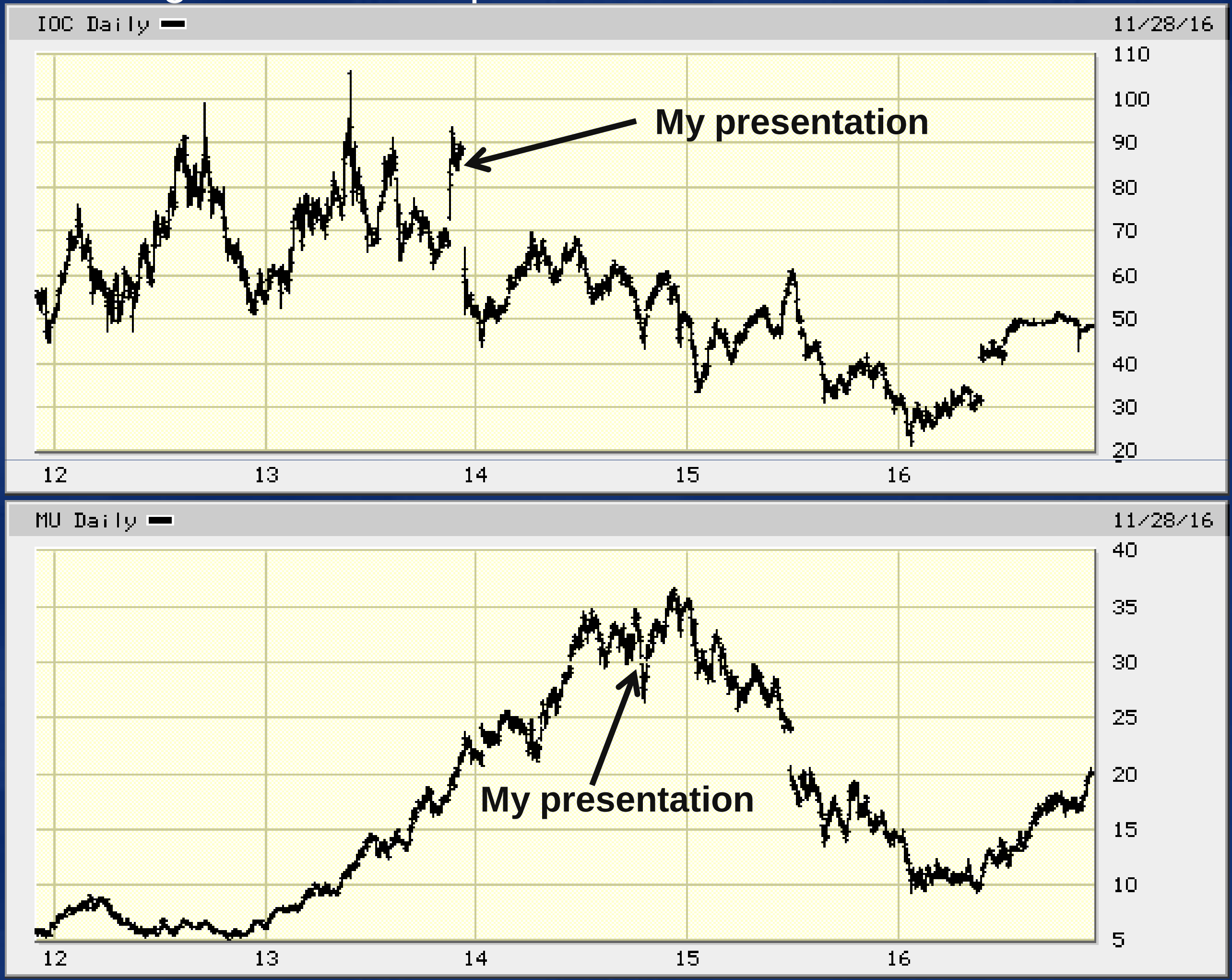
In 2013 and Again in 2014, I Pitched Lumber Liquidators as a Short at $115.36 and $59.05

- Amidst a formaldehyde scandal exposed by 60 Minutes, the stock has collapsed
  - Down 85% since my first pitch; 70% since my second
- The company is still struggling and losing money, but has settled most regulatory investigations and lawsuits so I think it's likely to survive – and might be a good acquisition candidate – so I'm no longer short the stock

Note: My original presentation and subsequent ones are posted at: www.tilsonfunds.com/LL.pdf

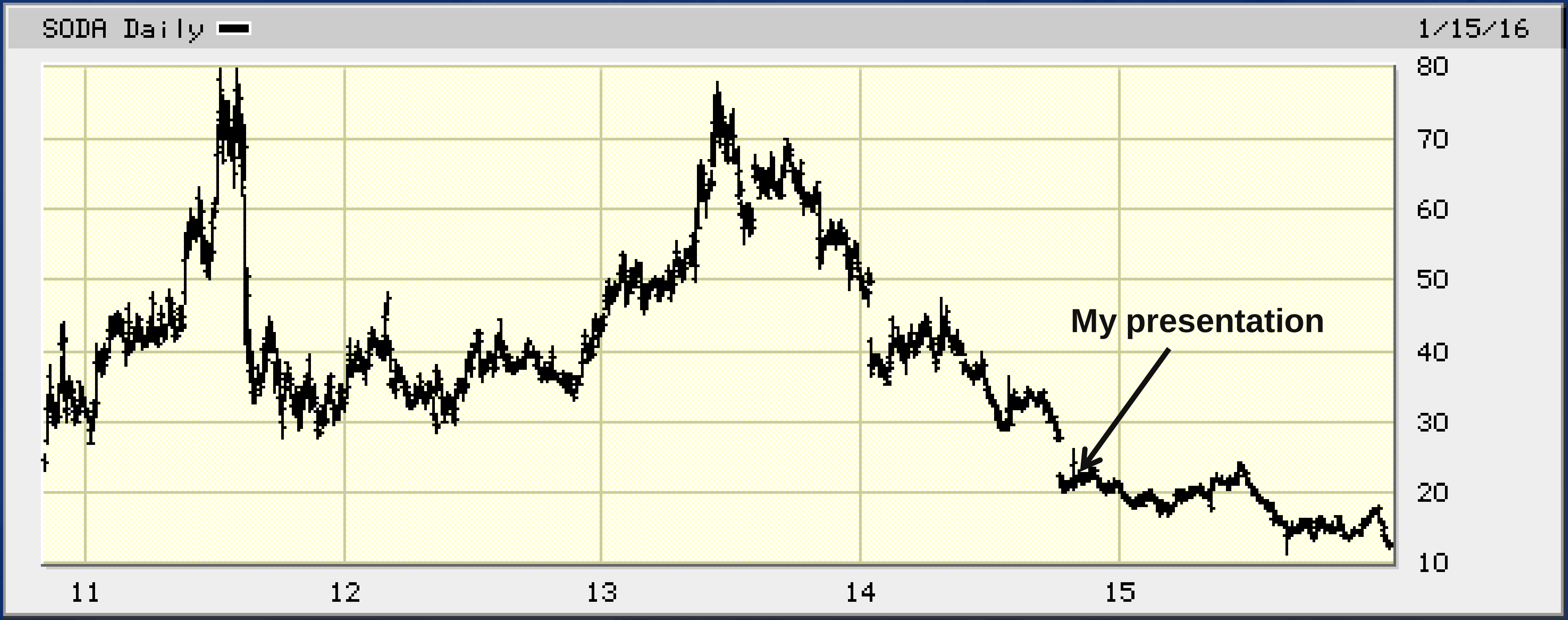
I Pitched InterOil as a Short 3 Years Ago at $86.50 and Micron as a Long 2 Years Ago at $31.19

- InterOil has fallen 44%; Micron has fallen 36%
- I no longer hold either position



In 2014, I Pitched Sodastream as a Long at $20.78 – and Looked Dumb for More Than a Year

- As is often the case, I was early as the company and stock performed poorly for more than a year



Note: My original presentation is posted at: www.tilsonfunds.com/SODA.pdf

Sodastream Has More Than Tripled Since Mid-January

- The company has reported three consecutive strong quarters and the stock has more than tripled since mid-January
- It's now up 75% since I pitched it
- I have trimmed the position to manage position size/risk, but continue to hold a ~4% position

Note: My original presentation is posted at: www.tilsonfunds.com/SODA.pdf

In 2014, I Pitched Four Airline Stocks, All of Which Have Outperformed, Especially JetBlue

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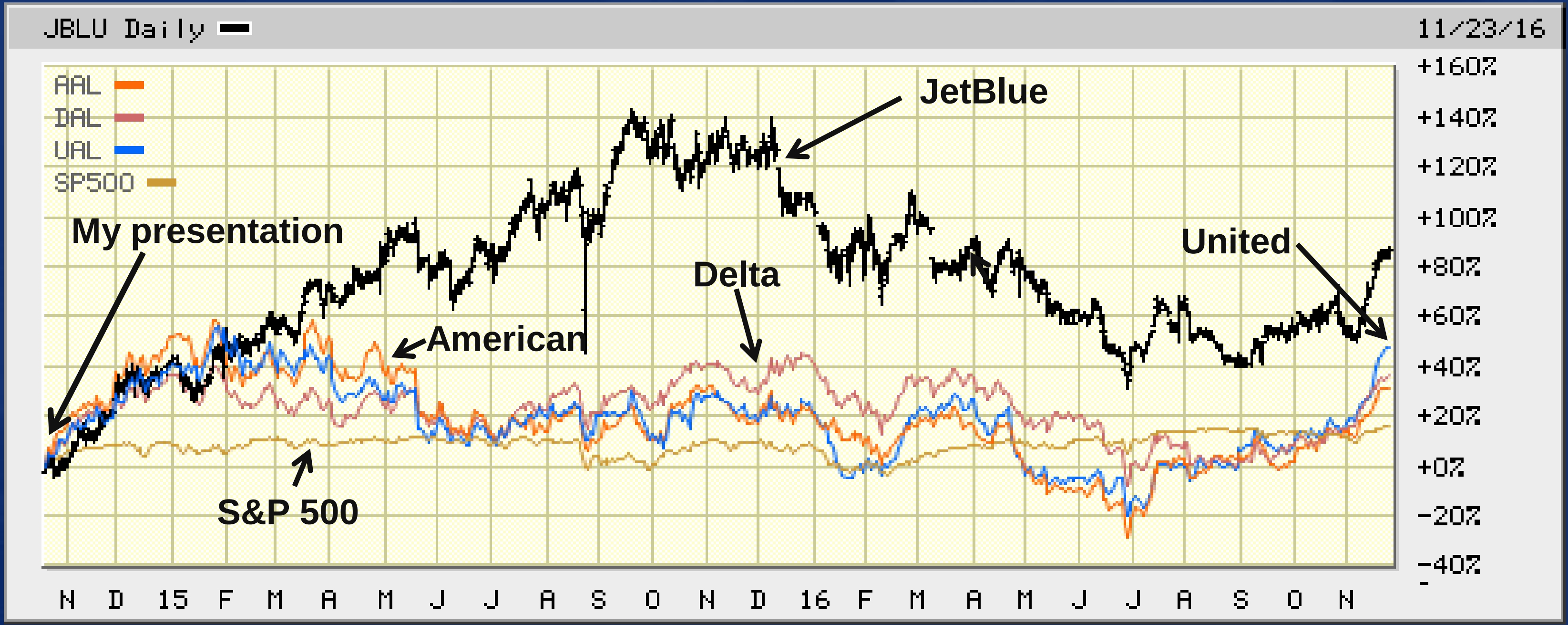
- Two years ago, I discussed the airlines and concluded: "I have invested 10% of my fund in four airline stocks (in descending order of size): Delta, JetBlue, United & American"
- Since then, all four have handily outperformed the market, led by JetBlue (+80%)
- I no longer own any of these, but continue to own the airline I pitched at last year's conference, Spirit



Last Year I Pitched Spirit Airlines as a Long at $33.77

- The stock is up 62% since then
- The price war, mainly with American Airlines, has eased
- In January, Spirit replaced its founding CEO with Bob Fornaro, the former CEO of AirTran, who is focused on improving Spirit's abysmal customer service ratings and reputation
- The stock now trades at 13.5x 2016 and 2017 estimates of ~$4.00, modest for a company with such high growth, margins and ROIC
- I have taken some profits, but continue to hold a 4% position

Note: My original presentation is posted at: www.tilsonfunds.com/SAVE.pdf

Last Year I Pitched Wayfair as a Short at $37.28

- The stock is down 8% since then (vs. +7% for the S&P 500)
- I covered when a key part of my investment thesis – formaldehyde in furniture Wayfair sells – didn't pan out
  - There was formaldehyde in some products, but not enough to warrant attention by consumers, regulators or investors
- I remain skeptical of the company's business model, but don't believe it's a good short given its high growth, good management, healthy cash position, and low (0.8x) EV/revenue ratio

Note: My original presentation is posted at: www.tilsonfunds.com/TilsonRH15.pdf

Two Years Ago I Pitched Exact Sciences as a Short at $23.86 – and Looked Like a Genius 16 Months Later

- Exact Sciences has a single product, Cologuard, a poop-in-a-bucket test that detects colorectal cancer and precancerous polyps
- The stock crashed to under $5 after the U.S. Preventative Services Task Force's Colorectal Cancer Screening Draft Recommendation listed Cologuard as an "Alternative Test" rather than a recommended one
- But I got greedy and didn't cover, as my price target was cash ($3)

Note: My original presentation is posted at: www.tilsonfunds.com/EXAS.pdf

Exact Sciences Has Rallied Strongly in Recent Months, Making It a Great Short Once Again

- The U.S. Preventative Services Task Force, in its final recommendation issued in July, punted on which screening test is best, giving A grades to Cologuard and six other screening methods, causing Exact's stock to quadruple before falling back to today's level ~$15, down 37% from when I pitched it (vs. +14% for the S&P 500)
- My pain is your gain: I believe the recent rally gives investors another opportunity to short EXAS
- It is currently my largest short position at 3.5%
  - I recently added to it at current prices after the largest insider sales (nearly $25m) ever
  - There's plenty of borrow at minimal cost

Note: My original presentation is posted at: www.tilsonfunds.com/EXAS.pdf

Slide presented two years ago:

So Why Am I Short the Stock?

1) It's not clear that Cologuard is so much better than the FIT test
2) There's a big false-positive problem
3) It's *23 times* more expensive than the FIT test (~$22 vs. $502), which has been around for a long time and is widely known, trusted, available, and covered by all insurers
4) Cologuard is much "messier"
5) Competition is looming
6) Commercial payor adoption may be slower than anticipated

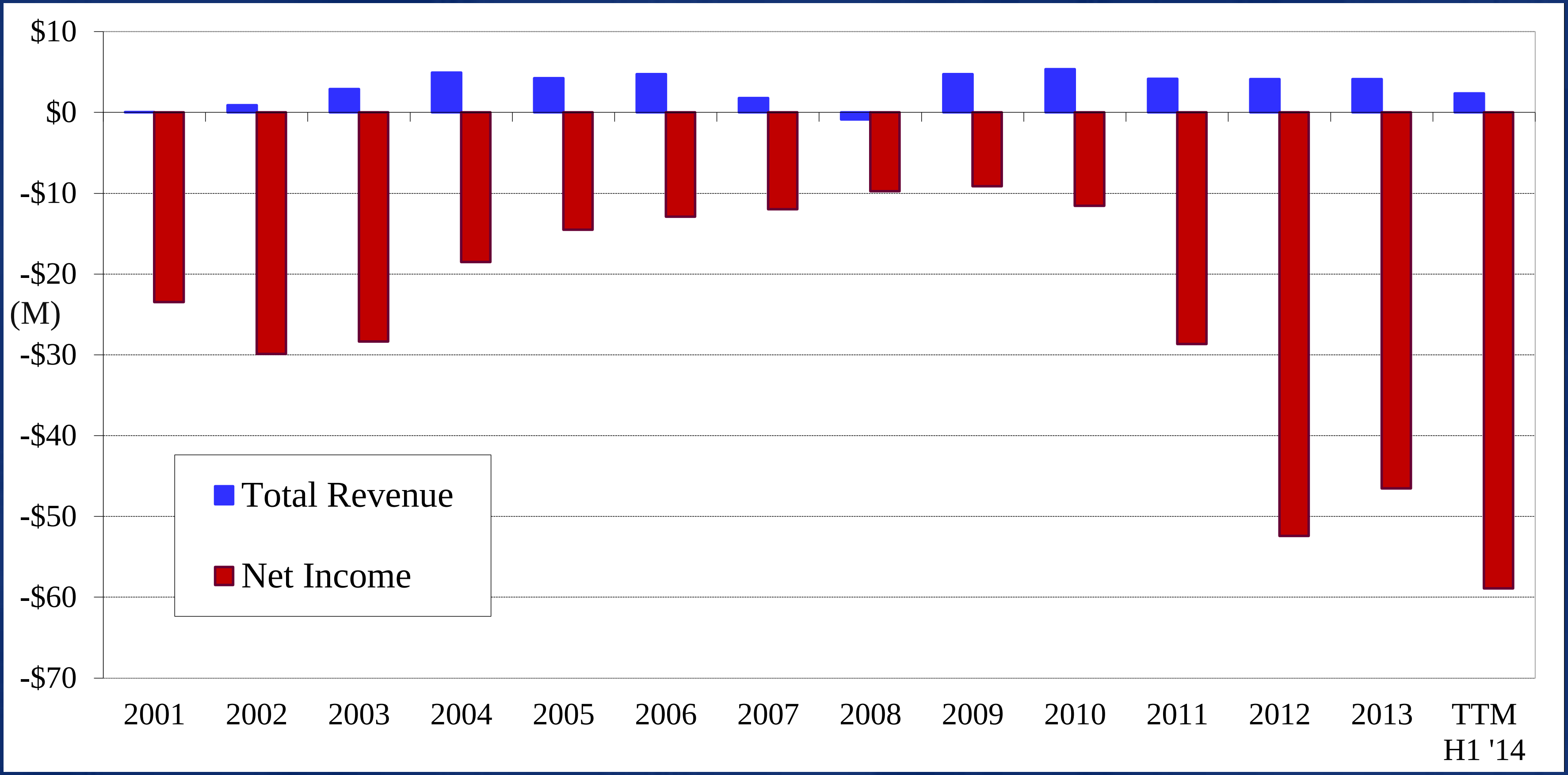
For all of these reasons, I think adoption of Cologuard will be gradual, which isn't what is priced into the stock

Note: My original presentation is posted at: www.tilsonfunds.com/EXAS.pdf

Slide presented two years ago:

Exact Sciences Has Never Generated Meaningful Revenues and Its Losses Are Accelerating

- In Q2 '14, revenues were zero and net loss was $19.4 million



Source: CapitalIQ.

UPDATE: Exact Sciences Has Started to Generate Revenues, But Losses Have Tripled

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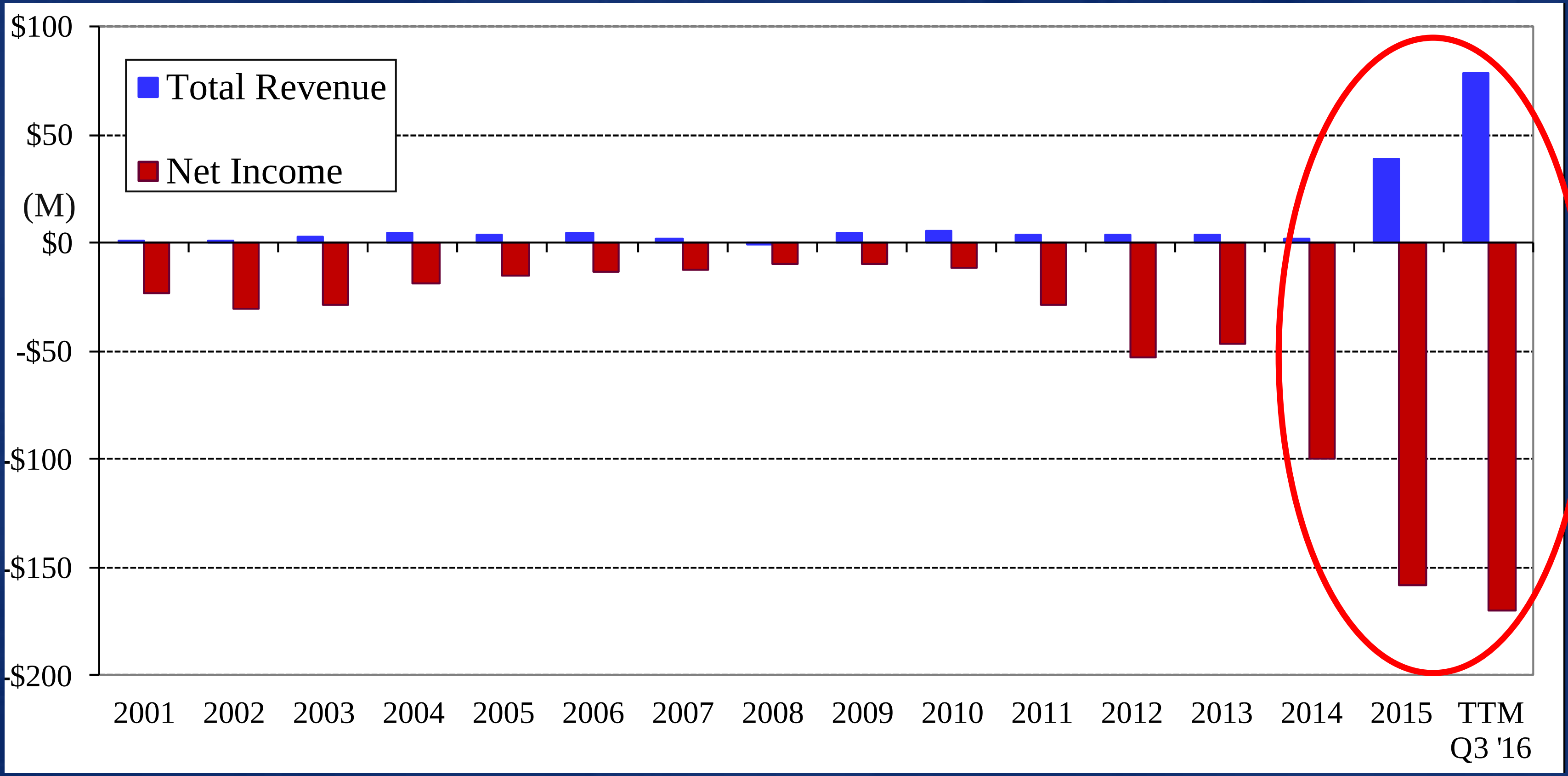
- In Q3 ‘16, revenues were $28.1 million and net loss was $37.8 million
- Sales & marketing costs alone in Q3 ‘16 were $26.3 million



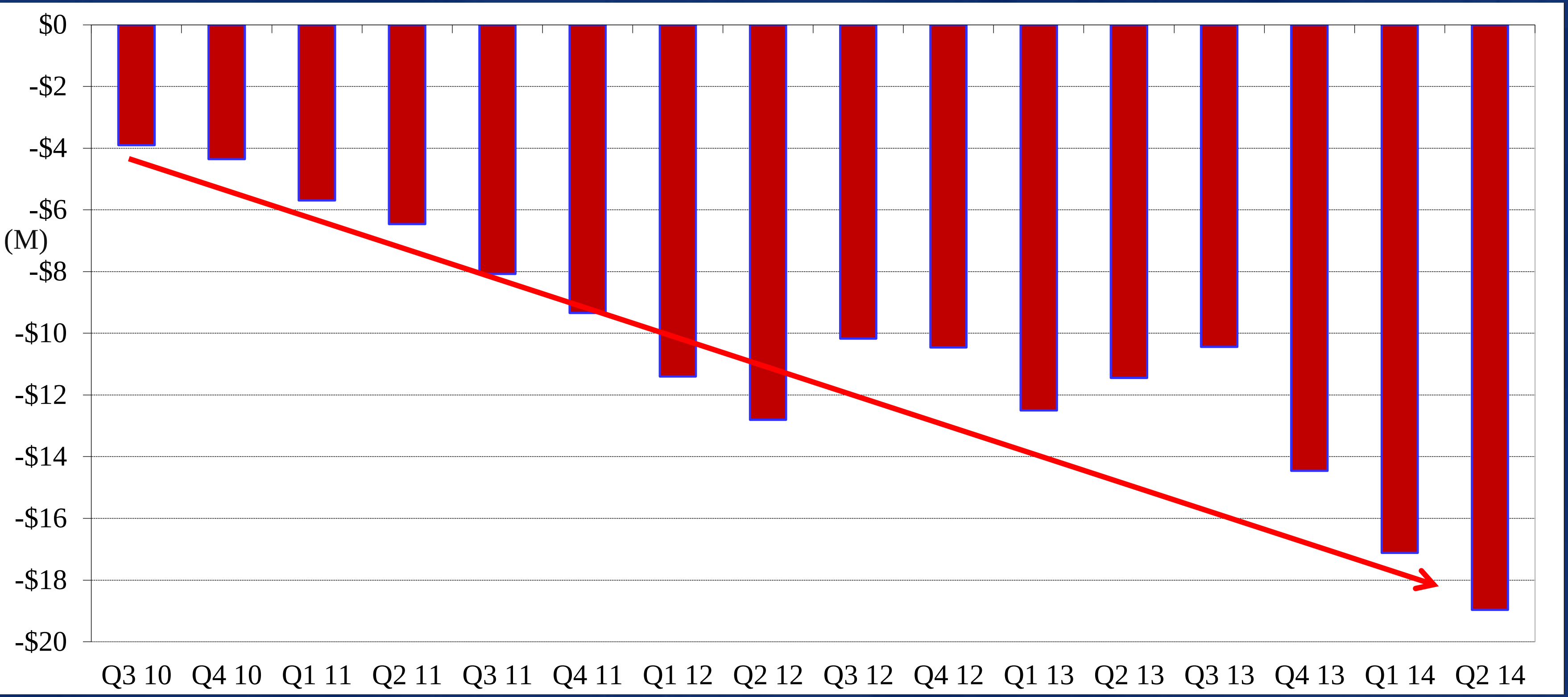
Source: CapitalIQ.

Slide presented two years ago:

Exact Sciences' Quarterly Cash Burn Is Rising – And Will Intensify as the Sales Force Is Hired

- Cash burn could approach $100 million in 2015

Free Cash Flow



FCF is operating cash flow minus cap ex

Source: CapitalIQ.

As I Predicted, Exact Sciences' Quarterly Cash Burn Rose Dramatically, Roughly Doubling

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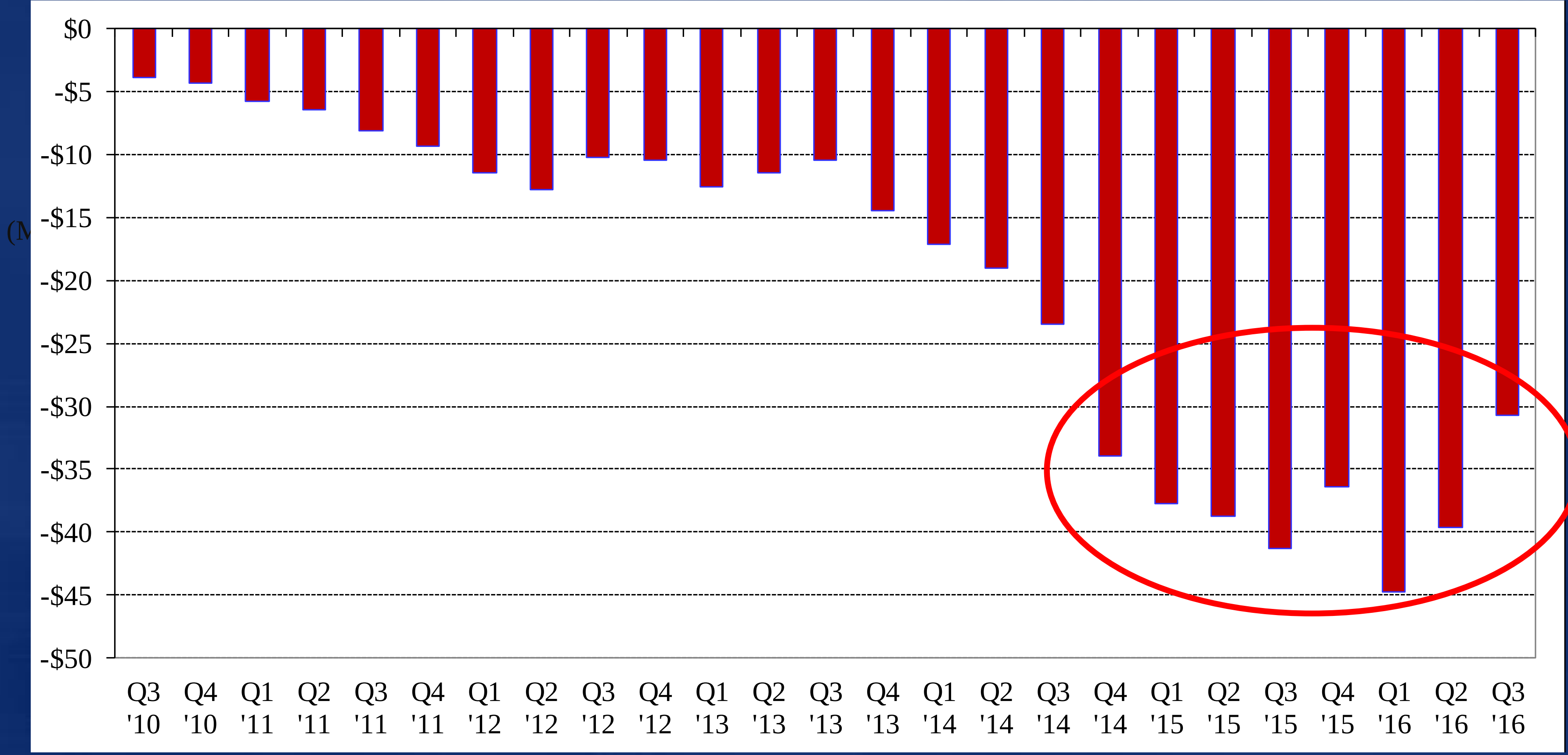
- Cash burn was $154 million in 2015 and is $151 million TTM

Free Cash Flow



Note: FCF is operating cash flow minus cap ex

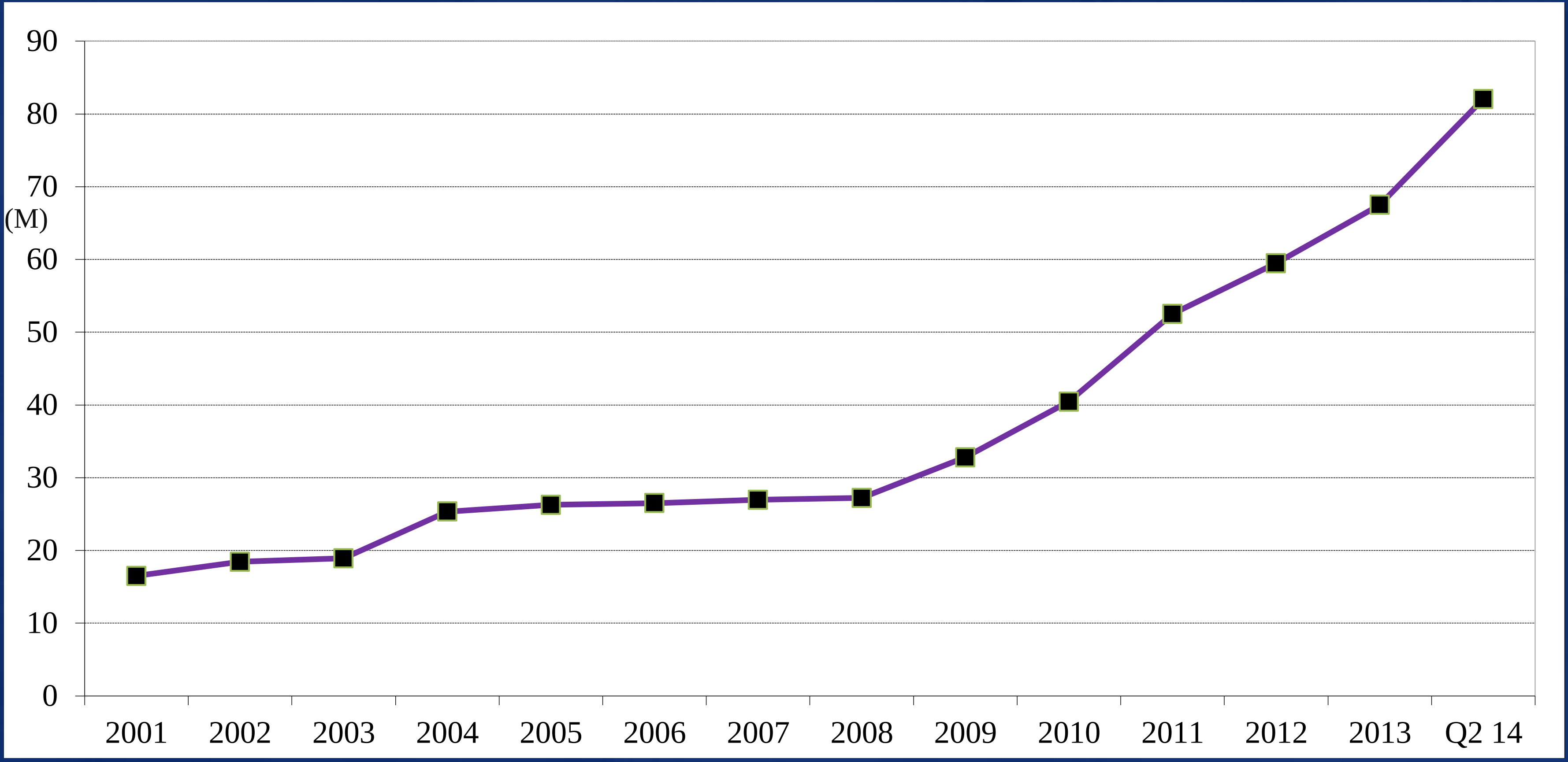
Source: CapitalIQ.

Slide presented two years ago:

To Fund Its Losses, Exact Sciences Has Issued More and More Shares, Diluting Shareholders

- The share count has more than tripled in the past six years

Diluted Shares Outstanding

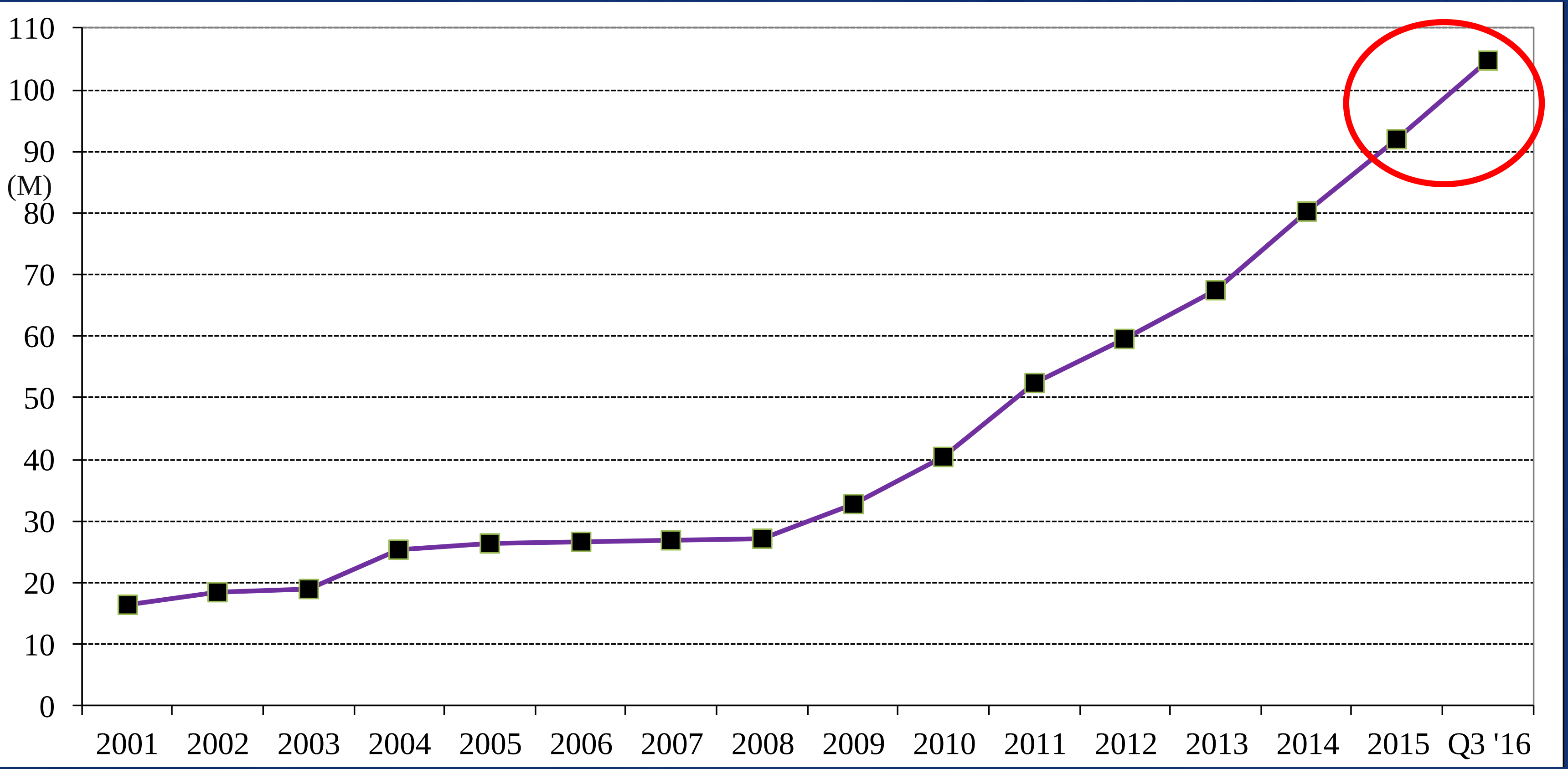


Source: CapitalIQ.

UPDATE: Exact Sciences Has Continued to Issue More and More Shares, Further Diluting Shareholders

- The share count has nearly quadrupled in the past eight years

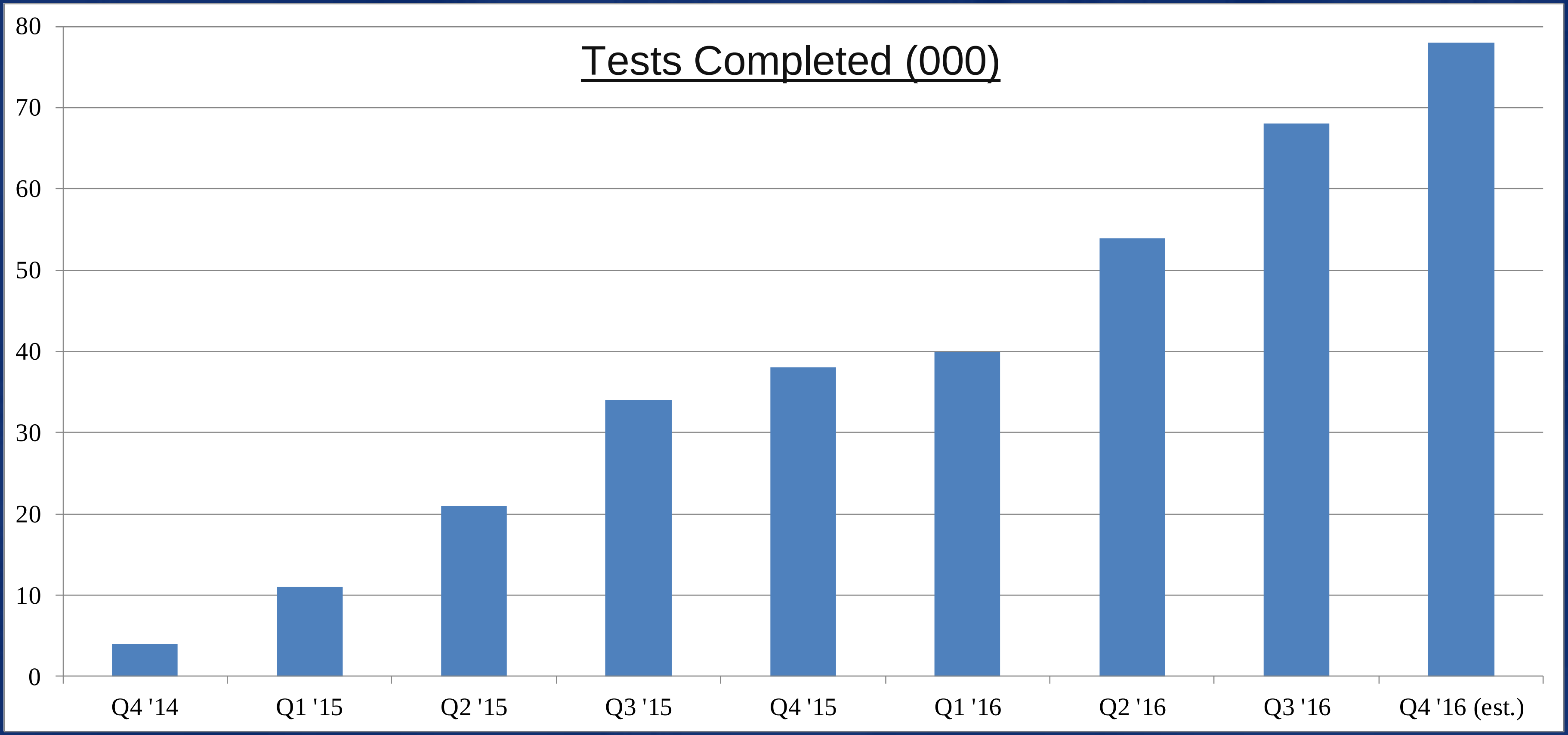
Diluted Shares Outstanding



Source: CapitalIQ.

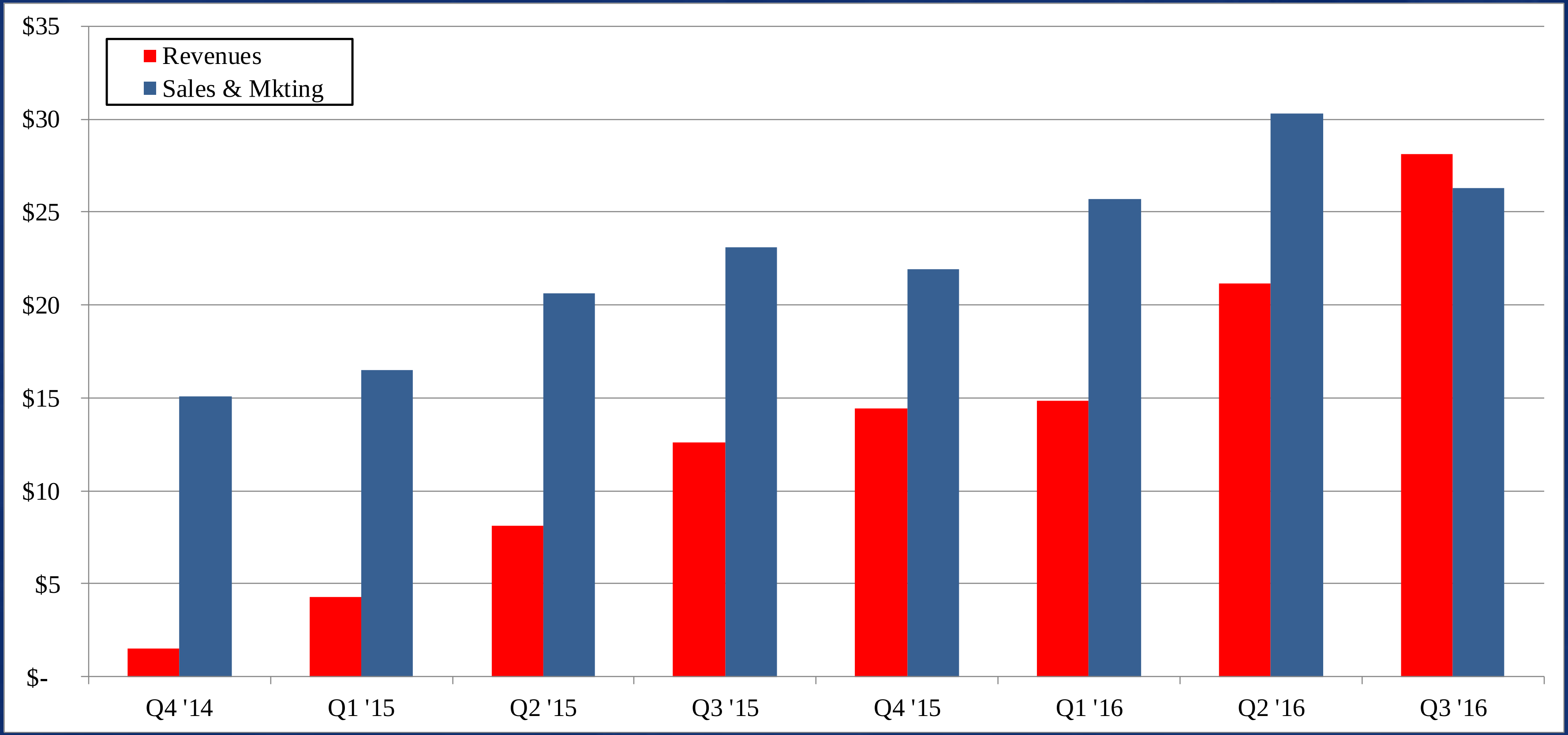
The Number of Cologuard Tests Is Growing Rapidly

- More than 50,000 providers have ordered 270,000 Cologuard tests in the two years it's been available, and the number of tests is growing rapidly



Huge Sales & Marketing Spend Has Generated Only Modest Revenues

- Exact Sciences has spent $180 million in sales & marketing since Cologuard's launch two years ago to generate only $105 million in revenues



Source: CapitalIQ.

Summary: There Are Many Ways to Win

- The valuation is extreme – a $1.7 billion market cap for a single diagnostic product company
- Exact Sciences has a legitimate and approved test, but the valuation implies Cologuard going mainstream, whereas I think it will remain a niche test for the reasons outlined earlier
- While the stock is down by 1/3 since I pitched it two years ago, the market cap is down less than half of this because of many more shares outstanding
- Analysts project high growth – but also high losses – for years to come
    - I think the latter is far more likely than the former
- Thanks to its heavy sales & marketing spend (including a national TV campaign), Exact Sciences has been able to buy more growth than I expected, but I think it's close to reaching the limit of this approach
- Once growth flattens – yet losses remain – I expect the stock to trade down to a slight premium to cash, which is $2.58/share

Three New Ideas:
One Long, Two Shorts

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Long: Berkshire Hathaway

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Berkshire Is a Conservative, High-Quality, Growing 80-Cent Dollar

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- The acquisitions of Precision Castparts (which closed at the end of January) and Duracell (end of February) have increased Berkshire's operating earnings by ~12%
- I estimate intrinsic value is now $292,500, nearly 25% above today's level
- In an uncertain world, Berkshire provides more certainty than any other company
- If the world becomes turbulent, there is no-one I would rather have allocating capital than Warren Buffett
- This is my second-largest position at 5.2%
- My entire slide deck on Berkshire Hathaway is posted at: www.tilsonfunds.com/BRK.pdf

Estimating Berkshire's Value: 2001 – Q3 '16

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Year End	Cash and Investments Per Share	Pre-tax EPS Excluding All Income From Investments[1]	Intrinsic Value Per Share[2]	Subsequent Year Stock Price Range
2001	$47,460	-$1,289	$64,000	$59,600-$78,500
2002	$52,507	$1,479	$70,255	$60,600-$84,700
2003	$62,273	$2,912	$97,217	$81,000-$95,700
2004	$66,967	$3,003	$103,003	$78,800-$92,000
2005	$74,129	$3,600	$117,329	$85,700-$114,200
2006	$80,636	$5,300	$144,236	$107,200-$151,650
2007	$90,343	$5,600	$157,543	$84,000-$147,000
2008	$75,912	$5,727	$121,728	$70,050-$108,100
2009	$91,091	$3,571	$119,659	$97,205-$128,730
2010	$94,730	$7,200	$152,330	$98,952-$131,463
2011	$98,366	$8,000	$178,366	$114,500-$134,060
2012	$113,786	$8,700	$200,786	$139,610-$178,275
2013	$129,253	$9,716	$226,413	$163,038-$229,374
2014	$140,123	$12,051	$260,633	$186,900-$227,470
2015	$159,794	$12,304	$282,834	?
Q3 '16	$155,000[3] +	$13,750[3] x 10 =	$292,500	?

1. Unlike Buffett, we included a conservative estimate of normalized earnings from Berkshire's insurance businesses: half of the $2 billion of average annual profit over the past 12 years, equal to $600/share prior to 2015. Starting in the 2015 AR, Buffett began to include all insurance earnings, so this is reflected in 2014 and 2015 earnings.
2. Historically we believe Buffett used a 12 multiple, but given compressed multiples during the downturn, we used an 8 in 2008-2010 and 10 since then.
3. Estimates.

Berkshire Is Trading 20% Below Its Intrinsic Value

* Investments per share plus 12x pre-tax earnings per share through 2007, then an 8x multiple from 2008-2010, and a 10x multiple thereafter. Excludes all income from investments, but including $600/share of insurance earnings

If You Think Interest Rates on U.S. Government Bonds Are Going Up, Then Here's a Short Idea for You: Direxion Daily 20+ Year Treasury Bull 3x ETF (TMF)

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TMF Is Designed to Move 3x the Daily Move of the U.S. 20-Year Treasury Note

- If interest rates rise, the value of the bond declines, benefitting the short position (my 3rd largest at 2.6%)
- The 20-year Treasury hit a low of 1.69% on July 8th and closed yesterday at 2.68% – TMF has declined by 40% over this period
- Over time, investors should also benefit from the decay associated with levered ETFs
- This is only for a small fund or personal account, as the borrow is tight and currently costs me 12% annually

Short: Wingstop

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Overview

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- Wingstop is in the chicken wing restaurant franchise business
- Founded in 1994, it began franchising in 1997
- There are 949 Wingstop restaurants in 40 states (93% of units) and 6 countries, of which 98% are franchised
- 75% of revenues are take-away (vs. 16% at Buffalo Wild Wings)
- Like most franchise businesses, Wingstop has high margins and low capex, thus generating healthy free cash flow
- Market cap (at $31.19): $897m; cash: $4m; debt: $157m; EV: $1.05b

Wingstop Is Growing Rapidly

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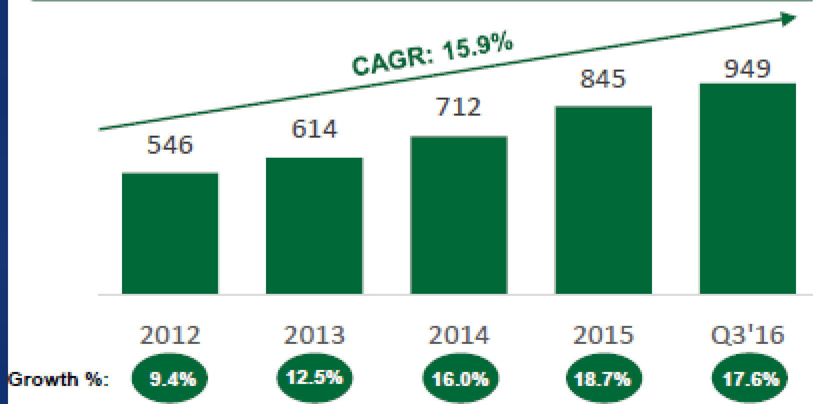
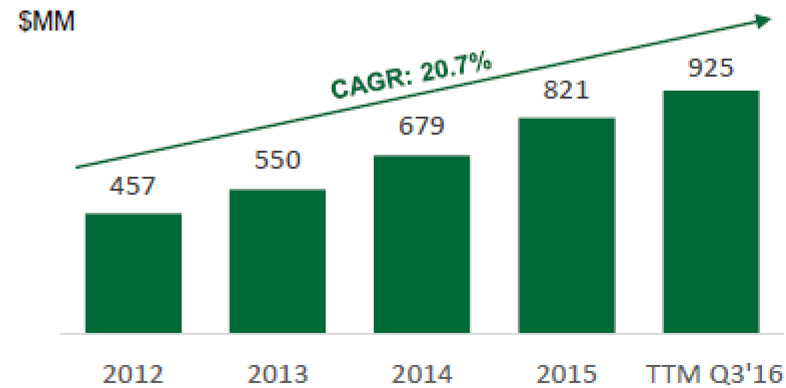
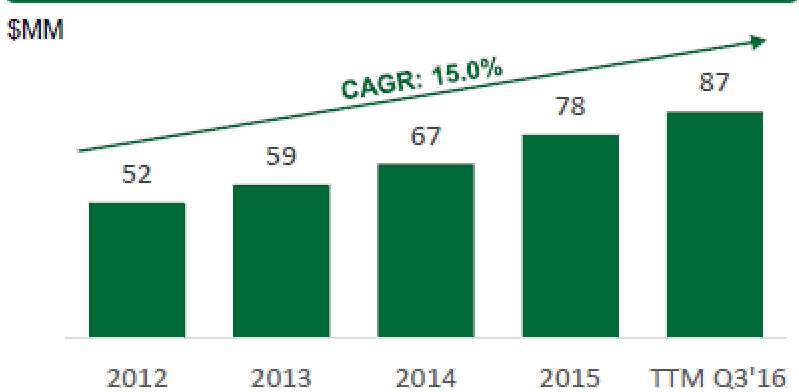
Total Units



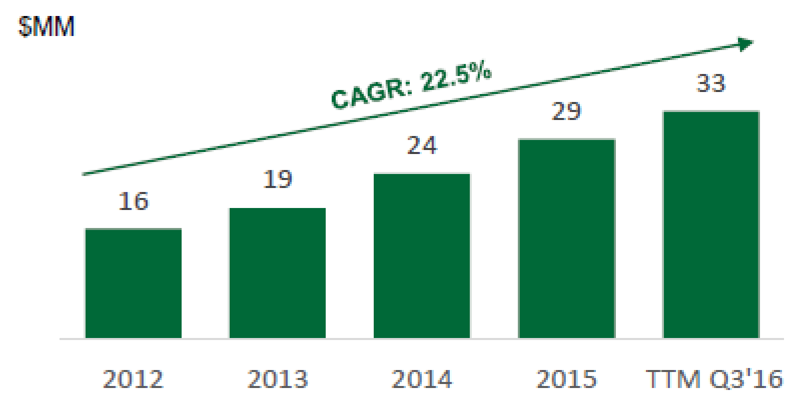
System-Wide Sales



Total Revenue



Adjusted EBITDA[1]



Source: Wingstop investor presentation, 11/16.

Wingstop's Stock Is Flat Since Its First Day Close After Its IPO in June 2015

Why Am I Short the Stock?

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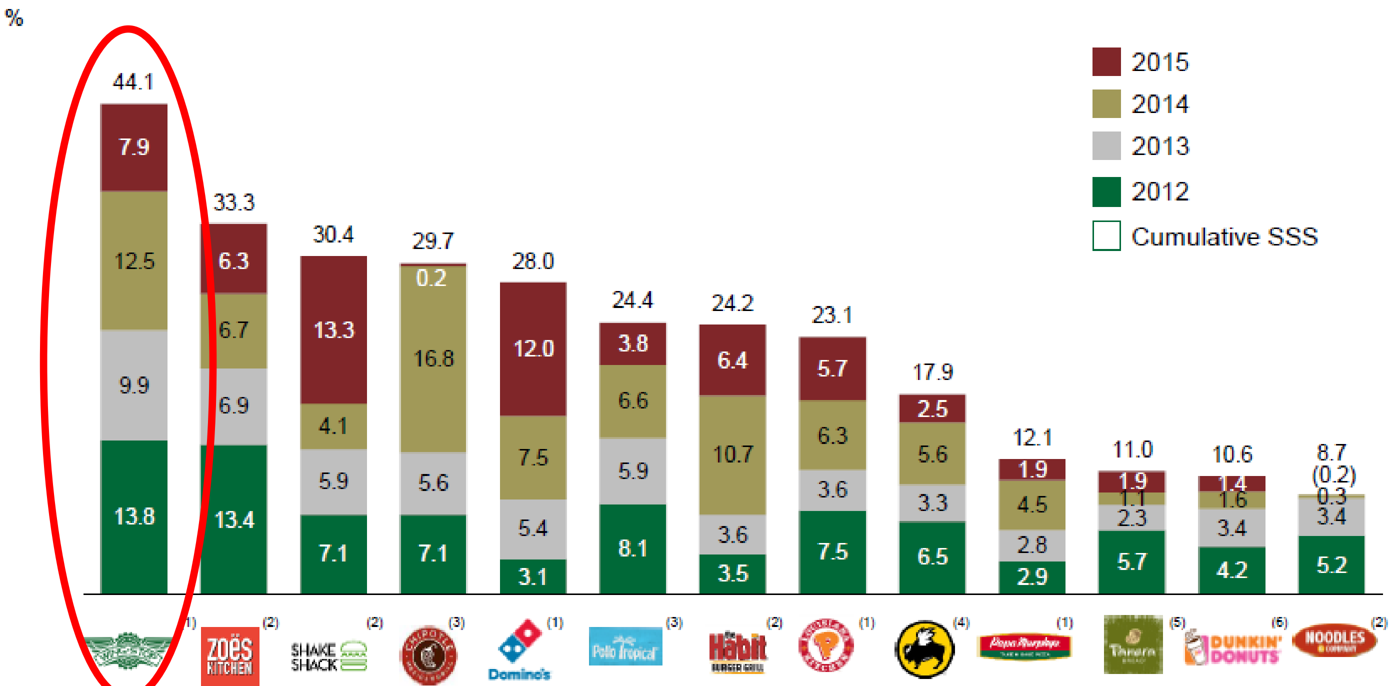
1) The valuation is absurd: 62x trailing EPS (47x NTM), 35x trailing EBITDA (28x NTM), and 12x trailing revenues (11x NTM)
2) Same store sales growth is decelerating
   - An estimated half of same store sales growth in recent years has been driven by price increases, which is likely unsustainable
3) There is little that is proprietary or unique about this business – these are chicken wing restaurants!
   - There are plenty of competitors, many much larger, with deeper pockets and better technology: head-to-head (BWW, Wing Street), other fast food chains (KFC, Domino's, Pizza Hut, Popeyes, Papa John's), and indirect (supermarkets selling ready-to-eat wings)
4) I doubt whether Wingstop can nearly triple the number of units in the U.S. to management's stated goal of 2,500
   - The market is much more competitive and may be becoming saturated
     - Roughly half of all chicken wing restaurants in the U.S. have been opened the last five years, a quarter in the last two years
   - Nearly 2/3 of Wingstops today are in two states, Texas (nearly 10% in Dallas alone) and California, so the business and brand are largely unproven elsewhere
5) After 22 years (including a dozen owned by two respected private equity firms) and growth to nearly 1,000 units, the company generated a mere $87 million in revenues and $15 million in net income in the last 12 months

Wingstop's Investor Presentation Boasts of Phenomenal Same Store Sales Growth

But Note That 2016 Data Is Missing

INDUSTRY LEADING SSS

2012 – 2015 Stacked Same Store Sales



Source: Company filings

Notes:
(1) Domestic system-wide
(2) Domestic company-owned
(3) Global company-owned
(4) Franchised
(5) System-wide
(6) Dunkin U.S. segment only

Source: Wingstop investor presentation, 11/16.

In Reality, Wingstop's Same Store Sales Growth Has Decelerated Significantly

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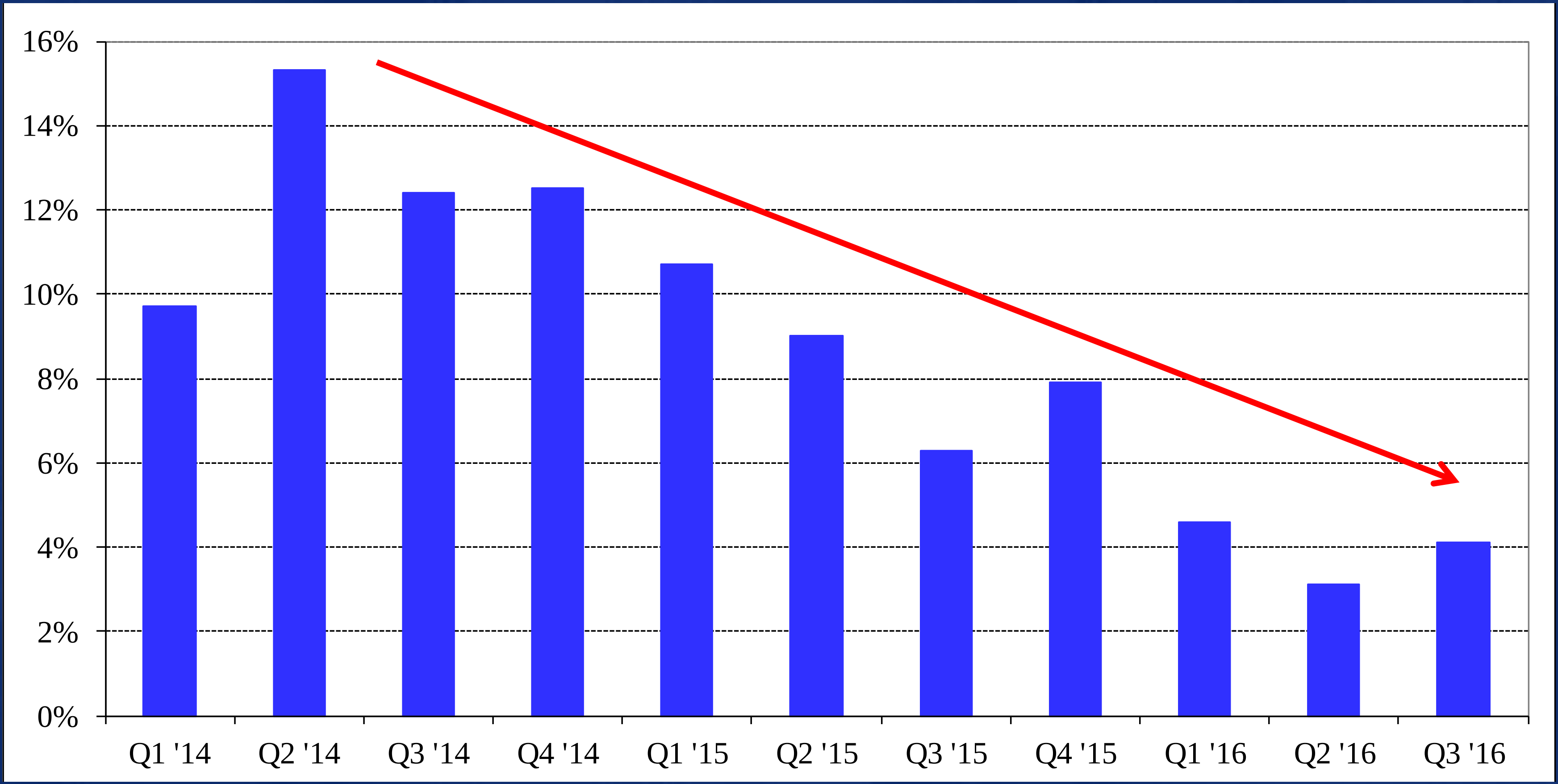
Despite Increasing the Pace of New Unit Growth

System-wide domestic same store sales growth



Public Shareholders Are Wingstop's 4th Owners – and the Prior Owner Has Already Cashed Out Entirely

- Founded in 1994
- Acquired by Gemini Group in 2003
- Acquired by Roark Capital in 2010
- Taken public in 2015

Roark Capital specializes in franchise businesses and currently owns 16 quick/limited/full service restaurants chains. It typically holds for a decade or more.

But in the case of Wingstop, it rushed to dump its entire stake:

- Jun 2015 – IPO – 3.2m shares sold at $19;
- Mar 2016 – Secondary – 6.3m shares sold at $24;
- July 2016 – Special dividend of $2.90/share, bringing debt to EBITDA to 5.2x;
- Aug 2016 – Secondary – 6m shares sold at $29.25;
- Nov 2016 – Secondary – all of remaining 6.8m shares sold at $26.28

Why the rush? My guess is that Roark saw a possible fad, oversaturation, and the signs of slowing growth, so wisely took the opportunity to cash out at an absurd valuation

Summary and Price Target

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- Wingstop is a decent company with reasonable growth prospects
- But its business is largely undifferentiated and faces ferocious competition from all sides
- It has only proved that its business and brand work in two states, yet its valuation assumes that it can scale rapidly across the U.S. and abroad – a highly questionable proposition
- Given that the stock is currently priced for perfection, if I'm wrong, it has little upside – and if I'm right, look out below!
    - For example, look at Papa Murphy's (FRSH), a fresh pizza (take-away to cook at home) franchising business with 1,570 stores in 38 states and abroad: the stock went public ~$10, soon soared to $20+ -- and has now crashed to under $5
- A discounted cash flow analysis, even assuming favorable growth and margin increases for the next decade, yields a share price roughly half today's level
    - Even at that price, the stock would still be richly priced at more than 30x trailing EPS
- This is my 2nd largest short position after Exact Sciences
- There is plenty of borrow at negligible cost

Thank you for supporting Robin Hood!

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