Transcript of Whitney Tilson's Appearance on Wall $treet Week with Fortune

Friday, July 16, 2004

Investor spotlight: Whitney Tilson

GIBBS: Deadly dull, lackluster, tepid trading. This is how The Wall Street Journal characterized recent stock market action. With little opportunity to make money, that leaves lots of chances to lose money. In our investor spotlight - Whitney Tilson, founder of Tilson Capital Partners. He says if you can't find something smart to do, don't do anything. Whitney, good to see you.

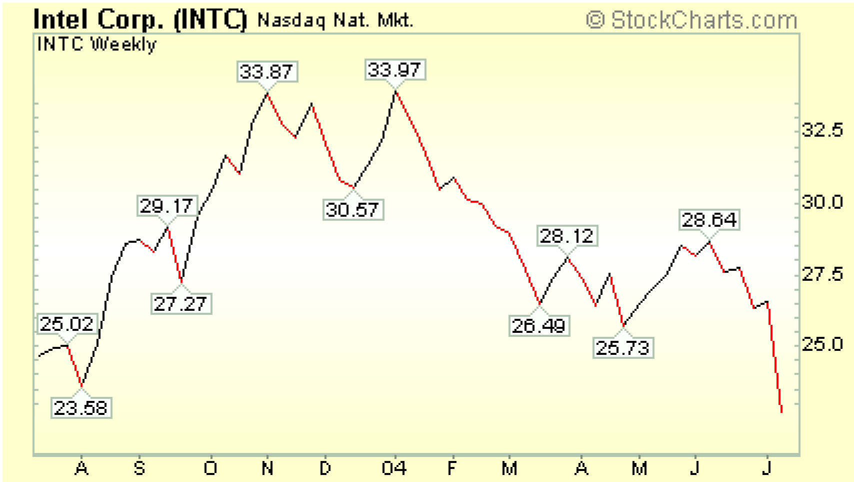
TILSON: Thank you for having me here.

GIBBS: We just heard some very interesting things about telecom and telecommunications, technology. What would get you excited about tech?

TILSON: Well, as a consumer, I'm very excited about it. Every time I hear about these exciting new products that are going to cut my phone bill in half, make even faster Internet available to me, I go out and buy the latest gadget. That increases my productivity at work, and that's great as a consumer.

As an investor, I tend to steer far clear of those sectors because usually the companies involved don't have any profits, have no history of real profitability certainly, and valuations, certainly in this market, are rather extreme. So that kind of speculation is a recipe for losing your money as an investor, in my opinion. I tend to steer clear of that and just buy the products and benefit from it that way.

GIBBS: Even some of the big names, the giants such as Intel, came out with earnings this week that aren't great, but didn't necessarily disappoint.



TILSON: Well, Intel -- how can you knock a company that made $1.8 billion in a single quarter? But the valuation of Intel is still very high, and I think investors are missing the fact that this is a cyclical company and should probably trade, as it did many years ago, at a discount valuation multiple to the overall market, but instead it trades at a substantial premium.

And all is not well at Intel. If you look closely at the earnings release, sales were flat sequentially, but inventories rose 15 percent. Year-over-year sales were up 15 percent, but inventories soared 50 percent. Simply put, Intel is producing more product than it can sell, and gross margins were weaker than expected this quarter, and when they have to get rid of that excess inventory, gross margins are going to get a lot weaker. So I think Intel's at high risk for earnings misses in the next couple of quarters, so I wouldn't go anywhere near the stock.

GIBBS: Well, you do call yourself a value investor. In fact, you look for the 50-cent dollar investment. Things are not cheap now. How about going up to an 80-cent dollar investment?

TILSON: Well, that's the dilemma these days. It's probably the toughest environment for a value investor that I've been in in my career, over ten years. Every asset class, every industry, every type of stock -- growth, value, small-cap, large-cap -- all are trading at full if not significant overvaluation. So the real dilemma is do you compromise your standards and start paying a little bit more and apply relative valuation? I'm trying to be disciplined enough not to do that, because once you start compromising those standards, you can lose a lot of money.

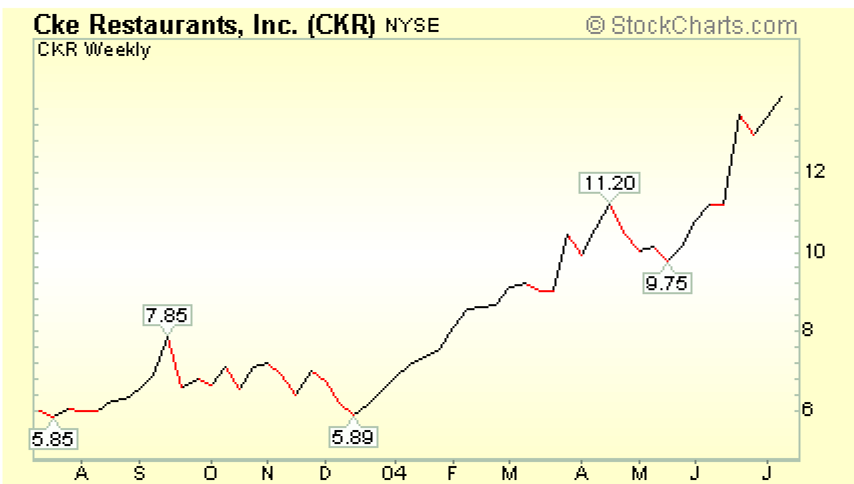
GIBBS: Is that why you're sitting on a huge wad of cash, like 36 percent of your portfolio?

TILSON: Yes, exactly. I have real concerns about the market and the economy and so forth, but I'm not a market timer -- I'm a stock timer. My default option is cash and I will sit on cash until I'm, I like to call it "trembling with greed," where I'm pinching myself, saying "I can't believe the market is so badly misunderstanding this particular company that it's pricing this stock at such a low level that I can buy it at half of what I think it's really worth." Trembling with greed opportunities over the past 6 to 12 months have been few and far between, and so cash has built up in my portfolio, and I'm quite comfortable with it.

GIBBS: Well, what do you say to investors that say, ”Hey, I'm paying you to sit on cash?”

TILSON: I would argue one of the hardest things to do as a professional money manager is sit on a lot of cash. There are enormous pressures to be fully invested, one of them being investors might call you up and ask you that kind of question. I guess my response to them is, ”You're paying me to allocate your cash in the best way I know how, and you as an investor want me to only put that cash to work -- and put it at risk -- in situations where the odds are extremely favorable to us, and if I don't find those situations, then let's just sit on cash and wait until the market serves up a nice, juicy pitch that I can hit out of the ballpark.”

GIBBS: I know one of your largest holdings is, is it CKE Enterprises?



TILSON: CKE Restaurants is the name of the company.

GIBBS: CKE Restaurants, Carl's Jr., Hardee's. Why?

TILSON: Well, it was a very interesting situation a couple of years ago where in 2002 the fast food industry had its worst year in 20 years. There were burger wars going on between McDonald's and Burger King, and smaller burger companies, like Carl's Jr. and Hardee's, were getting caught in the crossfire. CKE Restaurants was reporting terrible comp store numbers, was losing money and the stock went from $12 to $3.00. Those are the type of situations that I tend to look for: stocks trading at multi-year lows where investors are very bearish about a company's prospects. And every once in awhile, if you find a real good company that's been thrown out with the bath water, you can make a lot of money on that.

In this particular case, Hardee's was in the midst of a turnaround, and I did quite a bit of research on the company and became convinced that Hardee's was in fact going to turn around. Over the past 15 months or so, everything I could have hoped for and then some has transpired, and the stock has nearly quadrupled.

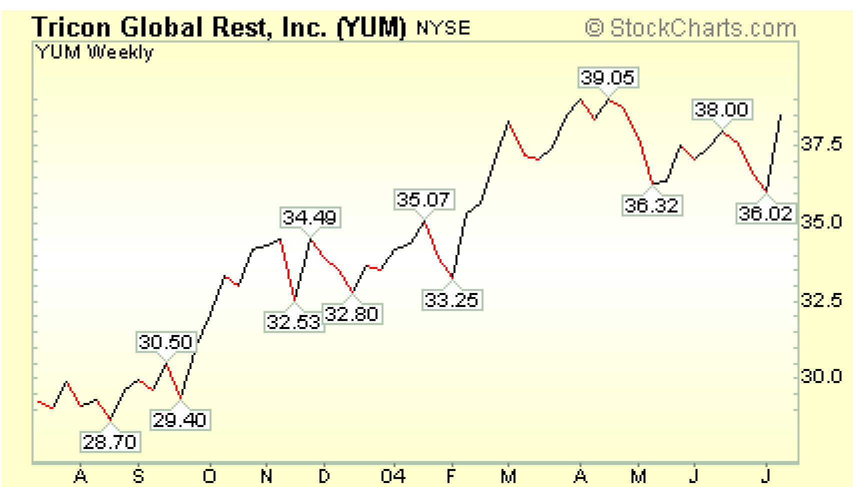
GIBBS: Talk to me about the way you do research. You call it "scuttlebutt" research.

TILSON: Right. Well, I always start with the basic analysis that every investor does, perhaps meeting with management, but certainly reviewing the annual reports, the SEC filings and so forth. But I look for an information edge, because typically I'm making a bet contrary to what the general consensus is in the market. And since everyone in the market has the same general information, to invest successfully I think you need an edge.

And so in the case of CKE Restaurants, we went out and met with management and learned about a new menu that they were developing to turn around Hardee's called the Thickburger menu: big, juicy, thick Angus burgers that were going to be the best fast food burgers you could buy anywhere. And so the real bet in owning CKE Restaurants was: Would this Thickburger be a home run, or would it be yet another failed turnaround attempt of Hardee's?

An investment colleague and I picked up the phone and just started smiling and dialing Hardee's restaurants all around the country. Whoever picked up the phone, typically a store manager or assistant manager, we told them exactly who we were -- that we were shareholders of the company – and we'd heard about this new Thickburger menu. Tell us how it's going? What's the customer response like? After about 30 restaurants gave us the exact same answer -- which is that the Thickburger is the best new product Hardee's has had in years, the customers are going crazy for it -- we were trembling with greed at that point, and ramped this investment position up, very fortunately right at the bottom, at about $3.00 a share, and we've held almost all of it ever since. Today it just went over $14.

GIBBS: So you talked about how you look for discounts to get into stocks and how difficult it is for a value manager to get out at the right time, not trying to time the market. What do you do with a stock, say, such as Yum, the parent of Pizza Hut, etc. When do you know to get out?



TILSON: It's funny, because just on the ride over here I was talking with one of my colleagues about Yum, which reported earnings this week, and the story continues to be a great story. The company is doing exceptionally well, particularly with its international businesses. I'd initially established a position when the whole restaurant sector was getting killed about a year ago when the stock was at roughly $23 a share. Today it's in the upper 30s.

The stock today is trading at roughly 16 times this year's recently-revised-upward estimates, and I think it's a significantly superior company to the average company out there, say in the S&P 500, yet it trades at a discount to the S&P 500. So it's a stock today that I'm more thinking of selling than buying more of it certainly -- it's had a nice run -- but I sort of view it as an 80-cent dollar. I tend to buy 50-cent dollars and sell $1.00-dollars, and not do much in between.

GIBBS: Talk about not doing much in between, the stock market hasn't done much in between. Other than sitting on cash, do you see any opportunities that may present themselves if things cheapened up?

TILSON: Well, I mean "if things cheapened up" are the key words there I would say. It depends on where. Usually in the stock market, even in the most egregiously overvalued markets, say in March of 2000, if some sectors are extremely in favor, usually cash has been taken out of other sectors to invest in those sectors, so you look at the other sectors if you're a value investor. Almost any old economy sector back in March of 2000 you found tremendous bargains, so it was fairly easy to put money to work even in an overvalued market.

The problem today is that every sector is in favor, but it has always been my experience that if you just wait awhile -- it's like New England weather, just wait a few minutes, and it will change. I don't need the whole market to go down 50 percent for me to find bargains. I just need a few sectors to have bad things happen to them and I'll put that 36 percent of my fund that's in cash to work. Typically I'm almost fully invested, if not fully invested, and was as recently as 15 months ago.

GIBBS: Will you let us know when you're going to make a change, Whitney?

TILSON: Sure. I'll be back to tell you.

GIBBS: Thanks very much, Whitney Tilson.

TILSON: Thank you.

Follow-Up from Whitney Tilson's July 16, 2004 Appearance on Wall $treet Week

Friday, August 13, 2004

Foot Locker

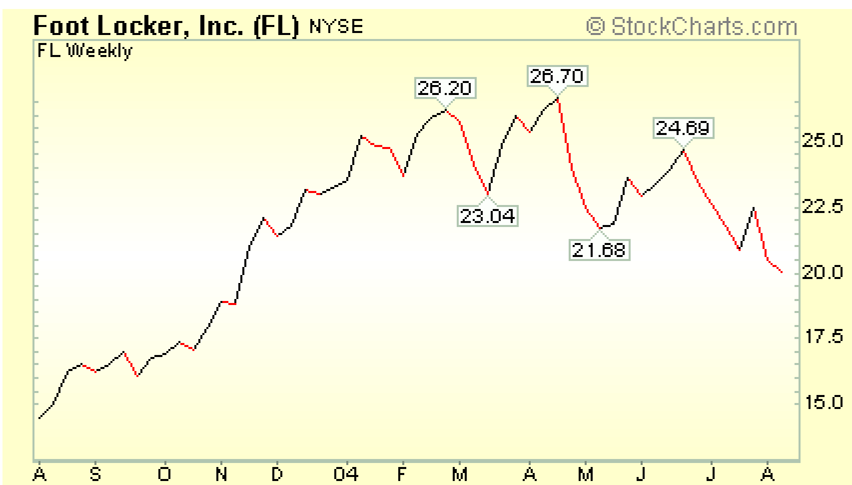
COLVIN: Now, Let's drink this in: When super value investor Whitney Tilson appeared on our show a short while back, he called this market environment the toughest he had ever witnessed. Every single asset class was just about overvalued, and there we no bargains to be had.

(video excerpt begins)

> "I will sit on cash until I'm, I like to call it trembling with greed, where I'm sort of pinching myself, saying I can't believe the market is so badly misunderstanding this particular company that it's pricing this stock at such a low level that I can buy in at half of what I think it's really worth. And trembling with greed opportunities over the past really 6 to 12 months have been few and far between, and so cash has built up in my portfolio."

(video excerpt ends)

Whitney promised he'd get back to us when he found something worth investing in. And true to his word, he let us know that he just bought shares of the world's leading retailer of athletic footwear and apparel, a company called Foot Locker.



Now Foot Locker was a poorly performing unfocused retailer in the late 1990s, but management began a major turnaround and implemented what Whitney considers to be an enormously successful restructuring plan. They closed underperforming stores, got rid of non-core businesses like Kinney shoes and Burger King franchises, and repaired its broken relationship with its most important supplier, Nike.

Whitney says, now the company has a strong balance sheet, a focused business strategy and is generating a lot of cash. The stock is selling right now for about $22 and Whitney predicts the stock will trade at about 35 bucks within two years or so. That's about a 60 percent return on your money. That might just make you jump in your Nikes.