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THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

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

Mike Alkin: Welcome to the podcast. It's Monday, September 24, 2018. Hope you had a good weekend. Mine was enjoyable. My birthday this past weekend, so I got the breakfast in bed. Kids made me lunch. I got to watch football all day. So, not bad. Pretty good birthday.

Aside from that, took my son ... Our high school is a perennial football powerhouse, and we've lived here for 10 years or so. And I grew up about 20 minutes from where I live now. Don't worry, plenty, I've lived elsewhere. So it's not a total bubble. So, anyway, so this past weekend, our local high school team played my alma mater, where I was a quarterback and I was a free safety, many, many years ago. So we went down. I took my son and his buddies. We drove to my old neighborhood. We saw the house I grew up in, to which my son said, "Really, Dad? That's really small." I said, yeah. Exactly. So when you hear me ranting and raving all the time about, I didn't have that when I was a kid so stop being spoiled or whatever it might be, now you understand where it comes from. And they've seen it 10 times, my kids.

So anyway, a buddy of mine, we took his daughter, we went down to the football game, and I gotta tell you ... Boy, times have changed. So again, our local high school is just dominant. Always ... A typical season, if they lose one game, it's a big deal. But a lot of undefeated teams. A really powerful program. The kids play from a very early age. And my kid plays in the middle school. He's played football since he's two. I know, I hear, I know the injuries and all that stuff. But I played, I think it's great lessons that you learn. I take with me from the time ... I played football from the time I was a young kid, seven years old. But for me, I carry life lessons from my experience with football that are immeasurable, that just really still stay with me. Coaches had a huge impact on

my life, and I never at all forced my kid to play. But he loves it, and I see him learning the same lessons, and it's pretty cool.

Anyway, we go down, we go to my alma mater, and it was a disaster. We were winning 35-0 at halftime, and there's a rule in place in the county I live where you can't go ... A high school team, if they win by more than 42 points, the coach faces the possibility of suspension, which is kind of interesting. They're trying to bring some fair play into it and ... I shouldn't say fair play, but they're trying to not have kids feel devastated because they've gotten blown out all the time.

So anyway, boy, did I take abuse on the way home from my kids saying, Dad, I can't believe you went to this school where you guys were this bad. I said, no, we were like a 500 team, we were okay. I threw as many interceptions as I did touchdowns, but ... It was probably more interceptions, actually. But it was fun. But boy, I got to head shake. But it was a great day, it was nice, it was a lot of fun, a lot of nostalgia for me. But I realize now, after a lot of years that I've been gone, things and memories kind of fade and all that stuff. So it was a good day. And I had a lot of fun there.

And then it was funny, I was telling a story. We had some people over just to have some birthday cake. We had some good friends over, and we were talking. And a couple of my buddies are big hunters, and I'm not. It's just not my thing. So if we're playing hockey and you go into the corners, I'm a grinder, I'm a pounder, I'll hit. Playing football, I say now, but that was who I was. Same thing with football, stick my nose in there.

When it comes to outdoors sports like that, like hunting and fishing, it's just not my thing. I have nothing ... I think hunting's fine if you want to go do it, but the whole shoot, gut it, not my thing. So I had some buddies over and we were talking because I'm going out to visit a uranium mine in a couple of weeks in the middle of the country. And the project manager has a big ranch. And he said, hey, great, come on out, and we've got some great pheasant hunting here. So we'll set up a pheasant hunt. I'm like, oh, boy.

So I'm thinking, okay. I'm that guy, I don't know if you've ever seen the movie Wedding Crashers, where they're walking in the woods and they accidentally ... One guy shoots it, and he shoots the other guy in the butt. And I thought, oh, shoot. Now that's going to be me. So I had a decision. Do I do the pheasant hunt and just go out and do it, or just not? So I just said, listen. I emailed him back, I said, thanks, man. Really appreciate it, but I'm just a suburban guy, I'm not much of a hunter. And he wrote back,

yeah, no problem, I totally get it. I know what he's thinking. He's thinking, you big sissy. But I'm like, okay, so I'll deal with it.

So last night, my buddies are over. A couple are hunters. And they said, any traveling? I said, yeah, I'm going to visit a uranium mine. I say, you know, it's funny. They wanted me to go pheasant hunting. Now, these guys abuse me all time for not going hunting and fishing with them. They're always trying to get me out there. But if I go fishing, I'm going to throw up on the boat 'cause I can't handle the waves, and if I go hunting, they know that I'll complain the whole time.

So they say, well, where were you going to go? And I told them I was going out to South Dakota. And they're like, dude, are you kidding? That's the best pheasant hunting on the planet. I'm like, seriously? Are you kidding me? That is the mecca of pheasant hunting. So now they spent a half hour trying to convince me that I've gotta ... Just for the experience, I've gotta go pheasant hunting. So I'm wrestling with that right now. So anyway, that was my weekend.

I'm going to ... I'm bringing somebody on today. No, we're not going to talk uranium this week. But I want to bring a friend of mine on who I've known for about 20 years, and he's a hedge fund manager. But he's a hedge fund manager in an area of the market that is something that you don't pay attention to all the time. It's the distressed world. And a lot of people who listen may have all different interests, but a lot of people are mainstream equity investors.

But my friend who's going to come on has been in the hedge fund business for probably close to 30 years now. I've known him 20. An extremely, extremely bright guy, but he lives in the market's underbelly. To him, what is ugly to most people is not ugly to him. He's looking for value where others aren't paying attention. And he's not focused on the day-to-day noise of the market, and I get that a lot. Just like, for instance, when I'm around friends of mine, people will always ask me about the hot stock that's going. What do you think of the latest marijuana stock, or this stock, or that stock? Most of the time, I couldn't even tell you anything other than name, or if I read a headline or two on my Bloomberg machine on it.

I'm just not that focused on it. I'm looking for specific companies, specific industries, that I'm focused on at the time, where I think

are dramatically mispriced. So it's very non-mainstream, and there are times ... And I often ... I have a Bloomberg machine, a terminal that I ... I could get anything I want in the world, it's at your fingertips. But i'll find the more that I pay attention to what's going on in the mainstream, the more distracting it is for me. I don't watch CNBC during the day, I don't watch Bloomberg. I read, I'm a voracious reader, so I'm reading industry stuff that ... I'm looking at price movements of stuff, so I'm looking at different commodities. I'm looking at different industries where I think are the way out of favor. I look to see what's trading at real lows, and I look to see what's a little goofy and on the upside, and then I start to just hone in on those. And I'll look at those to see if anything piques my curiosity.

But it's really not a minute by minute, day to day ... There could be a day where I don't even look at the prices. I get alerts on everything, so I know if something's moving or not. But I find all that other stuff, to me, just distracting. I think a lot of times, less is more. And staying away from the mainstream is where you can really generate some alpha, alpha bidding, your ability to outperform whatever index it is.

So we're going to bring on this friend of mine today, Neil Weiner, and he runs Fox Hill Capital Management. It's his own firm. And he's a distressed investor. And we're going to talk about what distressed investing is, how to think about it ... For you who are professional investors that listen, you're going to understand it. If you're a capital allocator, you probably have some allocated to it. But a lot of people who listen to this podcast are not professional investors, and that's really the purpose I do this for, is to try and educate people on different topics. And we haven't spent too much time on distressed, so I thought the distressed portion of it would be interesting.

And Neil has been the Distress Manager of the Year, I think, in 2015 and 2018, by one of the big bodies. So he's been recognized for outstanding portfolio management. So we're going to bring him on, and we're going to take a walk down a little bit of a different road than we normally do. So we'll get Neil on the podcast now.

Neil Weiner, welcome to the podcast.

Neil Weiner: Thank you, Mike.

Mike Alkin: So you and I are old friends and have known each other for a long, long time, I think about 20 years now. And I remember, Neil, when

you and I first met, we met through a good friend of mine at ... your brother-in-law, Bruce Prescott. And I was always intrigued when we met early on, 'cause I had spent much of my time ... At that time, I was doing really nothing but deep-dive forensic short selling. So that's kind of living in the underbelly of the market.

And when you and I met 20 years ago, I was so intrigued, because you really were a distressed investor, and you too live in the underbelly of the market. So you run Fox Hill Capital Management now, and I know you're a significant investor in your fund and you have outside investors. But you also ... Take, for our listeners ... And our listeners, Neil, are individual investors, capital allocators, family offices, institutional investors. We've got a little bit of everything. So take us back, give us some background on your career. Walk us through when you first started and how you got to where you are now.

Neil Weiner: Sure. So my background goes all the way back. I'm a lot older than I sound. But I entered the business in 1982. I worked two years as a credit analyst on Wall Street, then went back to get my MBA at Wharton. Graduated from Wharton, went to work for Solomon Brothers in the equities department. Left there after the crash of '87, and ended up at a hedge fund called Liberty View Capital Management in 1992, I think. I can't remember.

Basically, it was a multi-strategy hedge fund that did a little bit of everything. Distressed, merger [ARB 00:13:30], long/short equity. And basically, I ran, for the longest time, distressed and high-yield. And then I moved over since the convert area needed some help with credit. I moved over to convertible bond arbitrage and volatility, and ran a separate fund for that for a bunch of years.

So I was there for eight years, then moved to a fund called Triage Capital Management. I was a junior partner there as a distressed and special situation fund, and I was there from 2000 to 2006. And we went through the debacle of the internet bubble there, which was interesting. And the high yield market, which was basically a venture capital finance market and high yield market, and all the players that finance themselves, including the cable and-

Mike Alkin: Telecom companies doing-

Neil Weiner: Telecom companies, that's a huge bust.

Mike Alkin: And the vendor financing and all that stuff?

Neil Weiner: Sure, yeah. So that was a WorldCom and Adelphia, all those types of players. And then I started Fox Hill. I left there, started Fox Hill in 2006, or actually 2005. Started the fund 2006 with some capital from a Belgian bank. And they were with us until the financial crisis of '08, in which they got bailed out by the Belgian government twice, so they had to redeem. But we've been able to survive, and so-

Mike Alkin: I'd say survive is a good word.

Neil Weiner: We're 12th year [crosstalk 00:15:48]-

Mike Alkin: 12th year, and also, I think you were ... What are you, somebody awarded you Distress Manager of the Year a couple of the last three years? What was that?

Neil Weiner: Yeah, we just won it for this year, and we won it back in 2015, the Hedge Week Distress Manager of the Year, which was a nice recognition from that magazine. I think they have 70,000 readers or something like that.

Mike Alkin: Oh, that's nice.

Neil Weiner: So I've been through a lot of cycles, starting with the crash of '87, crash of '89. Mexican market crisis of '94, long-term capital of '98, internet bubble of '99-

Mike Alkin: Asian financial crisis? Yeah, yeah.

Neil Weiner: So a lot of-

Mike Alkin: So Neil, when I think back to ... You talk about all these different cycles. I think back to when we were talking. I remember in the internet bubble, and afterwards, and you started to see the telecoms start to implode, and then just everything. You had the Enron's and you had the Tycos, but then you had the Nortels of the world. All those things are starting to implode. And while other people in the equity markets are panicking, you're a distressed investor and you're licking your chops, because you're starting to see things that are going to start to become distressed.

So talk about, if you can, for those investors who aren't as intimately familiar with what you're looking for. What is your investment strategy? Help them understand what you do as a distressed investor.

Neil Weiner: Sure. As a distressed investor, we're trying to buy assets that trade at $0.50 and may be worth a dollar at the bottom of the cycle, and we're essentially looking at a company through the lens of the debt and a possible restructuring. What a company is worth ... possibly coming out of a crisis, whether it's a change in a business cycle, a change ... which is a little bit harder in the industry like retail's going through right now. So that's really what we're trying to do.

And distressed is very complicated in that you have a bunch of creditors fighting for the value of a company among each other. So, when you either exit bankruptcy or an out-of-court restructuring, you get as much value as you can in the [inaudible 00:18:49] of credit you're in.

Mike Alkin: So I want to-

Neil Weiner: So it's very important.

Mike Alkin: Yeah, and I want to talk about that, because through the years, you and I have talked, where you might own the ... You might be buying the debt of a company that looks like it could be going bankrupt, and just getting involved. Or sometimes you own some equity, and you're on an equity credit committee. But talk about ... So a company's struggling, they're going ... It looks like they might go out, and then you start to get involved. And your view is that, hey, I want to own this debt, because I think they're going to go through a reorg and they're going to come out the other side and there's going to be new equity involved, and I want to get equity on that. Talk about how that works for people who might not be familiar with it.

Neil Weiner: Sure. So let's talk about something we're currently involved ... And this is an industry everybody can understand, which is retail. So we got involved in a company called Rue 21, which is a teen retailer that's a strip mall and somewhat of a mall-based retailer, and we actually got involved after the first bankruptcy.

So Rue 21 was an LBO. It had $800 million of debt, 1,200 stores. And as you know, the US is overstored, especially in teens. It had problems, especially with the internet retailing taking market share away. They went through a restructuring. The first time, they came out of restructuring with $50 million, down from $800 to $50 million of term loan, and $45 million of a working capital facility that was backed by its inventory, and they lopped off 400 stores, unprofitable stores.

So the company really went through a downsizing of their

business, and forecasted they would be able to increase their ... We view earnings through the lens of [EBDA 00:21:31], and so they would come out and do, say, $80 million of EBDA. Now, the company's coming out of bankruptcy, and we bought the first lien. It's a 12% coupon, and it's $50 million. And basically, our view was, 800 stores, this company's worth a minimum of $90 million. You have the inventory that's collateralized by the working capital facility, and then you have $50 million first lien, and then you just have equity.

Mike Alkin: And folks, he's talking first lien debt. That's what he's talking. Debt that is accompanied with a lien. So he's pretty high up in the capital structure when he's talking about that.

Neil Weiner: Right, so the lien would be-

Mike Alkin: And when I say high ... Yeah, Neil, explain for listeners who may not know how the capital structure ... You're thinking about it from senior debt on down, just so they have an understanding of that.

Neil Weiner: Sure. So the working capital facility, a company would have a working capital facility that would be collateralized by its inventory, clothes and things like that. And then, in this particular case ... And then would have a first lien term loan that pays 12%, and the first lien would be on property, equipment, trademarks, name, everything else. And it would have a second lien on the inventory, if it was overcollateralized. And then you had the equity. That was the capital structure coming out of bankruptcy.

Mike Alkin: Yeah.

Neil Weiner: So we purchased the debt in the 90s. We thought the company was-

Mike Alkin: And folks, just ... 100 is par. So Neil paying a discount on that by buying it in the 90s. So, go ahead, Neil. Sorry.

Neil Weiner: So basically, here's a company that used to have $800 million of debt, and now it was down to $100 million. So you had 80% less debt on this company. And we thought that ... And we still do think that this company will survive and thrive as a smaller company. But the company had a hiccup coming out of bankruptcy, and bank debt trades in secondary market, just like corporate bonds do. And the bank debt went into the 70s. So we bought more in the 70s, in the 60s. And because the company basically had, coming out of bankruptcy, hired a CEO who basically tried to change the business model of the company ... Historically, the

company has been very promotional, like JC Penney. You buy one, get one free, and they were trying to increase the quality and the price point. And their customers did not respond.

So the first two quarters, same stores sales went lower. The company, the new board, finally fired the CEO and has installed someone new. And here's something which is different than equity investing. As the debt got lower, we added, because we thought the margin to safety was still pretty high, that you were creating a billion dollar sales company, and at the time, it had a market value, when the debt was trading in the 60s, of $30-40 million. So that seemed very low to us.

The company got additional liquidity from the working capital provider. The first lien holders offered to provide liquidity, but it was offered by, as I said, the working capital facility lenders. And the company is now, or has done a better job in the second quarter, and it looks like hopefully in the third quarter, and the debt has now moved back in the high 70s.

So, if it were to go bankrupt again, which I don't think it is 'cause they have plenty of liquidity, that we'd be creating this company. What would happen in a second bankruptcy is that you would just have a working capital facility, and the first lien would take all the equity in a bankruptcy, and we can get-

Mike Alkin: Yeah, so Neil, talk to investors about how you're, if you will say, protected by owning that secured debt. Now, if you were an equity owner and it goes bankrupt, you're wiped out. But now, as a holder of first lien debt, talk about the process and how you're thinking about it, and should a company ... And it could be this one or another one where you own that type of debt ... should it go bankrupt, what you do and how you play that.

Neil Weiner: Sure. So as I said, if the company were to stumble, the waterfall in the debt restructuring is the highest ... It goes from the highest to the lowest in seniority. So the highest here would be the working capital since they have security on inventory, and then the first lien. And then the equity. So what would happen if we went through bankruptcy again is that the equity would be wiped out, and the debt holders would convert their debt into either all new equity, or mostly equity and a little bit of new term loan. But essentially, it's called cramming down. We would cram down the equity, maybe get nothing.

Mike Alkin: And Neil, in doing that, would you be forming a creditor's committee, I'm sure, and you'd have a seat at the table on that?

Neil Weiner: Yes. So let's talk about a different company. We're involved in another company. I can't say their name 'cause we're under an NDA, but it's an entertainment company. And basically, the capital structure's very simple. There's a working capital facility that it's under on. That means there's nothing outstanding. There's first lien debt that's preferred, and there's equity. And this company, their debt is due next year and it doesn't look like they can roll it over.

So the first lien debt holders such as ourselves have formed a committee with other first lien debt holders, and we're negotiating with the company on what a new capital structure would be. Hopefully we do it outside of bankruptcy, because in bankruptcy, it's a high cost to go through bankruptcy. You have to get advisors, and the bankruptcy court administers the bankruptcy proceedings. And it can be a very expensive process, especially for smaller companies, which we really ... That's our main focus, companies of $500 million or less.

So in this instance, it's the committee of the first lien holders negotiating with the company what a new capital structure should look like.

Mike Alkin: So when you're doing that ... And it's interesting, when people who own equity and they don't realize that behind the scenes are debt holders who could be forcing the hand of management and making the decisions for them, if you will, because you have leverage over them in certain instances.

Neil Weiner: Yeah. So let's just give the example. For example, we have no position here, but just at how debt holders view capital structure of a public company that has both equity and distressed securities. So there's a company called Ultra Petroleum, which is a gas company that's gone through one bankruptcy. And it's got ... The capital structure is they have bank debt, and they have bonds, and they have equity. And the bonds trade in the 50s. That means the credit markets are essentially saying this company's highly likely to go through restructuring or bankruptcy.

But the equity, it's $1.32, still has a $260 million market cap. So there's a big dichotomy. What happens a lot of times is that the debt, as the debt falls, it leads well before the equity. So that's one thing we tend to look at, is the debt that starts to break down before the equity does.

So there's a dichotomy here in Ultra Petroleum, who is right here.

The debt trades in the 50s, or the equity, which still has a $260 million market cap. So when you go through stress periods in the stock market, you see a lot of those types of dichotomies, where there's still significant equity market cap and the debt trades at significant distressed levels. And a lot of equity investors really don't see that. They don't see where the debt trades. And so the debt investors, I feel, in these types of situations, have a leg up on equity people, because they are much more focused on getting paid back and potentially restructuring.

Basically, Ultra Petroleum, at $1.32, is an option. If there's somehow, for some reason, gas prices rebound dramatically before they run out of liquidity, that option could double, triple, or quadruple even more. But if they don't, the equity's going to be wiped out in a restructuring.

Mike Alkin: It's interesting, because the debt holders focus on the cash flow, the EBDA, and the capital requirements to maintain or grow the business as required. A lot of times, the equity, though, is subject to a story. And sometimes a good management team can go out and tell a good story, but it doesn't necessarily reflect the economic reality of the business. Would you say that there's more story involved on the equity side than on the debt side?

Neil Weiner: Oh, absolutely. Let's just take a look at Tesla, for example. That is more of a story stock. Now, if you look, Tesla's got ... They do have some debt that's been issued. Some convertible bonds and a straight bond. And the straight bond trades at almost 9%, which ... It's a 5.30 of [2025 00:34:50].

Mike Alkin: Yeah.

Neil Weiner: And so that has first claim of the cash flows over the equity. So you hardly see a company that trades at 8% and 9% in this environment where the equity is $51 billion of market cap. So it's either-

Mike Alkin: I've been very vocal on it. There's a disconnect between ... And they have future cash payments coming up. But it's a pure story stock.

Neil Weiner: Yes. And as I said, we're in a bull market now. But once we get into a stress market, you see more of these types. This is a glaring type, a glaring situation here. But you see more of these situations. Companies that are highly levered, that the equity will go down faster and quicker because the debt will lead, the debt will break down first before the equity. And then you might have, as I said, a

company that's got bonds trading at 20% yield with a significant market cap. And there are ways to ... Sometimes we hedge it by being short the equity and long the bonds. Not on a full market value to market value basis, but on some sort of ratio.

So we're really focused, as distressed investors, on cash flow and liquidity. And really, it starts for us in modeling out what a company looks like a year or two out. One, if they can turn it around, and two, if they can't, by buying the debt at a discount, are you covered on a valuation basis? So we're really looking at it from a bottoms-up orientation of ... really, from a numbers standpoint and a valuation standpoint. And that's how we approach distressed investing. We're trying to create, to be high enough in the capital structure that if something goes south and we have to go through restructuring, we end up with the equity.

Mike Alkin: Now-

Neil Weiner: And we're not junior in the capital structure, where we'll get wiped out. Sometimes we'll be junior, but most of the times, we try to be as senior as we can. But that's kind of how we ... And sometimes we'll buy it knowing that it's going to go through bankruptcy, and it's called, essentially, loan to own. You're essentially ... By owning the debt, you're loaning the company, and you know you're going to go through a restructuring and get new equity. And that's what we call loan to own.

Mike Alkin: And sometimes, you can really find some interesting ... For those who are listening and they're not going to go through a distress process, those post-reorganization bankruptcy equities can really have some very interesting upside, and oftentimes, they're completely underfollowed.

Neil Weiner: Yes, totally underfollowed. Essentially, what happens ... That equity is in the hands of distress investors. If you do get a fundamental turnaround ... For example, and this is ... [inaudible 00:38:39] Media, which is a yellow pages company, everybody says, oh, it's a melting ice cube. It's terrible. But they've essentially been using their post-bankruptcy capital structure to use their free cash flow to pay down the debt. And the equity's gone from two to 10, or over 10. So you've had a [five bagger 00:39:05], just because the company has basically improved their operations. And bankruptcy, even though their EBDA continues to fall ... But their free cash flow has increased, because they've cut costs even faster, and they've paid down their debt.

So you see things like this where, if you're right ... And essentially, the post-bankruptcy equities migrate to mutual fund holders and other holders. So you've seen some very big moves in the past in post-bankruptcy equities, because remember, you're wiping out a lot of the debt in bankruptcy. And if the company does turn itself ... Or if it's a commodity like oil and gas, and the commodity improves, like oil did from the 40s to the 80s, you get a very, very big move in the post-bankruptcy equities.

Mike Alkin: Well, it's interesting. One of the things I like to talk about with listeners is ... I'm a generalist, so with the exception of biotech and trying to figure out what a Phase 2 trial's going to look like, in most industries ... I've been doing this 20+ years, you've been doing it longer. You've seen pretty much every industry, and you know the playbook for each industry, and you know what a good business is and bad business is. And I've morphed in my career over the years to where I used to think, well, that's a bad industry, and that's a good industry. And I want to stay away from the bad industries.

I don't think like that anymore now. I think, what's the valuation in this industry, and is there a disconnect between the valuation and what I think the price of the company is worth? So you have ... And I know you, I think I can remember back in ... I'm going to get the time period wrong, but probably '03 or '04, I'm talking to you one day, and you're telling me that you're buying a chemical plant in Mississippi. And I remember thinking at the time, what the hell do you know about chemical plants in Mississippi? And I think it was one of your biggest winners for a long time or something like that.

And I get that too. The last couple of years, I've been very, very focused on the uranium complex. And you do a deep dive in these industries, and when there's nobody around and everyone's left and institutional investors don't care, and there's this just abandoning of the space, and you really have time to focus and drill down, you can really understand the fundamentals. And when there's not a lot of sales-side analysts around writing and opining, and no institutional investors, you can really find some companies that are just completely mispriced.

So as you've gone through the years, you've probably pretty much looked at every industry, I would assume.

Neil Weiner: Yeah. There's certain industries we prefer and certain that we don't, and we generally don't like healthcare because I've had

my history of waking up to changes in Medicare rules one day, and the companies in that ... And then all of a sudden, cash flow disappears. So we generally shy away from that. And financials, except for the '08 debacle, we generally shy away from that-

Mike Alkin: Yeah, me too.

Neil Weiner: ... because it's hard to know what on the asset side of a balance sheet. But we're much more comfortable with companies where there's hard value, there's ... where there's cash flow or it's a building, a plant, or something that we can evaluate. And looking, doing valuation in terms of if the company were to liquidate, which would be the worst outcome in a bankruptcy, what would you get in a liquidation scenario?

So that's kind of how we look at industries. We generally are North American and Western Europe. Once you get into emerging markets, bankruptcy laws are very different. And there's other constituencies besides creditors who have equally say in a restructuring. So we tend not to go into emerging markets in bankruptcies.

But as you alluded to before, there's a lot of orphaned names in post-bankruptcy equities, or equities that have gone through a bankruptcy and no one's following them. And they just languish for a while until there's an event that propels them. Basically, it's almost like a step function. Something just stays there for a while, and then there's an event, and then you return.

Mike Alkin: So one of the things ... We've been speaking for a half hour now, and one of the things that's not come up ... And I was saying to listeners before I got you on the podcast is, I don't pay attention to the daily market noise. I don't pay attention to the big macro calls and the talking heads coming on, and I'm just looking for mispriced stocks, either on the long side or short side.

But we haven't talked about your view of the market. Where does that type of stuff come into play in your day to day? How do you think about it?

Neil Weiner: Sure. We're looking, bottoms-up, what we find interesting or not. And I could tell you now that there's one in 20 ideas that we find interesting. So that tells me that the market is overvalued in general and credit. And I would say just from my history, we've gone through different cycles. There's been a cycle where Wall Street's very good about financing different industries to the point

where there's going to be way too much capacity and there will be bankruptcies in the future. We saw it in airlines, we saw it in communications stocks and industries. We've seen it in various areas.

And I would say this time around, what I think is going to be interesting ... And I don't know what the event is going to be. But there's been, for the last several years, a lot of issuance of bank debt with very little covenants. Covenants are rules that companies have to abide by in the term loan, like they need to have certain interest coverage, or maintain certain liquidities. And there's been so much search for yield that investors have basically given companies a pass on this, and have basically bought bank debt with no covenants, so the companies really don't have to ... They're not held to certain, what I call, standards-

Mike Alkin: We've seen this before.

Neil Weiner: ... if the business goes south.

Mike Alkin: Yeah.

Neil Weiner: And I think that will be very interesting in the next cycle, when the economy decelerates, or if we go into recession. The companies will be essentially ... Creditors will have very little rights enforcing their rights in terms of companies being over levered and investors or debt holders being able to do anything about it, since there's been a lot of debt issued without covenants. And also, that the amount of leverage has been creeping up every year in terms of what lenders are willing to accept in LBOs or financing LBOs, and that is going to be a tipping point too.

And all this is ... What's wagging the tail here is collateralized loan obligations, which is a synthetic structure that ... Institutions want to essentially get higher yields, and CLOs are basically, buy bank debt. And so there's been a big demand for CLOs, which has been essentially translating into big demand for bank debt. And I think the next cycle, companies debt prices will go down, I don't know, to the 50s, 60s. And debt investors and bank debt investors won't be able to do anything, because they won't have any rights.

So I think that's going to be different this time around, and then the second thing I think is the huge amount of money that's gone into what we call private debt, which is funds like KKR and Blackstone. Big private equity funds raising money to have loans, essentially provide loans, to a company on a one-off situation.

Normally loans are syndicated by a bank to many investors. And in this case, a loan is ... They call it a bilateral loan. And it's just between the issuer and one investor. And there's been a lot of money going into that sector, and there's no liquidity there. And I don't think you're getting paid enough for that illiquidity.

So I think those are two big areas of concern going into the next cycle. I don't think it's necessarily a particular industry that's been overfinanced, but generally, a deterioration in covenants, in quality of loans that's been issued. And you've had the leverage loan market go from a trillion dollars to $2 trillion outstanding over the last 10 years. So that's a huge amount of increase.

Mike Alkin: How do you get your ideas? What strikes your ... How do you generate them?

Neil Weiner: They come in several ways. One, kind of, we talked about before. We monitor debt and equity, and if we see debt break down before the equity, then it's certainly a sign to look and do ... start a process of looking at something. Debt is one area of where we get ideas.

The second area is that we speak to a lot of bankers and restructuring advisors, and they tell us what they're working on or what we should look at. That's the second area that we get ideas from.

Third, obviously, is like any other investor, we have a network of other investors that we share ideas with, that we look at. And then on the short side, again, it's looking at ... And I'm not just picking on this, but a company like WeWork, which has issued some debt. And this company has ... I think their cost of sales is almost the same as their revenue. And this company issued debt. And this is kind of the poster child of what investors have been willing to finance. And it seems to us that if you can short it in your car, what's the worst that ... You're downsize limited. You're just going to lose seven ... I think the coupon is seven points. So seven points a year. And if you get a real dislocation in the market, those bonds could be 50.

Mike Alkin: Right.

Neil Weiner: So we're kind of looking at that. It's much harder to short high yield bonds, because if they're paying interest, you're on the hook for the coupon. So you have what we call a negative carry that you have to overcome when you're looking at shorting a bond.

Mike Alkin: So Neil, Lord knows, sometimes I feel like I've cornered the market on investing mistakes. And with each year that goes by, you make more mistakes and you learn from them, and you build a mental checklist of those mistakes. Throughout your career, what are some of the things that you could point to and say, these are some of the things I've learned that I wish I knew then but I know now and I'm going to try and avoid? What are some of the things that you could point to from a mistakes standpoint?

Neil Weiner: Certainly, as I said, healthcare is going through ... Healthcare ... That really, some of the things you can't control in healthcare ... I don't want to be subject to third-party risk. That's certainly a big lesson. Sometimes, another lesson, too, you have to take a grain of salt in liquidations. We did a couple, invested in a couple companies where we thought that they had significant collateral value, like helicopters. And you go to try to sell them, and it's a lot less than you think, because you have to sell 25 instead of one or two. So that's certainly been ...

I would say the biggest, over the years, the biggest lesson I've seen is ... we don't leverage our portfolio. Going through, especially in distressed and high yield bonds, the rates to return you're looking at are high enough. You don't need to magnify the return with leverage, because in a down market, you don't want to have ... to be sold out by your prime broker, and you could always take a mark to market loss if you're not leveraged, and an investment could come back just because there's no liquidity.

When you're leveraged, I've seen so many funds go out of business, because they're leveraging the portfolio to get a higher rate of return. And in this asset class, it's not like equities or large cap equities, I should say. The friction of getting in and out is much higher, and you always want to be the provider of the liquidity in a down market, in terms of having cash and being able to get down to [inaudible 00:57:25]. That's the biggest lesson I've seen over the years. I've seen plenty of smart guys and smart investors go out of business because of levered ... And you have to be able to have a portfolio that you can fight another day.

The best time, it's very funny, the best time you want to be buying something, especially in distressed, is when blood in the streets ... And a lot of people, investors and other people, like to see you react emotionally. And I think investing, you have to really ... whether you're making money or losing money, it's the hardest thing to do. But you have to really be unemotional about it, and really focus on what the value that you're buying. And if it goes down, it goes

down. If you really think the value is there, you just have to accept it goes down.

Mike Alkin: Which, Neil, goes to my thought about ... I was saying before you got on the podcast, my Bloomberg, I might not check the prices some days. I'll get alerts if something moves within a certain parameter, but the day to day noise of the markets can cause people to miscalculate the true value of something, because of the daily quote price. But you avoid the noise and you do your work and you get your sense of what the valuation is, and obviously, you're paying attention to the things that can impact that valuation. But you're not letting your investment decision-making be based on short term movements in the value of what's going on. That's kind of the way I view the world.

Neil Weiner: Yeah. You certainly have to pay attention to where things trade in terms of, do you want to add things to it. But really, in high yield and distressed, something could trade at 70 and the next trade is 60, just because someone needs to get out of something. And that doesn't necessitate that something is worse. That's the hardest part to really discern. Is there a change in fundamentals, or is it just a lack of liquidity? And that is really hard to decipher. Does someone else have more information than you do?

But if you've done your work and you have built in enough margin of safety in terms of where you want to buy something, you buy it there. You buy it 10 points lower, as I said. And if you're not levered, you can ride it lower if need be. And a lot of where the price goes is a function of sentiment, and supply and demand.

Mike Alkin: So talk about portfolio composition. You're a hedge fund, you long short. How do you think about net exposures? And for those who are listening, I'll explain. Gross exposure is the amount of dollars you have both long and short, and your net exposure is you're backing out your net, your shorts from your longs. And that's your net exposure. How do you think about it throughout different cycles, and how do you manage a portfolio from a net standpoint?

Neil Weiner: Sure. We view it a little bit different in terms of ... We look at the volatility aspect of our portfolio. So, for example, a bond that trades in the 60s for bank debt really has characteristics of an equity, versus a term loan that's high in the capital structure that's in the 90s ... has much less price exposure and price volatility.

So we'll have a much bigger position in something that trades in the 90s, that we're confident and that we believe has less

price volatility, than something in the 60s that has more equity volatility. We'll have a position in that, but in terms of looking at our exposures, they're two different things, in my mind.

Mike Alkin: Right.

Neil Weiner: So as I said, we generally don't ever go above 100% long in the portfolio. And we do hedge our exposure. I'd say the Russell index has the highest correlation to what we do, since the more investments that we have that resemble equities would have that same composition as a Russell stock. So we will ... I try to use my volatility experience from years ago to use optionality to hedge out a portfolio. I don't like to buy just out of the money [puts 01:03:27], or just short Russell. I like to use an options market to give us some optionality to hedging our portfolio.

And then things that we do that have no correlation to stock market, like trade claims or litigation claims ... I don't view that I need to hedge any of that if I wanted to.

Mike Alkin: Well, I was just going to go to that. So some of the things you've done that were just spectacular were trade claims, and there's one that, if you want to talk about it, that ... You know the one I'm talking about. If you want to explain what that is and how, as a distressed investor, you can create some real attractive returns.

Neil Weiner: Sure. So we get involved in situations where there's litigation involved. That's probably one of our larger themes now, since there's not much to do. So we have a position in ... It's called [Sanofi 01:04:46] contingent value rights, and it does trade over the count of market. And it's basically a security that has litigation against the drug company Sanofi ... for a merger six or seven years ago, in which they bought Genzyme and they issued a contingent value right that would give holders extra value if a drug that they developed were to come to market. And essentially, Sanofi delayed that drug ... We believe Sanofi delayed that drug approval and other steps. So we're suing Sanofi in court over that.

And so that type of investment basically has no correlation to the stock market. And the way we look at it, we want at least three, four times up, versus losing money. So we have a bunch of those in the portfolio that ... we're plaintiffs in litigation.

And then there's other things called trade claims in which, when you go through bankruptcy, that companies in retail ... You were to buy a claim from a vendor in bankruptcy. It's a much more liquid

market that they tend to be traded at a much bigger discount to bonds or term loan.

Mike Alkin: And why would you buy a trade? Explain the mechanics of that. You're taking somebody out of a position on the hopes of getting more of the recovery. Could you just talk about how and why you would look at a trade claim?

Neil Weiner: Well, say a trade claim is on the same level as unsecured bond, and the unsecured bond traded at 70. The trade claim traded at 60. Then essentially, you're being paid 10 points for more illiquidity in terms of valuation.

Mike Alkin: Right. So, okay. So what ... You've had the fund now for 12 years now, so you are a hedge fund. So you're a private partnership. How do people get a hold of you if they wanted to reach out and learn more about Fox Hill?

Neil Weiner: We have a website, foxhillcapital.com, that people can go to. And someone can email me at neil@foxhillcapital.com. I think we're in a couple of the databases. And we can get something back to them. We have a dedicated fund. We have separately managed accounts that we run for people, and that area lets them dictate what they want to concentrate more or less on. So there are various ways we manage money for people.

Mike Alkin: It was great talking. This is an area where a lot of listeners may not be familiar with, so it was nice to get you to take them down a journey that they don't hear about every day. Living in the market's underbelly, as you do.

Neil Weiner: I appreciate it, Mike. Yes. It's can be a sharp-tailed, bowed area, but it's always interesting and intriguing.

Mike Alkin: It is. Okay, great, Neil. It was good catching up, and I'll see you soon.

Neil Weiner: Thanks, Mike.

Mike Alkin: Thanks. Talk to you later.

Neil Weiner: Bye.

Mike Alkin: See you.

Well, I hope you enjoyed my conversation with Neil Weiner from Fox Hill Capital. Neil is a guy I've known for a long time, and Neil

lives in that market's underbelly. And like he said, he looks at the world from the bottoms-up. He is not focused on the big macro trends that you hear a lot of people talking about. He's looking at the signals in his world that will ultimately impact equity prices. For a lot of the people, you're listening to equity prices.

But he's looking at things that are not readily apparent, and I hope you were able to extract some of those. And I'll have him back in the future to talk about it. It's a very different perspective. Neil gives me great perspective because I don't spend my days looking at the things he's looking at, but I know that what he's looking at does impact the equity prices. I do look at certain fixed income items. I am looking at the equities, if they have bonds, where the bonds are trading. And I know that the bond guys are really good, because they're focused on the cash flow and not the story. And the story can be sold to people, hook, line, and sinker. But the cash flows can't. Or lack thereof. Or decelerating, or debt obligations that are coming due. You can't bullshit your way of those, excuse my language.

So anyway, I just wanted to bring someone on with a very different perspective, and I'll have him on again. And that's it for now. I hope you enjoyed listening to Neil. I just want to let you know that I am the co-founder and chief investment officer at Sachem Cove Partners, LLC. And due to industry regulations, I don't discuss any of Sachem Cove's funds on this podcast. And all the opinions expressed by the podcast participants are solely their own opinions, and do not necessarily reflect the opinion of Sachem Cove or its affiliates.

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We'll speak next week. Thanks.

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