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listeningin

Sal Muoio, Patient Value Opportunist

S. Muoio & Co.'s Chief Focuses, Gabelli-Like, On Private Market Value

Meet Salvatore Muoio, one of the sharpest value-oriented hedge fund managers in New York that few folks have heard of, much less invested with. Sal runs funds totalling in the hundreds of millions, not billions, from the Madison Avenue offices of his firm, S. Muoio & Co. LLC, where the only hubris in evidence, if you look hard enough, is Sal's name on the door.

It's a self-effacing style honed during years working as an analyst and eventually research director in offices variously described as "closets" or "conference rooms." The upside was that all were within earshot of the famed investor and larger-than-life personality whom Sal credits with teaching him virtually all he knows about successful value-oriented investing, Mario Gabelli.

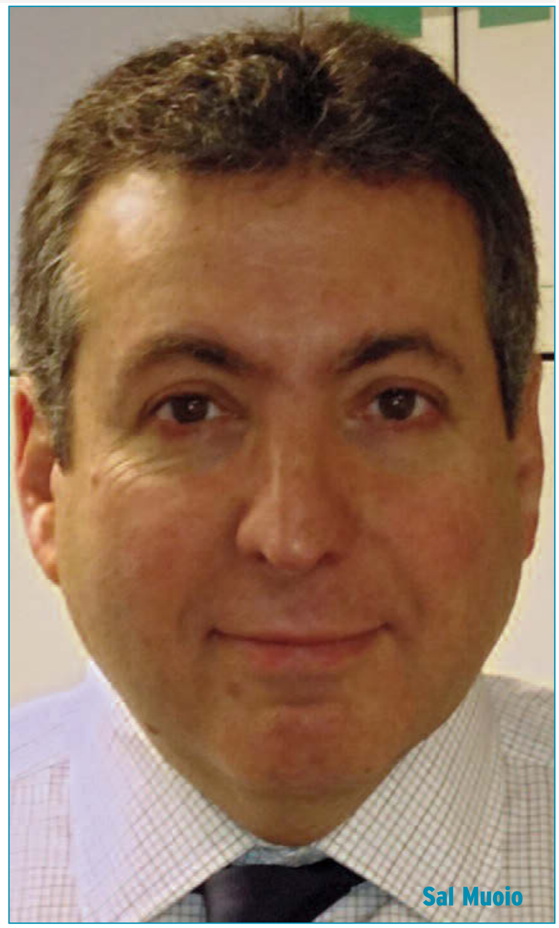
Sal clearly "got it" and he's been demonstrating as much, with admirable consistency, for investors in his own hedge funds for much of the past decade.

Oil was in freefall, and the retreat in the major indexes was building up steam as we spoke in early January, but Sal was seemingly imperturbable. Listen in, and learn why.
KMW

Hey, Sal. Happy New Year. Though the stock market seems to be starting out on the wrong foot —
Happy New Year. But so much for the January effect.

There's still the Super Bowl indicator —
There's always something, but last year didn't end in the usual way, either. No Santa Claus rally.

What do you make of the way stocks have been retreating?


Sal Muoio

Who knows? There's always plenty to worry about. In the fourth quarter, I didn't feel like realizing gains until late December, so perhaps there was a little lack of selling involved in that run-up. The environment feels somewhat artificial, with rates the way they are. The only thing you *know* is that you're not really stealing stocks at these prices. You wouldn't describe the market as at a bargain level. Is it fairly priced? I don't know. It's like trying to predict interest rates. You think about them a lot, but you don't base your investment

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decisions on your rate forecast. Here, the processs is more bottom-up and all we know is that you can't find bargains, on the whole. I feel sorry for macro guys. They have to make bets on decisions on where rates and currencies are. By contrast, value investing makes good common sense to me.

But it can be very frustrating, when the market isn't rewarding value pickers —
Oh, definitely. But that doesn't mean you're wrong.

Unless your clients lack the patience to stick with you —
Well, sure, you *do* have to remain in business through those periods. Stock prices aren't always going to reflect value, however you measure it. Sometimes stock prices go off the rails. They're driven by lots of things other than valuation — emotion, greed, worry. Valuation is just part of it.

"The core of what I've learned about investing came from absorbing everything I could while working for Mario Gabelli."

Because humans are the "deciders." Or at least write the software —
Right. The best you can hope for is that stock prices track value in a loose way over time.

You're saying you try to opportunistically buy low and sell high, as the saying goes?
If you can do that, you generally get the direction right. You add to positions at the generally right time, that's how you maximize long-term gains for people. You also have to try to keep them from themselves, when the markets are particularly difficult. Think of 2008. We had people who called us right at the bottom, saying, "Oh, I've got to take money out."

You weren't alone. What did you say?
Uh, okay. Sure. But do you *really* want to do that now? Forget about where you came from to get to this point and just look at where the market is at this point. Then you'd say, Oh wow, this has got to be one of the four or five great moments to deploy money in my lifetime.

That's very hard to do when you're focused on what you've just lost —
Exactly. But that's why you hire a money manager.

Let's back up and talk about how you started managing money. Does your affinity to value investing stretch back to Notre Dame?
No. When I got out of Notre Dame in 1981, I was determined to teach myself how to invest and to get someone to pay me for being an analyst. But I didn't know anyone in Wall Street. I was just a kid from Centerreach, out in Suffolk County. I just decided I was not going to take no for an answer, so I signed up for the CFA exams and started reading all the books I could get my hands on. Discovered Ben Graham. You teach yourself how to do this. I read *Barron's* a lot, read the Roundtables and interviews with Mario (Gabelli), clipped things. I remember Mario talking about Storer Broadcasting, and saying "You have to get the FCC's Rule 7. Put it under your pillow."

Don't tell me you did that!
I didn't put it under my pillow, but I got it. I discovered that the FCC had a reference room. You could call and order documents — for a fee. So I sent a check, 50 cents a page or something. I got the darn thing in the mail and I read it. It dawned on me that Mario was someone I should try to contact. Maybe he would hire me, or something. I got him on the phone and he said, "Why do you want to do this for a living? You have to work late. You have to work weekends. Besides, we're small, we don't need an analyst right now." That was that and he hung up. I had been scared to death. He did almost all the talking.

A typical conversation with Mario!
I know that now. But at the time, to me, he was this mythical figure in *Barron's*. I was overwhelmed that he just picked up the phone. Eventually, I got a job at a bank doing money transfer investigations, then went to Chase as a budget analyst. Eventually, I got hired to do securities analysis for a couple of newsletter publishers in Jersey City. They started something for me to write called "Penny Stock Ventures," about stocks under $3. Until then, I had been living at my grandparents'

house in Brooklyn, plastering the walls with technical charts because I'd read Marty Zweig. That was in 1981-'82, a nice little bear market.

"Nice" and "little" weren't words used to describe that bear at the time —

No, it was pretty nasty. But that's when I bought my first stocks, American Sterilizer and DLJ. I panicked when they both started going down and sold them at a loss. When the market turned up, both were acquired at big premiums. That was my first lesson, right there.

Anyway, it was also quite an education reading all the filings for the penny stocks, all kinds of bootstrap venture capital stuff and also companies with 300 million shares trading at two cents a share that actually didn't have anything. When you found something real, it stood out like a sore thumb, and I'd write about those stocks. I learned to focus on the central questions involved in any decision to buy a stock: What are you buying? What are you paying for it? And what do you get? But I knew I didn't want to work in Jersey City doing a newsletter forever and I kept studying for the CFA exam. I also wrote to Mario again, looking for a recommendation. His response was, "Come in, keep in touch, go to school, get your business degree." Which I did. Eventually, Doug Jamieson [Gabelli President and COO), called and offered me a summer job, so I went to work for Gabelli trying to balance commissions and write little one-pagers for Mario in 1984.

Bet your education really ramped up then -

Absolutely. I remember being sent to a meeting Sierra Spring Water had at the American Stock Exchange that summer. When I came back ready to report what they'd said, I found out Mario wanted to know something else entirely. "Why did they actually come to New York to do that meeting?" That hadn't been discussed during the meeting, but I said it sort of sounded like they were trying to sell themselves. Well, that's what ended up happening. That was among my first lessons in approaching investments by looking at what the private market value of a stock is.

Go on.

Basically, before I met Mario, my conceptions of the investing process were built around some combination of watching the short-term trading index (which I do still track) and a host of various other technical indicators and finding little companies that were real and trading under $3 a share.

After that, I pretty much dumped the charts and focused on posting companies' fundamentals to hand-maintained spreadsheets; going through 10Qs and 10Ks constantly. My office was always geographically pretty close to Mario's, meaning he was either next door or two doors down. Eventually, I took over his conference room, which was really good. I learned a lot listening to the way that Mario interacted on the phone all day long with everyone from the staff to corporate managements. It often got very heated during takeover battles. But the core of what I've learned about investing came from absorbing everything I could while working for Mario.

Which you did for quite some time —

Until '95. I went to Lazard that year as director of research and then I started my own business in '97. We still do some research for Gabelli & Co. But starting my own partnerships has been a whole other learning process ever since. You're always fine tuning your approach a bit when you are running portfolios instead of merely analyzing stocks.

It strikes me that 1997, as the internet was really bubbling the market, wasn't an easy time to sell a hedge fund with a value-oriented approach.

True. Right through the end of 1999, we had that incredible run-up in everything internet-connected. All those crazy stocks, the WorldComs of the world and even the pets.coms, just soared higher and higher. But they also pulled the media and communications stocks that I owned along with them.

You were lucky. For most value investors, that was a terrifically dispiriting stretch of the market.

I know. No one was buying anything that wasn't "new economy." It was a very difficult time for traditional value investors. But that also created some opportunities. That is when I was actually able to buy Genuine Parts (GPC). I had followed it for all those years at Mario's, but I was never able to buy it, because it had always traded too dearly. I had waited and waited and finally, I got a chance to buy it at 10 times earnings with a 6% yield — and I haven't sold it since. That was at $23 or $24 and now it's over $100. That's another lesson: When you own value companies like Genuine Parts long enough, you understand how the value keeps accumulating there. That's where experience helps, because it takes a long time to see that.

What are the most significant things you've learned running your own partnership?

Things like determining position size, how aggressive to be with certain ideas. Hedging. How much merger arb to put into a portfolio. I've slowly become quite a bit more involved in merger arb than I used to be. If my firm were larger, we'd have a merger arb desk. My private market value orientation helped me during the dot.com boom. Many value investors stayed away from the media and communications companies back then, because they tend to have a lot of leverage. But they *should*, they're very steady businesses. There's a lot of free cash flow in TV stations, for instance, and only modest capital spending requirements. And culturally, I had become comfortable at Gabelli investing in companies with leverage. Of course, in bad markets, leverage does certain things that investors don't like. But on the upside, leverage enhances returns. Coming out of the 2008 crash, you had great communications companies go from nothing to very big prices. So what I have learned is to really appreciate the value of very good balance sheets.

Sure, but how do you do that?

Our basic idea is, we're a private equity investor in a public form. So the important questions are: What is the business worth? What are we paying? What does the model say? What's the rate of return over our expected holding period? If you focus on free cash flow and free cash yield, you can then be comfortable with debt. It gets paid down.

At least, that is fundamentally the way we *want* to think. We're willing to hold something with a lot of leverage if we know the equity is worth multiples of the price we paid, after the leverage. *But there's this thing called volatility.*

Exactly. And companies encumbered with a lot of debt tend to have it in spades on the downside.

Right, because the equity is such a small component of the capital structure. So we've learned that volatility is important, because clients don't appreciate going through a 2008-type experience. No one does. So as a portfolio manager, you need to think about volatility. We own companies and pieces of companies and fractional interests in companies and we think of them like private equity investors. But we also have to be mindful of market volatility and think about the big picture as well. We want to invest bottom-up, but we have to think about top-down also. What I'm saying is that I have had to learn layer on extra levels of perspective to try to mitigate volatility.

So you use options and ETFs to try to hedge your funds?

Yes. We started doing that in 2011 or 2012. Before that, I didn't feel we needed them, because the market was still such a bargain. But I had let those positions wind down a bit in December, as the market rallied; it just seemed like it wanted to run up then. As we came into the New Year, we initiated put spreads on the QQQs, IWMs, and EEMs. And we added a put spread on a financial index. That's four put spreads on four different ETFs, which is a lot for us. In addition, we're short SPDRs outright in a relatively significant way at this juncture.

In other words, this downdraft didn't exactly surprise you?

Not really. Right towards the end of the December, I anticipated a not-very-good start to the year. It just felt like there wasn't a lot of selling in those last few weeks in December; like the market was drifting up with no selling. I figured we were overdue for a correction. Plus, as I said earlier, there is no shortage of things to worry about.

It took the market a long time to adjust to lower interest rates, to adopt some belief that lower interest rates will be here for a while. But that's clearly happened. The aircraft carrier eventually turned. But all you can really say is that the market is not a bargain. Stocks, generally, are not bargains.

Certainly not the way they were in 2008 or 2009 or 2010, when all you had to do was throw darts. For the last couple of years, I think, it *has* paid to be a stock picker — contrary to what you read in the papers about how investors would be better off in a Vanguard funds than relying on active managers.

Passive investing is the fad *du jour* —

Jim Grant has published a running debate on that — and his point is that investment styles become all-encompassing fads at market tops.

The thing is, if you invest "the right way" — if you're a value investor who's very conscientious about your research and position sizing and holding periods, and if you've bought cheap stocks, you might be up 30% in a year. But if the market also happens to gain 30% that year, well, what did you do? Or more precisely, what does the client *think* you did? You could have thrown darts, or just owned the S&P.

Conservation of energy is an important principle!

Seriously, my point is that you *want* to do it the right way, regardless of whether you're getting immediately rewarded — because ultimately you *are* rewarded for investing the right way, even though it's hard to see at times. It comes down to risk management, which you don't see all the time. In other words, you can make 30% while really controlling your risk in the right way. Or, perhaps you can throw darts and make 30%, but then you won't be controlling risk along the way. That risk gets hidden when the market gets very strong.

But is all too obvious when it's weak. And no matter how much volatility a portfolio manager can stomach, clients usually want less —

Yet, if you have the stomach — or the ability to add to positions in companies that you like — at those times, that's when the money's made. Much of the money we've made for clients in the past few years, stems from investments we made in 2008 and 2009, at very favorable prices — and we don't trade around a lot. Our investments aren't tax-driven, but we tend to be very tax-efficient. And some times, admittedly, if you're waiting for a catalyst, it takes longer than the two-three year timeframe you'd prefer.

No kidding. How long are you prepared to be patient?

I'm still waiting for Cablevision (CVC) to sell to somebody. It's only been 20 years in that case. But it should happen. The same thing with Crown Media Holdings (CRWN). That company should be part of something larger, and it will happen. So, you end up waiting. Getting the timing right on catalysts is hard.

Sometimes, even when you're waiting for the inevitable — what I remember Mario calling a "geriatric play."

Or "octogenarian plays." That points up that it *really* helps to understand and like the attributes of the business you're buying, because you don't really know how long it will take the motion picture to unfold. You want to get paid, well, while you're waiting, essentially. If you can argue that the private market value per share is growing steadily, you don't necessarily mind that it takes longer than you expected. After all, once you do realize that value, you'll just have to find a new idea to replace it in your portfolio.

What is it that attracts you to media and communications companies as investments — other than your years of researching them at Gabelli?

Solid franchises with moats. Whether they are TV station licenses or specific business niches that they have built up. Great cash generation. The classic value prescription. The difficulty is finding the ideas when they're appropriately priced. One nice thing about the stock market, though, is that it does tend to cycle through phases, on both the macro level and the individual company level, so ideas renew themselves. If you are patient, you can catch stocks at the right times.

But you don't invest only in media and communications?

Not at all, though I tend to gravitate to the sectors that I've followed for years. I was lucky to start when I did at Mario's, because I was the only analyst there for a few years. I got to do everything and learn everything that was in those research cabinets full of spreadsheets. I used to do them all.

When you say "spreadsheets," you're not talking about running some primordial version of Lotus 1-2-3, are you?

Nothing of the kind. These were — and still are — created by hand on 13-column paper. Each company has its own set, tracking its fundamentals. Pages and pages of them. I have Crown Media on my desk now — it's 31 pages worth, on one little company. Working on those spreadsheets, I became immersed in everything Mario followed, from Mack Trucks to Rollins Inc. (ROL) and

Champion Spark Plugs — all the auto parts retailers and parts manufacturers and distributors and the little special situation companies, as well as all the media companies. But there are certain industries I have complete blind spots on, so we just don't focus on them.

Which are?
Well, financials — other than Gamco (GBL), of course. There's just no way to actually determine value there from the financial statement. We also avoid oil and gas, and other commodities-driven businesses. And, much of the cyclical and industrial sector, we tend not to focus on. So, if you compare us to the S&P 500, say, we focus on a very small subset of the market. But a subset with financial attributes that are very similar, no matter what economic sector the business falls in.

In fact, we used to play a bit of a game with the spreadsheets, hiding the company names and seeing if we could identify them just from the numbers.

Was it difficult?
Yes. You'd be amazed how similar a nice cable programmer is to, say, a Rollins Inc., in terms of nice, steady, slow growth and free cash flow generation. You see the pricing power reflected in the numbers. The quality of the business is reflected in how often they have to restate the darn financials. You can tell that companies have problems, when you see writedowns after writedowns.

You've got to love those annually recurring "non-recurring" events—
Exactly. The good companies really stand out when you're posting the fundamentals by hand, and you're doing enough of them. That's one of the main things I learned from Mario, something I guess he adopted from Warren Buffett, along with a focus on great franchises. While it may look, to someone who glances at our portfolios, that we're a bit sectory, what we really do is focus on steadily growing, free cash-generating franchises. It just so happens that you find many in media and telecom.

You clearly share Mario's affinity for cash machines —
Certainly. Free cash flow generation is sort of a catalyst unto itself. It's a very high-class problem for a company to generate so much free cash that it piles up on the balance sheet and debt disappears. If they use it to shrink the capitalization very consistently and meaningfully, that is also a catalyst to me. It leads to an increasing private market value per share, as debt is paid down and share capital shrinks. Buying stock back at 50 cents or 60 cents on the dollar is extremely accretive to the remaining shareholders, after all.

Alas, too many managements fail to pay attention to what they pay for buybacks.
Absolutely. You definitely want a management with some notion of what the business is worth; who understand private market value per share. There are companies that understand it, but don't do anything about it, which makes you wonder if they doubt that the value is real. And there are companies that seem to have mental blocks when it comes to the concept of per share value. That doesn't mean we won't invest in them, at a certain price, but it heightens the importance of timing and so you'd like to see multiple potential catalysts.

Which brings me back to Mario's octogenarian plays. Now we're all living longer because we're eating kale and quinoa salads, so they've become nonagenarian plays.

Which may — or may not — be great on an individual basis, but requires even more patience from investors —
Sure, but as long as you've chosen the right kind of business, where value keeps accumulating, that is perfectly okay. Viacom (VIAB) is the great example today of a company we're content to hold while waiting for the catalyst to unfold.

I'll grant you that Sumner Redstone isn't getting any younger —
So that is a catalyst. But the key is that its business is the kind we really like. It is very free cash generative. They've had pricing power, although that is moderating for Viacom, just as it is for the whole cable programming industry.

You think that trend has staying power?
Yes, the consumer can only pay so much for cable and there *are* alternatives. The industry might be bumping against a bit of a temporary ceiling, until we see more growth in household income. And the fragmentation of programming sources is working in consumers' favor as well. The younger generations tend to want their entertainment on demand and not necessarily from traditional distributors.

What that tells me is that you want to focus on the programmers, as an investor. There will always be a market for good content. Conversely, there's not going to be a market for bad content, whether over broadband, cable, wired or wireless. And Viacom has good content.

How riveting is its cash flow?
Viacom probably throws off $2.7 - $2.8 billion of free cash flow a year. For 2015, I have $2.9 billion as an estimate. That's on roughly $4.8 billion of EBITDA. Its capital expenditure requirements pale next to that $4.8 billion of EBITDA — about $150 million annually.

Wow.
That's the kind of businesses we like. They are not capital-intensive. So Viacom will have $2.9 billion of free cash flow at the end of the year, with probably 370 million shares outstanding. Share count is currently a little higher, but they'll probably being buying back during the year. If the share price stays anywhere around the current $70 or so, they'll probably use $2.8 billion to buy in stock this year, which would be a lot of shares — around 40 million. That would shrink the equity by 10% in a year, and they've been doing that since 2010. So they have shrunk the cap dramatically and they've been buying stock back at a discount to value. It's a big company. It's liquid.

But are you a buyer *here*?
We've been adding to our position lately, even though our initial purchases were at much, much lower prices, as they came out of the crash in 2008-2009. The balance sheet fine. Debt is to 2.2 - 2.3 times EBITDA, so very manageable. And the business grows at a moderate rate. A big part of the revenue comes from subscription fees, with long-term contracts and escalators; that tends to grow very nicely. It has been growing at a high single digit, low double digit rate, which is likely to continue for another few years, at least. Advertising can be a little cyclical, but it's not as cyclical as in other media. The combination makes for a business that is very predictable, even in a severe downturn, and that's the kind of business we like, at a discount to private market value. The value of our shares goes up, we estimate, close to 20% a year, as they shrink the cap, even though EBITDA is only growing around 5%.

What do you figure Viacom's private market value would be?
I think it is approaching $130 a share in 2015, something in the $125 to $130 range. So even with the stock trading above $70, we still have a margin of safety, and the value of the stock we are buying increases every year. To me, that's a much better investment formula than buying something with revenue growing 20% a year, and trading at private market value. Plus, Viacom is a business which is "value-able" — a term I've coined to separate those that are attractive from ones you just can't value with any precision.

Such as?
Banks are a prime example. What is a bank worth if you can't really analyze its balance sheet? Can't see the details behind the loan book, etc.? Or how do you value a cyclical, when its EBITDA has sharp peaks and deep valleys, based on ever-changing commodities prices? Any valuation you come up with in those situations isn't as good as one based on projections about a predictable business, like Viacom's.

It's also very helpful to focus on businesses where there are corporate transactions that you can use as cross-checks on your valuations. That's where a merger arb perspective comes in. Transactions give us the opportunity to measure our expected private market values against the prices companies are actually paying for one another. If there's one thing Mario taught me, it's that if you're a value investor and you don't think like a merger arb, something that you should have in your toolbox is missing.

Meaning a value investor should focus on his or her expected rate of return?
Yes, it's like doing merger arb without the announced catalysts. If I'm buying Viacom at 73 today, it's because I think its worth $125 — and may be worth $160 a share in two years, if it's still around.

While you wait, there are unrealized gains, so you don't pay taxes, except on the modest dividends. A business like this, with their financial strategy overlaid on the quality of the business, is a terrific strategy for making money long-term. Especially with a catalyst in the background, which will mature at some point.

Meanwhile, you don't spend time worrying about whether Larry Wilmore will be able to capture Comedy Central's 11:30 pm audience the way Stephen Colbert did?
We're not operating management. We're not going guess whether this or that program will work. You have to go with a management team that has been successful at building a business. I don't think investors belong micromanaging operations that way. Why think you can run someone else's business? As an investor, you really want a business that can run itself. The numbers that a business reports over time will tell you a lot about the kind of business it is — and the kind of people running it. So you have to let the numbers talk to you and just listen. But I do believe investors should have

strong opinions about capital allocation decisions. And, as long as I'm on my soapbox, if you're allocating to value managers, you should hedge by putting a certain part of your assets in something like merger arb that's not correlated.

Tell me about some stocks you like here, other than Viacom.
Well, lots of things in the cable programming space. Let's start with Starz Media (STRZA), which is a John Malone spinoff. They just had bankers helping them evaluate strategic alternatives — meaning, sell the business. But ended up not selling it. Didn't get the price they wanted, so they're running it. We like the business a lot.

Why?
Its value has been improving as it creates more original content instead of just repackaging movies. They've had a lot of hit series. It throws off a lot of free cash flow, around $2.80 per share last year, and is trading under $30. We estimate the private market value at a bit over $35 a share, so the discount is attractive.

Does Malone still control the company?
He does; there is an A and a B stock structure. The super-voting shares are controlled by John.

A typical Malone deal. How about something else?
And another stock we like is Madison Square Garden Networks (MSG). This one is a hidden asset play if there ever was one.

Hidden? Are you a Knicks fan and referring to the players' well-hidden talents this season?
I am a Knicks fan.

My sympathies.
Yes, they're setting records this year — the wrong type, in the loss column. But maybe, if they get a big center in the draft, it might all be worth it.

Sports fans and their dreams! What attracts you to MSG *as an investor?*
They are splitting this company into pieces. There is an A and B structure here, too, but when you look at Madison Square Garden, they have a total of 77 million shares out. So with the stock around $75 a share, you're paying almost $6 billion for the equity. They have no debt. They've got net cash of $300 million. So you're paying about $5.6 billion, net, for the company. With a perfect balance sheet, you get all of the assets for that.

But what's a lousy basketball team worth, even with Phil Jackson at the helm?
Well, MSG is much more than just the Knicks. The Knicks and the Rangers, which MSG also owns, actually contribute almost nothing to EBITDA. In a good year, maybe $50-$60 million, which isn't inspiring. But the Los Angeles Clippers just sold for $2 billion. That and other professional team transactions imply that the Knicks are worth at least $2 billion if not $2.5 billion. And the Rangers could be worth $500 million.

Those are assets that show up in MSG's EBITDA only in the most marginal way, if at all. Then, they own all of the Garden itself, plus air rights over the Garden, and those don't show up much in EBITDA either.

But MSG does generate EBITDA —
Yes, about $374 million of EBITDA — almost all from the MSG Network. Sports cable programming is a very valuable business. Usually worth at least a mid-teens multiple of EBITDA. So $375 million times 14, means it is probably worth $5 billion. In other words, the MSG network alone is almost worth what you're paying for the entire business. You're getting everything else for free, but we think it's worth a considerable sum.

You're saying the private market value of MSG is how much?
Something in the $110 to $120 a share range, so the stock is selling at 65 cents on the dollar. I don't know how much the Rockettes are worth. Hopefully, something. Radio City, too. The Christmas Spectacular. The sold-out Billy Joel concerts every month at the Garden. Still, I do have to note that their capital allocation has not been fabulous. We don't see a lot of stock repurchases at MSG. They did put $1 billion into renovating the Garden, but with that complete, they have a lot of free cash flow now, and you'd like to see them return some of it to shareholders. Maybe splitting of the company, which it looks like they're pursuing, could lead to them prepping the company to sell some parts, or do spinoffs. I don't know what it will be, but I see an event surfacing value.

Any other media properties in your sights?
We also own Scripps Networks Interactive (SNI). It includes the Food Network, HGTV, the Cooking Channel, the DIY Network, the Travel Channel now, which they bought from Liberty. Also Great American Country. Speculation perennially swirls around this company being acquired by someone

larger, but Scripps is really a good-size business. It has $1.3 billion of EBITDA. Grows very nicely. They've built a fabulous business.

And it's separate now from the old-line news business?

Yes, it was split from EW Scripps, the local media company, in 2008. There's been talk that Yahoo was very interested in buying them at one point. Discovery announced talks with Scripps at another. So, at some juncture, I imagine you'll see Scripps Networks get folded into one of the larger players.

Does the Scripps family still have a big stake in this business?

They do. All the media companies I've been talking about have super-voting structures except Crown and Time Warner. All the others have family ownership behind them. We also own AMC Networks (AMCX), which happens to be controlled by the Dolan family, just like MSG. Then there's 21st Century Fox (FOXA), which we actually like quite a bit. Time Warner itself, we've owned and is one of our bigger positions and Viacom, of course, which we talked about earlier. So we literally own this entire industry and it does seem like there should be consolidation here — because the distributors are consolidating. Of course, that assumes the mergers are approved —

Is that your bet, despite the vocal opposition to the Comcast - Time Warner deal?

I'm betting that the deal will going through. We have the arbitrage position on — though not in a real big way. I suspect it gets approved with a whole set of interesting conditions attached, which help the FCC approve the thing.

Like what?

There's probably room for some give and take in terms of the broadband policy aims that the FCC is trying to achieve. If they can achieve part of those in a negotiated agreement with Comcast/Time Warner — well then, they probably wouldn't have to pass a controversial new net neutrality rule. Not if they can get Comcast and Time Warner, which control a big chunk of broadband homes, to agree to doing certain things without one.

Still, that deal has no breakup fee, which is interesting. They could literally just walk. I think it would take quite a bit to get that to happen, but it's *not impossible*.

What about the combined companies' domination of the cable business?

Well, cable systems — expanding horizontally — don't compete against each other.

That's the industry's argument. But they are, by and large, local monopolies or duopolies, and a combined Comcast/TWC would be a formidable presence, nationally.

Well, the plan is for them to spin off 3.5 million subscribers, some of which Charter is buying, to keep below a certain percentage of cable video subscribers. But it is broadband subscribers who are really the hot topic at the FCC these days. What the issue is going to come down to, I think, is that, as big of a broadband distributor as the combined Comcast/TWC would be likely would be able to control a lot of what programming gets successfully and profitably distributed, especially from smaller programmers. So I suspect that — only with the right kind of conditions attached to it — can the deal get passed by the FCC.

What about the AT&T/DirecTV tie-up?

I think it is more of a layup in terms of getting regulatory approval. The point is that distributors are consolidating and therefore it will behoove programmers to also get larger to defend their places at the negotiating table. At some point, you're going to get consolidation among the programming companies. In the meantime, they're growing nicely, throwing cash off, and generally buying back stock.

Are you prepared to wait another 20 years, like you mentioned earlier in regard to Cablevision and Crown?

Don't think I'll have to. Crown, which trades at $3 and change, is the Hallmark Channel, which is decidedly not the Discovery Channel, HBO or MTV.

Putting it mildly. Does anyone watch it?

It's not an unimportant channel. I know people who watch it. Know people whose parents love it. In the midwest, it's a terrifically popular channel. Around the holidays, they win easily ratings nights. In fact, their ratings have been increasing, and among the cable programmers we've discussed, it's the only one, other than Fox, to actually grow advertising in the last couple of quarters. Everyone else has been flat to down.

They have a real niche, programming for women around 60 years old, maybe a little younger. It's not as competitive as some other niches in programming. They try to skew to women 24 to 54, with family programming. But with the aging of the baby boomers, you can actually argue that there's a lot of spending power in the demographics they reach. And they're doing more scripted series than before. We've owned Crown for a number of years now, and the value of the content they're creating is increasing, which should give them a boost with programmers. That said, Crown only gets about seven cents per month per subscriber. Contrast that with ESPN, at $5-$6 per. Even television stations now get $1 per subscriber per month when they negotiate retransmission fees. So Crown would seem to have some upside. Every extra penny they get per subscriber is worth $10 million to Crown.

Plus, the Hall family did want to sell it at one point. We ended up suing them a number of years back because they recapped the company, and it's probably not actively for sale in the same sense that Starz Media hired bankers to test the market. But, they don't need to. I think it's understood that if someone approached them with the right number, they would sell it — probably at a nice discount to private market value. We can be patient and wait. Hopefully, they won't screw us again.

What is Crown worth?
It's probably worth something around $6 a share, so it's trading at around 60 cents on the dollar, making it just about the cheapest of the cable programmers; Viacom is at about the same level.

Okay. Is there anything in your portfolio that isn't a media company?
A non-media company we do like a lot is Cincinnati Bell (CBB).

Why a phone company? Why now? Why, when cell phones are ubiquitous?
You sound like some of our clients, who can't believe we own these "melting ice cubes" for them.

Well, then?
We've made a lot of money in all these "melting ice cubes." Part of the trick is buying them right, at the right time, and part of it is understanding the business. Most people think about their telephone companies from a personal perspective. My own kids don't have landline phones. They have cell phones. I understand that. But what about businesses? Right now we're talking over a landline phone and I couldn't operate this business on a cell phone.

Nor could I run mine on one.
Because there's still a quality advantage to a landline phone over a wireless connection. A lot of times, it's a very big difference.

So Cincinnati Bell is catering to business?
In Cincinnati, they have a some very big S&P companies, like P&G. It's a good market for business and they totally dominate the market for fiber all over the city. CBB has 209 million shares out and the stock is around $3.10 - $3.15 We like it on valuation, on business approach and we like it in terms of where they are in the cycle.

What are the valuation numbers?
CBB has a market value of about $670 million. Debt, all in, is $1.8 billion, net of cash, and you're paying a little less than $2.5 billion for the business. Which includes the telephone company in Cincinnati plus 40-ish percent of something called Cyrus One, (CONE).

Who or what is Cyrus One?
It is a relatively large data center — the biggest in Texas, actually — that CBB bought and merged with their existing data center operations in Cincinnati, Indiana and Ohio. After growing that business for a while, CBB took it public as a REIT. It trades around $27. CBB owns 0.14 share of CONE for every outstanding share of Cincinnati Bell. That translates into $3.85 worth of CONE in each CBB share — and CBB trades at $3.15. What that tells you is the telephone company and the debt are trading at a negative 70 cents a share. It's like saying the assets of the telephone company are worth less than the debt they have. And their interest in CONE is worth $1 billion. We would argue that the telephone company is worth a lot more.

Because you're nostalgic for landlines?
No, for a time, they were putting all their free cash flow into growing Cyrus One's data center business, which is why they took it public. As it grew, it was demanding too much cash. Now, CBB is applying its free cash flow to building fiber to the home. They've probably passed about 40% of the households in Cincinnati and they're targeting bringing that to 75% or so the next two years.

When that's completed, they're going to have a lot of free cash flow. Right now, it's being applied to building a FIOS-like system for the home and offering video and very fast broadband speeds, and they have been capturing very nice market shares with it in Cincinnati, where they compete against a Time Warner cable system. It's one of the systems pegged to be sold to Charter if the Comcast/TWC cable deal closes, so CBB seems to have an opportunity to take market share that will be difficult to lose while offering the premium service in the market, because it's fiber to the home.

On the residential side of its telephone business, they're actually growing revenue and EBITDA, for the first time in years. But the main point is that as Cincinnati Bell grows to look more and more like a cable company, it should be accorded a slightly higher multiple.

They also have a $700 million net operating loss carry forward, so they don't pay taxes and so their EBITDA is sort of supercharged. And they're not going to pay taxes for quite a while. That tax shield could also be used if they sell more of their stake in Cyrus One.

Is that in the cards, you think?
Ultimately, Cyrus One is going to be acquired by someone. Cyrus One trades around $27.50. It's probably worth in the mid-$30s. Eventually, it is most likely going to be a takeover candidate. It's very big in Houston and Dallas.

When that happens, there will be a big payday for CBB, and in a few years, when they're finished building out their fiber network, they'll be throwing off a lot of tax-shielded cash. At that point, we'll either see stock repurchases or debt starting to pay down, very quickly. CBB is doing everything right.

Let's talk about another stock doing that.
Well, I was going to bring up News Corp. (NWS), but it isn't doing everything right.

Rupert Murdoch's baby? Heaven forbid.
Yes, well, I do like reading the *NY Post* first thing in the morning, let me say that.

If it's true confessions time, I was most pleased to have him take my Dow Jones stock off my hands at a nice price.
He did a lot of people a favor in that deal, but I'm not sure how smart of an acquisition it was.

My opinions there are more journalistic than financial, and I'm not a fan.
I've always thought the asset value of all those properties — that the *WSJ* and *Barron's* were so important — that he'd find powerful ways to fold their brands into the Fox Business News channel. Or that they'd find ways to integrate the Wall Street Journal brand with his programming. But it hasn't happened.

I can't point to positive impacts.
I have another problem with the News Corp., which is its capital allocation. But putting that aside for a second, the stock is one of the cheapest I'm aware of in the media sector. It's so compellingly cheap, in fact, that you have to just close your eyes to its capital allocation faults.

What do you mean by compellingly cheap?
There are 580 million shares out and stock is trading around $15 or so. That's an $8.9 billion market value and at the end of September, the end of their first fiscal quarter, they had $2.7 billion in cash and no debt on the balance sheet.

They spent about $1 billion in cash recently, acquiring Move Inc., but should generate another pile of cash this year, and end up with around that same level, so say they have about $5 a share in cash. They also have Australian media assets that are not consolidated: They own 50% of FoxTel; their share is probably worth $2 to $2.5 billion. FoxTel also owes a note to them of $600 million, so they have $3.1 billion of value in FoxTel. Then there are some other assets that are not consolidated. Anyway, if you take the News Corp. market capitalization of $6 billion and back out the non-consolidated assets, it ends up that you're paying $3 billion for it, which is a very low multiple of their EBITDA — some of which is very attractive and growing nicely. Some of the EBITDA, from the UK and Australian newspapers, is declining, but that is more than offset by a digital real estate business called REA Group, that trades in Australia. It's growing in the mid-20s and is very profitable. News Corp. owns 62% of that very fast-growing business with EBITDA approaching $250 million this year.

Then they have cable networks in Australia that generate very nice EBITDA, $130 million - $140 million annually. They own Harper Collins which is actually growing. So there are some nice assets in News Corp.

Do I hear a "but" coming?
Well, for some reason, they invested in a start-up education business called Amplifier last year, and absorbed some $250 million of losses from it. It doesn't make any sense to us. That's another problem with News Corp. They are willing to do things that make sense to no one but them.

Is one of Rupert's kids behind Amplifier?
I don't know, but that might help explain it. I mean, I can understand losing $40-$50 million a year on the *NY Post*, but burning through $250 million on an education start up? I think it needs to be re-evaluated if it doesn't turn around very soon.

Still, if you add up all of News Corp.'s parts, you end up with $9-$11 billion of consolidated assets. That would put its private market value in the mid-$30s a share range.

So the stock is now selling at a 50% Rupert discount?

Yes, though it's probably at least partly a newspaper discount, as well. And besides it being cheap, there's a lot of restructuring that could go on in News Corp. I mean, capital allocation is an issue, but the stock is cheap enough and they generate a lot of free cash flow that in this kind of market, this has good upside to it, if things can be slightly refocused.

How about an idea with fewer warts?

In the telephone business, we like CenturyLink (CTL) a lot. I've literally followed this company for 30 years. It was one of the first companies I ever went to see, down in Monroe, Louisiana. Interestingly enough, some of the people I met then are running it now. They've moved up from CFO to CEO or something, but they are the same folks. They've been there a long time and put together a terrific team. They had 50,000 access lines when I started following them and now they're the third-largest telephone company in the U.S. When they bought USWest, they really went to being a national carrier, from a regional one.

Isn't it another melting ice cube?

It's really a good example of the kind of business that we like. The total business is probably shrinking 1% - 2% a year — but the value of our share in the business is growing. It's a big aircraft carrier for them to turn around amid access line losses driven by the cellular revolution. But they're also one of the biggest data center companies in the country. The financial reason this is attractive to me is that it sells at a very big discount to private market value and generates almost $3 billion of cash a year — a little less than that this year. We didn't own it until they cut their dividend (sparking a 26% selloff in the stock) in February 2013.

Ouch. What was that about?

They had a big tax shield from the USWest acquisition and that ran out. The market forgot to anticipate that, for some reason, despite a lot of analyst coverage. Evidently no one thought to put it in their models. So we pretty much avoided it. But when they cut the dividend, they also announced a $2 billion stock buyback and gained a lot of flexibility. The stock had been owned for the dividend, but their payout had been absorbing 70% - 75% of free cash flow, which is not a good range for a phone company. Closer to 50% is much better. So they cut the dividend to get it down to that range.

Meanwhile, they continue to generate, call it, $2.6 - $2.8 billion of free cash flow, very consistently. Now they can buy back stock with it, as well as fund the dividend payout. So we made it a very nice position, at prices under $30. It was such a terrific entry point and it only took us only five minutes to look at the numbers and buy it because we'd followed it forever. It now trades around $38, but the private market value is closer to $45 a share.

Why does the discount persist?

Partially because of that dividend cut. But the growth in the value of our shares combined with current dividend is generating a really good return, probably in the low double digits. The free cash yield is 13% or 14%-ish, very consistently. And CenturyLink is doing things similar to what every smaller phone company is doing. Laying fiber all over the place, building fiber to the home systems. It's just going to take CTL a little longer because they're bigger. This business has all the same characteristics we talked about in Cincinnati Bell. It will take a little while to unfold its value, but in the meantime, we're getting paid very handsomely and so we will just wait. Coupled with a margin of safety, it makes an attractive equity for us.

Interesting, considering that so many investors won't touch a stock that's not growing full-tilt.

It took me a while to come to this conclusion, but the market, I think, focuses too much on top-line growth, when it really should focus on value and the growth in the value of a share. The share that you own — the growth in the value of that — is what matters and not the growth of the whole enterprise, necessarily. It's always nice to have an enterprise that's healthy and growing, but if you have to pay up for it, or overpay, or pay full price for it — or even pay a fair price for it — where's the benefit of that?

Only if the proverbial greater fool shows up with a higher bid —

You're better off finding something trading at a bargain price that has a margin of safety. And my view is that the market seems to undervalue free cash flow pretty consistently. Especially, free cash flow in a business that's predictable and steady and valuable. So those are the free cash flows that we look for, especially when the market is willing to pay so little for them that we get an attractive entry price.

I guess that pretty much explains another

holding I see in your portfolio — Gannett.
Exactly. We've owned GCI for quite a while. I remember, when we put that stock it had a free cash yield of almost 30%. In other words, they could have bought the whole company back in three and a half years at the price it was trading at. And the newspaper business was reasonably predictable.

Albeit shrinking, alas.
But they plug along with relatively flat results. Gannett has done a really good job on the newspaper side. Maybe they have just had the right assets, coupling the newspapers with digital assets and TV stations. We've just held it. Why not? It's free cash flow yield is still running around 13%. We figure its private market value per share is somewhere in the $40-$50 range, and stock is around 30.

How about a newer position, something that isn't media or telecom?
How about Zoetis? (ZTS) It's the animal health business spun off from Pfizer in 2013. Its financial characteristics are quite similar to those of the companies we have been talking about. It should have 2015 EBITDA of close to $1.5 billion on revenues that are running a little over $2 billion; its free cash flow yield is roughly 4%. The thing is, because it's in the health care area, it's not trading at the sort of discount to private market value we've been talking about, at this juncture.

Another non-media company we own is KAR Auction Services (KAR). Ten years ago, the first time it went public, the company was called Adesa. It's a wholesale used car auction business. There are only two companies in the business in the U.S. that operate on a national scale. One is Manheim Auctions, a subsidiary of Cox Enterprises, and the other is Adesa/KAR, based in Carmel, IN.

Did they change their name to protect the innocent (who can't spell)?
No. The company was taken private in a private equity deal in 2006 and then they came public again as KAR Auction Services. We figure it will generate free cash flow per share of $2.30-plus this year, for a free cash flow yield approaching 7%. Our estimate of its private market value is over $6 billion. There are, call it, 148 million shares outstanding, so private market value per share works out to over $42. And it's trading in the neighborhood of $34.

Another stock we love is Scotts Miracle-Gro (SMG).

Does their fertilizer work on portfolios?
No, but I got everybody Scotts' AeroGardens for Christmas. Everyone loves their AeroGardens. My daughter sent me a picture of her basil plant starting to grow this week. They're fabulous little things, if you like having fresh herbs year round. I didn't know it when we bought the stock, back in 2008, but people evidently spend more time gardening in difficult economic environments.

Victory Gardens and all the rest —
In any event, no one believed in Scotts back then, but it's been a terrific stock for us, climbed from the teens to $60 or so.

Is it still trading under your estimate of private market value?
Yes, we figure it's per share private market value should be close to $72 in 2015.

Another I could mention is Tootsie Roll Industries (TR). We own it for the same sort of reasons we held Beam Inc., which you know was just acquired for a very nice premium by Suntory.

Whiskey and candy, now you're talking.
Plus, Tootsie Roll is beyond an octogenarian play. It's a nonagenarian play by now. Just a great brand. At the current price, I wouldn't say it's the cheapest stock you could own, but you know that when they sell, it will be for a sweet multiple — surprisingly high, like Jim Beam, which went for on the order of 18 times EBITDA. Because you really can't create these kinds of brands anymore. Now, Tootsie Roll may be the Hallmark Channel of candies, but it's a wonderful niche brand. And it eventually will be sold. The company carries zero debt — and practically the entire board is in their 80s or 90s,

We own a collection, a basket, of companies like this that we bought absolutely at the right prices. Most of the positions, we've sold down over time to 1%- 2% positions. That's sort of symptomatic of the whole market's valuation. We love these companies. They're fabulous companies and terrific companies, just the kind of businesses we like to own pieces of. But darn it, you'd like to buy them a little cheaper if you were looking to buy.

Which is where a stock market correction like we're watching can come in handy —
It might. We're always looking at new businesses that we'd like to buy at more attractive valuations. What we end up doing is tracking them. Making

spreadsheets and following them, without owning them. Waiting for an opportunity. I just hope I don't have to wait as long as I did to buy Genuine Parts! But we love collecting businesses.

From a portfolio perspective, the one thing I know is you can't have a portfolio of great businesses that are not cheap. That's not the way to make money for anyone. So you need to continually refresh your portfolio with cheap ideas.

And sell the ones that become dear?
I generally don't completely exit companies that merely appreciate so that they're not as cheap as they were, as long as they remain cash generative. A lot of them shrink their shares outstanding, as I've noted, which is accretive over time, so you just right size the positions to the price and valuation levels available.

For instance?
We've owned Apple. We bought Apple at the right time. Using the same fundamental principles. It had a 20% free cash yield and now it's a bit less, but they've also grown. So the stock has doubled for us, and we've been selling a bit. We've also owned Microsoft, for the same reasons. What do I know about Microsoft, other than as a user of Windows and Office? Nothing, really. But we bought it because it had a huge free cash flow yield. It was growing at a 5% rate, and no one cared. So it was perfectly up our alley. But we've also been bringing that position down. For us, stocks like Apple and Microsoft are trading sardines.

You'd better explain.
It's another of Mario's terms. Some positions, you intend to sell from the first time you put them in the portfolio. You know they're not "eating sardines." They're "trading sardines." You know the stock is going higher, but the business isn't something that you want to own long-term. It's purely a market-driven, or valuation-driven, sort of trade.

I mean, how do you know a business is going to be a great business for a long, long time? How many businesses can you say will be terrific 20 years from now? Not that many. So, who knows about cell phones? Everyone has seen Nokia, Motorola, flip phones come and go. PCs being overtaken by mobile devices — so those companies are trading sardines.

A whole lot of both eating and trading sardines have been getting quite a bit cheaper as we've been chatting —

Over 300 points off on the Dow, and it's only lunch time. It'll be interesting to see how the rest of this month goes. Of course, if you're a company intent on buying your own stock back, watching its price drop is not the worst thing in the world, from your perspective. It gives a company a chance to buy back more shares at better valuations and is more accretive for remaining shareholders. We'd like to add a little more to our Viacom position, and we have recently, between 68 and like 71 or so. It just seems like it is a very logical thing to do. But when all the stocks go down at the same time, it doesn't quite feel as good.

No. Value investors need strong stomachs — or oceans of Maalox. How do you cope?
I don't know any special tricks, but I've always been able to deal with this kind of stuff. I can sleep in any kind of market, it seems — or most any. I did lose a few days of sleep in 2008, I remember. But I feel that investors just have to accept that prices are going to change, and that they're not always set by rational factors, like valuations — in fact, very often, they're not. So I find it best to keep focused on what the business is worth per share — and also to try to keep some sense of the motion picture of where that value is going, not just on a snapshot of today. It also really helps us, I think, that we do all our own analytical work. It helps tremendously when you're comfortable with your conclusions and how you got to them and can separate them from the emotion of the moment. So you can buy what you know are great businesses even when it looks like the world is falling apart. And when you own those kinds of businesses, you can definitely sleep better!

By contrast, I find that if there's anything in the portfolio that did not emanate from an idea generated in house — everyone has friends who say, "Look at this, you must buy that." Those are the first things to go when the world is getting ugly.

You also do some merger arb investing, as something of a portfolio hedge, don't you?
Yes, if we have cash, we will use it to do merger arb and if we have borrowing ability, in this market, we'll use that to do merger arb. If we're borrowing at 1% and I can make 5% in a merger arb on the year, we will definitely borrow for that. In short, I view merger arbitrage as a cash alternative. So is investing in companies that are liquidating. We also have a little specialty in that; a very small part of the portfolio. But collectively, as a percentage of our capital, we probably have 30%- 40% or a little more invested in cash alternative strategies

that are not stock market sensitive. So we are not fully exposed to the stock market in a traditional sense in this market environment, and I'm comfortable with that. It gives us the ability to be opportunistic.

This strategy worked well last year, because the stock market turned out to be not awful, and our portfolio was up like 11.5%, without taking nearly as much risk as the market.

Then, too, from time to time we do hedge with options and ETFs, as I mentioned. If I feel the market is fully valued, I'd rather take out insurance than start trimming, say, 10% from everything we own. And we do establish a very occasional short position. But we don't run a book of shorts just for the sake of showing we can. Or to be "market neutral." Shorting isn't easy for me, personally, maybe because of my background. Or because our research tends to focus on industries in which there are a lot of very good businesses. The prices and the catalysts may or may not be what you want to see, but there's usually not anything terribly *wrong* with those companies, either.

It's hard to find companies in the media like Yellow Pages, which we shorted twice. Before they went bankrupt and after. And they went to zero twice. But there aren't a lot of stocks like that, though I will mention that we have been short Sprint — still are. The cellular business is very competitive and being the third or fourth player in this wireless market means something quite different than it did 10 years ago. It basically means that I won't make any real money, ever. Verizon and AT&T make every dollar of real earnings that come out of the business. Or, at least, 99.2% of every dollar that's made in the wireless business. Everyone else takes whatever they generate and call earnings and has to plow it back into cap-ex — all the while continuously looking to borrow money.

Softbank seems to see upside in Sprint —
Well, I don't see how Softbank bailing Sprint out with more money actually helps their market position. It doesn't. And the regulators won't let Sprint merge. It would have been a big positive for them, had the T-Mobile merger gone through. Huge. I think the FCC was very shortsighted in that case.

In what sense?
At the moment, the FCC is seeing aggressive competition on cellular pricing, so they're probably happy. But that's only temporary. Sprint can't afford slashing prices forever. My point is that we've developed a great wireless business in this country, whether it has three or four competitors. The advancements in the technology have been incredible, and there's been plenty of competition to drive costs per minute down for consumers. The wireless company's cost to produce a minute of wireless has also come down sharply. Margins are expanding, at least at the major companies, even though cellular service prices have been coming down forever. Which just makes it very, very hard for a No. 3, like Sprint, to compete.

If this were 2010, we wouldn't have any of these hedges or shorts. We would just be plain old making long bets without worrying about the macro issues that can move markets. But in this environment, in 2015, in this part of the cycle, we are hedged.

You mentioned earlier that Gamco is the only financial stock in your portfolio. Does that reflect a sentimental attachment to Mario's organization?
LOL, as our kids say. Gamco has been a really good investment for us. But it's in the portfolio because, having worked there, I truly understand the company, and the people. And sometimes, understanding the people is what really matters. Besides, I noticed in their 10Q for last quarter that they are exploring perhaps splitting the company into different parts —

I missed that.
Take a look. I'm not sure what it means exactly. Maybe they could split the funds and investment accounts from the broker dealer — all sorts of permutations could be possible. I don't know. But just the news that they are exploring something is an example of a catalyst. And we have owned Gamco for a long time.

Where does it trade these days?
Around 87, last I looked. It's amazing when you look back at where it's come from; where it was 10 years ago. That's what happens when you own good stocks for the long term.

Is there anything you're looking at that might become a brand new addition to your portfolio in the short run?
Well, one stock we're looking at very closely currently is Loews Corp. (L).

Loews? I know it's in a lot of value portfolios. But you said you generally avoid the energy business.

Right, we don't invest in oil and gas *directly*. But one does have the sense here that there's a lot of value opportunity being created, just by this waterfall in the price of crude. We've just done all the fundamental work on Loews and we're thinking it could be very interesting.

Go on.

Well, one way to look at Loews, since it's a holding company, is to understand the components, add up the valuations of the pieces — the majority of which trade publicly. So you can mark things to market. There are plenty of comps and plenty of deals in the hotel sector, and in oil and gas and in pipelines as well. So you can really get a handle on the multiples for its operating subsidiaries, CNA Insurance, Diamond Offshore Drilling, Boardwalk Pipeline Partners and Loews Hotels & Resorts.

What do you think Loews is worth?

It looks to us like it trades at 50 cents on the dollar. And as Diamond Offshore trades down, you see them buying it aggressively in the open market, which is very interesting. They have a reputation as very smart buyers of assets. Meanwhile, Loews looks like it is trading at three times EBITDA, which seems pretty cheap. There's no debt, a terrific balance sheet, $5 billion of investments at pretty conservative valuations — I'd say it is relatively attractive here. But it's something we are just tracking at the moment, given what is going on in the world.

Does something look better to you?

Well, the point I'd make is that merger arb spreads currently are as attractive as I've seen them in a long, long time. The spreads have widened quite a lot since that AbbVie-Shire deal fell apart last fall.

Then too, after that, there were some very big deals announced, like Baker Hughes being acquired by Halliburton. You've also had Merck making an $8.4 billion offer for a maker of antibiotics, called Cubist Pharmaceuticals. Actavis and Allergan. There are others. These are very big deals. And it seems to me that there are just enough sizeable deals out there that the merger arb community isn't able to contain the spreads. Especially with all of the other big deals that are just sort of hanging out there without being closed — things like TRW Automotive, the battle over Family Dollar, Lorillard and Reynolds American. So spreads are quite big. There are what look like a lot of double digit annualized returns to be had, albeit there are always antitrust or other risks in merger arb. But I don't recall seeing 10%-15% annualized spreads in some time. It's a terrific time to get money in this area. You know, as long as we're in an environment like this where companies are generating cash flow but not growing, the way to grow is via acquisitions, and since balance sheets are generally good, and interest rates low, the deals will keep flowing.

Of course, that could change very quickly, if the credit markets shut down—

That's a place we definitely don't want to go! Thanks much, Sal.

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