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Hedge Funds Pay Up for Mark Roberts' Ideas. Here are 3 of His Latest.

By Bill Alpert May 21, 2020 3:16 pm ET

Mark Roberts, founder, Off Wall Street Consulting Group
Photograph by Tony Luong

It might seem a long way from Baudelaire to balance sheet deconstruction, but there's a certain logic to Mark Roberts' journey from French literature studies at UC Berkeley to a three-decade run as one of the hedge fund industry's most enduring sources of short-selling ideas . The French poet unmasked the hypocrisies of polite society; Roberts and the analysts at his Off Wall Street Consulting Group aim to expose ugly truths about glamour stocks .

From their home base on a side street in Cambridge, Mass., Roberts and his crew have put out more than 600 short-sale ideas since May 1990, with just shy of 75% of those recommendations closed out at a profit. Through the 10-year bull market ended 2019, Off Wall Street's shorts would have lost 1.9% a year, on average, but that was a stretch when the S&P 500 index more than doubled, so the popular hedge of shorting the index would have performed 97 percentage points worse over the 10-year period than Roberts' picks. (Roberts is an analyst, so he tracks his recommendations but doesn't have portfolio-trading results). His shorts actually made money in four of the past 10 years and broke even in the past five, while most short sellers were losing their, er, shirts.

That's why he has long been a regular subject of *Barron's* articles , helping readers avoid losses on stocks like the medical-practice manager Mednax (ticker: MD) and the now-delisted insurer AmTrust Financial Services. So, we revisited him for a few new ideas. Roberts suggests shorting the small-cap stocks of Quaker Chemical (ticker: KWR) and software firm blackbaud (BLKB). He also has one of his occasional Buy recommendations on the shares of Sandstorm Gold (SAND).

After deciding he'd never make a living teaching French, Roberts found his way to Wall Street. Well...off Wall Street. He put in some time at Boston shops, including Fidelity Investments. Then in 1990, he tried selling his first research idea: the short sale of the yogurt franchise chain TCBY Enterprises.

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public parent company. Facing a rebellion, TCBY's own profits started to slide. Within months, the stock slid, too.

Roberts' successful critiques caught the attention of the burgeoning hedge fund industry, which was always hungry for credible short ideas. In the years since, he's maintained a roster of funds that pay a steep price for Off Wall Street's idea output. The size of that roster has waxed and waned with the performance and popularity of actively managed hedge funds .

"We've proved that you could make more money by shorting well-researched individual stocks than you could shorting an index," Roberts says. That was clear in the March 2020 quarter, when Off Wall Street's short ideas yielded an average gain of 23%, while a short of the S&P 500 would have gained 20%.

The firm has about half a dozen open short recommendations. Among them is the stock of blackbaud, a company that provides software for nonprofit organizations. Roberts sees blackbaud's sales growth slowing as its turf is invaded by larger, cloud-based rivals like Salesforce.com (CRM), Microsoft (MSFT), and Facebook (FB). Revenue grew 6% in 2019 to $900 million—down from 8% growth the previous year—while earnings fell 73% to $12 million, or 25 cents a share. Even those profits were flattered, says Roberts, by how blackbaud capitalizes substantial amounts of its own spending on software sales and development. At the decade's start, blackbaud filings said the costs of software it capitalized were "immaterial." By 2019, company filings show it was capitalizing a third of its software-development spending and taking longer to amortize those costs than in previous years.

Some of blackbaud's recent profits have come from its British operation JustGiving, which drew criticism in the British press for taking a 5% cut of charitable contributions made through its website. After the unfavorable press, blackbaud switched last year to a "tip jar" that tacks on an even higher minimum "tip" of 10% unless the donor opts out. Roberts says that some donors might think the tips go to charities, but they go to blackbaud. Off Wall Street believes that blackbaud's shares will fall from a recent $55 to $35. On Wall Street, most analysts have a Hold on the stock, which trades at 25-times the average forecast for this year's earnings.

Blackbaud didn't respond to requests for comment about the criticisms of Off Wall Street. In February, the company guided to 2020 revenue of $930 million to $955 million, with a projected decline in profit margins and free cash flow as blackbaud spends on software development.

Another short recommendation is Quaker Chemical, which does business as Quaker Houghton since last year's acquisition of Houghton made it the world's largest pure play in fluids for industrial processes like hydraulics, metal cleaning, and lubrication. Quaker took on debt to do the deal. The resulting company had pro forma sales in 2019 of $1.56 billion—down 6% from the two companies' year-earlier results—and $234 million in earnings before interest, taxes, depreciation, and amortization—down 1% from the year before.

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Quaker sales—putting at risk the growth the company needs to justify last year's acquisition.

Off Wall Street thought Quaker shares would fall 28% from their $126 level when the short recommendation went out on March 31. They've gone the other way, jumping to $164 on May 12 as investors were relieved to hear that Quaker maintained good cash flow during its March quarter, even though sales edged down 3% for the merged business.

Roberts is sticking to his thesis and his $88 target price. Quaker communications director Melissa McClain told *Barron's* that the company expects Covid-19 to negatively impact sales and earnings this year, but remains confident it has ample liquidity to "navigate the current environment." In its latest quarterly call, Quaker said it now expects synergy cost savings will be 25% more than previously estimated. Cross-selling synergies will generate growth that's 2% to 4% above its markets, said Quaker.

Covid's economic shocks have boosted the price of gold, but that's not why Off Wall Street has a Buy recommendation on the shares of Sandstorm. The Canadian company finances gold miners in exchange for a percentage of production, similar to the approach of the larger firms Franco-Nevada (FNV) and Royal Gold (RGLD). Sandstorm has great management, says Roberts, and should reap earnings of 11 cents a share and cash flow of 35 cents a share this year, up from 30 cents.

Off Wall Street predicts that a feasibility study this year will confirm preliminary estimates that doubled previous estimates for the amount of gold to be produced in the next 10 years from one of Sandstorm's key investments: the Hod Maden mine in Turkey. The mine's prospects could send Sandstorm's stock from its current level of $8.55 to Off Wall Street's target price of $16, if investors give Sandstorm a multiple of 20-times the 83 cents a share in operating cash flow that Roberts predicts for 2023.

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