Antrim Investment Research has made a commitment to publish this newsletter on the first of every month. I have chosen to honor that commitment today. Within its pages, you will find no explanations for, or solutions to, the challenges that face our nation and divide its people.

IDIOSYNCRATIC RISK

Volume 1 / Issue 3 (June 2020)

IN THIS ISSUE:

Long Michaels Companies, Inc. (Nasdaq:MIK) 1

Short Restaurant Brands International (NYSE:QSR) 4

Special Situations Watch: Zoom Telephonics (OTC:ZMTP) 6

Idiosyncratic Risk is a monthly investment ideas newsletter written by Eric S. Jensen, Jr., CFA, and published by Antrim Investment Research, LLC.

Other side says NEUTRAL/ACCUMULATE

PUBLIC PRIVATE EQUITY, POST-PANDEMIC

ON WALL ST, MICHAELS IS DISTRESSED. ON MAIN, IT'S THRIVING

In the modern incarnation of the internet era, it's become virtually impossible to attribute any quote to Mark Twain with 100% certainty, but I'm a betting man and I have it on good authority that he once said, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." Equity investors will be familiar with the concept, if they've spent any time being told by the talking heads on CNBC what they "can," and "cannot" do. In the current market environment, for example, you cannot own the companies with bad balance sheets, and you cannot own any retailer lacking a significant e-Commerce presence.

Without addressing the existential question of just what exactly it means for a balance sheet to be "bad," I would submit for my readers' consideration: a highly levered specialty retailer without any meaningful e-Commerce revenue contribution; and I will shamelessly remind my audience that I pride myself on thinking differently and market the independent nature of my analyses insofar as it allows me to "break the rules" by pushing back against the prevailing wisdom of the herd. The subject of this article, then, is Antrim's long position in Michaels Companies, Inc. (Nasdaq:MIK), which I present as a viable (though volatile) alternative to speculating on Lululemon at 60x earnings.

Given that this newsletter is slated for distribution on the morning of Monday, June 1st, it is important that I note Michael's is reporting 1Q'21 results on Thursday, June 4th, before market open, and the coronavirus pandemic, along with the inconsistent, state-by-state implementation of lockdown restrictions on non-essential retail operations, has introduced significant uncertainty to that report. Frankly, I think that MIK will "miss" the headline consensus expectation for Q1, given that half or more of their stores were completely closed for half or more of the quarter, and that analysts are currently expecting revenue to be only 7% lower, year over year. The headline number, as usual,

is utterly worthless. Out of 7 published estimates, only 3 have been reduced in the past 90 days, while one analyst actually increased their numbers, which either implies that the current estimate is disingenuous, or the previous one was. What interests me about Thursday's report is not Q1 results, which could not possibly reflect any sort of underlying demand for Michaels' merchandise, but rather their commentary on Q2, and the month of May.

I've followed the Arts & Crafts retailer since deciding to launch Antrim Investment Research in January, and I've been a shareholder since early February, though I'd be the first to admit that initially I underestimated the extent and the risk of the global threat posed by the coronavirus pandemic. So I've had some months to ruminate on the nature of the threats and opportunities posed Michaels by the looming spectre of e-Commerce. And importantly, I've had two separate occasions to visit local stores. Once in early February, when local traffic was disproportionately allocated to clearance activity at not one, but two AC Moore locations that have since permanently closed their doors, and once over Memorial Day weekend, when a helpful but frazzled staff member told me, "this might be the busiest we've ever been."

NPD group reported that the Arts & Crafts category had grown +70% … for the week ending March 21st

It turns out that the packed parking lot and checkout line at my local Michaels is not, actually, an anomaly. On April 2nd, NPD group reported that the Arts & Crafts category had grown +70%[1] year over year for the week ending March 21st, as parents and children grappled with novel ways to reduce screen time in the new work-and-school-from-home "normal." Anxious to determine the extent to which MIK was participating, I called 30 stores on Memorial Day. Seven were not open at all (Boston, MA, and New York, NY). Six were open only for curbside pickup, but stated that curbside orders were busy, if inconsistent (San Francisco, CA, Seattle, WA, and Chicago, IL). Four were open and busier-than-normal, and four additional stores were open and experiencing normal in-store traffic but high volumes for curbside pick up. There was not a single employee lamenting a lack of store traffic, though twice I was referred to corporate for official comment on traffic trends. For those keeping score, over half the open stores willing to comment were experiencing higher-than-normal demand, and 10 of the 21 employees surveyed noted heavy order volume at curbside. (As an aside, if it's at all encouraging to MIK investor relations, I believe that part of the reason so many

MICHAELS FINANCIALS

Market Capitalization

Price:	**$ 3.86**
Shares Outstanding:	147.33M
Market Capitalization:	**$ 569M**
Net Debt (Cash):	$ 2.26B
Enterprise Value:	**$ 2.83B**

Revenue Breakdown

General Crafts:	49%
Home Décor & Seasonal:	23%
Framing:	15%
Paper Crafting:	13%

TTM Income Statement

Revenue:	$5,191M
Gross Profit:	$1,978M
Margin %	*38.1%*
EBIT:	**$ 641M**
Margin %	*12.3%*
Net Income:	$327.4M
EPS:	**$ 2.22**

TTM Cash Flow

Operating Cash Flow:	**$528.7M**
Free Cash Flow:	**$395.7M**

[1] Source: https://www.npd.com/wps/portal/npd/us/news/press-releases/2020/at-a-time-of-social-distancing-us-families-turn-to-activity-based-toys-books-and-art-supplies-for-the-home-according-to-npd/

employees were willing to comment on traffic trends to a stranger over the phone is that many of them assumed I had placed an order for curbside and wanted to know why it was taking some time before it was ready)

This exercise was encouraging on numerous levels. MIK shares trade hands at $3.86, down from a high of $30.41 attained four years ago. Over the past twelve months the company generated $2.22 in non-GAAP EPS (for a P/E ratio of 1.7x) and $396M in free cash flow, implying a 14% FCF yield on total enterprise value, and a 70% FCF yield on market capitalization. MIK sports a ratio of 3.4x net indebtedness to EBITDA, and as of April 30th, 38.72% of the free float was sold short. In other words, the stock is not trading at a valuation that implies disagreement over the intrinsic value of the enterprise, it's trading as a call option on the very survival of the retailer as a going concern. Welcome then, is the news that Arts & Crafts, the company's largest product category, is having its "moment" while the world attempts to navigate the coronavirus pandemic and shelter-in-place.

Michaels leverage comes as much from its legacy as a private equity investment, brought public in 2014 by Blackstone and Bain Capital, as it does from management's ongoing habit of running the business as a publicly-traded private equity stub, maintaining high levels of financial leverage in order to repurchase shares. The company bought back over $133M of their own shares last year, and maintains an authorization to repurchase $294M of additional stock (over 100% of the float, after excluding 73M shares still held at Bain and Blackstone), which was only put on hold as the novel coronavirus made landfall in the United States. The investor pessimism, though, comes from the company's relative lack of e-Commerce revenue. E-Commerce represented ~ 2% of MIK sales last year, even underperforming an Arts & Crafts category notable for its relative lack of e-Commerce penetration (5% of category sales are generated online).

Michaels' core product categories are relatively resistant to competitive incursions by e-Commerce players.

Viewed through a certain lens, the paucity of e-Commerce sales is a troubling condition for a highly levered retailer in a world where shelter-in-place restrictions and non-essential retail lockdowns have eliminated old-fashioned foot traffic from the "omni-channel" offering. But viewed through another, it's a curious but encouraging symptom of an underlying reality that Michaels' core product categories are relatively resistant to competitive incursions by e-Commerce players. The company's inventory turns over less than 2x per year, their products sell at an average unit retail ("AUR") of $4 per item, and the products, which engender some brand loyalty, consist primarily of local and regional brands. Hobbyists in need of consumables in order to complete an unfinished project are no more receptive to a 4-6 day standard shipping waiting period than a parent or kid working on a school project due the next day, and the shipping and handling cost of $5-7 per order is onerous in light of an average basket around $20-25 per Michaels visit.

At the same time, Michaels' current lack of a coherent e-Commerce strategy could be viewed as a source of opportunity. After all, Ashley Buchanan, acting CEO only as of April 1st of this year, was previously employed as Chief Merchandising Officer for Wal-Mart's extraordinarily successful e-Commerce offering. He's tasked with making something of Michaels' lackluster attempts in that arena, and I would wager, qualified to do it.

If the lines of cars around Michaels' curbside pickup locations on Memorial Day weekend are evidence of the challenges associated with migrating to a true omni-channel offering, so too are they evidence of the demand for Arts & Crafts product at *physical retail locations*. If MIK gets anything close to their fair share of the 70% year over year improvement in category

sales, and if any of those new customers find a new hobby that sticks with them, the company might be resuming their share repurchase activity sooner rather than later. If I'd misplaced a share that I owed to somebody else, I might be concerned about where to find one to replace it with.

WOULD YOU LIKE AN ICED CAPP FOR YOUR ZOOM CALL?

QSR IS OVERLEVERED, OVERVALUED, AND AT RISK

Having established Antrim's optimism regarding a specialty retailer levered at 3.4x net debt/EBITDA, paying 5.8% on their borrowings, with 4.2x interest coverage and no significant maturities until 2024, I feel compelled to note that the inverse of leveraged equity returns manifests all too often in the destruction of shareholders' equity. While the crucible of financial leverage can turn small operational improvements into explosive upside for shareholders, it also undeniably leaves precious little margin for error and uncertainty. With these considerations in mind, I've brought the full weight of my natural skepticism to bear on a more critical analysis of Restaurant Brands International (NYSE:QSR), a franchisor of quick service restaurants levered at 4.8x net debt to EBITDA, and generating enough operating income to cover their interest expense 3.9x, but only because they are currently borrowing at a paltry weighted average cost of debt of 4.3%.

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Of course, those numbers are backward looking. On March 30th, QSR announced that they had added $1B in cash to their balance sheet by proactively drawing on the entirety of their $1B revolving credit facility, which will add roughly $10M (1%) to annual interest expense while it's drawn, and bring their gross leverage ratio to 5.96x. The impact on net leverage, of course, will only be fully known when we are better able to assess where the cash and EBITDA goes. While the revolver is drawn, QSR's covenants forbid any borrowing in excess of 6.5x net debt to EBITDA.

As a franchisor, it is true, QSR is somewhat insulated from the vagaries of demand that influence comp store sales at their brands. In FY2019, for example, the company operated 26,971 franchise locations, and only 115 company owned stores. 58% of QSR revenue was generated from franchise fees and rents charged to franchisees. But 42% of revenue (and 27% of operating profit) was tied to actual product distributed to franchisees or sold directly to customers at company owned storefronts.

This $2.4B revenue stream cost QSR $1.8B in cost of goods sold, of which I estimate that roughly ~ $700M is fixed cost related to the company's distribution network[2]. The company filed an 8-K on the morning of May 28th to inform investors ahead of the Sanford Bernstein Strategic Decisions conference that Tim Horton's comparable sales had troughed in the negative mid-forties in March and had improved to negative mid-twenties. Comps at Burger King are trending negative mid-single digits after troughing at negative low thirties. Popeyes is trending +40% on the back of its chicken sandwich, which will be lapped August 12th of this year. On a weighted average basis, if QSR were to do -25% at Tim Horton's, -5% at Burger King, and +27% at Popeye's for the year, their comparable sales for the full year would come in at -23%. Assuming

[2] This estimate is based on ~ 47% incremental margins generated by the Popeye's chicken sandwich.

$700M in fixed costs and 47% product margins, Restaurant sales operating income would decline by an eye-popping 71%, to $159M.

And just like that, net debt to EBITDA would be 6.15x and QSR's interest coverage would fall to 3x. But that's not all. Those revenues are the same ones that franchisees tap into to satisfy the rent requirement that generates the other 58% of QSR revenue. On May 19th, the Wall Street Journal reported that Starbucks, Shake Shack, and Chipotle Mexican Grill were demanding rent concessions from landlords effective immediately[3]. I am not sure that QSR franchisees will be asking nicely. On March 27th, the Toronto Globe and Mail reported that Tim Horton's Franchisees were pushing back on rent expenses[4]. As detailed in the April 3rd issue of Grant's Interest Rate Observer, Carrols Restaurant Group (Nasdaq:TAST) is QSR's single largest Burger King franchisee. They produced a net loss of $9.9M in 2019 and carried 7x net leverage on their balance sheet. Carrols announced on February 25th of this year that they would be aggressively reducing capex.

At 27x a naïve consensus estimate for $2.04 in 2020 EPS, I'm not sure QSR shareholders are appropriately braced for additional weakness.

It gets worse. The restaurants that have stayed open have seen costs increase as they have instituted additional safety and cleanliness precautions and issued personal protective equipment to employees. Let's assume PPE costs $0.40 per employee, per shift and there are 12 employees required to operate a restaurant, in three shifts a day, 365 days a year. That's $5,256 per year in cost increase, just to remain open post-pandemic. For a franchisee like TAST, that's $5.26M annually. Across the entire QSR base, it's $142.3M. Who is going to pay? Somebody, otherwise, the employees will go on strike, like they did in Miami on May 6th [5].

At 27x a naïve consensus estimate for $2.04 in 2020 EPS, I'm not sure QSR shareholders are appropriately braced for additional weakness. It is indeed curious that while QSR's largest franchisee (who is currently insolvent) has seen 11% of their shares sold short, only 4% of QSR's float has been borrowed. Perhaps last year's dividend of $2.02 paid to shareholders has dissuaded a

QSR FINANCIALS

Market Capitalization

Price:	**$ 54.56**
Shares Outstanding:	298.42M
Market Capitalization:	**$16.3B**
Net Debt (Cash):	$11.9B
Enterprise Value:	**$28.2B**

Revenue Breakdown

Tim Horton's:	60%
Burger King:	32%
Popeye's:	8%

TTM Income Statement

Revenue:	$5,562M
Gross Profit:	$3,223M
Margin %	57.9%
EBIT:	**$1,979M**
Margin %	35.6%
Net Income:	$ 652M
EPS:	**$ 2.18**

TTM Cash Flow

Operating Cash Flow:	**$1,458M**
Free Cash Flow:	**$1,382M**

[3] Source: https://www.wsj.com/articles/landlords-fume-as-starbucks-other-chains-seek-extended-rent-cuts-11589889601
[4] Source: https://www.theglobeandmail.com/business/article-tim-hortons-franchisees-push-for-more-rent-relief-from-parent-company/
[5] Source: https://miami.eater.com/2020/5/5/21248306/strike-florida-fast-food-coronavirus-may

number of would-be short sellers. My modelling suggests that QSR might earn only $1.32 in diluted EPS this year, and is likely to cut that dividend payment.

If you think I'm being sensational and pessimistic by basing my analysis on a blended annual comp of -23% when the pandemic will surely come to a conclusion at some point, you must reconcile your relative optimism with two disturbing problems: First, QSR excludes from reported same store sales comparisons any stores that were closed "for a significant period of time." So they're tracking towards a -23% year on year comp, only at the *stores that never closed*. I'd be willing to wager that revenues were down 100% at the ones that did. Second, breakfast business at Burger King and Tim Horton's, the Canadian coffee chain that represents 49% of QSR consolidated EBITDA, will be permanently impaired by the shift from work-in-office to work-at-home.

If it wasn't yet clear, I'm betting that many will not be driving out for an iced capp, only to return home for their Zoom call.

MICRO-CAP SPECIAL SITUATIONS WATCH:

ZOOM TELEPHONICS (OTC:ZMTP) TAX ASSETS AMOUNT TO 120% OF MARKET CAPITALIZATION

On May 27th, 2020, Zoom Telephonics, a Boston, MA based, $46M market cap engineering firm with no CEO, responsible for $2.8M of losses in 2019, as well as the design and marketing of all Motorola branded cable modems and gateways sold at retail since 2015, announced that they had closed on a $3.4M equity offering priced at $1.52, sponsored by co-founder Frank Manning, chairman of the board and activist tech investor Jeremy Hitchcock, as well as another existing shareholder, Palm Global Small Cap Fund, whose portfolio manager, Joshua Horowitz, will be joining the ZMTP board. The stock traded higher on the news and closed at $2.15.

Without beating around the bush, the interesting aspects of this transaction are twofold. First, ZMTP has no debt and deferred tax assets amounting to $55M, or 120% of the market cap of the entire company, which are carried (net of a valuation allowance) at $0 on the ZMTP balance sheet because the company has been unprofitable for some time. Second, the company has not one, but two benevolent activist shareholders that have joined the board over the past 18 months.

Never averse to a hidden asset-which-amounts-to-more-than-the-market cap story, Antrim set out to answer two questions. First and foremost, why does unprofitable, micro-cap Zoom Telephonics trade on the pink sheets as a public company? And second, is there any reason to believe there is a catalyst for value creation and/or reason to believe that the value of the deferred tax assets might be realized, either by ZMTP themselves, or a strategic acquirer? I seek to reproduce the results of that investigation here only to endear myself to a readership that I know is starved for good ideas in their personal trading accounts. A business dinner at Le Bernardin might cost more than a days trading volume in ZMTP.

Zoom was founded in 1977 in Boston, MA by MIT engineering grad Frank Manning, a card-carrying member of the "Massachusetts Miracle" movement led during the 80s by technology and financial engineers out of Harvard and MIT. The company had its hey-day during the mid-to-late 90s selling analog modems at retail, but found themselves unable to successfully transition into the market for cable modems and wireless home gateways dominated, not by retail, but by the service provider sales channel as a result of their wildly popular "triple play," Cable TV/Internet/Home telephone offerings.

The company floundered throughout the naughts until 2009, when, during the depths of the great recession, and struggling to serially issue equity to fund operations while maintaining the $1 share price necessary to remain listed on Nasdaq, the

company sold its awesome ticker (Nasdaq:ZOOM) and some of its trademarks to Tianjin Tong Guang Group Digital Communication Corporation in a reverse merger intended to allow the Chinese provider of EMS services for Motorola products to access U.S. capital markets. ZMTP in its current iteration was distributed to shareholders in a tax-free spinoff, and de-listed from the Nasdaq. I believe that it still exists today largely because any other outcome would have resulted in a taxable event for founder Frank Manning, or his late brother's trust, which once held around 10% of the outstanding shares. As for ZOOM, access the capital markets they did. Tianjin Tong Guang Group and its aptly named subsidiary "HK Profit Harvest Corporation" accessed U.S. capital markets repeatedly until 2015, when they stopped filing financial statements. That company, which now sports the ticker, ZTNO is notable only for being confused with Zoom Video Communications earlier this year and being halted by the SEC for public interest.

The tariffs placed on Chinese goods beginning in 2018 decimated profitability for ZMTP, whose products are exclusively manufactured in China.

In any case, returning our interest to ZMTP, the erstwhile subject of this article, one finds the seeds of a value creation catalyst in 2015, when the company acquired the rights to the Motorola trademark for its modems and wireless home networking products sold at retail. The company was able to use the well-known trademark to approach Amazon and Best Buy with renewed vigor, only to find that Arris had absolutely obliterated the channel by stuffing it full of dual branded Motorola / Arris Surfboard modems and gateways during the two year period that they owned a transitional right to the trademark.

And yet, inevitably, sales growth did take off, reaching 65% in 2017, 10% in 2018, and 16% last fiscal year. Unfortunately, the tariffs placed on Chinese goods beginning in 2018 decimated profitability for ZMTP, whose products are exclusively manufactured in China.

Having exhausted legal avenues for tariff relief, the company has decided to refocus its supply chain on manufacturing partners in Vietnam and looks to return to profitability at some point during the middle of this year. Challenges remain, but appear surmountable, and the company is not without some opportunity to inject a little bit of sizzle to the story. First and foremost, ZMTP is looking for a CEO, as Joe Wytanis stepped down this year during the coronavirus pandemic after splitting time between the company and his family in Atlanta became untenable. Second, manufacturing must actually be transitioned to Vietnam and

ZOOM TELEPHONICS FINANCIALS

Market Capitalization

Price:	**$ 2.15**
Shares Outstanding:	21.43M
Market Capitalization:	**$ 46M**
Net Debt (Cash):	($1.2M)
Enterprise Value:	**$44.8M**

Revenue Breakdown

Modems & Gateways:	90%
Other:	10%

TTM Income Statement

Revenue:	$ 41.6M
Gross Profit:	$ 11.6M
Margin %	27.9%
EBIT:	**($ 2.9M)**
Margin %	-7.0%
Net Income:	($ 2.9M)
EPS:	**($ 0.14)**

TTM Cash Flow

Operating Cash Flow:	**($2.6M)**
Free Cash Flow:	**($2.8M)**

the company returned to profitability, and third, the company must seek to supplement its brand positioning as the product designer for Motorola modems and gateways with its own, in house trademark, ideally before renegotiating the license in 2025.

Once all that is done, it remains to be seen where ZMTP will set their sights. Perhaps on an app to turn Zoom modems and Wi-Fi routers into true home networking hubs that can communicate directly with Wi-Fi enabled devices throughout the house and be controlled using a Zoom Telephonics app, available for monthly subscription in the Android and or iOS App store? That would seem to be the logical evolution of the company's 2012 ZoomTether experiment, which was an app that turned Zoom Routers into boosters for Wi-Fi hotspots created using Android phones.

It might seem like a long shot, but the company is being advised by two profit motivated activist shareholders with board seats. If it ever were to become a recurring revenue story, ZMTP would likely be able to recoup the value of those deferred tax assets after all. Antrim is not currently a ZMTP shareholder, but will be seeking to initiate a starter position in the coming days, with a view towards reassessing liquidity and position sizing as the year unfolds.

PAST PERFORMANCE IS NOT A RELIABLE PREDICTOR OF FUTURE RESULTS

Recommendation	Date	Performance Since Recommendation
Long NLY	May 1st, 2020	-1.4%
Long AGNC	May 1st, 2020	+5.2%
Short SWKS	May 1st, 2020	+14.1%
S&P 500	May 1st, 2020	+4.8%
Long DESP	April 1st, 2020	+25.2%
Short KNSL	April 1st, 2020	+42.8%
S&P 500	April 1st, 2020	*+18.1%*

I will never forget this picture of Grand Central Station, on a weekday.

DISCLOSURES

Antrim Investment Research is long shares of MIK, NLY, AGNC, and DESP. Antrim is short shares of QSR, SWKS, and KNSL. Antrim will seek to establish a long position in ZMTP over the coming days. Neither does Antrim nor do I, personally, have any business relationship with any company mentioned in this newsletter.

AS ALWAYS, LIKE, SHARE, AND SUBSCRIBE!

If you are reading the third issue of ***Idiosyncratic Risk*** then you are a friend of Antrim Investment Research (in my eyes anyway), and I would always like to make new friends. If you find my views interesting or helpful, and if you'd be so kind, feel free to forward this newsletter along in your network to those who might also make use of its content.

I sincerely appreciate the friendship, support, mentorship, and camraderie I've experienced during my career in Investment Management and I would like to thank my friends and readers for supporting me, whether by forwarding this email and my contact information along in your network, or merely reading these pages and considering what I have to say.

Feel free to reach out with questions, criticisms, suggestions, and investment ideas if you've got any good ones.

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