

BETWEEN THE LINES

April 13, 2018

Spring Cleaning: Throwing Sunlight on Q1 Wins, Fresh Look at Stormy Daniels

Introduction

It's springtime here at BIA's Boston headquarters, which means the snow is melting, the birds are chirping, and the broken-hearted Patriots fans are starting to dust off their Red Sox caps. It's also time for some spring cleaning around here. We've had a lot of interesting behavioral finds in Q1 and have compiled some to share with you! At BIA, we apply our proprietary Tactical Behavioral Assessment® (TBA™) methodology to analyze management teams' statements and provide insight into the completeness, transparency and confidence surrounding all types of business issues. In this spring cleaning edition of *Between the Lines*, we take a look back at our recent findings on Theranos, Rovio Entertainment, and Amazon. We also use our behavioral lens to zoom in on the White House – after all, what would spring be without a little Stormy weather? We'll analyze Stormy Daniels' recent *60 Minutes* interview and take a look at how long the White House knew about ex-staff secretary Rob Porter's domestic abuse before relieving him of his position. Finally, nothing says the start of spring quite like the Masters! We will take a look into the largely unpopular winner Patrick Reed's statements to see how much he cares that his reputation is in the rough.

Theranos: BIA Drew First Blood, SEC Confirms Suspicions

In October 2015, the *Wall Street Journal* published an article reporting that Theranos, then a high-flying blood-testing company touting revolutionary technology, used its proprietary technology for only a fraction of the blood tests it offered in Walgreen's stores, and that former employees of the Company doubted the technology's accuracy. In an attempt to clear the air, CEO and founder Elizabeth Holmes was interviewed at WSJDLive on October 21, 2015. At the time, BIA analyzed the interview and concluded that many of the allegations against Theranos had merit. Since then, the Company has been under investigation by numerous regulators and authorities, most recently the Securities and Exchange Commission. The SEC has charged Elizabeth Holmes with "massive fraud" through "deceiving investors by making it appear as if Theranos had successfully developed a commercially ready portable blood analyzer that could conduct a full range of laboratory tests from a small sample of blood." Our 2015 analysis yielded valuable insight to our clients and provided them with an important dose of skepticism years before the SEC pressed charges. Here are some of the behavioral highlights:

Theranos was using mostly commercially available technologies for its testing.

When asked if it was correct that Theranos was only testing for HSV on its proprietary technology, Ms. Holmes answered, "It's not correct." However, the remainder of her response did not clarify the issue for listeners. Instead, she launched into an overly detailed explanation of the Company's decision to switch to the FDA framework and quality standards, and highlighted that the Nanotainer tube had been FDA approved for HSV testing and that the Company was "taking it through for use with any combination of tests." This is a concerted effort to convince listeners that the perception that the Nanotainer was at the time only being used for HSV was a strategic choice. When asked again if Theranos was using the Nanotainer tube only for HSV testing, she did not confirm that this was the case. Ms. Holmes instead elected to correct the question ("you said technology initially") and clarify that Theranos had many other types of proprietary technology. Finally, when pressed to answer whether Theranos was testing for other medical conditions using Edison, Ms. Holmes again elected to explain that Edison referred to one early version of the Company's device that was no longer used. Ms. Holmes never offers an explanation or specifics to support her

statement that it was “not correct” Theranos was using its proprietary technology for only one test. Furthermore, Ms. Holmes took advantage of how these questions were asked to make distinctions between terms that she claims had been conflated in the *Wall Street Journal* article (“technology” versus “Nanotainer” versus “Edison”), but more significantly to completely evade confirming what tests were performed using which technologies. This suggests that there was merit to the accusation that Theranos was using mostly commercially available technologies for its testing.

When asked if the Company was using equipment that was not theirs to do some testing, Ms. Holmes eventually admitted that “when we do venous draws, we use commercially-available machines.” She attempted to give the impression that the Company had always been very transparent about when they used venous or finger-prick blood draws. However, her response bombarded listeners with excessive, superfluous detail, but did not clearly say the Company had been transparent with customers about what technology they used in each scenario. Although Ms. Holmes technically answered the question, this response sidestepped the heart of the issue and left open the extent to which Theranos used commercially available machines instead of their proprietary technology.

Ms. Holmes had doubts about the accuracy of Theranos’s technology.

When responding to whether Theranos’s technology works, Ms. Holmes offered one direct statement: “I know it does.” She then resorted to a series of protest statements to convince investors that the technology worked. To support this statement, she referenced her confidence in the Company’s interactions and their great relationship with the FDA. She claimed that the FDA’s approval of the device was evidence that the device works, and went on to invoke the authority of the FDA as evidence that the data the Company had submitted was good. At no point did Ms. Holmes offer any hard evidence to support her confidence. This raised the possibility that, despite her proclaimed confidence in the Company’s ability to get FDA approval, she doubted the actual efficacy of the Company’s technology. When asked if she considered the variability that some people said existed to be outliers, Ms. Holmes did not answer. She ultimately claimed that things needed to be considered on a case-by-case basis and insisted that “you can’t take one person and make a generalized statement” that “the whole lab’s not working.” Her reluctance to say these cases were even possibly outliers suggested that she harbored doubts that they were, which in turn suggested that she lacked confidence in the consistency of the Company’s test results.

The FDA had concerns about Theranos’s data.

When asked if the FDA conducted an unannounced inspection because they had concerns with the efficacy of Theranos’s data, Ms. Holmes did not answer. She declined to say what the FDA thought of the Company and was somewhat defensive in an effort to shut down the line of inquiry. This indicated that she was not willing to confirm in public that the FDA did not have concerns about the Company’s data. Furthermore, she qualified that “I can tell you what I can say about it” is that the inspection was a QSR audit. This initial qualification suggested that there were aspects about the inspection about which she could not say anything. This left open the possibility that the inspection did in fact extend beyond the QSR audit to include inquiries about data concerns. Furthermore, when asked again about the reasons for the FDA’s unannounced inspection, it is notable that, while she had previously stated the *Wall Street Journal’s* explanation for the inspection was “false,” she here stated the Company “disagree[d]” with it. This indicated that there was room for interpretation about the motives for the FDA’s inspection. Notably, Ms. Holmes then launched into a lengthy effort to “paint the halo” over Theranos’s decision to work with the FDA and convince listeners of the higher purpose of the Company’s vision. She also goes on the attack with efforts to trivialize other companies that issue press releases “every time they submit something.” These behaviors were meant to garner sympathy and support for the Company’s cause, while at the same time defend the lack of transparency about FDA interactions. These emotional appeals, along with the ultimate refusal to fully explain the reasons for the FDA’s inspection, provided further behavioral evidence to conclude that the FDA had concerns about Theranos’s data.

Ms. Holmes doubted Theranos’s readiness to move forward.

When asked if she felt the Company went to market too quickly and if she had any concerns about where the Company was that day, Ms. Holmes did not answer. She instead resorted to a series of protest statements to insist that the *Wall Street Journal* articles had no bearing on the Company’s mission or performance, that management had a great relationship with their investors and Board of Directors, and that she cared deeply about what the community thought about the allegations. At no point did she even acknowledge the questions about whether the Company was ready to come to market or if she had any concerns about where they were. These impassioned efforts to insist there was nothing wrong with the Company in lieu of providing any insight, evidence or expression of confidence about the Company provided strong behavioral evidence that Ms. Holmes harbored serious doubts about Theranos’s readiness to move forward.

This Angry Bird Has Flown...and Crashed: Rovio's Stock Takes a Beaking

Kati Levoranta, CEO of Rovio Entertainment, was interviewed on CNBC on October 3rd, 2017, following Rovio's listing on the Nasdaq Helsinki Stock Exchange. Rovio Entertainment is the creator of the immensely popular video game franchise Angry Birds. When asked whether the Company could sustain the over-90% sales growth experienced over the previous two quarters, Ms. Levoranta tried to reassure investors that sales growth would remain strong. However, in analyzing her response, BIA noted a series of behaviors that called into question the sustainability of that growth. Specifically, Ms. Levoranta never directly answered the question, instead detouring to previously provided information in an effort to appear responsive. She stated that they said in the "official guidance" they had given out that their "aim" was to grow faster than the Western market, and that is what they anticipated "at the moment." This need to pivot to "official guidance" in lieu of a direct response, combined with her qualified language about that guidance, suggested to BIA that Ms. Levoranta did not expect sales growth to remain above 90% sustainably. The market, however, was convinced, and over the remainder of the week Rovio's stock increased 6.5%. It remained in a narrow range until the Q3 earnings report, when the unsustainability of Rovio's previous growth was revealed. Revenue growth decelerated to 41% year-over-year in Q3 and the stock plunged 22%. Things would only get worse in Q4, when revenue grew a tepid 17% and management acknowledged that 2018 revenue would be flat at best. The stock was pummeled, falling 50% in a single day. Since Ms. Levoranta's CNBC interview, Rovio's stock has fallen almost 60%, with early expectations for sales growth clearly outpacing what management realistically expected. BIA's methodology was able to warn clients of this risk in advance, even as the market bid up Rovio's shares.

Amazon Won't Give Up the Shipping

In June 2017, BIA released a *Between the Lines* entitled *The Amazon Effect Flows into Shipping*. That report analyzed public statements made by Amazon that related to shipping, specifically their increasing control over delivery logistics and their expanding fleet of company-owned trucks and cargo planes. BIA noted that over multiple years of earnings calls, management consistently failed to answer questions about their logistics strategy and the potential to offer their company-owned capacity to third-party shippers, displaying a concerted effort to avoid transparency. Instead, they made a number of protest statements about how they "value" the "great relationships" that they have with their shipping partners. While these protests were meant to downplay concern on the part of their shipping partners about the potential of Amazon ultimately competing with their services, management consistently failed to explicitly rule out that possibility. This behavioral evidence led BIA to conclude that Amazon was likely to try to compete directly in the shipping industry at some point in the future. In February 2018, this prediction proved true. The *Wall Street Journal* reported that Amazon was preparing to launch a delivery service for businesses, called Shipping with Amazon (SWA) that would position it "to compete directly with United Parcel Service Inc. and FedEx Corp." Rolling out initially in Los Angeles for third-party merchants selling goods on Amazon's website, the Company plans to expand to more cities as soon as this year. The application of BIA's proprietary methodology allowed investors to position themselves for this possibility before the press reports confirming Amazon's entry into shipping.

Stormy Daniels Brings the Thunder, Her Lawyer Brings the Politics

On Sunday, March 25th, 21.3 million people tuned in to watch adult film actress Stormy Daniels sit down with Anderson Cooper on *60 Minutes* to discuss her affair with President Donald Trump, the largest ratings the show had seen since Barack and Michelle Obama were interviewed in 2008. With interest in the story so high, and denials coming from the White House about both the affair and the reported cover-up, BIA decided to apply our methodology to Ms. Daniels' statements to gauge their credibility. We found no behavioral evidence to suggest that the affair or the cover-up by Mr. Trump's lawyer, Michael Cohen, was made up by Ms. Daniels. Even so, behavioral indicators suggest that Ms. Daniels is casting her role in a more favorable light than it actually was. For example, when describing her first encounter with Mr. Trump in Lake Tahoe in 2006, Ms. Daniels tries to give the impression that Mr. Trump's presumption for sex was unexpected when she says, "I realized exactly what I'd gotten myself into." However, her qualification "exactly" indicates that she, at a minimum, had a suspicion that the interaction would lead to sex. In another instance, Ms. Daniels answers why she feels the need to set the record straight. She says that it is because she does not like "people thinking that I did this for money and people are like, 'Oh, you're an opportunist. You're taking advantage of this.'" After acknowledging that she is receiving more job offers, she becomes defensive, saying, "tell me one person who would turn down a job offer making more money than they've been making, doing the same thing that they've always done?" This ardent justification of her actions, rather than a simple statement of facts, suggests that Ms. Daniels is more shrewdly opportunistic than she wants the public to believe.

Similarly, the motivations of Michael Avenatti, Ms. Daniels' lawyer who also appeared in the interview, may not be as "righteous" as he claims. Confronted with his opposition research work for Democratic political operative Rahm Emanuel, Mr. Avenatti is asked whether his motivations are political. Failing to answer directly, Mr. Avenatti protests that he has not "done anything in politics in over 20 years." This falls short of a denial that Mr. Avenatti is, at least in part, motivated by political

considerations. In the end, while both Ms. Daniels and Mr. Avenatti attempt to manage the public's perceptions of the situation, BIA finds no behavioral evidence to refute Ms. Daniels' claims that the affair and the subsequent cover-up occurred.

Rob Porter: What and When the White House Knew

On February 6, 2018, the *Daily Mail* published a report detailing allegations that ex-White House staff secretary Rob Porter physically and emotionally abused his ex-wives, Colbie Holderness and Jennie Willoughby. On the same day, Chief of Staff John Kelly and Press Secretary Sarah Sanders defended Mr. Porter's character, stating that he is "a man of true integrity and honor." Early in the morning of Wednesday, February 7th, photographic evidence of the abuse was released and Porter was removed from his position. In defense of how they handled the Rob Porter allegations, the White House protested that they "learned of the extent of the situation involving Rob Porter last Tuesday evening" and that "within 24 hours his resignation had been accepted and announced." They did so in order to give the impression that they responded to the information immediately. However, stating that they learned of the "extent of the situation" on February 6th signals that they were aware of the situation to some degree earlier than implied. Sure enough, the next day on February 13th, FBI Director Christopher Wray refuted the timeline that the White House put forth in front of the Senate Intelligence Committee. He informed the Senate that the White House was made aware of the allegations as early as March 2017 and then later in July, and that Porter's security clearance was being restricted as a result.

He May Deny It, but Patrick Reed Wants a Mulligan on Popularity

The history and importance of the Masters always ensure high levels of anticipation for the first major golf tournament of the year, and the buzz around the 82nd version was especially deafening. However, the wave of expectation crashed down unpleasantly, at least for some, when the famous green jacket went not to a big-name, popular star, but to Patrick Reed, a man for whom the fans' dislike is especially notable in the genteel world of golf. When asked about his lack of popularity – evidenced by muted cheers and chatter on social media – Mr. Reed tries to give the impression that it is not important to him. He claims that he does not regret anything he said in the past, and that he doesn't know why fans dislike him. However, some of the behaviors he exhibits when responding to questions suggest that the lack of popularity bothers him more than he wants to acknowledge.

"I don't know. Why don't you ask them? I mean, I have no idea, and honestly I don't really care what people say on Twitter or what they say if they are cheering for me or not cheering for me."

The combination of the qualifier, that he doesn't "really" care, and the credibility booster "honestly" provides further evidence that Mr. Reed is more bothered by the criticism than he acknowledges. Additionally, he tries to give the impression that he is not bothered "if they are cheering for me or not cheering for me" or "what people say on Twitter." The effort to imply that there are people cheering for him suggests that Mr. Reed wants the audience to believe that those fans exist, indicating that he cares more about his popularity than he claims. Regarding those cheers, Mr. Reed acknowledges that the crowd's roar at the sight of Rory McIlroy teeing off was "a little louder" than the cheers for him, protesting that this disparity helped to "fuel [his] fire a little bit." This protest inadvertently reveals that Mr. Reed does care about the crowd's admiration, and that a desire to win them over motivated his performance. Altogether, Patrick Reed's behaviors suggest that his lack of popularity matters more to him than he is willing to acknowledge.

About this Report:

This report represents the application of BIA's Tactical Behavior Assessment® methodology and reflects BIA's assessment of the completeness and responsiveness of statements made during earnings conference calls, television interviews and other presentations. In each case, our assessment represents the opinion of BIA applying the Tactical Behavior Assessment® methodology and does not purport to indicate that any individual is in any specific instance being truthful or deceptive. BIA does not make stock recommendations. Under no circumstances is BIA's analysis intended to be a recommendation to buy or sell the securities of the company which is the subject of this report.

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