

## **Selling Short: Green Mountain Coffee Roasters**

Martin Dirks

In this case, Green Mountain Coffee Roasters is considered as a short sale candidate. (A stock sold short makes money if the stock price declines.) This business is growing at a high rate, but there are signs of potential problems. This is a very real illustration of bullish investors versus bearish investors. Like a mystery novel, there are spies, possible misrepresentation and conflicting information. Decision-making under uncertainty is explored, a factor professional investors must deal with every day. Case discussion topics include risks in short selling, margin loan calculation, investor behavior, stock valuation analysis, forecasting business growth potential, forecasting earnings reports, management incentives, actions taken by management to increase stock price, aggressive accounting practices, assessing business impact of a patent expiration and the impact of business growth rate on stock market valuation.

### **Learning Objective**

Green Mountain Coffee Roasters is an excellent case to be taught after teaching at least one case on the usual analysis of a public company as a potential investment. The case takes the analysis process to a greater depth and brings up the possibility of making a "bet" that a stock will decline in price. The case forces students to see that things are not always as they may appear at first glance: Management may act for its own benefit, not for the benefit of shareholders. Accounting may not represent the actual condition of the business; earnings may be manipulated. Different investors may have differing expectations. The case illustrates an attempt to determine which forecast is correct. The case illustrates an in-depth, business forecast/modeling methodology for Green Mountain's business. The requirement to make a decision with incomplete information, something all professional investors must deal with every day, is brought to students who usually are expected to find a "correct answer." Green Mountain has all the common characteristics of a great short sale candidate. The case also brings up an opportunity to discuss several advanced investment topics, which are covered in the teaching note: Long/short hedge fund investment strategy, Portfolio risk assessment/modeling, Margin calculations

This case is available from Harvard Business Publishing, a subsidiary of Harvard University reporting into Harvard Business School. You may purchase a copy of the case here:

<https://www.hbsp.harvard.edu/product/W12073-PDF-ENG>

The first page of the case is shown on the following page.

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## SELLING SHORT: GREEN MOUNTAIN COFFEE ROASTERS<sup>1</sup>

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*Marty Dirks wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author may have disguised certain names and other identifying information to protect confidentiality.*

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It was a cool day on October 18, 2011, as institutional investor Marty Dirks looked out his office window at the Bay Bridge that led from San Francisco to Oakland. He wondered, “Do I feel lucky?”

The day before, Greenlight Capital (Greenlight), a highly-regarded long/short equity hedge fund, had presented a bear case (the analysis supporting a short position) for Green Mountain Coffee Roasters (NASDAQ: GMCR) at the Value Investing Congress in New York. It was an intriguing investment idea, but held huge risk.

Green Mountain Coffee Roasters (Green Mountain) was a volatile stock; in the past year its price had ranged from a 52-week low on December 16, 2010 of \$31.21 per share to a 52-week high on September 20, 2011 of \$115.98 per share<sup>2</sup> (see Exhibit 1). If Dirks had sold Green Mountain’s shares short on December 16, by September 20 he would have had a loss of 270 per cent in the position — in a market in which the Standard & Poor 500 had declined 2 per cent over the same period of time.

Could Dirks ever obtain enough conviction from his analysis to take on the investment risk inherent in Green Mountain?

### COMPANY HISTORY

Green Mountain Coffee Roasters was founded in 1981 in rural Vermont, where it was still headquartered. Initially, it roasted and distributed coffee to restaurants and supermarkets throughout the region. For most of Green Mountain’s history, sales of wholesale coffee represented the majority of the business.

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<sup>1</sup> This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Green Mountain Coffee Roasters or any of its employees. The case is solely the work of Marty Dirks and was not prepared by, nor endorsed by, Greenlight Capital or its affiliates.

<sup>2</sup> Thomson Reuters.