What is value?

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Carlyon AG

club b

Madrid conference - 11.11.2021

Warren Buffett

Edgar Wachenheim

Paul Singer

Well known managers associated with an active value style have successfully navigated markets for five decades, whilst pure value outperformance is only evident in sporadic episodes.

By observing actions taken by exceptional value managers we can better understand the reason for their long-term outperformance.

Using public disclosure of single line holdings we can create composite financial metrics to help explain their stock selection.

We examine factors and underlying financial metrics of stocks selected by passive value funds as comparison to active outcome.

Summary

- Active value strategies of exceptional managers have outperformed over multiple decades whilst pure value episodes typically occur when multi-year bull markets end.
- Common traits of greatest value investors i.e concentrated portfolios and stock selection based on multi-year outcome assessment, is referenced to 13F holding information and multi-factor analysis which yields interesting results.
- Disclosure of new holdings & position size changes provides further insight into investment process.
- Rule-based stock selection of passive value funds is underwhelming vs standard index returns.

According to renowned value investor Edgar Wachenheim (Greenhaven) we should be extremely worried by current attitude to risk by investors. Using long-run forward PE of 16 as input, they see S&P 500 as over-valued by 50%.

Common traits of exceptional value investors (I) - general principles

Margin of safety	Buying assets on sale / at discount - discount to underlying value - tangible assets > intangibles (less important these days) - consider worst-case scenario	
Power of compounding income	High return companies & reinvestment opportunities Power of compounding cash flows FCF: 1m, ROIC: 20%, reinvest over 10 yrs -> 6x Compounding machines: companies that can grow intrinsic value year after year	
Invest where there is a moat	Focus on companies with a sustainable & competitive advantage Monopoly like situation -> pricing power, margins increase	
	Brands	Coke
	Network effects	iphone ecosystem
	Stickiness	Software
	High Set-up cost	Railroads, Electrical grids
Focus on business risk	Not beta or price volatility Look at risk with a credit mindset: probability of loss Capital structure & leverage Capital requirements Commodities have no pricing power	
Be very skeptical of new paradigm	Holding cash when targets don't meet criteria Don't join the herd Be ready with cash	
Stay within your circle of confidence	Invest in what you know best	
Absolute return orientation	Don't focus on indices	

Common traits of exceptional value investors (II) – investment criteria

Consistency is king	growing earnings	
	low debt	
	low capex and R&D	
	profitability	
	look for cost reduction over time ie production, marketing, R&D, Inventory	
Income Statement	consistently growing Revenues	
	Gross profit margin	>40%
	consistently growing Net Income	
	Net income margin	>20%
Balance Sheet	Retained Earnings	
	Return on Equity	
	Little to no long-term debt (use cash flows to grow business)	
Cash Flow Statement	Capex	
	Capex/ net income %	as low as possible
		<25% good
		<50% acceptable
	Augmented payout ratio	share buybacks and dividends
When to Sell?	when other investments are available with higher expected returns	
	when company loses competitive advantage	
	during strong bull markets	P/E > 40

Manager universe – return profile and longevity

Manager	Year of inception	Years	Compound annual return since inception	Volatility (10 yrs)	Size of fund
Berkshire Hathaway*	1965	55	20.0%	16.3%	544 bn
S&P 500 index (inc div)			10.2%	13.3%	
Elliott **	1977	44	13.1%	3.5%	48 bn
S&P 500 index (inc div)			11.8%	13.3%	
Greenhaven***	1987	34	17.0%	26.4%	7 bn
S&P 500 index (inc div)			10.4%	13.5%	
Vanguard Value ETF****	2003	18	8.8%	13.8%	126 bn

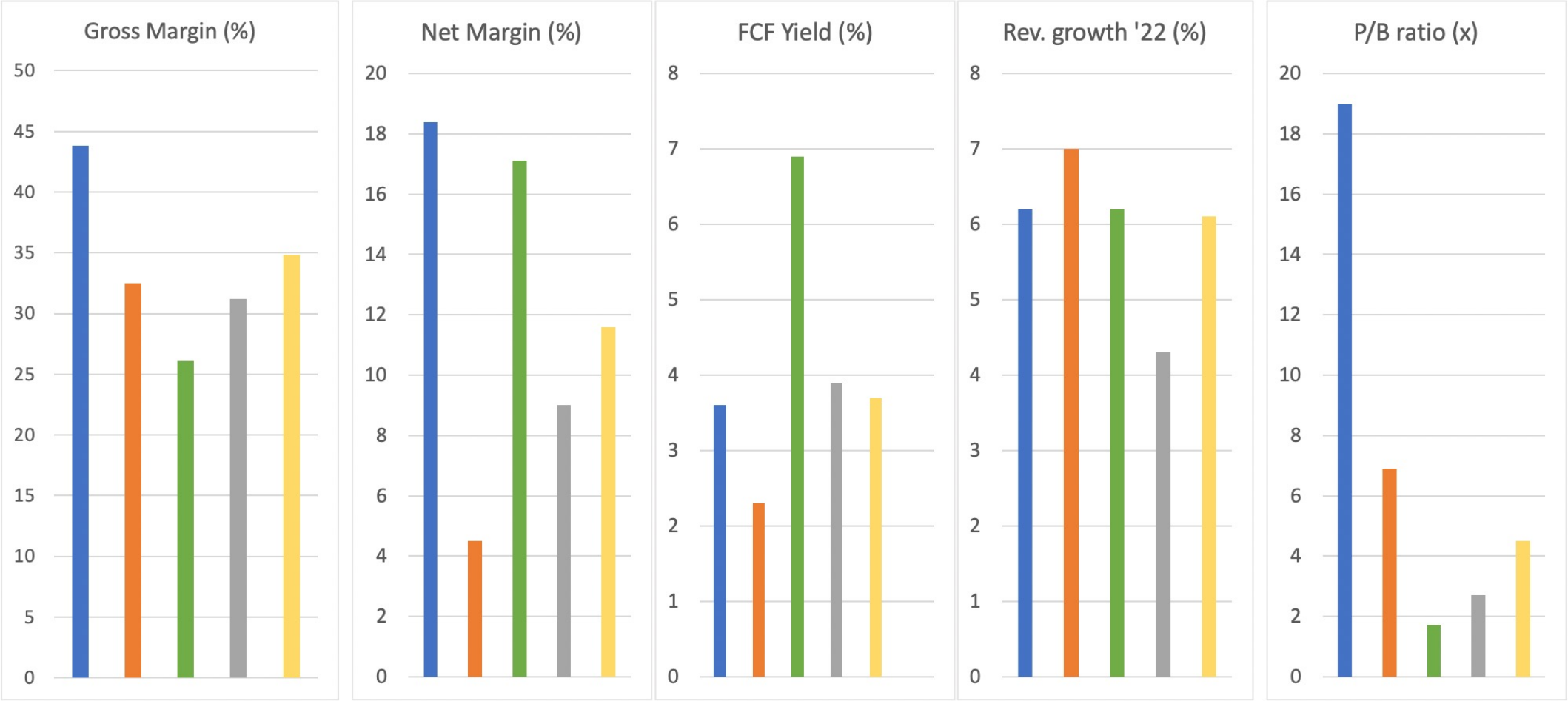
* Berkshire Hathaway - annual shareholder letter as at 31.12.2020.
** Elliott - 2nd quarter 2021 investor letter. Volatility from SOC Investment Group from 2021 repeort.
*** Greenhaven - October 2021 Investor letter, return is net of fees. Volatility estimated not disclosed.
****Vanguard Value ETF (VTV) inception date: May 16th 2003. Based on June 30th information sheet.

SPY ETF performance over 18 years from 2003 = 9.3% p.a

Manager universe – top 5 positions, concentration, recent changes

Fund	Top 5 posiitons	Percent of portfolio	Portfolio changes of note in 2021	Disclosure by 13F
Berkshire	Apple Inc	42%	Chevron stake reduced 50% in Q1 2021 from new position 4Q 2020	May.21
	Bank of America Corp	15%	Pharma reduced for 2nd consecutive quarter in Q2 Merck, AbbVie, Bristol MS	Aug.21
TOP 5 holdings = 76%	American Express Co	9%	General Motors reduced for 3rd consecutive quarter in Q2 2021	Aug.21
	Coca-Cola Co	7%	Aon new position taken of USD 1bn in Q1, added in Q2 2021	Aug.21
	Kraft Heinz Co	4%	Kroger stake added 52% in Q1 from 4Q 2020 & again in Q2 2021	Aug.21
Elliot	Dell	26%	New Toshiba position in top 5	Aug.21
	Howmet Aerospace	15%	New position Duke Energy	Aug.21
TOP 5 holdings = 65%	Toshiba	10%	New position DropBox	Aug.21
	Twitter	7%	New position Frontier Communications	Aug.21
	Marathon Petroleum	7%	New position Endevour Group	Sep.21
Greenhaven	Goldman Sachs	25%	Reduction of existing position	Sep.21
	Lennar Corp	22%	Reduction of existing position	Sep.21
TOP 5 holdings = 94%	Whirlpool	19%	Add to existing position	Sep.21
	General Motors	18%	Reduction of existing position	Sep.21
	Toll Brothers	10%	Add to existing position	Sep.21

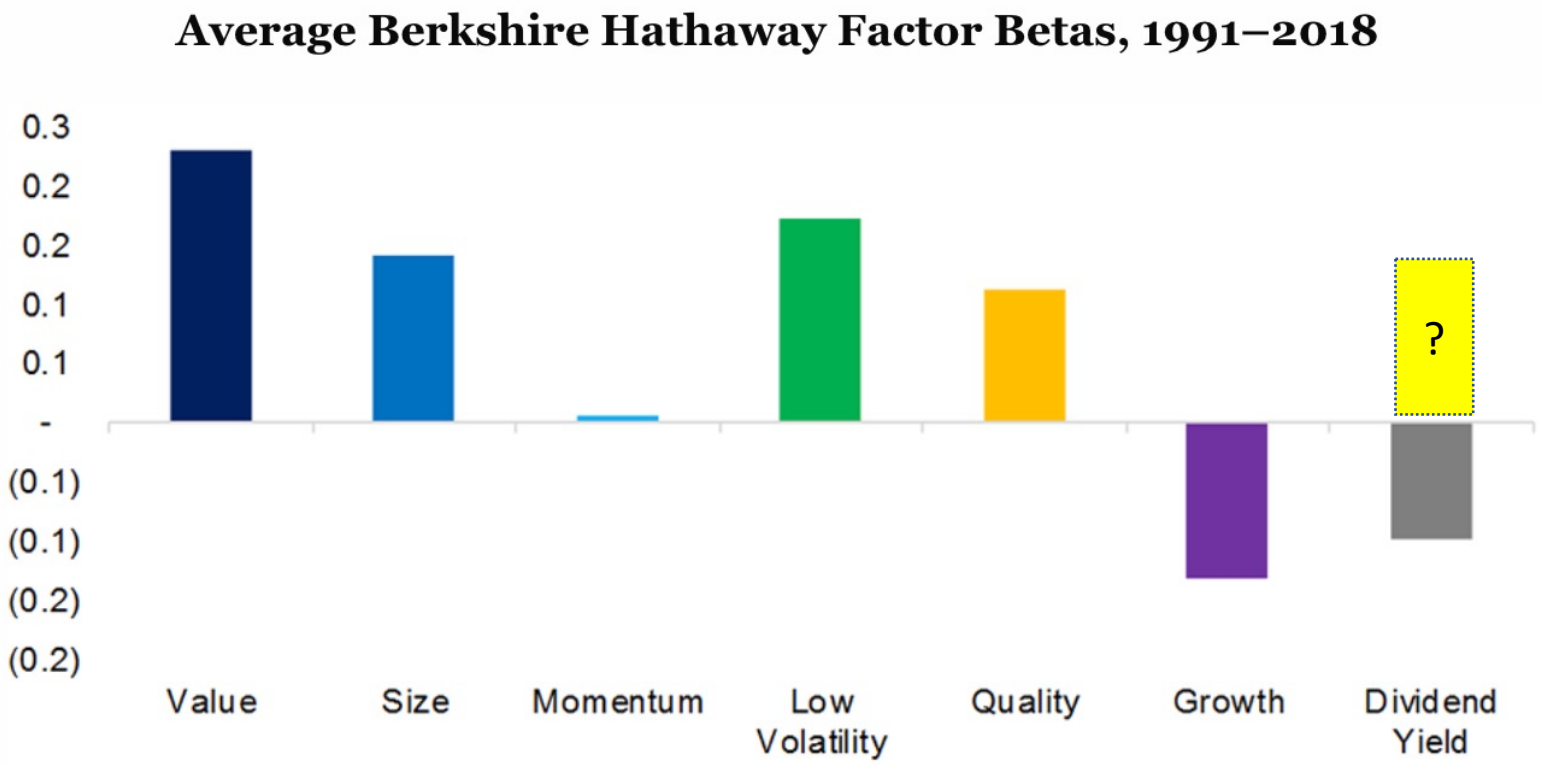
Composite financial metrics from analysis of holdings



Source: company accounts for each holdings as per latest 13F filing

Berkshire Hathaway

Berkshire Hathaway – factor analysis



Source: FactorResearch

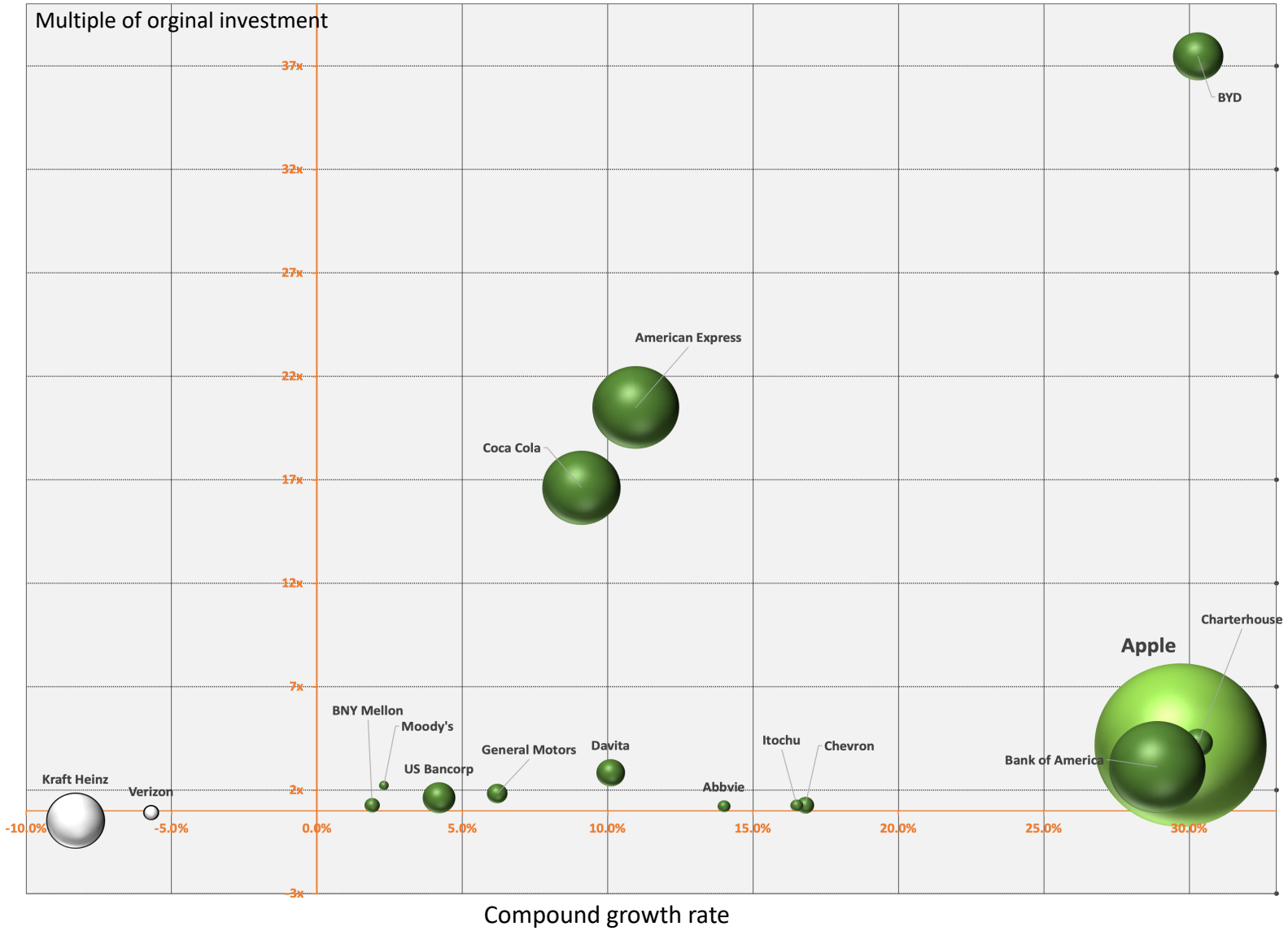
What about buybacks input – study did not include (PH comment)

https://blogs.cfainstitute.org/investor/2019/04/15/warren-buffett-the-greatest-factor-investor-of-all-time/

Berkshire Hathaway – stock selection

Berkshire listed equity holdings	ticker	value USD bn	stake	mkt cap bn	trailing 12 months gross margin	post tax - trailing 12 m net income margin	trailing 12 months Free cashflow yield	Next fiscal year (2022) revenue growth (EST)	Most recent quarter PBR x
Apple Inc	AAPL	130.3	5.50%	2339	43%	25%	4.1%	3.90%	36.4
Bank of America Corp	BAC	46.1	12.30%	366	32%	7.1%		5.60%	1.5
American Express Company	AXP	26.7	19.10%	138	58%	18.2%	7.0%	14%	5.4
Coca-Cola Co	KO	21.6	9.30%	234	54%	22.0%	4.9%	5.7%	10.5
Kraft Heinz Co	KHC	12.2	26.60%	45	35%	8.1%	8.8%	-3.7%	1.1
US Bancorp	USB	9.4	9.90%	91	42%	31.0%	9.0%	5.5%	2.0
Moody's Corporation	MCO	9.1	13.20%	67	67%	34.0%	3.5%	6.6%	30.6
Verizon Communications Inc.	VZ	8.6	3.80%	212	58%	15.0%	-11.0%	-0.9%	2.9
BYD Co. Ltd	BYDDF	7.3	8.20%	106	16%	1.8%	4.2%	25.0%	7.5
Bank of New York Mellon Corp	BK	4.1	8.60%	48	32%	22.0%	-3.0%	2.9%	1.2
DaVita Inc	DVA	4.1	34.40%	11.5	31%	6.9%	10.0%	3.8%	9.4
Charter Communications Inc	CHTR	3.9	2.80%	126	39%	7.9%	5.7%	5.5%	6.6
General Motors Company	GM	3.4	4.10%	84.7	15%	8.9%	-0.8%	17.0%	1.6
Verisign, Inc.	VRSN	2.7	11.50%	23	85%	46.0%	2.7%	8.8%	0.0
Chevron Corporation	CVX	2.5	1.20%	206	29%	3.0%	4.6%	4.7%	1.6
Kroger Co	KR	2.5	8.30%	29.5	23%	0.8%	5.7%	1.2%	3.2
Itochu Corporation	ITOCF	2.3	5.10%	43.67	17%	5.0%	1.0%	0.0%	1.3
Vie Inc	ABBV	2.3	1.20%	191	66%	12.3%	10.2%	6.1%	15.5
Visa Inc	V	2.3	0.50%	488	79%	49.1%	2.6%	19.9%	13.8
Liberty Sirius XM Group Series	LSXMK	2.1	19.20%	18	51%	-5%	8%	3.5%	2.0
Snowflake Inc	SNOW	1.9	2.00%	98	59%	-82%	0%	64.0%	20
Amazon.com, Inc.	AMZN	1.8	0.10%	1663	26%	7%	0.4%	18.30%	14.3
Mastercard Inc	MA	1.6	0.50%	337	75%	43%	2%	19.90%	53
Bristol-Myers Squibb Co	BMY	1.5	1.20%	126.8	76%	-11%	9%	3.60%	3.5
Aon PLC	AON	1.3	1.90%	67.9	46%	17%	4%	5.30%	14.9
Restoration Hardware Hldg	RH	1.2	8.40%	13.7	49%	14%	4%	9%	16.9
Simple average					**46%**	**12%**	**3.9%**	**9.8%**	**10.6**
Weighted average					**43.8%**	**18.4%**	**3.6%**	**6.2%**	**19.0**

Berkshire Hathaway – current portfolio return contribution

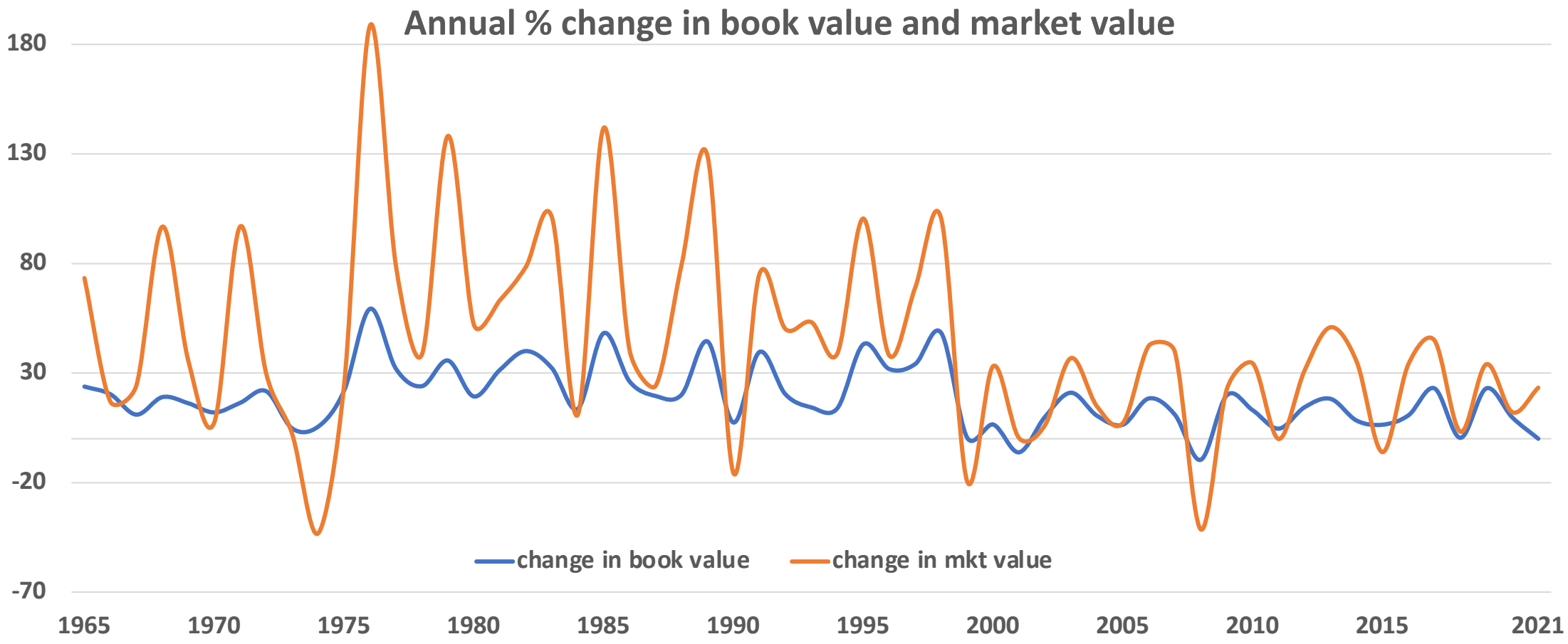


BYD postion taken in 2008 with highest multiple on original investment cost of 37x

Coca Cola investment made in 1988 and American Express in 1993

Size of bubbles represents capital gain. Apple position equates to $100bn of capital gain vs 2016 original cost basis.

Berkshire Hathaway – book value and mkt cap



Source: Annual Berkshire Hathaway - newsletter 2020

Buffett guiding principles

Invest in good businesses with low capital needs

Buffett has long advocated for owning businesses that earn high returns on the capital invested in the business. During inflationary times, businesses with low capital needs that are able to maintain their earnings should fare better than ones that are required to invest more money at ever higher prices just to maintain their position.

Look for companies that can raise prices during periods of higher inflation

"The single most important decision in evaluating a business is pricing power," Buffett told the Financial Crisis Inquiry Commission in 2010. "You've got the power to raise prices without losing business to a competitor, and you've got a very good business."

Berkshire Hathaway – succession and leverage

Succession - online discussion from May 2021

When Greg Abel takes over, he won't have the same level of experience (Buffett is one of the founders and has been running Berkshire since the late 1960s). There is simply no way he will be able to have the same level of control. He'll have to share power with Ajit Jain, Todd Combs and Ted Weschler. Buffett is also the largest shareholder, another advantage that his successor will not have.

I think it's improbable that these four individuals will be able to work with the same level of harmony as Buffett and Charlie Munger (Trades, Portfolio). After all, adding extra layers of management has rarely been an excellent strategy for improving business outcomes.

Better than debt or equity: Zero-cost financing

Berkshire has access to two low-cost, non-perilous sources of leverage that allow us to safely own far more assets than our equity capital alone would permit: deferred taxes and "float," the funds of others that our insurance business holds because it receives premiums before needing to pay out losses...

Better yet, this funding to date has been cost-free. Deferred tax liabilities bear no interest... Neither item, of course, is equity; these are real liabilities. But they are liabilities without covenants or due dates attached to them. In effect, they give us the benefit of debt-an ability to have more assets working for us-but saddle us with none of its drawbacks.

Elliott

Elliott - stock selection

Multi-asset hedge fund has returns derived from illiquidity premium, leverage and trading activity. Risk adjusted outcome extremely successful.

Elliott portfolio holdings	ticker	Position value USD (m)	Stake	Mkt cap USD bn	trailing 12 months gross margin	post tax - trailing 12 m net income margin	trailing 12 months Free cashflow yield	Next fiscal year (2022) revenue growth (EST)	Most recent quarter PBR x
Dell	DELL	2475	8.54%	81	31%	4%	13%	1%	16.7
Howmet Aerospace	HWM	1415	9.57%	13.2	25%	6%	7%	15%	3.8
Toshiba	Toshiba	940	5.00%	18.5	26%	4%	1%		1.9
Twitter	TWTR	688	1.25%	50.4	64%	9%	1%	23%	6.4
Marathon petroleum	MPC	638	1.66%	42.5	4%	9%			1.4
Evergy Utility	EVRG	637	4.60%	14.59	46%	15%	-25%	1%	1.6
Peabody Energy	BTU	458	23.73%	1.81	14%	-11%	-10%	18%	2.1
Nielsen Holdings	NLSN	409	4.63%	7.1	56%	11%	7%	3%	2.3
arconic	ARNC	370	9.50%	3.4	14%	-8%	-11%	14%	2.1
E2Open parent holdings	ETWO	319	9.35%	3.862	0%	0%			1.9
Uniti Group (REIT)	UNIT	216		2.8	90%	0%	-4%	4%	
Public Strorage	PSA	172	8.77%	57.1	73%	42%	4%	6%	10.8
Valero energy	VLO(CALL)	156	0.33%	32.3	-0.5%	-1.7%	2%	13%	1.8
Endeavor Group	EDR	115		6.5	50%	-25%	-3%	16%	5.7
Duke energy	DUK	98	1.59%	78.2	48%	11%	0%		1.6
SNAP	SNAP	95		121.1	55%	-21%	0%	47%	40.0
Dropbox	DBX	90	0.11%	11.86	80%	-8%	6%	9%	
Frontier Comm	FYBR	79	0.95%	6.72					
Pintrest	PINS	46		33.85	77%	7%	1%	31%	13.0
Wayfair	W(PRN)	21	1.23%	25	29%	2%	3%	19%	1.8
Simple average					**41%**	**2%**	**-1%**	**15%**	**6.8**
Weighted average					**32.5%**	**4.5%**	**2.3%**	**7.0%**	**6.9**

Scope of Elliott fund - 48bn AUM

Equity orientated	The firm takes equity-oriented positions in several of its strategies, and takes on such positions in a variety of forms. It is less common for the firm to take on long equity positions which are just driven by valuation considerations. Elliott seeks out positions in particular which are uncorrelated with other positions in the portfolio or with the risks and expected price movements of equities generally, or where value and protection against risk can be enhanced by the firm's manual efforts. Positions with a high asymmetry of reward to risk create a high degree of optionality
Private Equity	Elliott may seek to take equity positions that result in gaining control of, or a substantial minority stake in, private companies or, on occasion, companies with a small public float. Elliott may also seek to purchase or source credit and preferred equity positions in companies. These positions may have longer investment horizons and are less liquid than listed securities. The firm also forms and establishes from time to time certain special purpose vehicles, operating companies, joint ventures, or similar arrangements for investing in and developing opportunities related to a particular industry, sector, or strategy.
Private Debt	ditto
Distressed securities	The firm's distressed-securities trading strategies are rooted in complexity, either by itself or together with process, rather than business-value-driven situations. To create value in complex, dynamic situations, distressed securities are highly dependent on deep skill sets and lengthy, intensive hands-on efforts. Our primary focus is uncorrelated situations governed by process, complexity, negotiations, and factors unrelated to the forces impacting stocks and bonds generally.
Non-distressed	Non-Distressed debt includes first lien bank debt, unsecured corporate debt which the firm believes will be serviced without restructuring, and structured credit products. These highly complex products often involve analyses of multiple layers of securitization and are not well understood by many investors. Elliott's expertise in these products allows the firm to identify attractive relative-value situations where securities can be mispriced significantly. The firm's opportunistic approach and experienced team enable Elliott to delve deeply and quickly into areas of the credit markets which are under pressure or suddenly present interesting opportunities.
Arbitrage	A portion of Elliott's portfolio is in what are referred to as hedge/arbitrage positions. This strategy is comprised of event arbitrage, related securities arbitrage, convertible arbitrage, volatility arbitrage and fixed-income arbitrage. Hedge/arbitrage are designed to take advantage of small anomalies between similar or related instruments on an opportunistic basis and to assist in achieving overall portfolio risk management goals.
Asset backed RE	There are real estate-related securities positions in several of Elliott's books, including distressed securities, non-distressed debt, event arbitrage, and equity-oriented positions. Elliott's approach is opportunistic and flexible – the firm will invest at any part of the capital structure, as well as in non-performing loans. Unlike traditional real estate investors, Elliott is drawn to distressed or otherwise unique and complex situations. Elliott seeks to apply the same process-driven, active management philosophy that has served the firm well with other asset classes. The firm's knowledge of the securitized commercial mortgage-backed markets (CMBS) complements Elliott's real-estate-related securities efforts and enhances Elliott's ability to identify relative-value trades and hedging strategies.
Commodity trading	Elliott's commodities trading strategy aims to exploit mispricings in the forward curves of certain commodities, as well as taking directional positions based on its views of the prices levels and trends. Elliott primarily trades crude oil and oil products, natural gas, power, precious and base metals, and agricultural commodities. Elliott trades actively in the U.S. and Europe.
Portfolio volatility protection	Portfolio Volatility Protection positions are intended to hedge Elliott's portfolio against certain adverse market conditions; hedging individual positions against general market fluctuations as well as price volatility in various asset classes. Elliott utilizes a variety of instruments within this strategy including, without limitation: credit, equity, volatility, interest rates, gold, and currency instruments.

Source: Elliott website 2021

Greenhaven

Greenhaven – stock selection

Classic value investing with focus on multi-year opportunities where tangible book value is relevant and where sum of the parts analysis and strict valuation philosophy applied.

Greenhaven portfolio holdings	ticker	Position value	Holding % of portfolio	mkt cap bn	trailing 12 months gross margin	post tax - trailing 12 m net income margin	trailing 12 months Free cashflow yield	Next fiscal year (2022) revenue growth (EST)	Most recent quarter PBR x
Goldman Sachs	GS	761	25.4	132	45%	35%	7%	-16%	1.4
Lennar Corp	LEN	656	21.87	29.7	19%	16%	8%	18%	1.4
Whirlpool	WHR	565	18.82	12.8	22%	9%	19%	1%	2.5
General Motors	GM	547	18.26	83.75	15%	9%	-1%	20%	1.6
Toll Brothers	TOL	287	9.59	7.2	20%	7%	17%	22%	1.4
Dr Horton	DHI	64	2.13	31.1	27%	14%	2%	16%	2.2
Morgan Stanley	MS	26	0.87	186	34%	25%	-1%	-2%	1.8
Lear Corporation	LEA	24	0.79	10.7	9%	4%	8%	8%	2.1
FCF yield based on 5 years average given positive and negative data on annual basis.									
Simple average					**24%**	**15%**	**7%**	**8%**	**1.8**
Weighted average					**26.1%**	**17.1%**	**8.9%**	**6.2%**	**1.7**

Explain to me how Goldman became a value stock ?

- **JIM CRAMER**: Okay. So I pick up this morning's paper in the Business Day section of "The New York Times," and the headline is: A Ho-Hum Change for Goldman. And then a discussion that Lloyd Blankfein is saying to Solomon: I would say that the consumer business has moved to us. It's become mathy, algorithmic, platform, distribution, digital, all the things we've been historically good at. Is that what we want from Goldman? You like Goldman Sachs. Is Goldman going the right way? And does it matter who runs Goldman or not?
- **EDGAR WACHENHEIM**: Well, I think the bench is so deep at Goldman in terms of the management, they probably have hundreds of people that could lead a firm. I mean, they get the best and the brightest, maybe 100, 200 young, bright people each year into the firm. Some leave and some stay, but they've got tremendous depth, which is one of the reasons we like the firm. I like what they're doing in terms of Marcus and what they're doing in terms of technology, because they're experimenting. It's good to take some money and put it into a new area. And if it works, fine; if it doesn't work, they go on and do something else. They're not old and stodgy and just doing the old investment banking and the old market-making. I think it's a positive that they're somewhat innovative at this particular time.
- **JIM CRAMER**: Because as a value player, you need to see -- have others see the value that you do in order for the stock to go higher. Book value of $197 for what was -- I always thought the premier investment bank -- a nine multiple. These are things that I don't understand. Can you explain to me how Goldman became a value stock and whether it should be considered a stock of higher value or a growth stock? What is the market missing as a paradigm for the kind of investment?
- **EDGAR WACHENHEIM**: So it's betterment. Its betterment can change. So let's start out with the earning power. I think this year, they've earned just a little under $13 in the first six months, it's sort of a $26 annual rate. There are some recurring things in there. But they're doing well. I think a couple years down the road, their earning power is in the high 20s -- $27, $28, $29 per share, which would be about a 15% ROE. We use tangible books.

CNBC'S JIM CRAMER INTERVIEWS EDGAR WACHENHEIM III FROM CNBC INSTITUTIONAL INVESTOR DELIVERING ALPHA CONFERENCE 18.07.2018

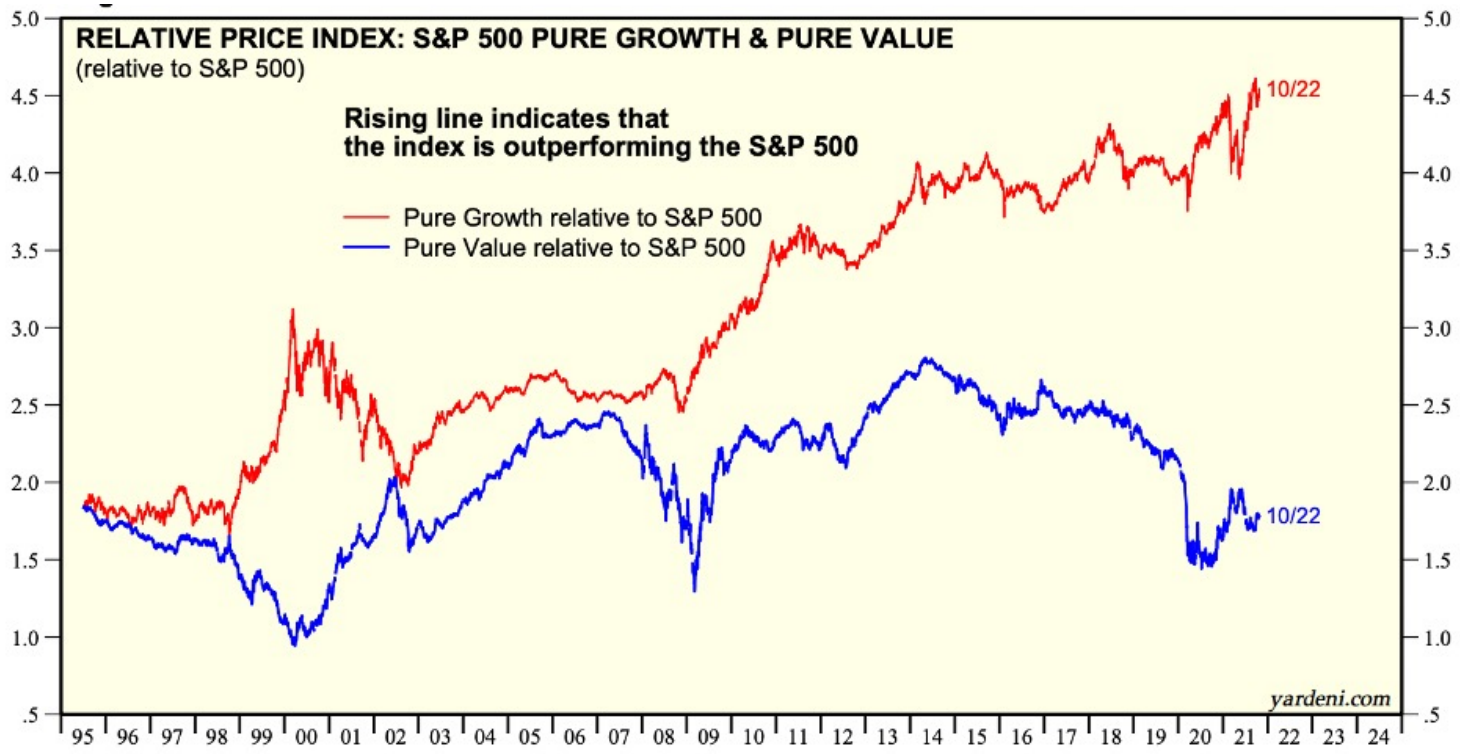
…interview continued

- **EDGAR WACHENHEIM:** So we use $183 as book value, not the $190 I think that he used. If you think about what it's worth, I would take the investment banking business and put a very, very high multiple on it. I would do sort of an analysis, making the company --
- **JIM CRAMER**: I agree. Yesterday, the news commentary was that investment banking is not the business to be in. David Solomon ran -- when I worked at Goldman, you were second-rate if you weren't investment banking. It's always been like that. The commentary is so wrong. That's the money division.
- **EDGAR WACHENHEIM:** It earns about $7.50 a share, if you want to take the 26, 27; and it's probably worth 18, 19, 20 times the earnings. You know, the average stock sells -- historically, it's 16 times earnings; this certainly is better than average. So when you take the investment management business, I happen to feel -- I'm sorry, I hope there's no Goldman people in the audience -- but I happen to feel they don't do a very good job at it. But it's a high return business, maybe worth 15, 16, 17 times the earnings. But the market-making is only worth 10 times the earnings. I could make the case that the company's worth 12 or 13 times the earnings. And if you put a 13 multiple on -- someday it will be -- our government uses simple arithmetic --
- **JIM CRAMER**: Right.
- **EDGAR WACHENHEIM**: -- $30 a share of earnings, which may not be in two years, at $30, it may be in 2021 -- you have a stock that sells roughly at $400, and it's $230 today.
- **JIM CRAMER**: And your performance speaks for itself. What people should recognize is that that's actually not a long time at all in your world.
- **EDGAR WACHENHEIM**: We look out two or three years.

Passive value and growth ETF’s

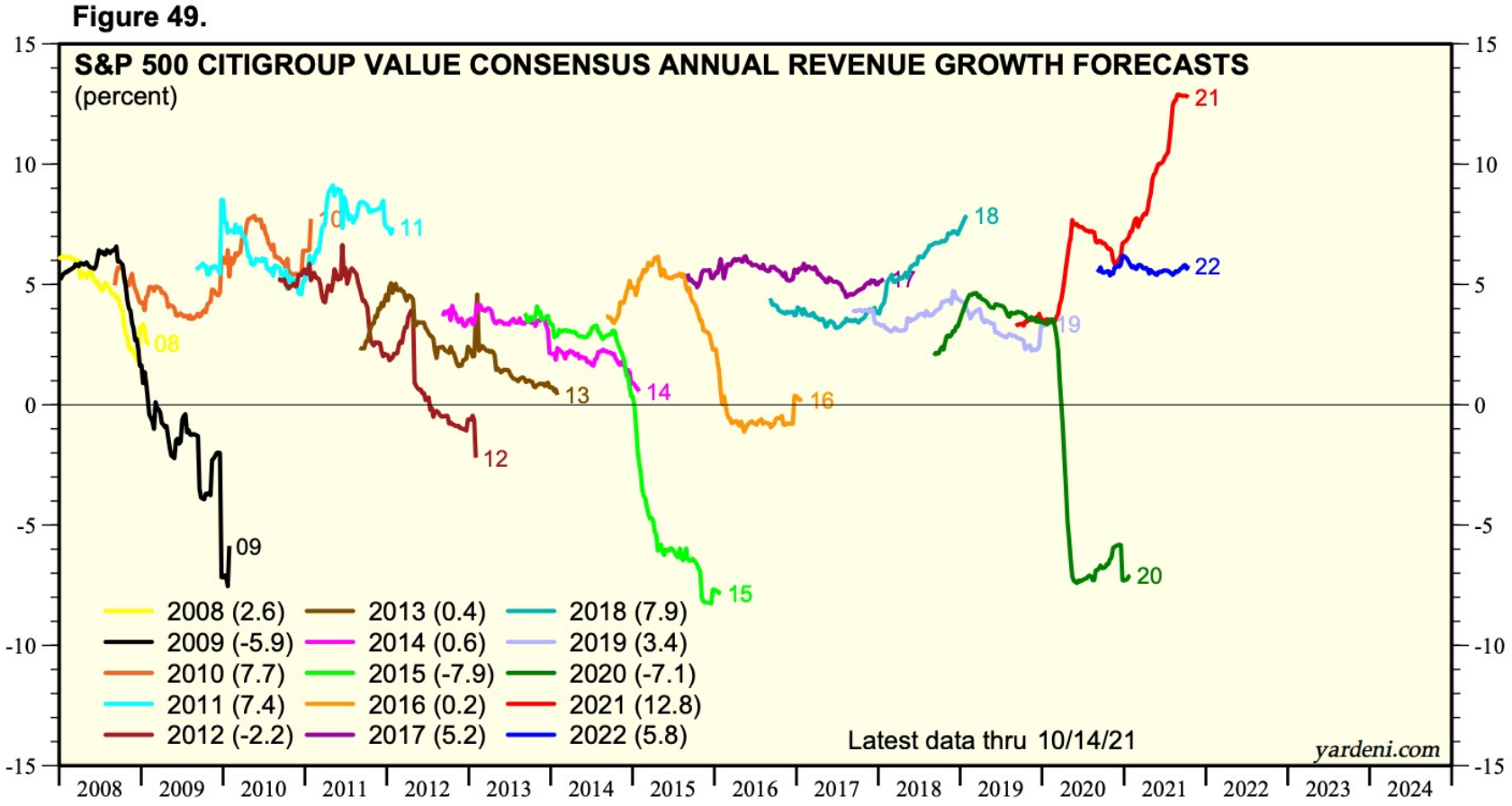
Value and Growth ETF's

ETF	ticker	Positions	Holding average % of portfo	mkt cap bn	trailing 12 months gross margin	post tax - trailing 12 m net income margin	trailing 12 months Free cashflow yield	Next fiscal year (2022) revenue growth (EST)	Most recent quarter PBR x
Vanguard Value	VTV	350	0.28%	81	31.20%	9.00%	3.90%	4.30%	2.7
iShares growth Russell 1000	IWF	501	0.20%	74	41.60%	14.00%	2.80%	9.20%	14.1
S&P 500	SPY	500	0.20%		34.80%	11.60%	3.70%	6.10%	4.5



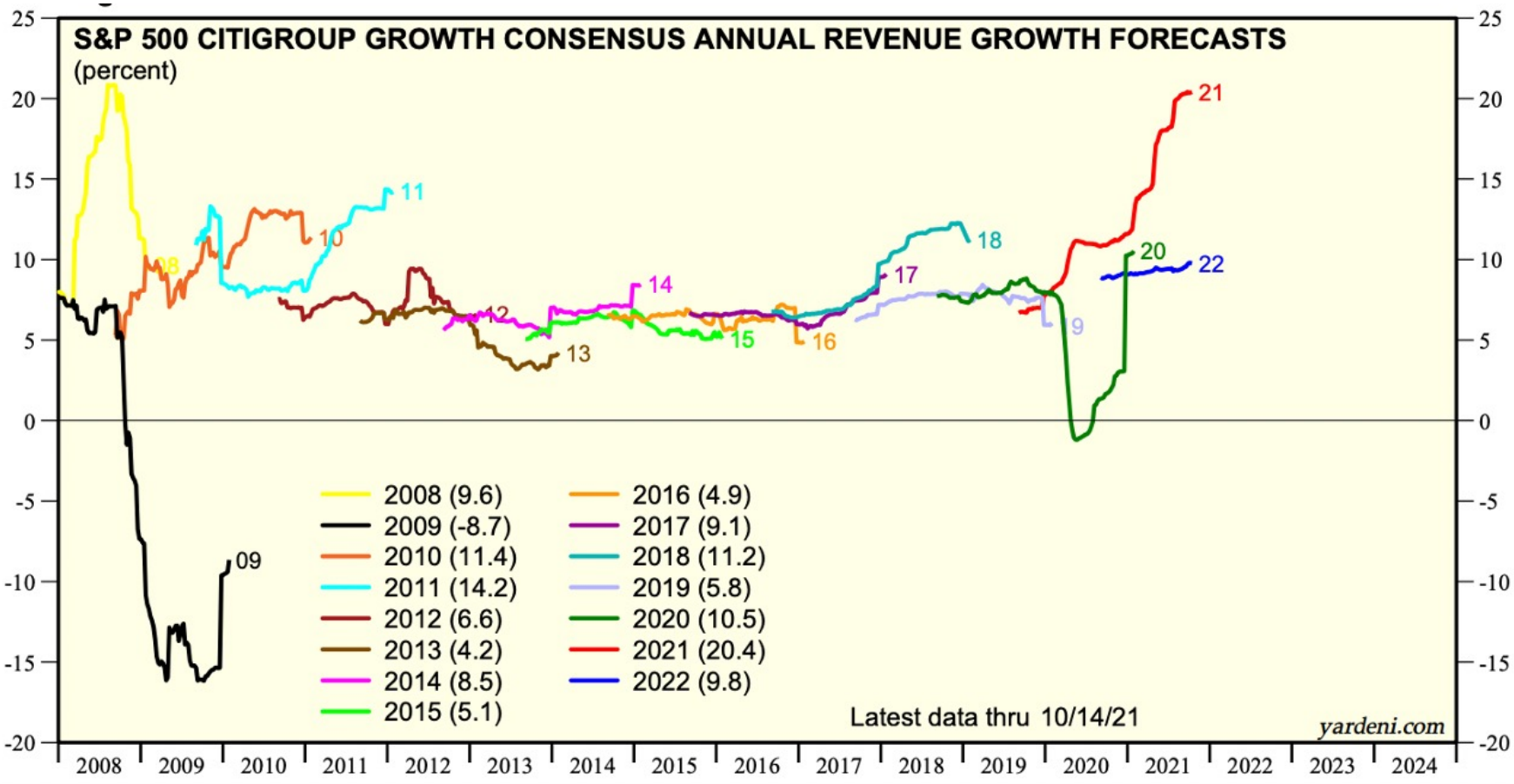
Source: Standard & Poor's Corporation and Haver Analytics.

Value stock revenue history and outlook for 2022



Source: I/B/E/S data by Refinitiv.

Growth stock revenue history and outlook for 2022



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