The Missing Link: Compelling Valuations
Multi-Cap Value Webinar Transcript

Weitz | INVESTMENT MANAGEMENT

Presenters:
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Conference Call Participants

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Presentation

Brad Hinton

Good afternoon, and welcome to the Weitz Multi-Cap Value Strategy webinar. We appreciate you taking time out of your day with us. This is Brad Hinton, Director of Research, and Co-Portfolio Manager of the strategy. Founder, Chief Investment Officer and Portfolio Manager, Wally Weitz is here with me and together, we will run through some slides and then answer your questions.

While these webinars are always a group effort, Gina Ladd from our marketing team deserves special thanks for coordinating and helping to pull the slides together.

With that, let's turn to the agenda for today’s webinar. We will start with a quick rundown of our core principles, followed by a brief overview of the Multi-Cap strategy. I will spend a few more minutes reviewing our investment results, hopefully putting the last few years into context. After that, Wally will take over to talk more about where we’re at and where we’re going. He will discuss the strategy’s positioning then run through a half dozen stock capsules to breathe some life into the facts and figures. Wally will close our prepared remarks with a few thoughts about the outlook and then we will roll right into the Q&A session. You can ask questions any time throughout via your webinar screen.

Wally started the Company back in 1983 and a few key values have resonated over the past 33 years. The first is that we are a research-driven organization. We have pursued a single timeless value investing philosophy since day one. Think like a business owner, understand what a rational private buyer would pay to own the whole thing and then buy shares at a significant discount to that value. We’re fortunate to have a highly experienced highly stable research team. There has been no turnover amongst the analyst or portfolio manager group in the last eight years, which is very unique in the industry and the team continues to methodically execute a consistent investment process. This approach leads to a steady flow of quality investment ideas, which over the long haul has translated into strong results for our clients.

The second core value is “Independence.” As value managers, we are comfortable leaning into the wind. We run concentrated strategies and our time horizon is much longer than most. Our active share is 94% in multi-cap, so you can count on us looking very different from any index. Our ideal is to be fiercely independent without being stubborn, that requires having the courage of our convictions, but also holding our stories lightly enough that we can change course when warranted. A simple concept, but it is difficult to execute well. Common sense, flexibility and a collegial culture all help.

The third core value is "Alignment." The basic idea is that we will all win together over the long-term, when our short-term results are poor, we all feel it as fellow investors and as owners. We're passionate about what we do and you can be sure that the investments we manage on your behalf have our full attention.

The Multi-Cap Value strategy dates back to the beginning of the firm with a 33-year track record. We have the flexibility to pursue companies of all sizes. We manage a little over $1 billion in the strategy, so there are no capacity concerns. Small and especially mid-cap companies can still make a meaningful difference to results. As you can see though, we have tilted more towards larger companies in recent years, simply as a function of value and business durability. We have always believed that good ideas are rare, so we want to make them count. Our comfort zone is 4-7% position sizes for our favorite ideas, so it is a restrained approach to concentration. We own 28 companies with 44% of net assets invested in our top 10 positions.

Finally, our low portfolio turnover reflects our process of investing like business owners.

Next up, performance. Here is the required disclosure, which now takes up two slides, double the fun. Let's start as we always do with the long view. We look for companies that can compound business value at high rates over long periods of time, so it makes sense to see how we have done on that score for our investors. In our view, the longer the timeframe, the more relevant the results. The top panel shows annualized returns after all fees and expenses for the Partners Value Fund along with comparative returns for the Russell 3000 and the S&P 500. The bottom panel shows annualized excess returns for the fund over the indices. This is what we're really after, and as you can see, the approach has withstood the test of time. As we're all acutely aware, the past few years have been much more challenging. We're not at all happy with these results and we don't take them lightly. At the same time, we acknowledge that performance from our investing style does tend to come in waves. Highly active managers should be out of step with the market and usually by a lot. It does work both ways, three years ago, this same table would have showed very strong trailing metrics. It has been the same philosophy with the same managers using the same process during both periods. Nonetheless, whenever a three-year stretch like this one rolls downhill into all of the trailing comparisons, the relative mountain can look and feel insurmountable. It is not, and we will come back to that in a few slides.

What has happened during this three-year stretch? How did we get here? First off, our newer ideas have been a mixed bag, but overall, they have detracted from results. While that is not a huge surprise later in a bull market with extended valuations, it is still annoying. We have had a number of good calls, but they have generally fallen into three sub-optimal buckets:

1. Stocks with decent but not exciting returns, like Brown & Brown
2. Stocks with exceptional returns that we just didn't size up enough, like Post Holdings
3. Stocks that have taken a deeper V-shaped path to prosperity, like Pioneer

A few missteps have been more severe and they have happened more quickly than usual. These include companies trying too hard to make their own breaks, turnarounds, and financial leverage. Early looks a lot like wrong in a rising market, but we like the risk reward that Allergan and Fox in particular from here, and then as you can see, we have had a few takeouts along the way.

The second big area, we have had a lot of consumer discretionary exposure, and our stocks haven't done well on an absolute or a relative basis. We have a great deal of collective experience in this sector, and it has been a big source of return for us over the years and decades. We like our chances here going forward, and Wally will highlight a few specific reasons for optimism.

Third, the absence of winners in yield-chasing areas like staples and some of the hot stocks of the day, the index has been tough to beat for all active managers, and it has been a particularly rough stretch for many of the value folks.

Then finally, residual cash drag. It hasn't helped, but it is not as obvious as it looks. Just a reminder, in our process, cash is a residual of our search for value, and it really reflects more than anything the absence of bargains in the marketplace. Just to give you some quick ideas, if we had invested the cash in an index, obviously, it would have been great. If we had invested it in our overall portfolio, it would have been just okay over this period, and if we had invested it only in our new stock ideas, it actually would have hurt. Cash is really something that we view as a strategic asset, and something that has a lot of optionality in a market environment, particularly like this one.

Well, let's come back to this idea of waves of performance. Here is an interesting chart. The green squares are calendar years where the strategy has outperformed the S&P 500, and the red squares are years of underperformance. What you will see is a lot of both colors and quite a bit of blocking of the colors/years of outperformance or underperformance. We have only outperformed a little over half of the calendar years since 1983, yet the long-term record is very strong, and while it is not on this chart, in 17 of those years, the annual difference was 500 basis points or greater, so 10 of the years were big outperformers and seven of the years were big underperformers. Looking very different from the index is actually normal course for this strategy. In fact, we would argue it is a necessary ingredient to winning over time. Ultimately, it is all about slugging percentage and generating superior long-term results.

Then finally, we have been here before. We have had deep and long tough periods over our history, and you can see what has generally happened thereafter. It says nothing specifically about this time, other than we're not in unchartered waters.

It has clearly been a lumpy path to the gold on the bottom of this chart. We're going through one of the inevitable rough patches now, and I would like to turn it over to Wally to talk more about the portfolio and some of the stocks that give us confidence that we can build on this record for the next 20 years.

Wally Weitz

Okay, thanks, Brad. This slide shows our top 15 positions as of 2nd September. 58% of the portfolio is in these top 15 positions, 19% is cash and there are two new stocks in the top 15 that are highlighted in blue, and we will talk about those later. Here is the same list, it is color-coded. The stocks we have added to since midyear are in green, the stocks we have trimmed since midyear are in red, and all these adds and trims have been just based on valuation as the stocks have bounced around.

Now, we will give you some capital comments on half a dozen stocks, and this is what we really look at stock-by-stock. The first one, an old favorite, Berkshire Hathaway, a collection of well-managed, above average businesses that generate cash and send it home to Omaha. It has a fortress balance sheet that is built for opportunistic buying. I think Warren's cash is over $70 billion now. Market distress is where this really shines. We believe that Berkshire's worth between 150 and 160% of book value, and that premium is widening. It is now about 132/133% of book and that is growing. We think the book is growing 8-10% a year, and Warren has been very clear lately that he would like to buy stock at 120% of book, and that is only down about 10 or 11% from here.

The next one is Liberty Broadband. For those who follow Liberty Media, you know that change is a constant for John Malone, but Liberty Broadband really equals Charter Cable which just bought Time Warner Cable and Bright House and we were able to buy Charter at a discount by buying Broadband. They have got several years more to run the cable playbook, and we have Tom Rutledge as a great operator and Malone calling the strategic shots, so what we need here is blocking and tackling over the next few years, not a great economy or magic of any kind. Broadband is selling at about $70 a share and we think there is – well, we know that there is $80 a share of Charter behind every Broadband share, and we think that Charter is selling at a discount to its business value, and if you look at Broadband holdings of Charter, they're probably worth about $100 a share of Broadband.

The next one is Allergan. This is a portfolio of drugs growing, and growing in diverse therapeutic area. Their "open science" as they call it model, very strong R&D pipeline with proven M&A. Brent Saunders we think is a great manager of this company, and for those who might know other stories of pharmaceutical companies, we think he is the anti-Mike Pearson. It is a cheap stock, it has got lots of optionality and they just sold their generics business to Teva for about $40 billion, so there is a lot they can do going forward.

Liberty Global is European cable. They have got geographic density and a competitive product advantage. They have favorable market structures that limits the risk from abrupt shifts in the media environment. Mike Fries who is a great operator and their levered equity model has been great at creating value over time, and we expect that to continue, and we have John Malone calling the strategy shots and the capital allocation.

LabCorp is a leading healthcare diagnostics company. It a clinical lab and drug development company. The Covance deal in 2015 expanded the growth avenues and their global presence. David King has done a great job building per share value of the company, and we expect this one to be a reliable multiyear grinder, and we use that term affectionately, starting now in the high-70s price-to-value. Incidentally, I didn't explain it, but each of these charts that we're showing you has the stock price over time in blue, and the green stair-step line above that is our estimate of the company's business value.

Finally, you have Colfax, that was one of our new stocks in the last year. It is a leading industrial company, it does fabrication work, welding, it works in gas and fluid handling businesses, so it has had very stiff headwinds in their end markets, but we think they have long-term tailwinds for patient investors. The Rales brothers who have done such a beautiful job with Danaher started this to build up another industrial company, and if we think that is… we have followed it for several years before actually buying the stock, because we love the Rales brothers, but not so much the cyclical businesses a few years ago, but when the stock came down from 75 to about 30, we got started and brought it down, I believe, into the high teens, so we feel very good about the long-term prospects for Colfax. It will take some patience.

The outlook, the stock market is not cheap, there are various ways to measure that. We have listed several here, also, measuring the market cap of the whole stock market as a percentage of GDP, near the high end of that range historically. We think our stocks are more attractive than that expensive market, but they're still not great bargains. The weighted average portfolio, the price-to-value is about 80% now for our strategy, and the four new companies that we bought over the last year came in at 73% price-to-value. We would much prefer 50 or 60%, that has not been available. Our companies, each have ways of growing their business values over time and regardless of what the stock price does, it is the underlying business value growth that really makes a difference for us, so we will all have to be patient, but we like the three to five-year outlook, if not the day-to-day outlook.

Okay, so why don't we turn to questions now?

Brad Hinton

All right, we're ready for the question and answer session. We will get started with one that comes up pretty regularly and it is kind of, "Where are you finding value now?" I will take a crack at that and Wally can chime in if he would like to.

I think you can probably tell by both the title of the presentation and the content therein that we have not been finding a terrific amount of value these days, just a few companies this year as we indicated. I think we can give you a little flavor for where we have been spending our research time. We talked about how the portfolio is tilted to large-cap companies, but interestingly, we have actually been spending more of our time tracking out new ideas in the small and mid-cap space. Over the last many months, probably three-quarters of the ideas that we have discussed as a full team have been small or mid-cap, not of the large-cap variety. Some of the areas that have

been getting more attention, we have had a few building products companies, pretty good tailwinds in the businesses, valuation is getting closer, nothing that we have nibbled on yet. Some of the healthcare companies are starting to come our way, much more services, not so much pharmaceuticals, but some of those are actually companies that we have tracked down a while back that are kind of coming back around for us. We have been spending less time on energy lately after the rebound, and probably more time in the industrial areas. Then one area of large-cap more recently has been a couple of the growth darlings that have fallen way out of bed. We're in more the early stages of analysis.

As you would expect from us, it is a pretty eclectic mix, it does not go by industry or sector lines, but we're always looking for the next great stock idea.

Why don't we move on? We have got a question here, "What is your take on the Liberty Global spin-off last year of LiLAC, which is Liberty Latin American Caribbean?" I will let Wally start on that one.

Wally Weitz

LiLAC originally was some of Liberty Global's Latin American properties and they recently have made a deal to acquire cable and wireless, which will add more Latin American properties. There is not a lot to say about this company yet. I think it is going to be a platform that are known quantity acquirers, it will turn into something interesting for us. It is a tiny position at this point, and I don't think we're likely to do anything major with it until we get a better handle on what the new company looks like with cable and wireless.

Brad Hinton

Okay, another Liberty Media related question. Specifically, have we looked into the acquisition of Formula One, and any thoughts on the deal? We should probably preface comments there by saying that it was Liberty Media Corp, ticker LMCA that made the purchase of Formula One and we don't own that particular security in this strategy. We do own it in a few others, so I think Wally will be happy to probably share our initial thoughts on that transaction, but I think our very initial reaction out of the gates was probably that it was a hefty price, an asset that has got strategic value. Perhaps we might have breathed a little bit of a high of relief that some of our other Liberty Media holdings did not participate. We don't need to necessarily muddy up their strategic picture right now.

Onto the asset itself, Wally.

Wally Weitz

I am sure they will use Formula One as content along the way, but Drew has done some work on the Formula One company and, of course, we know [Jays Kerry] from other companies in the past, he will be in charge of Formula

One. There has been some speculation among some of the Wall Street analysts that they $8 billion for it and it might be worth 12, but I think it is very premature to try to make that sort of judgement. We're learning more and we would be happy to come back to it when we think we have a good handle on a bargain price.

Brad Hinton

Another one of our companies in the news, Wells Fargo, obviously, we talk a lot about management integrity and our partners in the business. Maybe Wally can share his thoughts on some of the latest headlines there.

Wally Weitz

Wells is accused of having some of its bankers or advisors setting up phony accounts for people. Any time somebody is cheating, it is just repulsive, especially when it is coming from a company that you have really known for a long time and whose culture you have admired, so it is the black eye for them. We don't like it, and they get another reminder that when there is a lot of pressure at the top for performance that individuals further down the chain can misbehave. The actual signing people up for accounts is not about stealing their money, it didn't generate revenue for the company, however ugly it is, in the scheme of things, we don't think it is going to have a big impact on the ongoing value of Wells Fargo and in one of our funds this morning, we bought some more when the stock fell down under 46.

I think we're going to wrap it up here and say if you had burning questions that you couldn't communicate to us, please call them in, or send them in by email and Brad and I and the rest of our team would be happy to try to give you some better answers. Otherwise, thank you for joining in.