Research Perspectives

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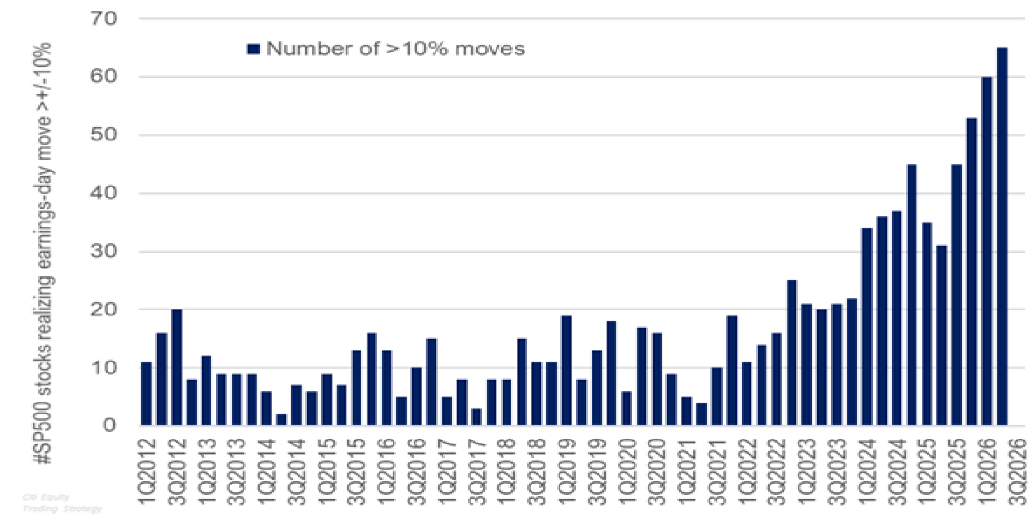
Southeastern Asset Management

Short-term stock price moves are not always rational, yet delivering more long-term FCF/share than is priced into a stock still works in Business, People, Price investing. One signal for future FCF/share is the most-recently-reported set of numbers. These (usually quarterly) reports have grown in importance for the stock market, with more big moves on earnings day over the last few years as this S&P-500-focused chart shows. We have done our own work on non-S&P-500 stocks and note a rough doubling in big moves in recent years.



Source: Citi Global Markets, Bloomberg, Refinitiv, like-for-like

Whenever we see something like this that does not seem like it makes sense, we listen to Charlie Munger's advice to "invert" – maybe there are some real reasons that explain it? A change in investment research over the last 10+ years has been the increase in intra-quarter data that makes a company's revenue more trackable. Think shopper data via credit card swipes or the prevalence of expert networks. A higher level of confidence in part of a company's short-term earnings story might increase the level of surprise when the actual results are off (even if in a miniscule way within a normal margin of error). Studies have shown that jolts vs. an expected result like this are tough for people to take (blame dopamine). It is also possible that since revenues past and present are better known than they were previously, more variable parts of a company's earnings report (cash flow conversion, capital allocation, etc.) and management's forward-looking comments are more important now.

This information is assessed with quantifiably more hair-trigger trading going on, be it from a larger part of the market that comes from retail traders of zero-day options or pod shops with their short-term career risk. While the Situational Awareness episode is already fading from the market's memory, we were pleased with how we performed then and think it was an interesting dress rehearsal for something bigger. On the other end of the spectrum, a material percentage of the long-term investors left in the market today have shifted over the last 10+ years to seek out "compounders" at higher prices. This was a smart decision throughout most of the 2010s and early 2020s. However, if a compounder stops compounding or has increased concern on its moat (more of both happening recently), that can lead to abrupt decisions. Finally, there is private equity (PE). The initial PE pitch was a good one: buy businesses at 6-8x non-optimized EBITDA, improve things behind the scenes, then sell after a few years at a higher multiple on higher margins. Now with increased intra-PE competition and higher multiples paid on higher margins, the pitch has changed to avoiding frequent price marks to ride a false sense of "stability" that sets a tougher volatility-tolerance bar for individual stocks.

It is hard to say what parts of these reasons have created the chart above. What is easier to say is that when over 2/3rds of a company's intrinsic value comes from cash flow delivered after five years from today, it is unlikely that this true value can change by 10%+ in a day too often. We believe that this dynamic will prove to be an opportunity for long-term investors and also a sign of the times in this late-in-the-day bull market. We have found new investments recently after they have had big earnings drops with minimal long-term value per share impact, but we have also had to weather more down 10% days than up 10% days at existing holdings over the last 12 months. It is not easy living with these short-term moves, though they offer opportunities to add to positions. We believe improved FCF/share is coming, and our investee partners are on offense in the meantime. We have already written detailed Research Perspectives notes about some of our holdings on this list – good and bad – like Mattel, Albertsons and Canal+, so we will move on to two newer holdings.

Late last year, we purchased shares in Magnum Ice Cream, a spinoff from Unilever. In our opinion, the Business is a great one: #1 and #2 market positions in most countries with brands like Magnum, Ben & Jerry's, Cornetto, Popsicle and others. Ice cream is an industry with unique barriers to scale and solid growth. Magnum's FCF has material room to improve as the other large player in the industry (private-label-focused, PE-owned Froneri) already prints higher margins that Magnum should eventually exceed with its stronger brands. For any new public company, the People part of the case can be a risk, since there is not a long track record yet. We like both the board of Magnum and CEO Peter ter Kulve. We also strongly support the company's incentive plan that encourages insiders to pay their own money to own more of Magnum, leading to plenty of insider buying this year. The Price started out cheaply at the spinoff, since the company has no public comps, was listed in multiple cities and was a late-in-the-year spinoff of something small from something big. The stock traded up to start the year, but the first quarterly call in February did not go well. 2026 guidance was below sellside estimates, and management did not succinctly address the issues. Magnum ended that day down 16% and eventually traded all the way down to €11 from a high of €16 after its first days of trading post-spin at €12-€13. But… nothing had really changed on the company's ability to produce ~€1.50/share of FCF in 2028/29. It felt lonely as we added to our position, but since then we have had two good quarterly releases with better communication from the team. There was also an article about potential PE interest in the company. The stock has traded back up over €16 and remains an important position for us. 20%+ EBITDA margins at a 20%+ return on capital and a 20x+ FCF multiple combine for a value per share above €30 in a few years, if this is still a standalone public company then.

Sometimes a quarterly transgression is worse. The question then becomes if it is thesis-changing and/or fixable. Our investment in Alaskan telecom company Liberty Capital (formerly known as GCI Liberty) had such an episode in May. The Business should be a relatively simple one, as GCI is the largest telecom in Alaska and offers an attractive bundle of both wired and wireless connectivity. The state has not grown as much as others recently, but that could change as it has a wealth of resources, especially the potential for a game-changing LNG export facility. The People include founder/CEO Ron Duncan and Chairman/large owner John Malone of Liberty Media, who we feel both have great track records and are aligned with us as owners. GCI had previously been a stand-alone public company, then (when we owned it successfully from 2018 to 2020) it had been part of Liberty Broadband/Charter, then it spun out anew last year. The Price was attractive at a mid-single-digit multiple of EBITDA and a single digit multiple of FCF power. At earnings in May, the company announced it would invest into another Liberty entity in a way that, for the sake of keeping this note to two pages, can be summarized as having too much hair on it. The stock went down 19%. After talks with us and others, the company realized this was the wrong move and canceled plans, but perceptual damage had been done: do they not actually like the core business in Alaska, is SpaceX's Starlink going to kill this company (and the rest of telecom), what about future capital allocation, etc.? As the stock went from a high earlier this year of $40 to a low of $20 in June, we reassessed the case and came away confident enough to buy more. Since actions always speak louder than words, it was therefore good to see the company come out this month with three key pieces of news: 1) a normal quarterly report that showed the business is still solid; 2) a new capital allocation framework that prioritizes dividends and potential share repurchase in the short term; 3) a $13.5 million insider buy from Malone at $25/share after Duncan had purchased over $1 million at $21 in June. We still see a value well above the stock price and expect this to become more apparent as time goes on and patience is rewarded.

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