Southeastern Asset Management

Gwin	0:00	Hello and welcome to the P/V podcast with Southeastern Asset Management, where our Global Investment Team will discuss the topics that are most top of mind for our clients, from our Business, People, Price point of view. We at Southeastern are long-term, concentrated, engaged, value investors, and we seek to own high quality businesses, run by capable people at a discounted price-to-intrinsic value, or P/V.
Gwin:	0:30	I'm Gwin Myerberg, Global Head of Client Relations and Communications. I'm joined today by Mason Hawkins our CEO and Chairman, Ross Glotzbach our President and Head of Research, Staley Cates our Vice Chairman, Ken Siazon, our Head of Asian Research and Portfolio Manager for Asia-Pacific and Non-U.S. strategies and Josh Shores, Portfolio Manager for our Non-U.S. strategy.
Gwin:	0:53	Today, we're going to be tackling the question, “Is value investing dead?” This is a question we often hear and one that we all have seen in the news. If

		you Google “Is value investing dead?” over 20 million hits come up from over the years. We've been through periods of value being out of favor many times before. Mason, can you start us out by talking about your experience in previous cycles and how today feels different?
Mason	1:16	When we first began Southeastern in 1975, there were very few intermediaries. You talked directly with your customer, and you talked about this concept of sensible or intelligent investing with them. It was summarized by us as Business, People and Price. So, clearly, we want the qualitative factors to lie upon our side, terrific managers that are intelligent capital allocators, along with a very good business that's very assured to grow its free cash flow production into the future.
Mason:	2:12	So, ever since Southeastern was formed, it's become more complicated, if you will, in terms of the way people look at it. Now, we've got all these subsets of how people think about investing. It's helpful to go back, we think, to just the earliest definition of what an investment is. The market cycles each time almost always focus on stocks and those that have been going up. We spend most of our time assessing the qualitative factors of our investees and trying to appraise what we think that future stream is worth now, and clearly demanding a discount to conservative appraisals.
Mason:	3:12	If you went back into the late 1960s, small tech companies were all the rage. They got chased to extreme levels and - Telex and Memorex are two that come to mind - melted down completely. Then afterwards you had the "J.P. Morgan and First National City" favorite list that became known as the “Nifty Fifty”, and people chased those to 90 P/Es (price-to-earnings) or so. It all ended pretty much in 1974, and companies like Tambrands and Avon, Polaroid, Simplicity pattern, and Kresge almost disappeared. And, even good businesses went down by huge percentages.

Mason:	4:08	In the late '70s, everybody concentrated on inflation hedges, and great US farm land prices went up 70%, as that pursuit of what was considered to be a hedge. It went on until it didn't. Paul Volcker ended it, as we all know, with 20+%prime rates, and inflation was pretty much destroyed after Volcker quit printing excessive amounts of money
Mason:	4:52	Then, you got to what were then the favorite few growth stocks in the '90s, like Walmart and Coke. They went to significant premiums, and it took a decade or more for some of those stocks to get to even. We all know about the dot-com mania that occurred and ended in March of 2000. I thought Staley did a good job talking about this hyper indexing - passive investing and the greater concentration into the FANGS (Facebook, Amazon, Netflix, and Google). [Why We Believe Active Long-Term Value Investing in Common Stocks Will Actually Work] When there is a slight disappointment, you see what happens in a few days with Facebook or Netflix.
Mason:	5:43	We've seen a lot of various psychological pursuits of stocks that seem to be working. I would dare say that 90+%of market participants are focused on stock prices. Again, we're focused on business values and the people that run these companies and what that portends for our values out three or four years from now.
Gwin:	6:08	Mason referred to Staley's speech at the Omaha value conference earlier this year, where in fact, I'm pretty sure you called us the "skunk at the party" for value investing as being out of favor. Staley, can you give the high level, the quick version of why you think value is so out of favor today?
Staley:	6:25	Well, I picked skunk because it's the second choice after dinosaur, which is what most people call us. I just think it's a function of passive having gone way further than most people realize. People can easily count index funds, but to that you would add

a lot of ETF's (exchange-traded fund) that are mostly passive in their nature. Then, to us, the biggest uncounted item is the shadow indexers, which is a huge number. So, this is just all fed on itself.

Staley:	7:00	We're talking about previous cycles and, as the second oldest dinosaur, the second oldest skunk... To me, today seems a lot like a combination of Nifty-Fifty days and Internet Bubble days, where the index basically means you're going to own the same major names, and you're going to do that and not get fired, whether you're an indexer or a shadow indexer. But there's also this belief in a few companies that they can do no wrong, and that it doesn't matter if they make any money. In that sense, it's like the dot-com. So, it's kind of a combo of the two.
Staley:	7:32	We have no idea when this ends or how it stops, just as we never had with any of the cycles that Mason talked about. But, it's usually an event people don't see coming, or it's a rolling over of the economic cycle, which, these days, the economics are so good that no one worries about that, but that's usually probably when you should worry about it.
Gwin:	7:53	I'm curious because value investing being out of favor and active investing being out of favor is largely a US phenomenon – it's where you see most of the stats - but I'd be interested to hear your point of view, Josh or Ken, on if you see those similar factors outside of the US
Josh:	8:12	Yeah, for sure. We're definitely seeing the value growth dichotomy outside of US as well. It's not quite as dramatically pronounced as it is in the US, but on virtually every time horizon over the last five years, "growth" - if you cut the indexes most consultants and media do on some measure of growth versus value - has dramatically out performed outside the US as well. Just perhaps not as doubly dramatically as within the US. So, we've

seen a lot of the same factors, even though indexing is not as penetrated outside of the US.

Josh: 8:50 From a top-down perspective, when we look at our entire universe of companies that we follow and aggregate those, we look at Europe as pretty fairly valued across the range of every 700 or 800 companies that we've appraised. Then the Americas, ex-the United States, is also pretty fairly valued. Ken, maybe you can talk about the one part of the world that seems obviously cheap, and perhaps is the least penetrated by indexing, which would be the Asia-Pacific region.

Ken: 9:19 Yeah, the same growth versus value thing is happening in Asia. Growth has been the driver of performance in the last couple of years as well. This year, we're starting to see that change. So, it's a very interesting time because we're just not used to the Alibabas and Tencents of the world and the TSMCs (Taiwan Semiconductor). These three or four guys that have driven the Asian index, they have started to underperform for the first time in a long time. So, it seems to be that we may be starting to see a change.

Josh: 10:06 Interestingly, Europe is where there is the least disparity between value and growth. And partially that's because there's a lack of big “tech champions,” if you will, that are centered in China, Asia, and centered in the US. So that has resulted in a lot tighter correlation between the value-growth indices there. Which points, to me, to one of the themes that we have found relevant in Europe, which is there are still a lot of discrete opportunities - the proverbial, hundred euro note hiding in plain sight.

Josh: 10:41 Where there's more inefficiency, there's more opportunity to get engaged and to take advantage of companies that are just starting to open up to shareholders being higher on the stakeholder register than perhaps they would have been 10 or 15 years ago. And, that can be a discrete bottoms up driver of value. European markets are less

		driven by just this index-driven FANG or Baidu, Tencent and Alibaba heavily weighted indices in Asia and in the US.
Gwin:	11:06	Both Josh and Ken refer to Tech, which has pretty much become synonymous with growth over the past few years. This is an area where Southeastern, as a value investor, has rarely invested in our history, but we own Alphabet today. Ross, can you talk about how Alphabet became a "value stock" for Southeastern and your view on the business and valuation today?
Ross:	11:30	Yep, and we own Baidu as well. The important thing is that, with patience, we get shots at great companies like both of those two on our own terms.
Ross:	11:42	Alphabet, a few years ago, it was a company - we always like to frame things in terms of Business, People, Price: On the business side of things, you had this very strong position in search. YouTube was a younger business than it is today. A lot of people were worried about mobile, about apps, about Facebook cutting off Google's growth going forward.
Ross:	12:07	Then, on the People side of things, there was a lot of concern that these folks didn't really think like owners. They didn't even pay a dividend. They didn't give you quarterly guidance. They were spending all this money on wild things, like driverless cars and healthcare, and that segment was not broken out separately. Then, they had about $100 a share of cash that people just assumed that they'd blow on other crazy things.
Ross:	12:33	But, we did a bottoms-up appraisal. We backed out these money-losing businesses. We did our best work on what YouTube could be worth, and we thought that we were paying a low double digit multiple for something that would grow double digits for a very long time. That's historically been a very good thing to do. It's paid off for us.

Ross:	12:58	We'd love to own great companies like this, especially when they have great partners running them, but price matters, and price will matter *a lot* from here versus some of these valuations out there. We're still thinking Alphabet is somewhat undervalued, but it certainly not the bargain it once was. So, I don't know if Ken will probably have a somewhat similar story for Baidu.
Ken:	13:19	If you look at the market cap for Baidu, when you take out all the listed capital markets pieces, the iQiyi, the Ctrip, the net cash, you end up with a core business that does close to 50% margins that just in the last quarter grew 26%. That, also, you get for low double digits multiples. So, it's difficult to talk about value and growth because this is a really fast-growing company that happens to give us significant value today versus the price on the stock.
Gwin:	13:57	So, then maybe stepping back on that, how would you define value for Southeastern because we talk about Business, People and Price. Ross, you said price matters, especially it will today, but we're really looking at management teams that will grow the value. So, how do you balance those two, and what place do quality and growth have in our portfolios?
Ross:	14:23	Well, again in concentrated, long-term, engaged investing, we only need to get a few things right each year, so we don't have to swing at all these "way out of the strike zone" pitches these days. I feel like again, I think Staley stated once, that one of the things that we've done well over time is paying 12x PEs for things that are with 18 PEs. That's what we did for Google back when it was called Google, when you adjusted out the numbers and everything. That's what we'll get to do again.
Ross:	14:55	Now, certainly would we prefer a 65-cent dollar, wonderful, growing pricing power, high return on capital business with great people, over a 55-cent dollar, dying commodity business with people who are going to take the money and just use it to

		make themselves richer? That's a pretty clear case because over the long run, and we do want to hold these businesses for the long run, that incremental return on capital will matter much more, but not entirely swamp, today's price-to-value ratio.
Ross:	15:39	So, there is always a lot of art to go with the science in terms of lining up that quality growth, that value growth, that what the management's going to do, if they can even go on offence, versus just today's statistics on a spreadsheet. Of course, we do that, and that's important. But, it doesn't give us license to just change our stripes and just buy a bunch of things that people like because they’ve been going up. We're not going to do that.
Staley:	16:05	I would add a couple of other things about "growth" and "quality" within value. One would be that we do use the price-to-value metrics so much with the external world, that that sometimes loses the translation internally within our research team.
Staley:	16:23	We are focused on the growth of the business, the quality of the business, and that usually relates to the growth of that value. But, we don't do a lot of communication, nor will we ever about expected growth rates of our values because it's a way more complicated metric than price-to-value. But, it's unbelievably important, and it's what Ross was just saying about how the business goes forward.
Staley:	16:45	The second thing would be we have to be able to think - we know we won't know this - but, we have to be able to think that we still understand the terminal value. So, we will do something like a Level 3 - now CenturyLink - when we think that Fiber is going to be unchanged in seven years. We will do Google and Alphabet when we believe search will be very powerful in seven years. But, there are plenty other tech things and in favor things and "growth" things, where even their own management teams can't necessarily tell you what it'll look like in year five or year seven. That's when we put it into the too-hard bucket.

Gwin:	17:22	One thing that we haven't really talked about, but I think underlies everything that everybody said, is the importance of the long-term view as a value investor. You talked about it, Staley, in your speech. Can you talk about that a little bit and why, while the typical investment horizon for most people has shortened so much, why it's so important today for a value investor?
Staley:	17:44	Yeah. We think term arbitrage is our most important source of undervaluation and our most common denominator in our names. This touches on the non-earning assets that Ross has talked about both specifically and generally. This is the flip-side of all the data power and quant power.
Staley:	18:04	So, the chasing of the same names, the incredible depth of data you can get these days as a researcher, and the quant power, which we will never match, all of that is very much focused on the short term. We would argue that makes short-term moves even more efficient and therefore difficult to predict. But all that extra focus on the short term is what leaves long-term situations cheap because a lot of this technology cannot help with a three year outlook, even if it can help next quarter's outlook, and that becomes our biggest thing.
Staley:	18:38	If our clients can give us three years, and we have three years to wait - which most the industry doesn't have, either the manager isn't wired that way or the client doesn't give them that much time - that becomes our biggest competitive advantage, or one of them.
Gwin:	18:52	So, Ross, back to the question that started out this podcast, "Is value investing dead?" And, if not, what gives you confidence in value's ability to outperform going forward?
Ross:	19:06	Our answer is a clear "no," we do not think it's dead. We think that usually history has shown that when the question starts getting asked the most is when it's about to relatively outperform the most,

in the coming five years, which is what we are always focused on. Certainly we've seen a lot of headlines that remind us of the '99/2000 period and other times in the past when value has gone out of favor. The fact is that the math continues to work: paying a lower multiple for great businesses, run by great people, has just always made sense and it always will.

Ross:	19: 52	And, lately we've been seeing a little more volatility come into the market. We welcome that, we think it will favor our style of investing in the years to come.
Mason:	20:02	The answer is value always outs. How quickly is another matter, but if the business is compounding its intrinsic worth, we are very, very happy to be patient to get a terrific outcome with very little risk.
Mason:	20:30	As many of the listeners know, we're Southeastern's largest client. We literally think about one of the graphs that many of you have seen, where we're plotting intrinsic value per share over time. It's fairly easy to look at stock price and its schizophrenia in relationship to that plotting of value build or compounding of intrinsic value per share.
Mason:	20:58	The one thing Ben Graham talked about was getting a big margin of safety to avoid losing. He talked less about the importance to compounding of having the gap between price and value close. So, clearly if you buy a business that's capable of compounding its intrinsic value at 12%, and you buy it at half the value, you pick up another 17 points a year over a five-year period of time by just having Mr. Market weigh the intrinsic value fairly.
Mason:	21:34	If you paid fair value on the front end of that five-year period and you got fair value at the end, it was a great business, and it compounded to 12, you get 12 by being patient and disciplined and waiting for the price to get significantly discounted from a fair appraisal, you pick up substantially

		more compounding, and you're never exposed to a lot of risk because it's not above the value of the business.
Mason:	22:01	So, you have to have some confidence in weighing "of fair economic value" by market participants. They are very focused on stocks that are going up in the short run. In the long run, they're going to be very focused on what the value for business is. So, we are long-term, concentrated, patient capital allocators and fully believe that we get our due reward when people are not so narrowly focused.
Gwin:	22:40	Ross, my last question is “Where do you think that value investors, like Southeastern, can find opportunities today?” You talked earlier about how the increase in volatility is creating more opportunity, but what does that look like for us?
Ross:	22:51	Well sure, I’d just say that we need to keep looking in the same places that we’ve always been looking, first of all, which is usually the opposite of where the headlines are blaring and what everyone’s momentum fund has just been buying. We like things that have just gotten kicked out of indices or that have had a dividend cut. We like companies where 80% of the value is only 20% of the headlines. We like the kind of special situation, time arbitrage opportunities that Staley talked about.
Ross:	23:20	When we start to go around the world a little bit, Asia remains the statically cheapest part of the world overall, for some of the trade war and other reasons. In Europe, it’s not as cheap as Asia, but some of the conglomerates over there that have always attracted our interest and fit our style of investing very well have seen their sum-of-the-parts discounts increase some lately, so that’s encouraging. You’ve also seen some cases over there where a few countries, like Italy, are more in the headlines, and if a company has the taint associated with one of those countries but a strong majority of its value elsewhere in the world, that

can usually throw up some good opportunities for us.

Ross:	24:09	And, then in the US, there's actually been a little bit of volatility there, as this year has gone on, so that's good. We're finding some good places to put cash to work. When it comes to industries, specifically, staying on the US theme, all things related to housing have come down as the year has gone on, and there are some good businesses related to housing, and there are some bad businesses related to housing. So it fits our ability to really size up the Business and the People side of things and differentiate between different companies. But, overall, the opportunities have increased as the year has gone on, and that's what we like to see.
Gwin:	24:52	Thank you, Ross, Mason, Staley, Ken and Josh, and thank you to all of our listeners for tuning into the P/V podcast with Southeastern Asset Management. We hope you enjoyed it, and we look forward to speaking with you again soon. As always, if you have any questions or you would like to share topics that you would like to see covered in future episodes, please feel free to send us an email at podcast@SEasset.com.