Tweedy, Browne: How To Invest For The Long Term

Door Rupert Hargreaves

Bron: ValueWalk 27/5/2017 (http://www.valuewalk.com/2017/05/what-has-worked-in-investing-tweedya/?all=1)

There are few investment firms out there that have a history that's as rich as that of Tweedy, Browne. Founded in 1920 as a dealer of closely held securities, the firm has gone from strength to strength, and while it has changed its primary line of business during its 97-year history, the company's principles remain unchanged. Value investing also remains at the core of the business as described in their famous PDF what has worked in investing (http://www.valuewalk.com/2017/05/equity-market-sp-500-will-selloff/).

Tweedy, Browne has a model ownership structure for asset managers. At year-end 2016, current and retired principals and their families, as well as employees, had more than $1.1 billion in portfolios managed by the firm alongside other client assets. As a result, both managers and clients have profited as since inception (1993) the flagship Tweedy, Browne Global Value Fund has earned a net annualized 9.35%, vs. 5.93% for the MSCI EAFE Index.

TWEEDY, BROWNE FUND INC.

what has worked in investing Source: Made with Photoshop

In the February issue of Value Investor Insight, Tweedy's principals Thomas Shrager, John Spears and Bob Wyckoff, give some insight into their investment process and describe where they are finding opportunities today by following the firm's nearly 100-year-old strategies.

What has worked in investing Tweedy, Browne: How To Invest For The Long Term

With value at the core of the business, it is no surprise that Tweedy's investment process begins with value screens. The firm's highly insightful booklet *What Has Worked in Investing*, is a must-read for value investors and as Bob Wyckoff describes in the interview, forms the foundations of Tweedy's investment strategy:

> *"Most of our investments have characteristics that have been associated empirically with above-average investment rates of return over long measurement periods: a low stock price in relation to book value, a low price-to earnings ratio, a low price-to-cash-flow ratio, an above-average dividend yield, a low price-to-sales ratio compared to other companies in the same industry, a significant pattern of purchases by insiders, a significant decline in share price…the basic selection criteria described in What Has Worked in Investing have been incorporated in Tweedy, Browne's investment process for at least 60 years."*

Jay Hill adds that the firm is trying to buy securities at two-thirds or less of a conservative estimate of intrinsic value. AGCO Corp. Is given as an example of what sort of companies the trio likes. The team first started buying AGCO in 2014, believing that the long term normalized earnings power of the group was at least $4 per share. At the time the stock was trading at the low to mid $40s. Tweedy's advantage here Jay Hill notes is the firm's long term view point. A company that has been around for more than nine decades clearly knows how to invest for the long term and this gives the team at Tweedy a large advantage over the rest the market, as Hill describes:

> *"We were very comfortable that the big-picture trends around food consumption were a long term tailwind that argued for even better than a reversion to the mean. The sell-side in these types of situations tends to value companies at peak multiples of trough earnings, and only shifts to the more mid-cycle earnings and valuation we use when there's clear evidence the cycle has turned. Investing with a longer-term view when that's too uncomfortable for others often provides us with an attractive entry point."*

Another example given is Kia Motors. At the time, shares in Kia had been hit by the recent inauguration of Donald Trump given the company's plans to expand production in Mexico and export to the US. However, while the market may have been pricing in headwinds for the enterprise, Tweedy's analysts could see value in an unbelievably cheap stock:

> *"Because of policy-related concerns and other short-term issues, the stock trades at 60% of book, 6-7x earnings, with a 3% dividend yield and backed by a balance sheet with net cash, almost unheard of for a car company. You don't find many businesses with those characteristics around the world today, but in our experience when you do find them the odds are in your favor that things will work out."*

I think these two examples give a great insight into Tweedy's investment strategy. The firm is focused on value, but because the asset manager's analysts all own a significant portion of the business, they are not afraid to take the long term view when investing. This means that rather than chasing the latest market trends, they can take a contrarian stance.

Furthermore, the team is not afraid to invest outside of the US and developed markets. The reason for this is simply because "we've simply found more value elsewhere" as outside the US there's just a "greater level of inefficiency."

One of the themes earmarked in Tweedy's booklet *What Has Worked In Investing* is the observed outperformance of small caps over the long term. The team has tried to incorporate this theme into firm's flagship Global Value Fund portfolio. With 111 positions portfolio diversification allows the fund to allocate a larger weighting to such companies without having to worry about the usual small-cap problems.

So where does the team at Tweedy see value today? Well, it seems it's hard to find stocks that conform to Tweedy's rigorous valuation standards in today's market, as Bob Wyckoff explains:

> *"To give a sense of that, we recently did a global screen of nearly 5,800 non-financial companies with market values greater than $300 million, positive free cash flow over the past 12 months, at least an 8% return on equity over the past 12 months, net debt to EBITDA of no more than 2.5x and a trailing EV/EBIT multiple of no more than 8x. Between 2010 and 2012, we would have had 650 to 800 companies meet that criteria. Today the number is 188, concentrated largely in retail, auto parts, homebuilding, airlines and precious metals."*

As the MSCI World Index is virtually unchanged over the past four months, we can assume the same is true today.

Two examples of the companies Tweedy is currently looking at today are distribution company Avnet, and Canadian investment holding company E-L Financial.

With E-L, the value can be found in the company's asset value. At the time of the interview, E-L was trading at only 60% of latest reported tangible book value. Owners have been buying, and the C$890 per share pile of cash and securities is a solid foundation for the group.

Avnet is a semiconductor business that acquired the U.K.-based distributor, Premier Farnell, last year. Tweedy expects this merger to unlock significant growth for the enlarged group:

> *"On a pro-forma basis, including expected deal synergies but subtracting $40 million of restructuring expenses that Wall Street analysts are willing to ignore, we think Avnet within two years should generate annual EBITA of around $780 million. Applying a 10x EV/EBITA multiple – where a number of comparable M&A deals have been done – and subtracting pro-forma net debt of $359 million, we estimate fair equity value at more than $7.4 billion, or $57 a share. Adding in an other $2 for Tech Data shares Avnet now owns, our price target looking out 12 to 18 months is $59."*