WIDEMOAT Investing Summit

Fully online investment conference, hosted by ValueConferences, July 1-2, 2014

Selected Session Highlights from Wide-Moat Investing Summit 2014

PAT DORSEY, CHIEF INVESTMENT OFFICER, DORSEY ASSET MANAGEMENT

Likes the sources of moat in the aircraft aftermarket space owing to: 1) a lengthy qualification and selection process (e.g. FAA regulations in the U.S.); 2) low levels of aftermarket competition (most parts have just one supplier); 3) low customer incentive to push on price (maintenance = 9% of airline spending; fuel and labor = 65% □ which gets more scrutiny?). The end result is “insanely” high switching costs and revenue streams lasting 50+ years from airframe in-service to last plane retirement – at aftermarket margins of 30%+ (initial product sales are breakeven or negative margin). Dorsey favors the following two equities in the space:

MEGGITT (UK: MGGT): Supplier of critical parts and equipment to aerospace (civil + military) and energy markets. 75% of sales from aero, 25% energy/other. 75%-90% of aero revenue is sole-source. Two key insights: 1) Reported earnings understate economic reality by about a third (due to high amortization); and 2) Meggitt has a good shot at turning operational excellence into strategic advantage through the implementation of its lean manufacturing Meggitt Production System (big buyers such as UTX, Honeywell, Airbus, are getting fed up with subpar defects-per-million and delivery rates; suppliers that drive operational excellence have a chance to win incremental business). Dorsey sees a fair value of ~£6.5 billion (before any impact from lean initiatives).

MTU AERO ENGINES (Germany: MTX): Supplier of turbine (jet) engine modules and largest independent engine MRO provider. 75% of EBIT from engines, 25% from MRO. Model: secure “program share” on engine platforms, sell modules at negative margin, high margin on aftermarket. Moat: long-term agreements, onerous certifications, technical capacity. Opportunity: Strong new engine deliveries and declining spares sales have led to pressure on margins and working capital. But V2500 is entering “sweet spot” for shop visits and revenue should double by 2017. Lean program reducing capital needs. MRO gaining share from non-OEMs. Long term opportunity from geared turbo fan. By 2017-2018, Dorsey estimates FCF of €300m and fair value of ~€95/share.

http://www.valueconferences.com/2014/07/moat14-pat-dorsey/

CHRISTIAN RYTHER, PORTFOLIO MANAGER, CURREEN CAPITAL

CREDIT ACCEPTANCE CORP. (NASDAQ: CACC): Provides sub-prime auto loans, primarily to borrowers no one else will lend to. Anyone can make a car loan, so where is the moat? 1) niche market (subprime borrowers default, often – this requires very different servicing methods than prime auto lending; need a sales force to reach dealers, and staff to support the dealers as they learn and use the system); 2) cost advantages: began making loans in 1972 and has since developed economies of scale and learning curve advantages; and 3) management skill in operations and capital allocation: paid on economic profit; CEO owns $33M of CACC stock (30x annual compensation); generally uses tender offers to repurchase shares (ten tenders since 2003). This leads to high returns (mid-teens average ROIC since 2009 and 30%+ ROEs) and surprising resilience in downturns (profitable through 2008-09 with a ROIC of 17% in 2009). In Ryther's view, the equity is priced at a better than 5:1 upside/downside ratio (upside value: $250/share; downside value: $106/share).

http://www.valueconferences.com/2014/07/moat14-christian-ryther/

Matthias Riechert, Portfolio Manager, Polleit & Riechert Investment Management

ENERGY ASSETS (UK: EAS): UK-based company that collects stable, inflation-protected cash flows from gas meters and data loggers. EAS installs, owns and manages gas meters in the industrial and commercial sector in the UK (more than 2/3 of revenues are recurring). It is ideally positioned to profit from a land-grabbing opportunity: the exchange of old to new "smart enabled" meters (drivers are energy efficiency and EU-wide regulation) and a domestic regulatory-driven break-up of the traditional monopolistic market structure under National Grid. Moat: switching costs (costs for site visit, capex for new meter, gas supply interruptions) and search costs/reputation (for new business the company competes based on reputation). The equity is cheap on an absolute and on a relative basis compared to its main competitor Smart Metering Systems. Riechert estimates that EAS will grow its EPS to 0.42 in less than three years. Growth is less predictable (but not unlikely) afterwards.

http://www.valueconferences.com/2014/07/moat14-matthias-riechert/

Rupal Bhansali, Chief Investment Officer - International Equities, Ariel Investments

COACH (NYSE: COH): Continues to dominate the accessible luxury handbag category despite increased competition (Michael Kors and other premium lifestyle brands). Management has acknowledged recent missteps and is well along the way in terms of fixing the problems (new designer Stuart Vevers with a heritage in designing luxury handbags at Mulberry and LVMH; product: increased newness, broadened assortment and redesigned collections; new pricing strategy: launched higher quality, higher price point merchandise, reduced promotions; revamped distribution: reinvigorated retail channel via redesign, changed wholesale account management; increased marketing spend: $50 million on personalized marketing campaigns on loyal customers). While execution risk is high, there is light at the end of the tunnel (highly profitable and growing franchise in Asia; white space potential in men's collections, footwear and outerwear; brand repositioning from handbags to broader lifestyle assortment; and lucrative category exposure – end market is growing and very profitable). The recent valuation, including a strong balance sheet, provides a very attractive risk-reward for this out-of-favor equity (especially versus competitor and investor favorite Kors).

TUMI (NYSE: TUMI): Travel and business products leader with a business model built on: 1) design excellence; 2) functional superiority; and 3) technical innovation. Missed earnings guidance since going public in 2012 has created distrust among investors and led to an attractive recent valuation. The brand is only in the "early innings" of its global expansion potential in a fragmented category (market share wins can drive growth). At $20 per share, the valuation is attractive, especially relative to Samsonite, the investor favorite in the sector.

http://www.valueconferences.com/2014/07/moat14-rupal-bhansali/

Tim Eriksen, President, Eriksen Capital Management

FTD (NASDAQ: FTD): Recent United Online spin-off; premier floral and gifting company, providing floral, gift and related products to consumers, retail florists, and other retail locations mainly in the U.S., Canada, the U.K., and Ireland. Recognized FTD and Interflora brands, supported by the iconic Mercury Man logo displayed in tens of thousands of floral shops. Sources of moat: 1) network of florists is difficult to duplicate; 2) scale allows FTD to more easily add ancillary products such as cakes or gifts. This allows the company to operate with negative working capital (it collects from its customers before having to pay its florists) and to have stable, predictable cash flows. ~$50 million of annual free cash flow (8-9% FCF yield) would allow FTD to be debt free in three years. FTD authorized a $50 million share buyback program in February. Eriksen thinks it is likely that FTD is acquired after the two-year timeframe from spinoff (late 2015 / early 2016) as FTD has a history of private equity involvement due to the predictable (and modestly growing) cash flow profile.

http://www.valueconferences.com/2014/07/moat14-tim-eriksen/

Jerome Archambeaud and Eric Boroian, Portfolio Managers, Focus Asset Managers

DELTICOM (GERMANY: DEX): Online tire dealer with a leading position in Europe (45-50% market share), which contributes ~70% of company revenue. Offers ~100 tire brands with 25,000 models and has a network of 37,000 fitting partners in various countries across Europe. ROCE is over 30%, driven by: 1) size/scale, making them the largest and only online tire retailer that can work directly with manufacturers (most others operate with wholesalers, increasing their costs and reducing their margins), leading to a lower cost base; 2) only player to have their own warehouses, making them more efficient and better in terms of logistics and delivery; 3) has by far the most fitting partners in the industry (37k), making them the most convenient retailer to work with (tires are bought by customers online, but need to be fitted and installed in a local dealer/garage; and 4) large installed customer base, which is extremely hard to replicate, and which will be important in the next replacement cycle. Sales could reach ~€1 billion by 2017-2018 assuming 10-15% volume growth as online penetration increases (only ~10% currently), moderate price competition, and better mix. Given the upcoming tire replacement cycle, especially in Germany, a 7-9% operating margin at some point during the period (from a current level of about 4%) is achievable, leading to an EBIT range of €70-90m over the next 3-4 years. At a 12-14x EV/EBIT multiple (similar to the last cycle), this would imply an enterprise value of ~€1.1 billion, and an equity value of ~€1 billion (~€600 million present value, discounted at 10%).

http://www.valueconferences.com/2014/07/moat14-archambeaud-boroian/

Jonathon Fite and Arvind Mallik, Managing Partners, KMF Investments

WESTERN UNION (NYSE: WU): “World dominator” of the global money transfer industry. Core franchise is cash-based consumer money transfer, but WU also has fast growing online and mobile capabilities and recent acquisitions are enabling B2B capabilities. Sources of moat: 1) trusted brand; 2) economies of scale); and 3) network effect (500k+ agent locations, 100k+ ATMs, 200+ countries).

This leads to revenues and net income of 4x and 15x greater than the next competitor Moneygram. At the recent valuation (FCF yield of ~10%), the shares are priced for disappointment. What's making WU shares cheap? 2013 revenues were down 2% y-y as the company surprised investors with aggressive pricing cuts in late 2012. Regulatory and compliance requirements jolted investors (again) in 2013 with unexpected costs (incremental burden of 3%+ of revenue). Newer entrants (e.g. Xoom.com, Bitcoin, Walmart) also led to concerns about the moat. Fite and Mallik believe these are all solvable problems the company is already addressing (revenue growth is back with 4% constant currency growth in Q1; cost savings aimed at offsetting compliance costs; fighting competition with WU.com, growth accelerated to 45% in Q1 and WU likely to offer "instant" ACH online transfers this year). As the company mitigates the recent margin drag and restores growth, the stock should re-price to $29+. Another positive is capital allocation (reduced shares outstanding by more than 25% since 2008) and incentives (CEO Ersek owns 1.8M shares, 30X salary, bought when shares fell).

http://www.valueconferences.com/2014/07/moat14-arvind-mallik/

John Heldman and David Hutchison, Portfolio Managers, Triad Investment Management

NATIONAL OILWELL VARCO (NYSE: NOV): Leading provider of equipment and components used in oil and gas drilling and production. Sources of moat: 1) lowest cost of production and service delivery (largest in industry, competition only with specific offerings not entire product line; large installed base makes global service delivery cost-effective); 2) powerful brands (collection of 140+ branded products, some going back over 100 years, long track record with rig operators); and 3) high switching costs (difficult for new market entrant to combine wide product line with years of experience NOV offers its customer base; customers familiar with NOV equipment, training customer employees to use complex products; often "no other vendor"). This leads to 15-20% operating margins for years (highest among major oil patch vendors) and exceptionally high returns on assets of 30%+ pre-tax ($3.5B EBITA on ~$10B PPE + Inventory). Heldman and Hutchison estimate NOV fair value at $178 per share by 2017 based on $6,050 million of EBITA and an 11x multiple (assumes share count declines from 429 million to 374 million as a result of share repurchases during the period).

http://www.valueconferences.com/2014/07/moat14-heldman-hutchison/

Jason Subotky, Portfolio Manager, Yacktman Asset Management

TWENTY-FIRST CENTURY FOX - CLASS B (NASDAQ: FOX): Strongest growth prospects of any traditional major media/entertainment company. Valuation is attractive given the business quality (businesses have strong consistency and predictability due to income tied more to fees than advertising) and strong potential for earnings growth in 2015-2016. Huge long-term opportunity in international markets. Potential to receive better value for satellite units. Separation from News Corp in 2013 and significant investments in FY 2014 have caused both classes of shares to lag. As the Class B voting shares, which have significant liquidity, trade at a discount to the Class A shares due to the Australian de-listing, the Class B shares offer an even more compelling risk-reward trade-off.

http://www.valueconferences.com/2014/07/moat14-jason-subotky/

ROBERT DEATON, MANAGING PARTNER, FAT PITCH CAPITAL

BLACKHAWK NETWORK HOLDINGS (NASDAQ: HAWK): Pioneer in the prepaid gift space, providing gift cards, prepaid digital products, prepaid telecom products and financial service products via a global distribution network (partners with the best and biggest brands and retailers). Sources of moat: 1) proprietary platform for activation, processing and settlement; 2) network of 400 distribution partners with 180,000 retail locations in 21 countries combined with over 600 content providers; and 3) processed 242 million transactions with a load value of $10 billion in 2013. Fortress balance sheet with $135 million of cash and no debt. High returns on invested capital with low capital intensity. Shareholder oriented management team focused on widening the company's moat into digital transactions and to grow the international business. Attractive valuation at a ~7% forward FCF yield and long runway to grow free cash flow at double digit rates annually.

http://www.valueconferences.com/2014/07/moat14-robert-deaton/

JEREMY DEAL, MANAGING PARTNER, JDP CAPITAL MANAGEMENT

CYRUSONE (NASDAQ: CONE): Highest quality, least leveraged data center REIT growing earnings 20%+ annually. Wide moat will protect low-20s unleveraged IRR on stabilized data center portfolio. Key sources of moat: 1) scale (allows ability to maintain unoccupied space for customer growth at low costs) and 2) reputation (creates high barrier to entry, especially for new competitors). Undeveloped capacity to grow footprint by 400% organically. Attractive valuation caused by perceived control shareholder sell overhang and limited public float. 33% upside due to special situation despite recent run up, 60-80% upside over 18 months.

http://www.valueconferences.com/2014/07/moat14-jeremy-deal/

DAVE SATHER, PRESIDENT, SATHER FINANCIAL GROUP

REMY COINTREAU (FRANCE: RCO): Bad recent news creates opportunity to buy one of the premier brands in the global alcoholic beverage industry at an attractive price. The bad news revolves mainly around the recent Chinese government crackdown on extravagant gift-giving, which has reduced sales of Rémy products there (~30% of 2013-14 revenue is from Asia-Pacific). However, with a logical, long term focused family owner, strong management, and the unique Rémy Martin/Louis XIII cognac brands, the business is bound to grow over time. The margin of safety is provided by the value of current “eaux-de-vie” (estimated market value of €2.4 billion relative to current cognac pricing, or 70% of recent market cap), which implies a value for remaining brands of less than €1 billion. The latter include valuable brands such as Cointreau and Metaxa, which combined contribute nearly 30% of operating profit (the remainder is from Rémy Martin cognacs).

http://www.valueconferences.com/2014/07/moat14-dave-sather/

Paul Lountzis, President, Lountzis Asset Management

ZOETIS (NYSE: ZTS): Recent spin-off from Pfizer and the global #1 animal health provider serving the livestock (64% of revenue) and companion animal (34% of revenue) markets. Sources of moat: 1) 3,500+ member field force; 2) R&D and manufacturing capabilities; and 3) global regulatory expertise. Experiencing some difficulties due to the separation from Pfizer (creation and implementation of various internal departments; substantial costs to becoming an independent company) that lead current financials to understate true earning power. Lountzis estimates revenue growth of 5-6% and EPS growth of 8-12% over the next few years, implying EPS of $1.94 in 2016, which is more reflective of underlying earning power. Given market share leadership in a growing global category (benefits from population growth, increasing protein consumption and rising global middle class), Lountzis finds the ~6% earnings yield attractive.

http://www.valueconferences.com/2014/07/moat14-paul-lountzis/

Stephen Dodson, Portfolio Manager, Bretton Fund

ROSS STORES (NASDAQ: ROST): One of two leading “off-price” apparel retailers (TJX main competitor), selling name-brand clothes for a lot less. Sources of moat: 1) scale advantages (apparel makers want to offload excess inventory quickly, to few buyers; SG&A as % of revenue almost half of competition) and 2) logistics (keep 1,300 stores fresh with varied inventory that turns quickly; complexity of managing 700 buyers negotiating with 8,000 vendors). What Walmart and Costco are in mainline retail, Ross and TJX are in apparel retail □ taking share from traditional department store competition such as Kohl’s, JC Penney, Macy’s (customers, as a whole, are choosing price over experience in apparel retail). Importantly, the likes of Amazon are not significant competition as it’s tough to match experience online (with average price per unit of $10 the shipping economics don’t work; brands don’t want to see their goods online at huge discounts; needle-in-a-haystack, tactile “treasure hunt” best in-person; only 60% of Ross’s transactions made with credit/debit card). Recent valuation (adjusted for cash, at 13.6x consensus 2015 EPS of $4.69) offers attractive returns with a flat multiple and no margin expansion due to a long compounding runway: can get to 2,500 stores, almost double today’s 1,300 (TJX has 3,300) by expanding in the Northeast and Midwest. Ross is one of the rare businesses that can grow rapidly while distributing most of its earnings to shareholders (little capex required for growth; shares have declined by 30% in past 10 years).

http://www.valueconferences.com/2014/07/moat14-stephen-dodson/