

Asset-Based Investing in an Earnings-Focused World

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Moerus Capital employs a fundamental, bottom-up investment process, with the goal of investing in assets and businesses at prices representing significant discounts to our estimates of intrinsic value, all the while placing heavy emphasis upon risk avoidance and mitigation. Importantly, the risk that we seek to mitigate is not short-term share price volatility, but rather the risk of a permanent loss of capital. In fact, we embrace short-term share price volatility as a provider of periodic opportunities to invest in what we believe are high-quality assets or businesses at bargain prices. We believe that buying as cheaply as possible is critical both to risk mitigation as well as to the potential generation of attractive long-term returns.

In striving to buy as cheaply as possible, we estimate intrinsic value using very conservative estimates that weigh a company's balance sheet and what is known today much more heavily than projections of future earnings and cash flow, which may (or may not) materialize. In other words, as a general rule of thumb, we try to buy shares of businesses at sizeable discounts to what we think that they would be worth if they sold their assets today, using conservative assumptions. The asset-based investment approach that we follow at Moerus stands in contrast to the approach of many in the investment community who tend to focus more heavily on earnings and cash flows.

Our estimates of a company's intrinsic value generally do not heavily weigh forecasts of cash flows years into the future, simply because we believe the future is notoriously, inherently difficult to predict. We are not willing to "pay up" for businesses at prices that would only be attractive under optimistic assumptions of continued prosperity years into the future. By contrast, we believe that a conservative, asset-based valuation methodology often yields a "bedrock" (lower-bound) valuation, and that buying at a steep discount to such a bedrock valuation provides a cushion that not only provides downside protection, but also offers meaningful upside potential in the event of favorable future outcomes, which typically aren't "priced in" to the stock at such beaten down levels.

Implications of the Asset-Based Approach

Our approach to investing has several noteworthy implications regarding which type of situations tend to find their way into the portfolio, and why.

What's the catch?

At Moerus, we search for high-quality, long-term investment opportunities which are available at attractive prices relative to what we believe their net assets are worth today - attributing very little value to forecasts of earnings or cash flows, visions of the future which are far too often seen through rose-colored glasses. One implication of our approach is that, at the risk of stating the obvious, such opportunities do not come easily or often - alas, there

is usually “a catch,” or something “wrong” which drives pricing down to the unusually attractive levels which pique our interest. Common examples of what might be “wrong” include, among others, a challenging short-term outlook facing a company’s relevant industry or geography, or a company-specific misstep or hiccup that results in share price declines.

For traders and investors with very short time horizons, near-term uncertainty and turmoil might rule out any such investment. But our long- term focus allows us to look past temporary rough patches that render a company, industry or geographic market out of favor in the broader market as they often prove to be interesting sources of longer-term investment opportunity, provided that the turmoil is indeed temporary, and the potential investment has the staying power and wherewithal to survive tumultuous times and thrive if, as and when the situation normalizes.

Unappreciated, Misunderstood, or Event-Driven

In addition to situations involving short-term (but temporary) turmoil, asset-based investing has also often led us in the direction of two other scenarios that sometimes lead to atypically attractive investment opportunities. First, companies that are underappreciated, underfollowed, complex and/or misunderstood occasionally provide interesting opportunities, in part because fewer eyes are examining and recognizing the value that may (or may not) be present within the business in question. Second, opportunity periodically can be found in situations in which there is hidden value that could potentially be unlocked through event - driven scenarios ; examples of these include liquidations, corporate reorganizations, mergers and acquisitions, and changes in industry or shareholder structure, among others.

Patience

We think that it’s worth noting that given the nature of these sources of opportunity, patience is indeed a virtue when it comes to implementing an asset-based investment approach. Patience is needed to hold cash in the absence of attractive pricing and wait for quality investments to become available at truly modest prices. Once a promising long- term investment becomes available at a price that is cheap enough, patience is often required to hold (or add to) the investment, as the poor near-term conditions that contributed to the deep discount continue to run their course. Of course, patience must go along with and be backed by conviction – developed through research, analysis, and considerable reflection – that such a prospective investment has the staying power (financial, operational and otherwise) to navigate its way through temporary difficulties until its underlying value is ultimately realized.

Not for the Fashionable

The asset-based investment approach requires patience because investment opportunities available at the type of valuations we seek do not make themselves available frequently, and when they do, it is usually at a point in time in which the assets in question are underappreciated and/or out of favor. Attractive value investments, particularly those at the deep discounts to conservative intrinsic value estimates that we require, are not available whenever they are “in fashion.” In that sense, we often find ourselves looking for bargains in some of the most far-flung or “out-of-fashion” places, to which many others in the investment community for various reasons are biased against venturing. This is one of the reasons why we have periodically found emerging and frontier market securities to offer attractive opportunities, specifically of the kind that by and large fall under the radar of more earnings-based analysts and investors.

Deep Value and Emerging/Frontier Markets: Compatible...at Times

Another implication of our asset-based investment approach is that while opportunities to implement it in emerging and frontier markets are apt to be sporadic and infrequent, occasionally compelling balance sheet-based investments can and do become available at attractive prices in even these markets, which traditionally have not been considered a welcoming destination for deep value investors. Notwithstanding the bloodletting that occasionally takes place from time to time in many emerging and frontier markets, in general these markets have historically appealed to growth investors due to their attractive growth potential relative to that offered by more mature markets.

Simply put, many investors have historically been willing to pay up for the future – in the form of expected future growth – in emerging and frontier markets, whereas at Moerus we look for bargains here and now, based on our estimates of the net assets on the balance sheet today. Partly as a result of this dichotomy, the predominance of investors who are willing to pay for projected future earnings growth in emerging markets has, in our view, *generally* translated into less frequent opportunities for the asset-based value investor such as Moerus.

However, the very fact that these markets are heavily populated by short-term growth investors provides us, from time to time, with intriguing investments that fit our approach. This is because many such opportunities often bring “baggage” that shorter-term or growth oriented investors tend to avoid:

For example, emerging markets can sometimes bring extreme uncertainties – such as coups, political turmoil, wild swings in economic (mis)fortunes, *et al.* – that are difficult if not impossible to swallow for those who invest with a short-term time horizon and/or depend upon robust projections of future earnings and cash flow growth. Many times the “catch,” or whatever makes the investment compelling on a long-term basis in our eyes, is the very same thing that makes it off-limits for those who are unwilling (or unable due to their investment mandate) to be patient and take a long-term view.

As noted above, asset-based investing is not for the fashionable simply because such bargain pricing does not typically become available when things are going well, particularly in emerging and frontier markets which often command premium valuations during better times because of their greater observable growth prospects. On the contrary, these opportunities often become available in times of crisis and angst – take Brazil in recent years, with its historic recession, political turmoil and corruption scandals – just when many short-term investors who buy what’s popular have already fled.

Examples of situations that could create such opportunities for us include the following:

Quarterly earnings disappointments, or revenue growth figures that fall short of what had heretofore been lofty expectations – the kind that are typical of many emerging market securities during the good times – might result in growth investors heading for the exits, leading to a plunging stock price. For example, Company ABC might produce earnings per share growth of 5% – not spectacular, but certainly respectable – yet still see its share price punished, if shares had previously been priced based on expectations of, say, 15% annual EPS growth. In that sense, temporary slowdowns, setbacks, and disappointments occasionally offer opportunities to invest at reduced prices in companies that are usually well-loved, and consequently rarely marked down except

when inflated hopes are dashed.

Broader macroeconomic slowdowns and turmoil could be particularly punishing to investors in emerging markets given the growth bent of many who typically invest there. Heavenly expectations – the kind that are typically heaped upon market darlings and “the next big growth stories” – leave investors vulnerable to adverse shocks which could yank sentiment back to Earth in a steep, rapid descent. Amid the ensuing rubble, even previously well-loved gems can sometimes become available at compelling prices.

A final important point to make on this subject is that share price declines in emerging and frontier markets could be and often are exacerbated by the relative illiquidity of many of these markets. When investors flee illiquid markets, dramatic share price declines could result, potentially turning a stock that used to trade at a sky-high valuation a year or two ago into a bargain today. In sum, the main point which we’d like to make clear is that although emerging and frontier markets have traditionally been considered the preserve of the more adventurous, growth-oriented investor, we believe that compelling asset-based, deep value investment opportunities periodically can and do become available there, albeit perhaps more sporadically than in developed markets.

Summary Conclusions

The deep value, asset-based investment approach that we apply stands in stark contrast to those of many/most investors, notably many emerging and frontier market investors who tend to be heavily earnings-focused.

We believe that buying at a substantial discount to a bedrock valuation, one which is estimated using a highly conservative, asset-based methodology, provides downside risk mitigation while also offering attractive upside potential, since favorable scenarios typically are not priced in at such depressed levels.

Attractive investment opportunities that become available at sizeable discounts to conservatively estimated, balance sheet-based intrinsic values are unusual. Typically, there must be “a catch,” or something “wrong” that has created bargain pricing.

Common “catches” include short-term turmoil affecting a company, industry or geography, a situation that is complex or underappreciated, neglected, or misunderstood by the broader market, or event-driven scenarios which cause a business to become “unfashionable” in the minds of most market players.

Although sporadic, compelling asset-based value investments can and do become available even in emerging and frontier markets, which have traditionally been considered the stomping grounds of growth investors who often have shorter-term investment time horizons than what an asset-based investment opportunity might require.

Unusual bargains can sometimes be found in corners where, in our opinion, many market participants are biased against looking. Asset-based investment opportunities may additionally present themselves in the form of companies that create value by means other than recurring earnings from continuing operations, yet which at times are neglected in an earnings-focused world.

Many thanks – as always, your interest and curiosity are very much appreciated! For those interested in learning more about us, we invite you to visit our website at

www.moeruscap.com and contact us with any questions or feedback at ir@moeruscap.com.

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