

Surveying Selected Portfolio Holdings

This article by Matthew Haynes is excerpted from a letter of [1949 Value Advisors](#).

Shares in **Cirrus Logic** declined by 15.0% during the period [Q3 2017] as some investors see risk of dollar content loss in fiscal year 2018 at Cirrus' largest customer, Apple (76% of Cirrus' total revenues in the latest quarter). While it is true that the great majority of Cirrus Logic's business is very closely tied to the success of Apple's iPhone products, this can also be an opportunity as well as a risk. With the upcoming launch of Apple's iPhone X, there is significant pent-up demand that may lead to unit sales exceeding the market's expectations. In addition, and apart from Apple, Cirrus Logic increasingly benefits from premium mobile phone features migrating down to more moderately priced phones. Lower dollar content from mid-tier mobile phone manufacturers, but with much higher unit volumes would result in significantly greater revenues and operating profit than is currently implied by Cirrus' modest valuation (7.5x estimated EBIT).

Global Brands Group Holdings shares declined 8.5% during the third quarter following the release of its 2017 fiscal year results. The results were actually quite good amidst a very challenging business environment for all retail related companies. Global Brands Group is one of the world's leading branded apparel, footwear, fashion accessories and lifestyle product companies. Full year revenues increased by 11.6%, while core operating profit grew by 64.5% as margins expanded 250 basis points. The company also announced a new Three-Year Plan focused on reaching US\$5 billion in revenues by the end of fiscal year 2020, growing margins further and reducing debt. The company has already made progress on debt reduction during the third quarter, selling its remaining 49% stake in Frye Brand IP and using net proceeds of \$68 million to reduce corporate debt.

Shares in **Western Digital** fell 1.9% during the quarter as the company has been engaged in a bitter battle with its JV partner Toshiba Corp. of Japan over Toshiba's sale of its memory subsidiary. Western Digital has been pursuing legal action to protect its consent rights under the JV agreement, in the event of a sale of the division. As the quarter drew to a close, Toshiba signed a deal with a buyer group led by Bain Capital, with financing from Apple, South Korea's SK Hynix and others. Western Digital is seeking injunctive relief to prevent Toshiba from transferring any JV interests, in whole or in part, until the arbitration process runs its course. This uncertainty will likely serve to obfuscate the primary elements of our investment thesis until resolved (2018).

Positions that helped performance during the third quarter include Michael Kors Holdings (+1.6% contribution), Anglo American plc (+1.6% contrib.) and Industrias Bachoco ADR's (+0.8% contrib.). **Michael Kors Holdings** reported better than expected quarterly results, driving its shares 32% higher during the period under review. The report showed progress on the company's efforts to reduce discounting on women's handbags, with the hope for higher future margins and profitability. Also during the period, the company announced the acquisition of iconic shoe brand Jimmy Choo for \$1.2 billion – the first of many planned acquisitions intended to create a global fashion luxury group. Fiscal year 2018 is shaping up to be a transition year for the company on several levels. Although the market seems to like its growth ambitions so far, we remain disciplined about valuation in light of the greater financial risk that will accompany this and future debt-financed acquisitions.

Shares in **Anglo American plc** rose 34.6% in GBp during the quarter, in part due to the continuation of recent favorable trends in commodities markets as economic growth in China remains firm. On the company level, Anglo's deleveraging efforts also continue as the company generates tremendous free cash flow at current spot commodity prices. The ultimate fate of Anglo will very likely involve further restructuring including potential asset sales, and possibly a separation of its South African assets via tax free spin-off(s). This would serve to unlock significant latent value as the remaining non-South African assets rerate to a more appropriate valuation in line with Rio Tinto and BHP Billiton. Anglo's new Chairman Stuart Chambers could be a catalyst toward this eventuality since on two previous occasions, companies he chaired were taken over (ARM plc and Rexam plc).

American Depository Receipts (ADR's) of Mexico's largest poultry producer **Industrias Bachoco** gained 14.7% during the third quarter, bringing its year to date gain to 37.7%. In July, the company announced solid earnings results with poultry prices in Mexico remaining strong, driving margins and profitability higher. Bachoco has also been putting its rock solid balance sheet to work, using part of its net cash to purchase US-based poultry processor AQF for \$140 million, diversifying its geographic footprint in a business they know well. In addition, the relatively small acquisition of Mexican pet food company La Perla for approximately \$25 million will help to diversify its product offering.