

Portfolio Commentary

This article by Matthew Haynes is excerpted from a letter of [1949 Value Advisors](#), an absolute return-oriented global value investment firm based in Mahwah, New Jersey. Matt is a valued contributor to [The Zurich Project](#).

As bottom-up investors, individual security selection will often be the most important driver of quarterly portfolio performance. Positions that had the largest negative impact on performance during the quarter were Birchcliff Energy (-1.8% contribution), Industrias Bachoco ADRs (-0.7% contrib.) and Global Brands Group (-0.6% contrib.).

Shares in **Birchcliff Energy** declined 26.8% during the period under review on persistently weak western Canadian AECO natural gas prices. The confluence of production growth (including “associated gas” from oil producers) was met by warm temperatures and resulting stagnant demand. Weak demand and increased supply leads to lower spot prices. Simple stuff. While a deep freeze across Canada would certainly help, predicting seasonal weather patterns isn’t part of our investment thesis.

Birchcliff Energy is among the lowest cost producers in Canada, enabling positive cash flow generation even amidst depressed natural gas prices. We remain focused on Birchcliff’s immense latent asset value which we expect to be either slowly realized over time as they execute on their organic growth strategy, or more quickly unlocked through a catalyzing corporate event. Certainly, at the current depressed valuation, Birchcliff is an attractive target for a much larger company with the financial resources to develop its vast reserves on a faster track than the current plan.

After being mentioned in last quarter’s letter as one of our top contributors, American Depository Receipts (ADR’s) of Mexico’s largest poultry producer **Industrias Bachoco** were among our greatest detractors during Q4, declining 13.8%. For the full year, Bachoco ADR’s gained 18.6%. Recent weakness can be attributed to the weak Mexican peso and worries over NAFTA negotiations. The recent weakness belies Bachoco’s long term record of creating value, its already discounted valuation and its rock solid balance sheet and free cash flow generation which we expect to drive future capital returns and bolt-on acquisitions.

Global Brands Group Holdings shares declined 14.7% during the fourth quarter following the release of its fiscal 2018 H1 results. Once again, the results were actually quite good amidst a very challenging business environment for all retail companies. Global Brands Group (GBG) is one of the world’s leading branded apparel, footwear, fashion accessories and lifestyle product companies. Traditional bricks-and-mortar platform companies – the department stores and specialty retailers – are very challenged today by online platform companies like Amazon, and other major discounters like Walmart. GBG operates an asset light and scalable business model, escaping the challenges plaguing traditional retailers. The new three-year plan is focused on reaching \$5 billion in sales (up from \$3.9 billion in fiscal 2017), expanding margins by 150 basis points and increasing EBITDA by 50%. They’ve already exceeded the 150 bp margin goal during the H1 results just announced, and we expect them to over-deliver on the other objectives too.

Positions that helped performance during the third quarter include Michael Kors Holdings

(+1.2% contribution), Anglo American plc (+0.6% contrib.) and Berkshire Hathaway (+0.6% contrib.). Michael Kors Holdings again reported better than expected results, driving its shares 32% higher during the period for the second consecutive quarter. CEO John Idol said, “This is a transformative time for **Michael Kors Holdings** as we established our global fashion luxury group with the recently completed acquisition of Jimmy Choo.” While investors continue their fascination with this transformation, we will remain disciplined about the great expectations that are becoming baked into its rapidly rising share price, especially considering its newly acquired billion dollar debt burden.

Shares in **Anglo American plc** rose 15.7% in GBp during the quarter, bringing its full year return to +37.4%. Against a backdrop of synchronized global growth, a weaker US dollar and a Chinese economy seemingly on cruise control, commodity producers have enjoyed a good year. While we consider Anglo’s original restructuring efforts largely complete, the company continues to deleverage its balance sheet and could attract potential acquirers.

Finally, **Berkshire Hathaway** shares contributed positively by rising 8.3% during the quarter and 21.9% for the full year. The company is expected to be a major beneficiary of US corporate tax reform, as well as stabilized pricing in P&C insurance following a very active year for catastrophe losses. Cash continued to build on Berkshire’s balance sheet, amounting to over \$100 billion at September 30, 2017. The deployment of excess capital in value accretive ways remains a big part of the optionality embedded in Berkshire’s modest valuation of approximately 1.5x book value.