Latticework Conference

Framework Investing

Summary and Take-Aways

Agenda

- Overall Impressions
- Speaker Summaries and Take-Aways
  - Amit Wadhwaney
  - Adam Schwartz, Xiang “Sean” Huang
  - Bob Robotti, Mike van Bienia, Andrew Burns
  - Tom Gayner
  - Chamath Palihapitiya
  - Elliot Noss
  - David Pakman
  - Tom Russo

Overall Impressions

- Good group split between fund managers, individual investors, family office managers, RIAs, and a few sell-side people
- Many people interested specifically in small cap and international
- Speakers drawn from the investment world, academia, and the world of industry
- Manual of Ideas is the sponsor, so speakers and attendees have a strong value orientation
- Held at the Yale Club in NYC

Speaker Summaries

And Framework's Take-Aways

Amit Wadhwaney

Portfolio Manager and Co-Founding Partner at Moerus Capital Management, LLC. Previously worked for the famous Marty Whitman at Third Avenue Value.

Strong, traditional value investor whose approach focuses on balance sheet quality.

Summary

- Was asked about some potential pitfalls on the horizon and he drew a parallel between protectionism in the 1930s and the trend toward nationalism here in the US and in Britain.
- Danger areas? Any sector / industry in which debt issuance is very easy is worth taking a jaundiced view – easy money favors poor investments.

Take-Aways

- Wadhwaney mentioned preferring the balance sheet to the income statement (i.e., “stock” numbers over “flow” numbers). He looks for things that change very slowly, so favors businesses that are driven by demographic trends.
- These comments made me understand why some investors favor the balance sheet while I favor the “flow” valuation drivers. Flow number valuations rely upon making some projections about growth and that is the hardest part of a valuation. Framework looks at average growth and “investment efficacy” where balance sheet investors avoid thinking about growth by investing mainly in demographic-driven businesses like banks.

Adam Schwartz & Sean Huang

Adam Schwartz
Managing Director at First Manhattan Funds, a prominent value-based fund company.

Sean Huang
Managing Director at First Beijing, a subsidiary of First Manhattan.

Formerly was an analyst at First Manhattan

Summary

- Essentially this was a commercial for First Manhattan (represented by Adam) and its spin-off, First Beijing (represented by Sean).

Take-Aways

- This discussion convinced me that buying a well-diversified China ETF might be a good idea, but trying to invest directly in companies there is a risky proposition.
- Adam mentioned that in the US, anyone can get a 10-K for a public company. In China, you need to be a nominal shareholder to get financial information.
- Due diligence in the Chinese context is essentially auditing the work of auditors. Sean talked about verifying cash balances! To me, if you can't trust the published numbers, it doesn't make sense to waste one's time – US and European investors will never know that market as well as local Chinese investors do.
- Highlights the very important cultural differences in investing in other markets.

Bob Robotti & Mike van Biema

Bob Robotti
Portfolio Manager and Founder of Robotti and Company.

Formerly worked for Mario Gabelli and focuses on small capitalization stocks.

Mike van Biema
Founder of van Biema Value Partners, a concentrated fund of funds.

Formerly was a professor at Columbia's business school's value investing program.

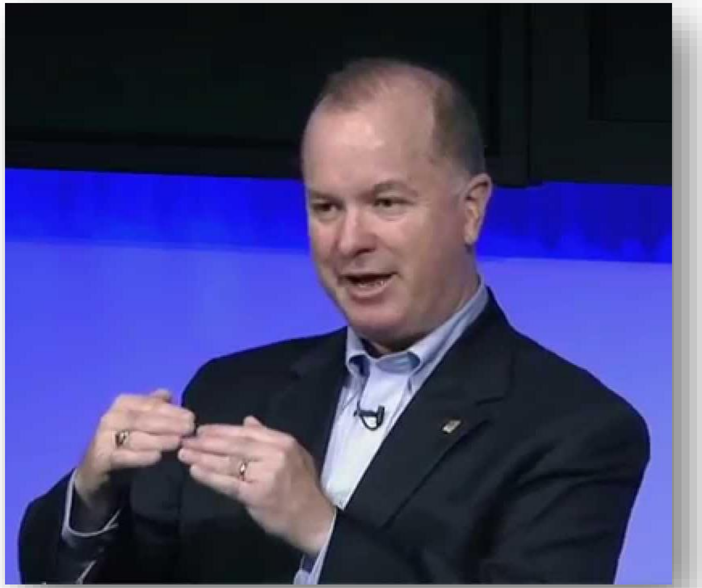
Summary

- Moderated Discussion Topic: "The Role of Active Management in the Modern World"

Take-Aways

- Both men mentioned that no matter what was happening to favor passive investing, there is one important element in the investing process that doesn't change: human decision making. People tend to invest and disinvest at precisely the wrong time – getting too excited in both booms and busts.
- Both men thought that passive investing is useful and that we should think about how to effectively blend passive and active strategies.
- Bob believes that the US market is very attractive and that he is fully invested (in small and micro-cap stocks). The US has plentiful energy (shale gas) and natural resources for industrial inputs.
- Bob believes that the days of China pushing prices down is gone. The country needs to import metallurgical coal and iron and labor is getting more expensive as well. This may put a natural pressure on inflation and on interest rates.

Tom Gayner



Co-CEO and Director of Markel Corporation (MKL), a company that is founded on insurance holdings, but also owns diverse other businesses (e.g., bakery equipment). Known as a young Warren Buffett kind of character and as a good asset allocator.

Summary

- Asked to talk about his experience at Markel, a company whose stock has compounded handsomely over the past 20 years. He spoke from the standpoint of an owner-operator, not as a “paper” investor, which I thought was refreshing.

Take-Aways

- Started off by talking about “horseshoe investing.” A farrier charges $0.01 for the first nail and doubles the amount for each of the next nails (4x7=28 in total). Even starting small, the power of compounding means that the last nail is worth more than a million dollars. He said that he just thought about finding businesses that would double in a fairly short period of time.
- “In a market economy, if you can solve someone’s problem, you can generate revenues.” This focus on the demand environment and on the importance of revenue generation hit me particularly forcefully.
- He thinks of his investments as the manager of a baseball organization. The big leaguers are relatively few, but there is an entire organization below that which can be thought of as a source of potential big leaguers someday. I do like the sound of that!

Chamath Palihapitiya

Original member of the Facebook management team, he retired from Facebook to start an influential Silicon Valley venture capital business called Social Capital Partnership. His business partners with potential investees and brings the experience of his social marketing expertise to their business. He invests in businesses that he believes can respond to a strong demand environment, as assessed by social criteria.

Summary

- Spoke about investing in the age of constant creative destruction.

Take-Aways

- His biographer describes his company as a Berkshire Hathaway for the 21st century.
- Palihapitiya believes there were three waves of business innovation: A) Start of time through 1985, business characterized by brittleness. B) The Excel Age, characterized by false precision and deterministic projections, C) Creative Destruction, characterized by strengths of networks and speed of adaptation.
- Essentially, Palihapitiya's company collects data about the characteristics of an underlying company's network interactions with their clients. They look for company's whose networks look as though they will expand rapidly based on the Facebook experience. I asked him whether his system was simply a way to gauge the strength of the demand environment, and he said this was exactly right. The focus on the demand environment struck me particularly.
- He said he invested in a maximum of 7 companies and held 40% in cash.

David Pakman

Partner at Venrock, a venture capital firm, specializing in early stage consumer and enterprise Internet companies. Prior to Venrock, he was an Internet entrepreneur, acting as the CEO of eMusic, and before that, co-founded another musical download service called Myplay.

Summary

- Pakman was asked questions about disruption in the consumer products (CPG) and retailing businesses.

Take-Aways

- The age of TV advertising driving travel to a physical store is dying off and companies run by “professional” CEOs, who tend to be risk-averse and slow to innovate are caught flat-footed.
- Pakman looks for: 1) Zero-sum markets (e.g., razors rather than jeans), 2) high product differentiation (so Amazon doesn’t white-label the product), and 3) products that can be improved over time.
- Spoke about Mohawk, a company that scrapes Amazon reviews to find the most favored product characteristics, then contracts production of those favored products. Great business model, but Amazon can do the same!
- Thinks that Amazon’s threat to grocery is lower than people think because grocery business is so large. Does think that auto insurance businesses(e.g., GEICO) may suffer from the introduction of self-driving cars.

Tom Russo

Partner and Managing Member of Gardner Russo & Gardner LLC since 1989. His Semper Vic hedge fund and associated RIA accounts manage $12 billion of investor assets in a highly concentrated portfolio that includes positions in Berkshire Hathaway and Altria.

Summary

- Russo talked about what he likes to invest in in the CPG world.

Take-Aways

- He thinks that companies willing to underperform in the short-term to build share in strongly-growing markets are especially attractive. He sees this characteristic most in companies that have a strong family involvement..
- He sees the main problem with CPG firms as being that they try to ride a cash cow for too long and fail to see innovative competitors (echoing Pakman's observations). He spoke about P&G squeezing consumers so much with the Gillette brand (going so far as to lock the consumer product in display cases) that Dollar Shave Club and Harry's started. Similarly, Chobani Yogurt started after Yoplait failed to see the upstart competition.
- Owns tobacco firms because those companies understand that their businesses will not continue forever, so are looking for ways to manage that glide path successfully. He was also the second person to mention Nestle, so I'd like to take a look at that company.
- Echoing my comments on China, he thinks Alibaba is a great company, but doesn't think that he would be able to enforce his investors' interests if local owners chose to do something contrary.

Thank You

Please bring your questions to Framework's Office Hours