



Global Value Investing  
Ivey Business School  
February 2015



THE OVERLOOK PARTNERS FUND, L.P.

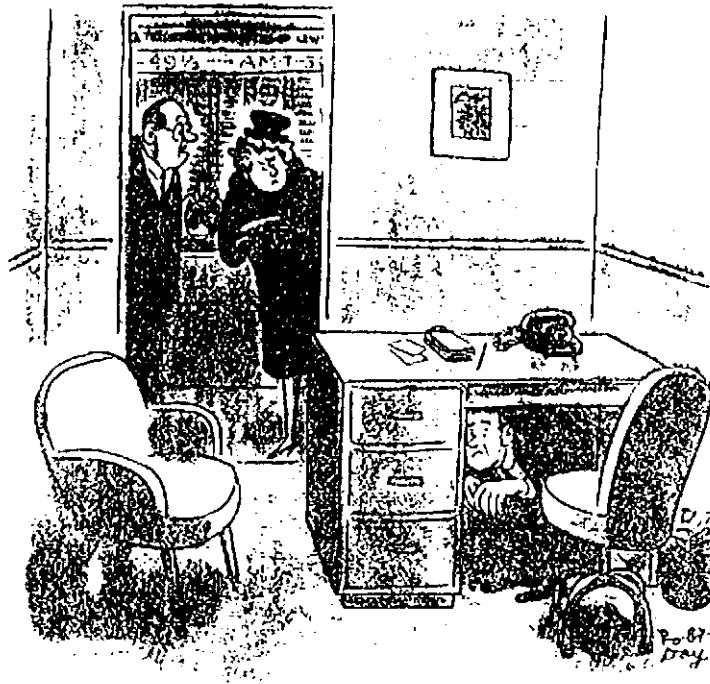


“Buy some stocks and wait for them to go up, and then sell them. If they don’t go up, don’t buy them.”

– Will Rogers



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*"He'll be sorry he missed you. But I can assure you that at the time we all considered it a stock with strong growth possibilities."*

WISHING YOU ALL THE ENERGY YOU NEED FOR  
A HAPPY AND PROSPEROUS 1974.

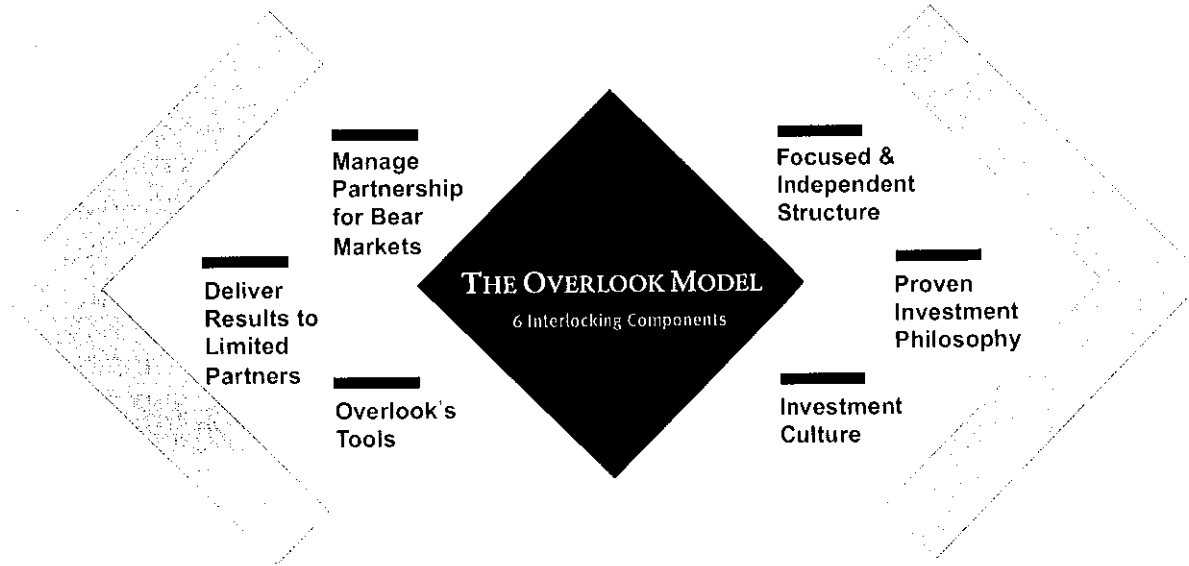
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# THE OVERLOOK MODEL



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## **Focused & Independent Structure**

- **Overlook Has One Boss: The Overlook Partners Fund**
  - One Fund
    - No Side Accounts, No Special Deals
  - One Asset Class
  - One Investment Philosophy
  - A Focused Portfolio of 20-22 Holdings
  - Small Team Incentivized by Ownership & Long Term Compensation
  - Benefits of Overlook Stay within Overlook
- **Major Contributor to Success**



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## **Proven Investment Philosophy**

- **Components Provide Framework for Picking Stocks**
  - Superior Businesses
  - Management with Integrity
  - Bargain Valuation
  - Long Term Investment Horizon
- **Confluence Creates Value**
- **Rigid in Its Demands, Yet Flexible**
- **Past Success Suggests Investment Philosophy Works**
  - Implementation & Execution Are Challenge, Not Creation or Design



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## **Investment Culture**

- **Create an Organization Whose Goal is to Invest Correctly**
  - Engage in the Art of Investing
- **Form Culture Around Key Philosophies**
  - Value Investing
  - Focus on Cash Flow
  - Engagement with Management
  - Contrarianism
  - Long Term Perspective
  - Aligned Incentives
  - Capital Weighted Returns



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## **Overlook's Tools**

- **Disciplines, Procedures, Processes, Reports & Methodologies**
- **Tools Form Basis of Day-to-Day Work**
  - Extensive List of Applications
  - Created & Tailored Over 24 Years
  - Vary from Simple Reports to Sophisticated Methodologies
- **Focus on Issues Critical to Overlook**
  - Profitability, Cash Flow, Drivers, Management, Valuation, Opportunities & Risks
- **Objectives**
  - Integrate Research to Investment Philosophy



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## **Deliver Results to Limited Partners**

- **Business Philosophies Allow Investment Philosophy to be Successful**
  - Control Growth of Assets Under Management
    - Capital Weighted Returns Confirm Value of Controlled Growth
  - Attack Conflicts of Interest
    - No Soft Dollar Brokerage, No Employee Trading in Asia
    - No Side Accounts, No Special Deals, MFN
  - Operate Partnership Professionally
    - 2014 Audit Completed January 16, 2015
    - K-1's to be Delivered in March
  - Share Benefits by Cutting Management Fees
    - 17 Times over 23 Years, Now < 1%
- **Simply Put: We Aim to Outlaw Greed**



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## **Manage Partnership For Bear Markets**

- **Bear Markets, Not Bull Markets, Are Times of Greatest Value Creation**
  - Actions During Bear Markets Create Years of Outperformance
- **Goal is to Be a Buyer During Bear Markets**
  - Maintain High Quality Investor Base & Backlog
  - Access to Capital in Bear Market is Essential
- **Commitment Must Start Years Before Bear Market**
  - Fortitude to Underperform During Bull Markets
  - Unquestioned Commitment to Investment Philosophy
- **Not Prediction of, but Preparation for, Bear Markets**



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## Results of The Overlook Model

- **The Model is Overlook's Strongest Asset**
- **6 Interlocking Components Provide Roadmap & Framework**
  - Simple Structure, Effective Investment Philosophy, Clear Objective & Long Track Record of Success
  - **History Suggests Model Delivers Value**
    - Capital Weighted Returns  $\geq$  Time Weighted Returns
    - 9.3 Percentage Points of Outperformance per Year
    - US\$ 2.6 Billion of Profits Since Inception
- **Implementation & Execution Critical Challenges**



# Path to Performance with Value Investing

- **Concepts that Create Success**
  1. Pricing Power
  2. Cash Flow
  3. High Profitability
  4. Sustainable EPS Growth
  5. Valuation Equations
- **Goal is to Secure a Margin of Safety**



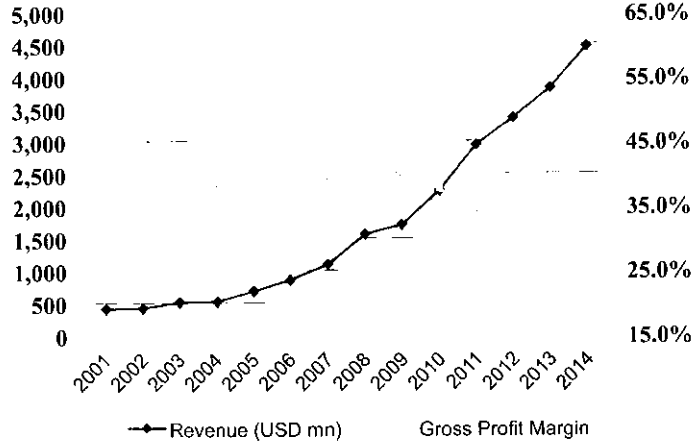
## Pricing Power

- **We read about the importance of pricing power from all the successful value investors, but I have never seen a formula that accurately quantifies pricing power.**
- **Can we Create One?**
  - Why do we want Pricing Power?
  - What are the components of Pricing Power?
  - How can we quantify Pricing Power?
  - How & where is Pricing Power reflected on Income Statement & Balance Sheet?
  - How would you index a Pricing Power calculation?
- **Four Examples of Pricing Power**

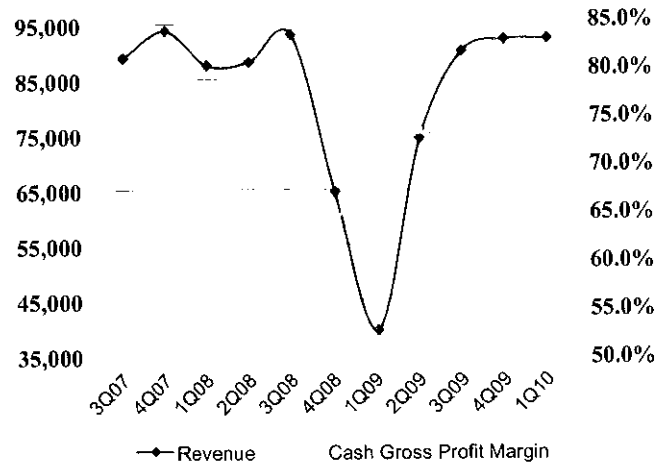


# ▶ Pricing Power In Action

## Want-Want Holdings



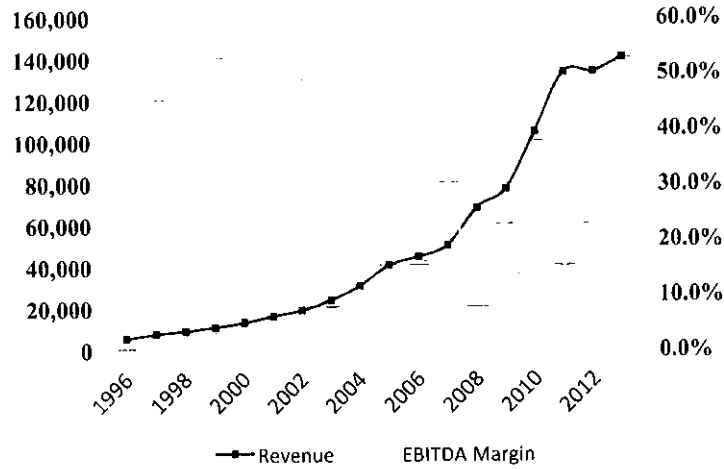
## TSMC



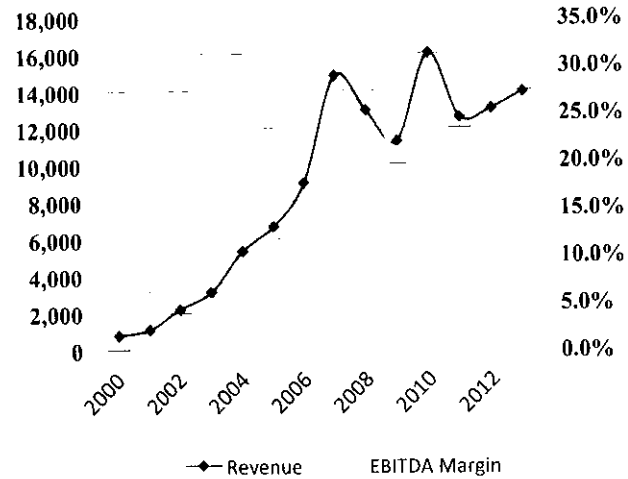
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# Companies without Pricing Power

## Huaneng Power International



## Au Optronics



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## **Cash Flow – Best Margin of Safety**

- **Cash Flow is Often a Misused Word**
- **What Are Definitions of Cash Flow?**
- **Why is Each Type of Cash Flow Important?**





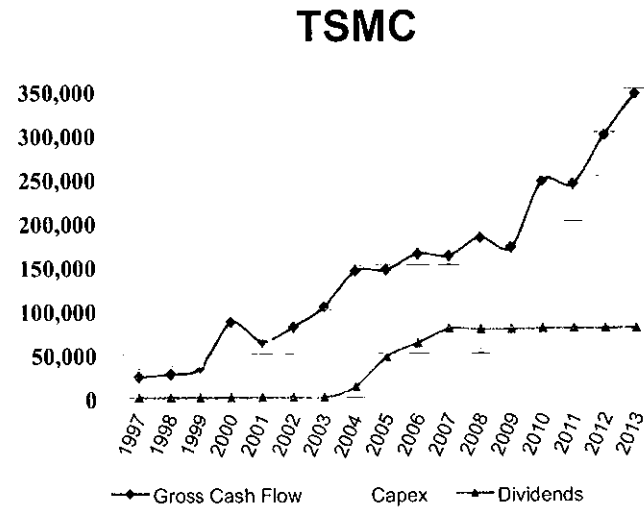
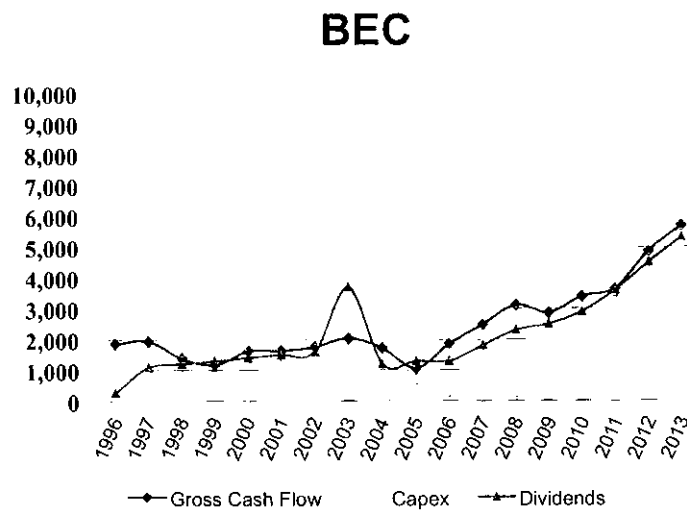
## **Cash Flow – Best Margin of Safety**

- **Four Specific Types of Cash Flow**
  - Net Income plus Depreciation & Non-Cash Items
  - Cash Flow Post Maintenance Capex
  - Cash Flow of the Corporate Structure
  - Working Capital Cash Flow
- **Places to Look for Attractive Cash Flow**
  - Low Capex Ratios
  - High Operating Returns
  - Negative Working Capital
  - Incorrect Depreciation Policies
- **Utilization of Free Cash Flow Also Critical**





## Different Utilizations of Free Cash Flow



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## **High Profitability**

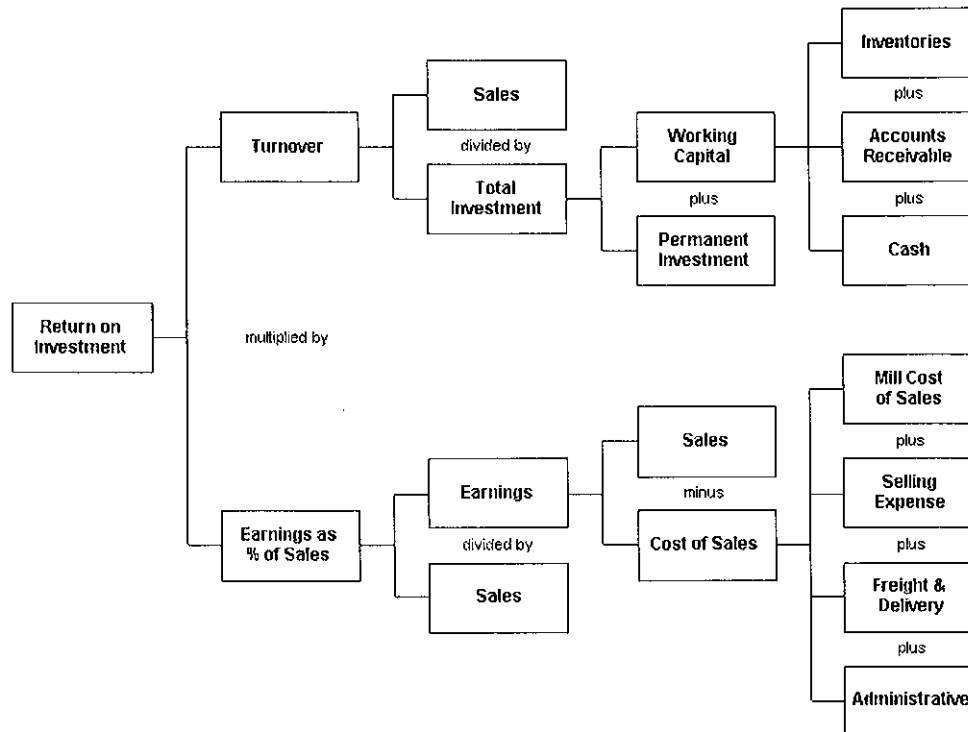
- **How Do We Measure Profitability?**
- **What Are the Benchmarks for Profitability?**
- **What Are the Components?**



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# The DuPont Model



## High Profitability

- **DuPont Model – Best Structure Available**

Return on Sales	47.0%	58.3%
Asset Turnover	0.43x	0.53x
Return on Assets	20.0%	30.9%
Leverage (Assets/Equity)	1.90x	1.62x
Return on Equity	38.0%	50.2%
Return on Net Operating Assets	100%	100%

- **Return on Equity**

- Mistaken Distinction Between High & Low Quality ROE
- How does this happen?

- **Operating Return**

- Purest Measure of Profitability
- EBIT/Average Operation Net Assets



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## **Sustainable EPS Growth**

- **Earnings Growth Critical to Long Term Performance**
  - Last 12 Years at Overlook EPS Growth plus Dividends Contributed 82% of Performance
- **Drivers of Sustainable EPS Growth**
  - Low Cyclicalilty of Business
  - Ability to Increase Market Share
  - Large Number of Customers & Suppliers
  - Proven Low Cost Status
  - Management Has Proven Track Record of Growth
  - Bomb-proof Balance Sheet
  - Other Ideas?
- **External risks make these components critical**





## Valuation Equations

- **Equations – Benefits**

- De-emotionalize Valuation Process
- Push You in the Right Direction
- Help Identify Extremes of Cycles

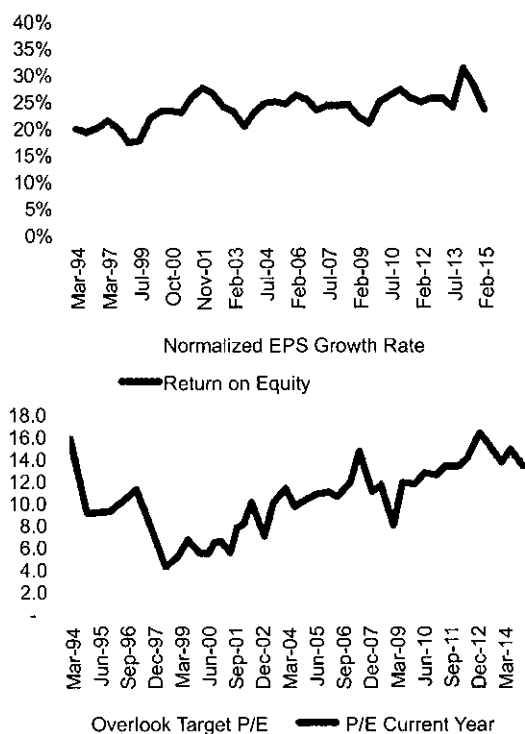
- **Examples of Useful Equations**

- Ben Graham's
  - Price / Book Value Times P/E < 22.5
- John Neff's
  - EPS Growth Rate, Plus Dividend Yield / P/E
    - ~ Measures Relative Value within Portfolio
- Overlook's
  - Sum of ROE Plus Normalized EPS Growth Rate / 4
    - ~ Example: 30% plus 14% / 4 Equals Target P/E of 11x





## The Overlook Equation



- **Consistent Investment Philosophy is Critical**
  - Otherwise Data Has no Value
- **Data Provides Valuable Benchmark**
- **Overlook Equation Pushes Investors Toward Single Digit P/Es**
- **Target P/E for S&P 500 Less than 6.0x**
  - Overvaluation More Extreme



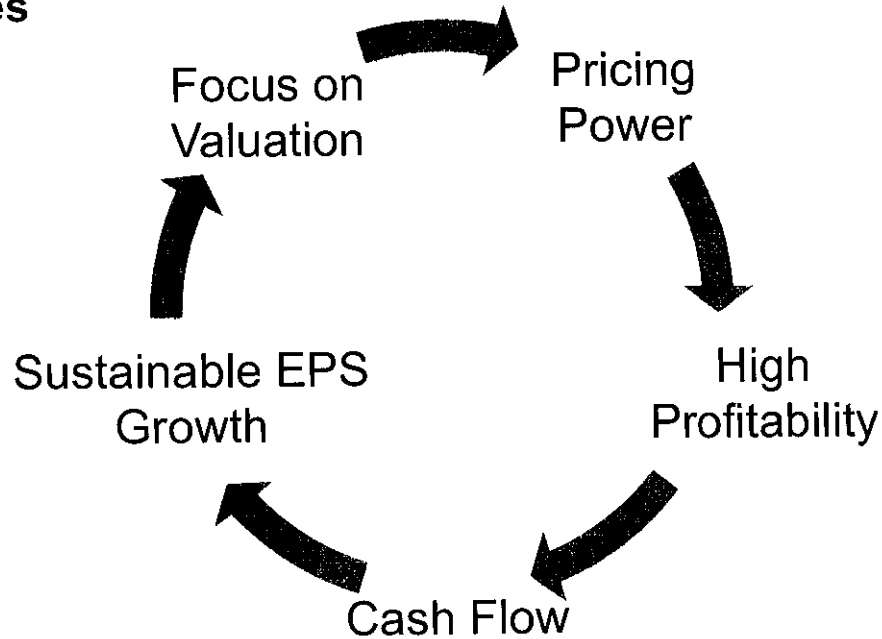
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## Virtuous Cycle provides Margin of Safety

In Closing, It Helps to Recall This Chart during Confusing Times



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