Intelligent Cloning

The winter 2018 edition

There are some great investment minds out there. Don't even think about trying to beat these guys. Just copy and profit from them. I mean, these ideas made it through the exhaustive due diligence process of one of the best investors on the planet. It's called "cloning".

If you are unfamiliar with that, 13F filings are the portfolio reports that institutional-size investors (anyone with a portfolio of over 100 million dollar) have to make to the SEC each quarter. They're public, and include any long US equity positions, so they give great insight into the portfolios of large and successful investors. You can find the initial write up on Intelligent Cloning over here, and the autumn 2017 edition over here.

In this winter 2018 edition on Intelligent Cloning, let's dig a little bit deeper in the autumn 2017 results, have a look at the current portfolios of Seth Klarman, David Tepper and Lou Simpson and finally enjoy lunch for free.

Looking back

In the previous edition on Intelligent Cloning I identified 10 companies with a market cap below 5B USD. These are companies that have their Value Creation Engine (VCE) up and running and are trading at a price that makes sense. The next step is the "quick fit".

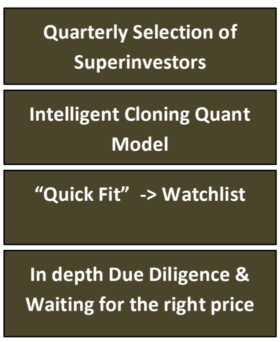

Figure 1: The process of intelligent cloning

During the "quick fit" phase I look at the business activities of the company and then decide if there is a fit between my investment experience (circle of competence) and the company. Here are my "quick fit" considerations.

DSW Inc., **Dillard's** and **AutoNation** are retailers. DSW Inc. is a footwear retailer. Dillard's is a retailer of fashion apparel, cosmetics and home furnishing. AutoNation is an automotive retailer. I don't want to touch the retail sector right now. It's one of the scarier ones to be in, I think. The fear, perhaps unjustified, is that these companies will be "amazoned". Let me put it like this: I do not have the expertise to identify the retailers that will not be "amazoned". So I just skip this sector.

Emcor is a leading specialty construction, building and industrial services provider, with significant expertise in project execution and delivery and excellence in managing skilled labour. It's a very impressive diversified group, but it is not the exceptional niche player I prefer to look at. The same holds for **MSC Industrial**.

A company I like more is **Tegna**. Tegna has spun-off Car.com and sold Career Builder to focus on its TV-Stations, moves that could appeal to a buyer. Its streamlined focus on TV-stations may invite activist interest. David Einhorn's Greenlight Capital Inc. recently acquired a 1.1% stake in the media company, heightening speculation that activists may be scrutinizing Tegna for a takeover.

USG Corporation is a manufacturer and distributor of building materials. It's a Berkshire Hathaway holding and Warren Buffett himself stated that USG overall has been disappointing because the gypsum business has been disappointing. "Just put that one down as not one of our brilliant ideas" (quote Warren Buffett).

The Boston Beer Company is a craft brewer in the United States. Although the competition is intense, keep an eye on Boston Beer. It has, I think, a lot of staying power, but it also could turn out to be a great take-over target. I was really surprised to find out that Allan Mecham sold this stock after just one quarter. I still like it though. I mean, in this world nothing can be said to be certain, except death, taxes and drinking beer.

Monro is the largest chain of company-operated automotive car facilities, with 1,136 stores across 27 states. There is a long runway with the company only operating in 27 states. I like the company, because of their customer loyalty. And there isn't an industry riper for consolidation than the car care industry. I mean, who doesn't like a good roll-up strategy?

And then there is **Valmont**. They are stewards of agricultural and economic growth around the world: from equipping Ag producers in third-world countries to expand their production to fabricating and installing some of the world's most complex steel structures. It is an interesting company to watch. Allan Mecham recently sold part of his Valmont holdings and that makes it less attractive for now.

The two companies I like most from the autumn 2017 edition are **Tegna** and **Monro**. The latter one doesn't look cheap from a traditional P/E multiple valuation. In this case I prefer to focus on the (certainty of the) future free cash flows, in combination with the current low 2.4% risk-free yield on the ten-year treasury rates. That makes it attractive, even at this high P/E multiple. And sure, I would applaude a lower stock price. For now, I add both companies to my watch list and start the in-depth due diligence.

Cloning Klarman, Tepper & Simpson

There are two ways to calculate the Value Creation Engine (VCE). In the autumn edition on intelligent cloning I used the more conservative approach, which is actually an adjusted ROC version. In this winter edition I use the more aggressive version of the VCE, which is ROC times GROWTH.

If I do just that and then rank the stock from the portfolios of Klarman, Tepper & Simpson with a Joel Greenblatt type of ranking system, I end up with the following companies.

1. Apple (David Tepper ↑)
2. Express Scripts (Seth Klarman)
3. AmerisourceBergen (Seth Klarman ↑)
4. Allison Transmission (Lou Simpson ↑)
5. Centene (David Tepper ↑)
6. McKesson (Seth Klarman ↑)
7. Avis Budget (Seth Klarman ↓)
8. HCA Healthcare (David Tepper ↑)
9. CBS Corp (David Tepper ↑)
10. Twenty-First Century Fox (Seth Klarman ↑)

If I had to pick just one stock from each of these super investors, my choice would be Express Scripts, Allison Transmission and Centene.

Express Scripts believes in practicing pharmacy smarter. They put medicine within reach of tens of millions of people by aligning with their customers, taking bold action and delivering patient-centered care to make better health more affordable and accessible.

Allison Transmission is the world's largest manufacturer of fully automatic transmissions for medium- and heavy-duty commercial vehicles and is a leader in hybrid-propulsion systems for city buses.

Centene is committed to improving the health of the community through health insurance solutions for the under-insured and uninsured, and through specialty services that align with their focus on whole health.

Lunch for free!

Have you read the Forbes article "The 15-Stock 'Free Lunch' Portfolio" by Mohnish Pabrai?

In my initial write up on Intelligent Cloning I wrote that you can probably boost the returns of the "shameless cloning approach" even further by using a specified set of 5 criteria. Let's do just that. Mohnish came up with 15 stocks in the Free Lunch Portfolio. Thank you, Mohnish!

If I use the first 4 criteria I end up with the following list of companies: Lowe's, NVR, Sleep Number, The Hacket Group, Alibaba, British American Tobacco, Fiat Chrysler, Micron Technology, Lamb Weston Holdings, GCP Applied Technologies, Synchrony Financial and CSRA.

I don't like the tobacco company, so I just skip that one. And if I apply the fifth criterion, an attractive price, I end up with these companies (random order):

1. Sleep Number
2. The Hacket Group
3. Micron Technology
4. Synchrony Financial
5. GCP Applied Technologies
6. CSRA

I guess that makes the 2018 conservative Free Lunch Portfolio.

In January, 2019, I will publish the updated "conservative Free Lunch Portfolio". The idea is to sell the companies that do not make the new year's picks and invest the proceeds equally in the "newbies".

It has been 10 years now since the publication of "The Dhando Investor" by Mohnish Pabrai. And Mohnish is sharing all his knowledge and experiences with us. For free. If you are a believer in the Free Lunch Portfolio, as I am, why not send Mohnish a "thank you gift". No costs involved.

Here is how it works. Just start an account with e.g. Interactive Brokers and make your pick which strategy you want to follow: the Free Lunch Portfolio or the more conservative version of the Free Lunch Portfolio that I just described. Both approaches will do fine in the long run. For the next 30, 40 or 50 years I want you to follow that approach and then wire the money to the Dakshana Foundation. Even if you take out "your initial capital adjusted for inflation times two" just before wiring, I am quite sure Mohnish will be pleased with this small gift for his foundation. On 8 January 2068 I have some "wiring" to do.

That's it for this edition on Intelligent Cloning. In the spring 2018 edition we will have a look at the portfolios of Bill Miller, Leon Cooperman and some of the Barron's Roundtable stock picks of Meryl Witmer.

Cordially,

Peter

Peter Coenen
Founder & CEO of The Value Firm®
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