



## Autumn 2022 Edition

*One of the best lessons you can learn in life is to master how to remain calm. — Bruce Lee*

In this edition, we'll start off with some thoughts on merger arbitrage, have a look at potential multi-baggers trading on the Amsterdam Stock Exchange, and then add some thoughts on the latest research by Michael Mauboussin. Enjoy!

### Arbitrage

Risk arbitrage, also known as merger arbitrage, is an investment strategy that seeks to profit from completed mergers and/or takeovers. It is a type of event-driven investing in which the goal is to profit from differences in stock prices before and after mergers.

Merger arbitrage was described explicitly in the third edition of Benjamin Graham's classic text, *Security Analysis*, and it has been an important contributor to the success of some of Wall Street's most well-known players. Warren Buffett practiced merger arbitrage extensively during the early part of his career, and he still is! For example, by buying Activision Blizzard stock, Buffett is betting that the video gaming maker's shares will close the gap with the price Microsoft has agreed to pay.

Tegna Inc. and Standard General L.P. announced on February 22, 2022, that Tegna and an affiliate of Standard General have entered into a definitive agreement under which Tegna will be acquired by the Standard General affiliate for \$24.00 per share in cash. The transaction has an equity value of approximately \$5.4 billion and an enterprise value of approximately \$8.6 billion, including the assumption of debt. Tegna was previously a component of The Intelligent Cloning Portfolio, which is probably why this transaction piqued my interest.

Yesterday, the stock traded at \$21.2 and that is the equivalent of a \$2.80 spread per share. Under reasonable circumstances one might expect the FCC to decide on this matter before yearend, and if unexpectedly the decision is delayed, the spread even becomes wider. Standard General will be liable for additional cash consideration (via a ticking fee) if the transaction does not close by the 9th month after the announcement, which would be late November.

With a 5 year average net income to equity (better known as ROE) of 22.3% and a 5 year average gross margin of 48.9%, Tegna most certainly qualifies itself as a high quality business, and if you take a look at the 5 year average free cash flow to equity ratio, things even look better. With the current stock price of \$21.20 the stock of this high quality business actually looks cheap:

Valuation multiple	Value
P/E Normalized (TTM)	10.2
Price to Book (TTM)	1.7
Price to Sales (TTM)	1.5
Price to Free Cash Flow per Share (TTM)	8.6
Price to Cash Flow per Share (TTM)	7.3
EV/EBITD (TTM)	8.6

You might argue that, from a valuation standpoint, the acquisition price of \$24 per share, only 13.2% above the current stock price of \$21.20, this deal looks disappointing for the existing shareholders. But I don't think it is, and here is why. Tegna faces fierce competition, and might be much better off in this newly created private company to compete with the likes of Nexstar, Sinclair Broadcast and Gray Television. For instance, Nexstar really outcompetes Tegna in terms of the Value Creation Engine (VCE), which is a for growth adjusted return on capital measure.

Company	VCE	TV Stations	Sales (\$bn)
Nexstar	32,1	199	4.5
Tegna	20,2	64	3.0
Sinclair	24,6	185	2.8
Gray	23,4	180	2.3
Fox	12,9	29	2.5

*VCE: Value Creation Engine*



Regulatory risks remain, and the merger approval is by no means guaranteed. You can find lots of information on the web outlining the pros and cons of this deal. A great read is entitled "TEGNA: Merger Spread Is Too Wide", which you can find on SeekingAlpha.Com.

It argues that at the stock price of \$21.50, Tegna offers a compelling merger arbitrage opportunity with a potential ~37% annualized return. I do believe that the deal will close sooner than later, and if not, you'll end up as a Tegna shareholder for a very reasonable price, which is not a bad idea at all.

There are other equally exciting merger arbitrage opportunities out there right now. Seek, and you shall find.

## Amsterdam stocks

Lots of back testing shows that exceptional investment opportunities can be identified by a newly created measure of value creation: the Value Creation Engine (VCE), which is a for growth adjusted return on capital measure. This measure was fine-tuned through extensive research and back testing on many, many multi-baggers.

Let's leave the phase of back testing behind us and put the corresponding algorithm to work. We'll have a look at the top 15 Hyper Value Creators (HVCs) trading on the Amsterdam stock exchange, as well as two compelling multi-baggers identified from that list by looking at small-cap HVCs. Here is the top 15 HVCs trading at the Amsterdam stock exchange:

Company	Market Cap (€bn)	VCE
Adyen NV	39.7	67,1
Inpost	3.0	57,4
PostNL NV	0.9	47,0
Alfen NV	2.1	45,8
Koninklijke Bam Groep	0.7	36,4
Ctac NV	0.05	35,8
ASML Holding NV	175.6	34,3
Galapagos NV	2.9	33,3
OCI NV	7.7	33,1
Just Eat Takeaway.com	3.4	31,2
Prosus NV	109.9	30,3
Heineken Holding NV	20.3	29,8
Sif Holding NV	0.3	29,2
RELX	42.5	29,1
ASM International NV	12.1	27,9

The two small/mid-cap HVCs pinpointed by the algorithm are Alfen NV and CTAC NV, and that is without any valuation considerations.

Alfen NV is engaged in the business of developing, producing, and selling various products, systems, and services related to the electricity grid. The company's business segments are Smart Grid Solutions, Energy Storage Systems, and EV Charging Equipment. The Netherlands is the company's main geographic market, followed by Belgium, Germany, and the United Kingdom, and it is also active in the rest of Europe and other parts of the world.

Ctac NV is a business and cloud integrator which provides a broad portfolio of systems, administration, and products (SAP) and Microsoft solutions on the cloud. It also provides business consultancy, managed services, project management, learning, and secondment services.

It's worth mentioning that the following companies almost made it to the exceptional list of small-cap HVCs, and they are definitely worth keeping an eye on: Pharming Group, ICT Group, Hydratec Industries and Holland Colours.

As a value investor, you want to buy with a discount, and most certainly do not want to overpay. Alfen N.V. is way overvalued, as far as I'm concerned, and that leaves us with a very reasonable valued CTAC, as an investment opportunity:

Valuation multiple	Value
P/E Normalized (TTM)	10.4
Price to Book (TTM)	1.8
Price to Sales (TTM)	0.4
Price to Free Cash Flow per Share (TTM)	13.6
Price to Cash Flow per Share (TTM)	4.6
EV/EBITD (TTM)	4.2

When I think of CTAC, what comes to mind is that it is one of the favorite holdings of Value8 N.V., the publically traded investment vehicle of the renowned Dutch Buffettologist, CEO Peter Paul de Vries. The company, Value8, is currently trading at a market cap of €54 million. Interestingly enough, its portfolio, spread over private companies and listed interests, rose above EUR 100 million for the first time in 2021.



And when I think of Value8, what comes to mind is that another favorite holding is Renewi PLC, which trades on the London Stock Exchange as well as the Amsterdam Stock Exchange. This company does not fit the small/mid-cap HVC criteria, but that doesn't mean it might not turn out to be a great investment.

Renewi PLC is a waste-to-product company providing services such as collection, recycling, and treatment of commercial waste; reprocessing and recycling of contaminated soil and materials; and consulting.

If you evaluate the certainty of the long-term investment thesis, in other words how confident you are that your investment thesis will work out in 25 years, I prefer Renewi over CTAC. The reason for this is that CTAC did not develop its own unique set of products and services but instead relies on companies like Microsoft and SAP, making the company much more vulnerable to competition. The company does not have the same tough "barriers to entry" as Renewi has. The long-term prospects of CTAC are, in my opinion, much more uncertain, but that doesn't mean that CTAC might turn out to be a great investment after all. We'll see.

I like to imagine Renewi as of today as United States based company "Waste Management, Inc." in its early days. Renewi now generates €1.9 billion in revenue, roughly the same as Waste Management did 25 years ago. Renewi's market capitalization is currently €0.5 billion, while Waste Management's market capitalization is \$67.5 billion. If that piques your imagination, just remember that there are no certainties in investing.

## Market Share

Michael Mauboussin and Dan Callahan have published a new research study titled "Market Share." This report takes a unique approach to assessing a company's competitiveness and is well worth reading. It begins by looking at market share and asks whether market share and related concepts can help inform industry structure analysis.

For example, it evaluates market share stability and contends that it is conducive to sustainable competitive advantage, whereas instability, as a result of new entrants, competitive actions,

technological change, and shifts in customer demand, makes it more difficult to create value over time.

There is an attachment to his report that contains 100 wide moat businesses. Morningstar.Com, for example, defines those as companies with strong enough competitive advantages to withstand competition and earn high returns on capital for at least 20 years.

There is also an attachment to this report that includes many of these companies to see if this new concept of the Value Creation Engine (VCE), which is actually a growth adjusted return on capital measure, is also an indicator for wide moat businesses. It is important to understand that the description "for growth adjusted return on capital" is an oversimplification. There is much more to it than simply adjusting ROC slightly. Back testing a large number of successful multi-baggers, which is actually a lot of work, yielded this VCE measure.

Based on previous research, I believe it is fair to say that there is a correlation between a high VCE and a wide moat business, but this does not rule out the possibility of a low VCE company with very strong competitive and long-term advantages. Canadian Pacific Railway is an excellent example, and I believe the previously mentioned company Renewi is as well. Renewi is, I believe, a very future proof and sticky business that will be doing well in 25 years.

## So here we are

My company started as a classic value investing company, often mimicking Warren Buffett and other great investors, which is still a great way to go. Over time, as experience grew, I developed the skill to identify fast moving small and microcaps.

I like microcap investing more and more, since it is a unique niche, with hardly any competition from e.g. institutional players. It takes lot of experience though to identify exceptional fast growing businesses early in their competitive lifecycle. Also, patience, discipline, and stamina are important.



In order to find these multi-baggers, you have to review as many listed companies as you possibly can, which is also known as "turning over many rocks." I use proprietary software to do the pre-screening. This VCE really helps.

Once a year, I narrow down the small and microcap opportunities to a watchlist of 25. And if I only find one or two attractively priced fast-moving businesses per year, I will be more than satisfied.

Does that imply I've given up on "Intelligent Cloning?" No way! There are fantastic small and microcap investors out there to study and copy. And if I can copy a phenomenal mid or largecap, I will most certainly consider doing so. But once you realize what a 100-bagger can do for your personal well-being, I can't imagine that you will not do your utmost best to find one, and the best place to find one is most certainly not on Planet Large Cap.

Thank you for taking the time to read my letter.

# Peter

Peter Coenen  
Founder & CEO  
The Value Firm®  
28 September 2022  
E-mail: [peter@thevaluefirm.com](mailto:peter@thevaluefirm.com)

Post scriptum. In enjoyed the McKinsey study on [Value Creating Growth](#) very much.

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*Everybody makes mistakes now and then. If you find any, let me know: [peter@thevaluefirm.com](mailto:peter@thevaluefirm.com). Always do your own research!*



## Wide Moat Businesses

Company	VCE	Company	VCE
Evolution AB (publ.)	55,7	LVMH Moët Hennessy	21,6
Autodesk, Inc.	50,2	CBRE Group, Inc.	21,4
DexCom, Inc.	47,5	Verisk Analytics Inc	21,1
Bausch + Lomb Corporation	46,0	Diageo Plc	21,0
Jumbo Interactive Limited	45,3	MSCI Inc.	21,0
Pool Corporation	42,8	Arthur J. Gallagher & Co.	20,8
Fair Isaac Corporation	40,1	Visa Inc.	20,6
NVIDIA Corporation	39,6	Bolsa Mexicana de Valores SAB de CV	19,3
Amazon.com, Inc.	39,2	Danaher Corporation	18,6
VeriSign, Inc.	39,0	China Tower Corp Ltd	18,6
IDEXX Laboratories, Inc.	38,6	Canadian Pacific Railway Limited	18,0
Moody's Corporation	38,4	Johnson & Johnson	18,0
Rightmove Plc	37,9	Crown Castle Inc.	17,9
Christian Dior SE	37,7	Union Pacific Corporation	17,8
Lockheed Martin Corporation	37,6	Intuitive Surgical, Inc.	17,8
O'Reilly Automotive, Inc.	37,5	Brown & Brown, Inc.	17,6
S&P Global, Inc.	37,3	Illumina, Inc.	17,2
Mastercard Incorporated	35,7	Kering	17,1
Mettler-Toledo International Inc.	35,3	PPG Industries, Inc.	17,0
Aon Plc Martin	34,9	Waste Management, Inc.	17,0
American Tower Corporation	34,8	AMERCO	16,1
ASML Holding NV ADR	34,5	Intercontinental Exchange, Inc.	15,7
Sherwin-Williams Company	33,9	Cooper Companies, Inc.	15,2
Adobe Incorporated	33,9	Douzone Bizon Co.	15,0
Altria Group Inc	32,6	CoStar Group, Inc.	14,9
Texas Instruments Incorporated	32,5	Brookfield Asset Management Inc.	14,2
Microsoft Corporation	32,2	General Dynamics Corporation	13,8
Zoetis, Inc	31,9	L'Oreal	13,7
Cadence Design Systems, Inc.	31,3	Air Products and Chemicals, Inc.	13,7
Taiwan Semiconductor Manufacturing	30,5	McCormick & Company,	13,6
Intuit Inc.	30,4	Grupo Aeroportuario Del Pacifico SAB	13,0
AutoZone, Inc.	30,1	Marietta Materials, Inc.	12,1
RELX Plc	29,7	TransDigm Group Incorporated	11,8
Tesla Inc	29,2	Warner Music Group Corp.	11,6
Tencent Holdings Limited	28,9	SBA Communications Corp.	11,2
Estee Lauder Companies Inc.	28,4	Black Knight, Inc.	11,0
Northrop Grumman Corp.	27,5	Vulcan Materials Company	10,7
Alphabet Inc.	27,5	British American Tobacco Plc	10,7
Philip Morris International Inc.	26,4	Analog Devices, Inc.	10,5
Copart, Inc.	26,3	Sony Group Corporation	10,4
FirstService Corp	25,6	Republic Services, Inc.	10,4
Essilorluxottica SA	25,4	Waste Connections, Inc.	9,7
Hermes International SCA	22,6	Universal Music Group NV	9,6
Thermo Fisher Scientific Inc.	22,2	Grupo Aeroportuario del Sureste SAB	8,7
Linde plc	22,1	Raytheon Technologies Corporation	8,7
Marsh & McLennan Companies, Inc.	21,8	CME Group Inc.	8,1
Synopsys, Inc.	21,6	Transurban Group	4,9