North Star Investor

The 16th Annual Value Investor Conference in Omaha

By Rune Mosbech, Editor, North Star Investor, May 2019

The North Star Investor head-quarters is located on an island on the Norwegian west coast. It is surrounded by deep fjords, high mountains, and beautiful nature. It is a great place to read, think, and write about investments without distraction. It is not the best place to meet new likeminded people, at least not face to face. So, at the beginning of May, I traveled to Omaha to meet people, get new inputs, and enjoy the simplicity and beauty of value investing and the many ways to approach it.

I spent two days at the Value Investor Conference hosted by Robert Miles at the University of Nebraska at Omaha (UNO). It is conveniently located in the days leading up to the Berkshire Hathaway annual meeting. The conference attracts speakers and audience members from across the world – 180 people from 6 continents and 30 countries attended.

Miles did a great job putting together an impressive lineup with speakers such as Tom Russo, Tom Gayner and Tony Nicely.

Here is the complete list of speakers:

2019 Berkshire System Summit Speakers

Don Wurster	National Indemnity
Bob Batt	Nebraska Furniture Mart
Tony Nicely	GEICO
Ron Olson	Munger, Tolles and Olson

2019 Value Investor Conference Speakers

Robert Robotti	Robotti & Company Advisors
Per Håkan Börjesson	Spiltan
Florian Bartunek	Constellation Asset Management
Ross Glotzbach	Southeastern Asset Management
Tom Russo	Gardner Russo & Gardner
William Smead	Smead Capital
Beini Zhou	Matthews Asia
Yefei Lu	Shareholder Value Management
Joel Cohen	MIT Investment Management
Mike Billings	Vanderbilt University
Brian Neale	University of Nebraska Foundation
Jennifer Oppold	Alpine Peaks Capital
Tim Hassinger	Lindsay Corporation
Brian Ketcham	Lindsay Corporation
Chad Naylor	Naylor & Company
Francisco G. Paramés	Cobas Asset Management
Charles Murphy	Liberty Park Capital Management
Tom Gayner	Markel Corp
Robert Hagstrom	Equity Compass Strategies

You feel the proximity to Warren Buffett and Berkshire Hathaway when you enter the buildings at UNO. Both Mammel Hall and the Scott Conference Center are funded by early investors in the Buffett Partnership and shareholders in Berkshire Hathaway. A large painting of Warren hangs inside the door, it is painted by Michael Israel using Benjamin Moore paints (a Berkshire owned company).

The first part of the event, the Berkshire System Summit, is a half-day event with presentations by managers and board members from Berkshire Hathaway companies. They shared insights on how the culture, organization, capital allocation, and interaction with Warren impacted their businesses and what they think characterizes the 'Berkshire System'.

Speakers at the Summit included senior people such as Tony Nicely, the long-term GEICO CEO, and Ron Olson, a board member of 20+ years in Berkshire Hathaway and Partner in the law firm Munger, Tolles and Olson. If you want to learn about the way Berkshire Hathaway operates, I can recommend Miles's book on the subject: *The Warren Buffett CEO: Secrets From the Berkshire Hathaway Managers*.

Right after the Summit, the actual Value Investor Conference started. Many different areas were covered by the presenting portfolio managers. The focus was mostly on investment philosophy and process, but also on specific investment cases. Below are some highlights from three of the presentations:

Charles Murphy, Liberty Park Capital Management

Charles Murphy is the founder and portfolio manager of Liberty Park Capital Management in Austin, Texas. He presented Liberty Park's interesting and highly specialized investment strategy and talked about how they have built a moat that helps them maximize the true repeatable alpha.

Murphy invests in small- and micro-cap companies with a niche focus on more complex, multi-industry, and cyclical businesses that require time and experience to understand. The skills and knowledge required for these investments are rarely scalable and most investors will not spend the time to learn about all the potential drivers. Murphy sees less competition in this area and more volatility. He has built a unique knowledge base by following these companies longer than most, in some cases longer than the current management teams have been in place.

It has taken several years to build a catalog of the 800 companies that fit their criteria. They have gone through all the companies, read the 10Ks, talked to management, done the research and cataloged it. They have front-end loaded the research and tried to become some of the foremost experts on each company they follow. They rarely invest in companies they have known for less than two years.

The 200–300 most interesting and relevant companies in their catalog are followed on a regular basis to find opportunities as they arise. This leads to a portfolio of 40–50 long and short investments in the Liberty Park Fund and 10–15 long investments in the select opportunities fund.

Murphy on the right also led a panel debate with university endowment investors. On the left UNO's Derek Geschwender makes sure that the technology works seamlessly.

Liberty Park owns many niche market leaders. The companies in the portfolio are not viral growth names, but some of the greatest compounders started in this space.

According to Murphy, generalists often mistake cyclical strength or weakness as secular. They extrapolate the recent past, buy high, and sell low. People also tend to focus too much on low PEs. Companies often look cheap on PE at the top of the cycle, but earnings will come down as the cycle reverses and the share price will follow. You need to understand the industries well to be able to navigate successfully.

Robert Robotti, Robotti & Company Advisors

Robert Robotti is the President and Chief Investment Officer of Robotti & Company. He founded the company in 1983. It is a value-focused New York-based boutique. Robotti talked about his investment approach, the opportunities he sees in today's market and went through his investment case for Subsea 7.

Robotti has a contrarian approach to cyclical investing. He sees a lot of opportunities in small-cap value stocks after ten years of underperformance. Most investors avoid near-term uncertainty and a contrarian view is difficult even for a value investor. However, with the right framework, deep industry knowledge, and the right investor base, you can take advantage of this and invest in things that others disagree with.

According to Robotti, cyclical companies with a low valuation and a competitive advantage can give great returns if you are able to invest at a good time in the cycle. The process is often the same. The valuation discount in cyclical companies continues to grow in a downturn and you are likely to be too early when you buy. So, you need to have conviction and be able to increase your position when the stock gets even cheaper.

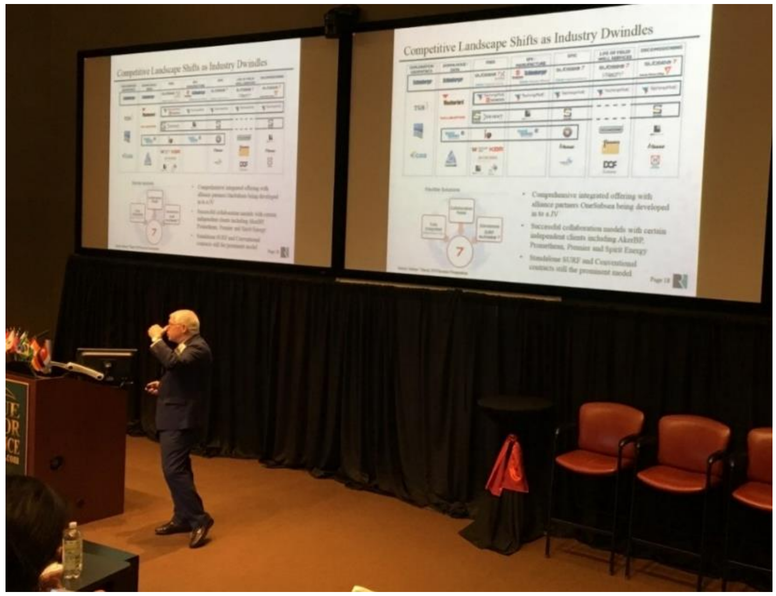
Robotti went through their highest conviction energy investment idea, Subsea 7. He believes that the company has a durable competitive advantage and that long-term dynamics are in place for significant growth:

Subsea 7 is a global leader in seabed-to-surface engineering, connecting seabed wellhead structures to surface production facilities. Industry headwinds, revenue declines and margin compression in recent years have driven companies out of business and led to an oligopolistic market with barriers to entry that continue to increase over time.

Robotti described how the activity level in the offshore oil market is now growing. Four hundred fields are identified, half of which are economic at a USD 45 oil price. And the cash flows are good at large oil companies.

The addition of offshore gas also being economic today is another tailwind. One third of the fields that are to be developed by Subsea 7 are natural gas.

Few can do what Subsea 7 does. Several companies have tried to enter the industry in the past, but



Robotti presenting his investment case for Subsea 7

have failed. Subsea 7 generates 0.8 dollars on service during the lifespan of the project for every 1 dollar they generate from the project upfront. They also have a renewables business. The vessels they use can install offshore wind farms and they provide service for 20–30 years for these assets after installation.

Kristian Siem is the chairman and Robotti believes he is a great capital allocator. Subsea 7 has a net cash position, they utilized the downturn to buy back more than 5% of their shares and to buy a competitor who had gone into bankruptcy.

Robotti also expects the alliance with Schlumberger to be valuable. Together they cover the whole process and can operate as a one-stop shop. Schlumberger needs a partner in this area, and it is not an unlikely scenario that they will end up buying Subsea 7.

Robotti admits that they were too early, as is often the case in these investments, and that they should have waited two years to get into it. He stresses that you need the conviction and a long time horizon if you want to invest in these kinds of companies. They own a portfolio of companies like Subsea 7, which makes it easier to wait as different cases play out at different times. In general, they see a lot of similar opportunities like this in today's market.

The stock trades at 6x EV/EBITDA and Robotti believes that EBITDA margins can expand from the current level of 15% to 20–30% longer term.

Yefei Lu, Shareholder Value Management

Yefei Lu is a portfolio manager at Shareholder Value Management AG, a value-investment company based in Frankfurt, Germany. He is also the author of the book *Inside the Investments of Warren Buffett: Twenty Cases*.

Portfolio manager and author Yefei Lu

In the book he takes an in-depth look at Warren Buffett's investments from the perspective of a potential investor at the times when Buffett made the investments.

There is a lot of interesting information in Lu's book and it's fun to see the old documents that Buffett had available to assess his investments. Here is a link to the [1987 Coca Cola annual report], the last report available to Buffett before he made his investment in the company.

The cases in the book span from Buffett's 1958 investment in Sanborn Map Company to his 2011 IBM investment. They are selected as they either taught a special lesson in Buffett's career or made up a big part of his AUM at the time.

Lu went through a couple of cases from his book and shared some of the key takeaways he gained writing it:

The importance of strong long-term growth drivers

When Lu went through 10 years or more of financials of Buffett's past investments from the time the investment was made, he found that most had extremely consistent revenue and earnings growth in the preceding years. Buffett clearly valued consistent historical financials and good data. Most of the companies grew revenue and earnings in eight or nine years out of the prior ten. Less than 5% of today's investment universe lives up to this.

Lu emphasized how important it is to identify and understand the long-term structural growth drivers that can support this kind of future growth, preferably for decades, just as in cases such as Coca Cola or American Express. Time should be spent determining the drivers and the level of earnings in 5 or 10 years rather than on next year's earnings forecast, and the growth should be supported by a high ROTCE (return on tangible capital employed).

Let investment opportunities drive your style

Buffett had many skillsets and styles. Lu believes you need multiple skillsets to be able to consistently find opportunities. You should be able to do at least three to four kinds of investments and let the opportunities drive your investments, not the other way around.

If you can only do one type of investment (either industry or style) you will be forced to lower your hurdle rate when this type of investment is in favor and overpriced. Buffett matched his investment strategy to the market conditions and to his setup.

The importance of carefully evaluating management

Buffett spent a lot of time directly with the management of the companies he invested in. He usually didn't have just one or two meetings. He often had personal relationships with the managers for decades.

He understood the person and had a long-term dialog with them. He looked for integrity, capital allocation skills, and a history of operational success. He seemed to value owner-managers or managers with a long history with the company and who cared deeply about the company they ran.

Meeting audience and speakers

Almost as important as the quality of the presentations is the opportunity to meet and get inputs from other investors and presenters. It was interesting to meet the diverse group of people with a common interest in value investing.

Conference audience

I sat next to a German entrepreneur who was attending the conference for the fifth time. He shared his strategy to get good seats at the Berkshire meeting (Thanks Tobias, I got a great seat) and highlighted some interesting portfolio managers he followed. During a break, I got an investment idea from a South African portfolio manager.

The attendees were a mix of portfolio managers, fund selectors, heads and owners of family offices, business owners and dedicated private investors. During the breaks, you get the chance to speak to a lot of different people and most of the speakers stayed around to talk during the breaks or at the dinners.

If you are going to Omaha for the Berkshire meeting and are considering attending this conference, just go for it. I can highly recommend it, and I hope to get a chance to go back. It was worth the time and money. For more information see the conference website.