



The Winning Hand

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Over time (typically between 6 months and 3 years), stock prices will approximate the intrinsic value of the businesses they represent.

If you're a speculator or you base your investment decisions on emotion, intrinsic value means absolutely nothing to you and we wish your hard-earned money well with your magic eight ball.

And if you believe short to intermediate-term volatility in the stock market means anything for the long-term intrinsic value of your holdings, you will become market prey. In that case, the vultures will eat you and your money alive in due time.

General guessing, speculation, and emotional investing are not for us or our hard-earned money at FMT Investment Advisory. We hope they're not for you, either, unless you are looking for permanent tax write-offs.

We are firmly grounded in the study of businesses, their intrinsic values, their competitive positions, and their management teams. The word "business" encapsulates the meaning of endeavors that create wealth. Great businesses are long-term wealth generating machines, just as the stock market is.

And volatility, when applied soundly, is a shrewd way to acquire businesses cheaply and occasionally sell them dearly.

We simply use volatility in publicly-traded markets to our advantage or ignore market moves when it is not advantageous to do so. This is easy, but it's very hard to do.

How to Think About Intrinsic Value

We do the heavy lifting for our clients that invest alongside us by applying our analytical skills to businesses.

While we have a few varied methods for calculating intrinsic value, the basic definition is one in which you take all future cash flow into and out of a business over its lifetime and discount them back to net present value using an appropriate discount rate.

Let's think about intrinsic value with *one of our portfolio holdings* and how it applies to market volatility.

Nomad Foods

Nomad Foods generated \$200 million in free cash flow in 2017 (and that cash flow is also growing). Incidentally, the **recurring** \$200 million and growing free cash flow is allocated by **Superinvestors**, which is a powerful combination all on its own (the Superinvestor story is for another day). On top of the predictable, growing free cash flow, Nomad also has a healthy balance sheet.

The stock *market* doesn't affect these numbers. What the stock market affects is Nomad's stock price in the *short-term* (under 5 years).

In 2017, Nomad Foods, using just their balance sheet cash, was happy to repurchase nearly 5% of their outstanding shares from Premira and another nearly 5% from Pershing Square, retiring 10% of their outstanding shares at a discount to value.

This is an intelligent use of cash that is immediately accretive to the existing shareholder pro-rata share of earnings by 10% - with just the use of their balance sheet cash. This is akin to a 10% overnight raise. Not bad.

Now, let's imagine Mr. Market wants to get VERY short-term manic depressive stupid in 2018. *Under this hypothetical scenario*, Nomad's stock price crashes 41%, from \$17 per share to \$10 per share, in a general stock market sell-off. Meanwhile, the no-nothing "investors" are deeply troubled by this or overly worried, even thinking they need to sell a crown jewel like Nomad at fake pearl prices – because their emotions are being dictated by short-term market price noise.

Meanwhile, Nomad Foods continues to generate over \$200 million in predictable and growing free cash flow while Nomad Foods' share price continues to sit at depressed prices (where any rational investor is a buyer and not a seller).

Nomad's board of directors decides it's an unwarranted stock price, too (like they did in 2017 when they were happy to buy back 10% of their outstanding shares). They decide to use what will be roughly \$210 million in free cash to repurchase another 12% of their outstanding shares in 2018 (they can now buy a larger percentage of shares because there are less outstanding after retiring 10% in 2017).

Now, existing shareholders just got another 12% bump in their pro-rata share of earnings (an increase of 22% with just the share repurchases in under two years). And now, the free cash flow yield (free cash flow divided by market cap) is a monstrous 38%.

Now, let's assume investors open their accounts and continue to see Nomad is still stuck at \$10 per share in 2019 and 2020 because the market stays depressed for a long time. Of course, every investor wants to bolt out of sheer disgust! The horror! But meanwhile, Nomad just keeps buying back their own shares with their free cash flow.

Suddenly, at just \$10 per share in 2020 and with angry investors everywhere, Nomad Foods has a free cash flow yield of 60% (akin to getting a 60% yield on a 1-year certificate of deposit, only this yield will continue to grow).

Finally, Mr. Manic Market comes to his senses and just cannot possibly let this 60% yield exist in the marketplace anymore... and he begins to bid up the share price to make it more rational (or another company starts to offer a premium to buy Nomad). Next thing you know, as 2020 is coming to an end, Nomad is selling at \$42 per share—with a still ridiculously attractive 18% free cash flow yield.

And investors suddenly have a 42% compounded average return in Nomad (\$17 per share to \$42 before), even though they had to withstand some serious frustration and short-term pain for a couple years at \$10 per share.

The moral to this hypothetical story is that it happens all the time at Mr. Market's table. Those that bought and held and only cared about the company's intrinsic value outperformed just about everyone alive with a 42% compounded return because they knew intrinsic value always gets realized.

Those that threw in the towel because intrinsic value meant nothing to them and "the market" spooked them out of a good thing, while they also lost their patience, ended up the suckers at the market's table by losing their hand and chips.

At FMT Investment Advisory, we prefer not to be the sucker at the table. We hold intrinsic values in our grips, which is the long-term winning hand for serious money.

Sincerely,

Nicholas Green

CIO