



Friday Morning Coffee

Nr. 126 — Is it a Value case?

Recently we came across a couple of articles formulating cases either “for” or “against” value investment. True to their style of financial journalism, authors bucketed the entire investable universe based on a few fundamental metrics and ran all sorts of academic analysis based on lowly valued deciles to put forth their respective arguments. But is this all there to value investment? Or is this how value investors approach investing? We do not think so.

As per the Gandalf of value investing, Benjamin Graham “An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.” We believe that any stock trading at low or distress multiples does not necessarily become an attractive value case.

Having said that we do acknowledge that we do regularly cast our nets in the very same pond to look for new investment opportunities, but not every catch land on our dinner table. We do not distinguish value investment in different types such as; classical or old-school or new-age or cigar-butt etc. For us, value opportunity arises whenever there is a significant mismatch between the current market cap and the intrinsic value of the company. Period.

The mismatch could occur for a variety of reasons, our job as an analyst and as an investor is to identify (1) Why is there a mismatch? and (2) What is the catalyst that would enable realignment of the share price to its intrinsic value.

As an example, we will briefly discuss our existing holding; Jeronimo Martins. It is a food retailer with significant presence in Polish and Portuguese markets and is rapidly expanding its footprint in Columbia. Jeronimo started out as a typical food retailer in Portugal, but just as any visionary start-up founder, its management embraced known-unknowns and placed their feet in the Polish market. Instead of competing against heavyweights in Super/Hyper markets, they focused on discount and convenience retail format. Since then there has been no stopping for Jeronimo martins in Poland, as of last year it held more than 23% market share in the Polish modern retail market.

Moreover, this growth has not come at the cost of profitability of the business, in fact to the contrary, the Polish chain accounts for 70% of the group revenue, but close to 80% of the group earning. And as they are nearing saturation in Poland, the management was proactive enough to enter another growth market in the middle of the decade: Columbia. Jeronimo martins is an ideal company from the Quality perspective that we like to own, it is financing its growth by internally generated cash, and when the incremental growth becomes unprofitable, it looks for profitable opportunities elsewhere. Prior to ramp up in Columbia, Jeronimo had c. 17% ROIC and if we go by the track record of the management, the group ROIC should climb back to 17% at least once the operations in Columbia are scaled. So here is the business which if hold long enough its long-term share price performance should be close enough to underlying profitability of the business i.e. high-mid double digit CAGR.

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In 2018, share price collapsed c.60% after the Polish government-mandated closure of retail stores on Sundays and it became a value case for us because (1) If the stores are closed on Sunday, people will buy their groceries on other days and (2) Underlying market positioning and fundamentals of the business had not changed, same can be seen our Quality-Value chart.



Source: ECP

Since our holding period of slightly more than a year, the stock has appreciated by c. 20%, in addition, we clipped 2.5% in dividend for the last year. It continues to remain our high conviction holding and, as expected, it proved its worth during the Covid-19 crisis.

That brings us to another great observation that Benjamin Graham had “The memory of the financial community is proverbially and distressingly short” and for us value investors this short memory of Mr. Market presents ultimate gems at a bargain which becomes value investment.

Have a nice weekend,

The ECP Team
October 30th, 2020