# UNIFORM INVESTING GENIUS

## Four Great Investors' Philosophy and Current Portfolios Analyzed

## GAAP Loses to Uniform Analytics Every Time

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## Foreword

# Accounting Matters

Thank you for signing up for this eBook, and for your interest in Uniform Accounting (UAFRS) and Valens Research.

Our core goal at Valens Research is to democratize access to the cleaned-up accounting analytics that the great investors use to be able to deliver alpha.

Nine of the top 10 investment managers, and 200 of the top 300 read our Uniform Accounting work regularly. The biggest investment managers understand the importance of looking at adjusted accounting analytics. The (adjusted) numbers speak for themselves.

Traditional accounting analytics offer an incomplete picture to real corporate profitability, growth, valuations, and risk. Accounting rules and management discretion in interpreting them create significant issues.

Under Uniform Accounting, over 130 different key adjustments are made to the as-reported GAAP and IFRS accounting statements of over 32,000 companies globally, to correct these distortions.

Under a Uniform framework, issues with comparability for companies across different countries and accounting standards, in different industries, and even with changing accounts over time, are now comparable. This enables investors to better understand their opportunity costs, enabling them to make educated investment decisions.

The chapters that follow highlight examples of how Uniform Accounting informs how investing greats construct their portfolios. As importantly, the analyses show how without Uniform Accounting, these investing greats look like they're making questionable portfolio construction decisions, when they're really just seeing through the noise of distorted accounting statements.

# Did a Hedge Fund Legend Play in the 1932 World Series?

It's game 3 of the 1932 World Series, and the score is tied 4-4 in the 5th inning.

October baseball is always special, but an at bat in a tied game in the World Series is a true pressure cooker.

Babe Ruth strode to the plate for the Yankees, facing the Chicago Cubs in Wrigley Field.

As he takes strike one, the Cubs bench players are jeering at him, and the Wrigleyville faithful are screaming any insult they can think of.

Ruth doesn't tune them out, instead he steps one foot out of the batter's box and points the head of his bat to the deepest part of center field. He steps back into the box.

He takes strike two.

The fans, the players, the atmosphere only gets louder. They smell blood.

Ruth steps out again. And he again uses his bat to point to the Exact. Same. Place. He's calling his shot!

He steps back into the batter's box… and Charlie Root throws a curveball that never makes it to the catcher's mitt.

Instead it ends up over 440 feet away into the center field stands. Exactly where he said he would.

The Yankees went on to win the game 7-5, and to win the series also. And baseball fans have loved telling that story every day since.

That story has such staying power because of the improbability of it. It's easy for a pitcher to say after a no-hitter that he felt like something special was going to happen as he warmed up that afternoon. It's easy to look back and call David Ortiz one of the most clutch players of all time after he helped the Red Sox win 3 world series. But to be able to call your shot, not just that you were going to get a hit, but that you were going to hit a home run, over right center field, is near impossible.

Which is why it's so impressive that sixty years later, Seth Klarman did the exact same thing. And its why he's a legend in his field, almost to the scale Babe Ruth is in baseball.

Seth Klarman didn't play in the World Series for the Yankees or hit a home run in Wrigley. He's actually a minority owner of the Red Sox, so the idea of him playing for the Yankees is rather ironic.

But Seth Klarman has been a wildly successful investor. His fund Baupost has produced 20% returns a year since 1983. He's outperformed the market by almost 4x since he started the strategy.

But what's impressive isn't just that he has had such phenomenal returns. It's that he told everyone how he was going to get those returns before he did.

Long before Klarman became a billionaire, he wrote a book called *Margin of Safety*. The name is an homage to Ben Graham's *Security Analysis*.

In the book Klarman laid out his value investing philosophy and how he would pick stocks. He laid out his exact strategy that would eventually lead to Baupost's phenomenal performance. He called his shot, and then he delivered 4x the market's performance.

Klarman and Baupost are still picking stocks today, and doing an amazing job.

Part of the reason they remain so successful is because Klarman has as much skepticism about as-reported accounting metrics as we do here at Valens.

Klarman has regularly railed against the issues with as-reported accounting metrics. He has mocked investors who use metrics like EBIT and EBITDA to value companies, because of how distorted they are. He's said things like:

> *"Those who used EBITDA as a cash-flow proxy, for example. Either ignored capital expenditures or assumed that businesses would not make any, perhaps believing that plant and equipment do not wear out."*

At Baupost, they are focused on the real operating profitability of companies, not the inaccurate noise of as-reported accounting metrics.

Because of Baupost's strong research, their analysis unsurprisingly lines up with Valens Uniform Accounting. To show what we mean, we've done a high-level portfolio audit of Baupost's current portfolio, based on their most recent 13-F (see Exhibit 1.0). This is a very light version of the custom portfolio audit we do for our institutional clients when we analyze their portfolios for torpedoes and companies they may want to "lean in" on.

Using as-reported accounting, investors would be scratching their heads at the companies that Baupost is buying. The average company in their portfolio has a *negative* return on assets (ROA). On an as-reported basis, it is losing money. If we look at the median, the median company in their portfolio is only producing a miserly 2.5% ROA. That's well below cost-of-capital levels, according to any model.

But once we make Uniform Accounting (UAFRS) adjustments, we realize that the returns of the companies in Klarman's portfolio are much more robust. Once the distortions from as-reported accounting are removed, we can realize that Allergan (AGN) doesn't have a 0.6% ROA, it's actually at 35%. For some companies, as-reported metrics are even directionally wrong. Akebia Therapeutics (AKBA) doesn't have a -19% ROA, like as-reported metrics show, they have a 15% UAFRS ROA. Sinclair Broadcast Group's (SBGI) ROA is really 39%, not 6%.

If Baupost was looking at as-reported metrics, they would never pick most of these companies, because they look like bad companies and poor investments. For the average company, as-reported ROA understates profitability by almost 80%. Uniform ROA is 500%+ higher than the distorted as-reported metrics.

**Exhibit 1.0: Economic Reality of Baupost Group's Equity Holdings***

| Ticker | Company Name | Baupost Ownership Level ($m) | ROA' FY0 | As-Reported ROA | As-Reported ROA Distortion |
|---|---|---|---|---|---|
| LBTY.A | Liberty Global Plc | 1202.2 | 3.13 | 1.14 | 174% |
| VSAT | Viasat, Inc. | 987.5 | -1.19 | -0.35 | -243% |
| EBAY | eBay Inc. | 948 | 25.78 | 7.28 | 254% |
| FOXA | Fox Corporation | 894.5 | 34.55 | 9.31 | 271% |
| BMY | Bristol-Myers Squibb Company | 691.6 | 16.60 | 10.05 | 65% |
| QRVO | Qorvo, Inc. | 683.6 | 15.18 | 4.34 | 250% |
| AMEX:LNG | Cheniere Energy, Inc. | 679.6 | 7.84 | 3.81 | 106% |
| AGN | Allergan plc | 515.8 | 35.06 | 0.64 | 5345% |
| MCK | McKesson Corporation | 382.4 | 24.99 | 3.34 | 649% |
| CBS | CBS Corporation | 363.5 | 15.93 | 8.21 | 94% |
| UNVR | Univar Solutions Inc. | 204.3 | 13.24 | 4.02 | 229% |
| PCG | PG&E Corporation | 197 | 2.76 | 1.22 | 126% |
| ABC | AmerisourceBergen Corporation | 191.9 | 9.46 | 2.88 | 228% |
| TSE:4502 | Takeda Pharmaceutical Company Limited | 165.4 | 7.14 | 2.19 | 226% |
| TBPH | Theravance Biopharma, Inc. | 160.3 | -6.82 | -33.00 | 79% |
| NXST | Nexstar Media Group, Inc. | 139.8 | 37.55 | 6.80 | 452% |
| XPO | XPO Logistics, Inc. | 116.1 | 12.28 | 3.92 | 213% |
| AKBA | Akebia Therapeutics, Inc. | 101.6 | 14.97 | -19.10 | 178% |
| LSE:DC. | Dixons Carphone plc | 99.8 | 19.22 | 2.21 | 769% |
| ATRA | Atara Biotherapeutics, Inc. | 86.9 | -23.55 | -46.53 | 49% |
| AR | Antero Resources Corporation | 73.5 | 4.45 | 0.18 | 2375% |
| VRTV | Veritiv Corporation | 48.5 | 4.57 | 1.46 | 214% |
| SBGI | Sinclair Broadcast Group, Inc. | 23.3 | 38.75 | 5.67 | 584% |
| PRTK | Paratek Pharmaceuticals, Inc. | 7.7 | -16.54 | -23.39 | 29% |
| | Average | | 12.31 | -1.82 | 530% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Baupost Group's 13-F Filing*

But Baupost isn't just finding companies where as-reported metrics mis-represent a company's real profitability. The reason Baupost has such phenomenal returns is because they're also identifying companies where the market is significantly undervaluing the company's potential. This is where Klarman's "Margin of Safety" comes into play. They are buying companies that the market has low expectations for, that they think the companies can exceed.

**Exhibit 1.1: Earnings Growth Expectations for Baupost Group's Equity Holdings***

| Ticker | Company Name | Baupost Ownership Level ($m) | 2 Year EPS' Growth (FY2/FY0) | Market Expected EPS' Growth | EPS' Growth Spread |
|---|---|---|---|---|---|
| LBTY.A | Liberty Global Plc | 1202.2 | NM | 23% | NM |
| VSAT | Viasat, Inc. | 987.5 | -17% | -250% | 233% |
| EBAY | eBay Inc. | 948 | 12% | -9% | 22% |
| FOXA | Fox Corporation | 894.5 | 2% | -13% | 15% |
| BMY | Bristol-Myers Squibb Company | 691.6 | 57% | -11% | 68% |
| QRVO | Qorvo, Inc. | 683.6 | 14% | -3% | 18% |
| AMEX:LNG | Cheniere Energy, Inc. | 679.6 | 25% | 7% | 19% |
| AGN | Allergan plc | 515.8 | -2% | -15% | 13% |
| MCK | McKesson Corporation | 382.4 | 8% | -8% | 16% |
| CBS | CBS Corporation | 363.5 | 10% | -9% | 20% |
| UNVR | Univar Solutions Inc. | 204.3 | -5% | -7% | 2% |
| PCG | PG&E Corporation | 197 | NM | 5% | NM |
| ABC | AmerisourceBergen Corporation | 191.9 | 6% | -7% | 13% |
| TSE:4502 | Takeda Pharmaceutical Company Limited | 165.4 | -1% | 12% | -13% |
| TBPH | Theravance Biopharma, Inc. | 160.3 | -44% | -197% | 154% |
| NXST | Nexstar Media Group, Inc. | 139.8 | -5% | -6% | 0% |
| XPO | XPO Logistics, Inc. | 116.1 | 18% | 0% | 18% |
| AKBA | Akebia Therapeutics, Inc. | 101.6 | -4% | -22% | 19% |
| LSE:DC. | Dixons Carphone plc | 99.8 | -8% | -15% | 7% |
| ATRA | Atara Biotherapeutics, Inc. | 86.9 | 44% | -182% | 226% |
| AR | Antero Resources Corporation | 73.5 | 88% | -11% | 99% |
| VRTV | Veritiv Corporation | 48.5 | -7% | -3% | -4% |
| SBGI | Sinclair Broadcast Group, Inc. | 23.3 | 87% | -18% | 105% |
| PRTK | Paratek Pharmaceuticals, Inc. | 7.7 | -48% | -174% | 126% |
| | Average | | 10% | -38% | 53% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Baupost Group's 13-F Filing*

This table shows three interesting datapoints:

- The first datapoint is what earnings growth is forecast to be over the next two years, when we take consensus Wall Street estimates, and we convert them to the Uniform Accounting framework. This represents the earnings growth the company is likely to have the next two years

- The second datapoint is what the *market thinks earnings growth is going to be* for the next two years. Here we are showing how much the company needs to grow earnings by in the next 2 years, to justify the current stock price of the company. If you've been reading our daily and our reports for awhile, you'll be familiar with the term

embedded expectations. This is the market's embedded expectations for earnings growth

- The final datapoint is the spread between what the company could do, if the Uniform Accounting adjusted Wall Street estimates are right, and what the market expects earnings growth to be

If the spread is highly positive, that means a company is undervalued, and the stock is likely to rise if the company delivers on what earnings are forecast to be. If the spread is highly negative, that means the company is overvalued and will fall if the company hits on estimated earnings growth rates.

For context, the average US-listed company (above $1 billion market cap) has an EPS growth spread of 5%. For the average company, the market is undervaluing their earnings growth by 5%, which is basically fairly valued. For most companies, the market gets it right, and correctly prices the company's potential.

But Baupost is finding companies the market is MASSIVELY undervaluing. The market is mispricing the average Baupost company's earnings growth by 50%+. For some companies, like Sinclair, the market is undervaluing the company's earnings growth by over 100%. The market is expecting Sinclair to have shrinking earnings the next 2 years, when they're actually forecast to almost double.

Baupost is even finding megacap names with significant mispricings. Bristol-Myers Squibb (BMY) is priced for earnings to decline by 11% a year the next 2 years. It's actually forecast to grow 57%.

There are some names that we'd recommend Baupost review in their portfolio if we were meeting with their PMs. Two that jump out are Takeda (4502:JPN) and Nexstar (NXST). For Takeda, the market is pricing in 12% annual earnings growth right now, but the company is actually forecast for Uniform Accounting EPS to shrink by 1% a year the next two years. For Nexstar, the market appears to be getting the company right. The company is forecast to see Uniform Accounting earnings shrink by 5% a year going forward, and the market is pricing it for 6% a year declines.

But for the most part, Baupost gets it right. And they get it right because they're not trusting the as-reported accounting statements, and they are following the maxims that Klarman wrote long before he became as successful as he is today.

# It Took a Maverick to Uncover This 7x Return Investment

When Mark Cuban bought the Dallas Mavericks on January 4, 2000, the team had had a 240-550 record the prior 10 years.

Through the entire 1990s, the team went to the playoffs once, in 1990. They lost all 3 games in that playoff series. Mavericks fans had not seen a playoff win in over a decade when Cuban bought the team.

And yet, Cuban paid an eyewatering $285 million for the franchise. At the time, no one had ever bought an NBA franchise for more than $200 million. His acquisition raised more than a few eyebrows.

Who buys one of the most poorly run franchises in the league, in a football town, for 40%+ more than anyone had ever paid for another NBA team?

But Cuban understood something important.

The Mavericks' worth had nothing to do with their record the past 10 years. What would matter is the potential growth drivers he could unlock in the business going forward.

That would determine whether he was overpaying for a trophy asset, or he was as savvy with this purchase as he had been in building Broadcast.com and selling it to Yahoo for $5 billion.

Cuban was an avid basketball fan. He had courtside seats next to the Mavericks bench before he ever became an owner. He had done his research. He could see opportunities to unlock, to justify the value of his investment.

He saw where he would drive growth in the business, and how he could make a significant return on his investment. He was confident in betting on growth when others were just focusing on valuing the business as it was.

He started by focusing on filling up the arena. He sold seats in the nosebleeds for $8 a game to get people in the door. He knew he'd make up the money on concessions. He raised the high demand courtside seat prices 10x, from $200 a seat to $2,000. People still came, they wanted to be on TV.

Importantly, he also invested in the team itself. The way to make real money on the team wasn't to starve the product and wait to make money on the broadcasting and ticket sales as they stood today–it was to drive growth in all sides of the business by investing to facilitate that growth.

The team had a core of Steve Nash and Dirk Nowitzki, who had both joined the team prior to Cuban buying the team. He surrounded them with the players they needed. When the team needed rebounding, he brought in Dennis Rodman, the seven-time NBA rebounding champion.

His investment yielded a return on the court. The following 10 years, the Mavericks didn't have a losing season. They won the NBA championship in 2011. But just as importantly, his investment benefited the business' ability to throw off revenue.

He also had great timing. Cuban purchased the team just when the industry he had made his money in, media and the internet, were making the league more international. They were also making overall fan engagement in the league stronger.

This meant bigger broadcasting deals, and new lines of revenue for the league as a whole. Lines of revenue that would trickle down to the Mavericks.

Cuban's focus on investing in growth in the business, and his timing in riding a macro wave have led to the Mavericks value rising to $2.3 billion today, according to Forbes. That's a 7x+ return for Cuban from his investment 19 years ago.

That is the kind of return you only can generate if you are comfortable betting on growth.

Buying a value stock, a company that is trading at 50% of its intrinsic value, can lead to a stock doubling. But it's almost impossible to find a company that is intrinsically undervalued 7x what it is worth, based on current cash flows.

Only by finding investments that can transform their cash flows, can one generate 7x returns.

Few investors have more impressive track record finding growth investments than Richard Driehaus. For context, in the 1980s, a dollar invested in the Russell 2000 would have turned into $4.65. For Driehaus' fund, that same $1 would have turned into $24.65. That's a 5x higher return.

He's kept on producing returns like those since.

Ever since Driehaus read John Herold's *America's Fastest Growing Companies* he'd embraced the idea that the best way to find companies that could massively outperform was to find companies who could grow.

As Driehaus himself has said:

> *"One market paradigm that I take exception to is: Buy low and sell high. I believe far more money is made by buying high and selling at even higher prices."*

Driehaus doesn't trouble himself with P/Es. If a P/E is high, but the earnings growth means the company can deliver, and already is showing strong results, his fund will jump in.

He doesn't spend his time understanding what the company is worth and if it's intrinsically undervalued. He focuses on if the company has positive operating momentum, and the ability to drive growth that can look like Cuban's 7x return…or more.

Said differently:

> *"I believe you make the most money by hitting home runs, not just a lot of singles."* - Richard Driehaus

Driehaus understood, and his firm still understands, that traditional valuation metrics, and the traditional valuation process for those who use as-reported accounting metrics, is deeply flawed. And so, they focus on identifying companies that those methodologies have missed.

One of Driehaus Capital's flagship funds is the Driehaus Small Cap Growth Fund. While as-reported methodologies may distort these companies' performance, looking at Uniform Accounting analysis can start to unlock the power of Driehaus' strategy.

To show what we mean, we've done a high-level portfolio audit of the Small Cap Growth Fund's current portfolio, based on their most recent 13-F (See exhibit 2.0). This is a very light version of the custom portfolio audit we do for our institutional clients when we analyze their portfolios for torpedoes and companies they may want to "lean in" on.

Using as-reported accounting, investors would be scratching their heads at the company's that Driehaus is buying. How can they think that these companies are good growth candidates, when these companies cannot even earn cost-of-capital returns? On an as-reported basis, these companies average a 2% return.

Growth in below cost-of-capital return businesses is value destructive. This isn't the type of growth that the market would reward. If the Driehaus funds invested in poor performing companies, they wouldn't be able to produce the outsized returns they are known for.

But once we make Uniform Accounting (UAFRS) adjustments, we realize that the returns of the companies in Driehaus' portfolio are much more robust. Once we make these adjustments, Roku doesn't have a -3% ROA, the company's operating return is really almost 20%. RingCentral doesn't have a -1% return, it's really 17%.

**Exhibit 2.0: Economic Reality of Driehaus Capital Management Equity Holdings***

| Ticker | Company Name | Driehaus Ownership Level ($m) | ROA' FY0 | As-Reported ROA | As-Reported ROA Distortion |
|---|---|---|---|---|---|
| FIVN | Five9, Inc. | 1.7 | 0.43 | 1.21 | -65% |
| FRPT | Freshpet, Inc. | 1.7 | 0.94 | -2.63 | 136% |
| MDB | MongoDB, Inc. | 2.1 | -19.27 | -9.88 | -95% |
| TTD | The Trade Desk, Inc. | 2.1 | 40.35 | 6.55 | 516% |
| BPMC | Blueprint Medicines Corporation | 1.8 | -3.73 | -29.94 | 88% |
| COUP | Coupa Software Incorporated | 2.7 | 7.78 | -3.67 | 312% |
| GH | Guardant Health, Inc. | 1.7 | -27.97 | -8.69 | -222% |
| ITRI | Itron, Inc. | 1.9 | 17.69 | 3.89 | 355% |
| KTOS | Kratos Defense & Security Solutions, Inc. | 1.8 | 6.30 | 2.34 | 169% |
| LGIH | LGI Homes, Inc. | 2.7 | 12.78 | 8.86 | 44% |
| MRCY | Mercury Systems, Inc. | 2.2 | 16.38 | 4.00 | 310% |
| PCTY | Paylocity Holding Corporation | 2.2 | 28.25 | 2.12 | 1231% |
| ROKU | Roku, Inc. | 3.5 | 19.58 | -2.85 | 788% |
| SEDG | SolarEdge Technologies, Inc. | 2.7 | 34.66 | 8.34 | 315% |
| STRA | Strategic Education, Inc. | 1.8 | 20.76 | 4.51 | 360% |
| WING | Wingstop Inc. | 1.9 | 222.90 | 19.17 | 1063% |
| ACA | Arcosa, Inc. | 1.8 | 5.99 | 4.50 | 33% |
| AYX | Alteryx, Inc. | 3.1 | 26.88 | 2.10 | 1182% |
| BLD | TopBuild Corp. | 2.2 | 10.00 | 6.83 | 46% |
| BOOT | Boot Barn Holdings, Inc. | 1.7 | 12.95 | 6.31 | 105% |
| CHGG | Chegg, Inc. | 1.7 | 12.68 | 0.25 | 4917% |
| CVNA | Carvana Co. | 1.8 | -26.98 | -12.32 | -119% |
| EPAM | EPAM Systems, Inc. | 2.1 | 50.22 | 10.54 | 376% |
| FCN | FTI Consulting, Inc. | 2.9 | 21.16 | 7.12 | 197% |
| GNRC | Generac Holdings Inc. | 1.6 | 33.47 | 9.97 | 236% |
| INSP | Inspire Medical Systems, Inc. | 2.9 | -52.68 | -10.37 | -408% |
| IPHI | Inphi Corporation | 2.6 | 8.50 | -3.61 | 335% |
| KBR | KBR, Inc. | 1.7 | 13.29 | 3.76 | 253% |
| LAD | Lithia Motors, Inc. | 2.5 | 8.24 | 5.53 | 49% |
| RNG | RingCentral, Inc. | 2.3 | 17.42 | -1.46 | 1296% |
| TREX | Trex Company, Inc. | 2.3 | 28.59 | 20.81 | 37% |
| | Average | | 17.66 | 1.72 | 447% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Driehaus Capital Management's 13-F Filing*

If Driehaus was looking at as-reported metrics, they would never pick most of these companies, because they look like bad companies and poor investments. Not viable platforms to build growth of. For the average company, as-reported ROA understates profitability by almost 90%. Uniform ROA is 450% higher than the distorted as-reported metrics.

That being said, there are some companies that Driehaus might need to do greater research on. Uniform Accounting shows these companies are

poorly performing companies that may not be the growth engines the fund is looking for.

Two that jump out are Inspire Medical Systems, who doesn't have a -10% ROA, they have a -53% return. Similarly, Five9 is still a below cost-of-capital return business, even after making Uniform Accounting adjustments.

But Driehaus isn't just finding companies where as-reported metrics mis-represent a company's real profitability. The reason Driehaus has such phenomenal returns is because they're identifying companies with good businesses with massive growth opportunities.

This is where Driehaus' goal of buying high and selling higher comes into play.

Exhibit 2.1 shows three interesting datapoints:

- The first datapoint is what earnings growth is forecast to be over the next two years, when we take consensus Wall Street estimates, and we convert them to the Uniform Accounting framework. This represents the earnings growth the company is likely to have the next two years

- The second datapoint is what the *market thinks earnings growth is going to be* for the next two years. Here we are showing how much the company needs to grow earnings by in the next 2 years, to justify the current stock price of the company. If you've been reading our daily and our reports for a while, you'll be familiar with the term embedded expectations. This is the market's embedded expectations for earnings growth

- The final datapoint is the spread between what the company could do, if the Uniform Accounting adjusted Wall Street estimates are right, and what the market expects earnings growth to be

**Exhibit 2.1: Earnings Growth Expectations for Driehaus Capital Management's Equity Holdings***

| Ticker | Company Name | Driehaus Ownership Level ($m) | 2 Year EPS' Growth (FY2/FY0) | Market Expected EPS' Growth | EPS' Growth Spread |
|---|---|---|---|---|---|
| FIVN | Five9, Inc. | 1.7 | 23% | 185% | -162% |
| FRPT | Freshpet, Inc. | 1.7 | 433% | 130% | 303% |
| MDB | MongoDB, Inc. | 2.1 | -36% | -247% | 210% |
| TTD | The Trade Desk, Inc. | 2.1 | 7% | 23% | -16% |
| BPMC | Blueprint Medicines Corporation | 1.8 | 65% | -254% | 319% |
| COUP | Coupa Software Incorporated | 2.7 | NM | 69% | NM |
| GH | Guardant Health, Inc. | 1.7 | -45% | -241% | 197% |
| ITRI | Itron, Inc. | 1.9 | 6% | -7% | 13% |
| KTOS | Kratos Defense & Security Solutions, Inc. | 1.8 | 115% | 30% | 86% |
| LGIH | LGI Homes, Inc. | 2.7 | 11% | -3% | 13% |
| MRCY | Mercury Systems, Inc. | 2.2 | 18% | 9% | 9% |
| PCTY | Paylocity Holding Corporation | 2.2 | 11% | 26% | -14% |
| ROKU | Roku, Inc. | 3.5 | 6% | 54% | -49% |
| SEDG | SolarEdge Technologies, Inc. | 2.7 | 17% | 6% | 11% |
| STRA | Strategic Education, Inc. | 1.8 | 16% | 4% | 12% |
| WING | Wingstop Inc. | 1.9 | 8% | 32% | -24% |
| ACA | Arcosa, Inc. | 1.8 | 17% | 1% | 17% |
| AYX | Alteryx, Inc. | 3.1 | 5% | 38% | -32% |
| BLD | TopBuild Corp. | 2.2 | 22% | 16% | 6% |
| BOOT | Boot Barn Holdings, Inc. | 1.7 | 14% | 7% | 7% |
| CHGG | Chegg, Inc. | 1.7 | 54% | 37% | 17% |
| CVNA | Carvana Co. | 1.8 | 56% | -203% | 259% |
| EPAM | EPAM Systems, Inc. | 2.1 | 13% | 9% | 4% |
| FCN | FTI Consulting, Inc. | 2.9 | 11% | 2% | 9% |
| GNRC | Generac Holdings Inc. | 1.6 | 3% | 0% | 3% |
| INSP | Inspire Medical Systems, Inc. | 2.9 | 0% | -224% | 225% |
| IPHI | Inphi Corporation | 2.6 | 49% | 19% | 29% |
| KBR | KBR, Inc. | 1.7 | 18% | -1% | 19% |
| LAD | Lithia Motors, Inc. | 2.5 | 1% | -1% | 2% |
| RNG | RingCentral, Inc. | 2.3 | -15% | 51% | -66% |
| TREX | Trex Company, Inc. | 2.3 | 11% | 11% | -1% |
| | Average | | 31% | -14% | 47% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Driehaus Capital Management's 13-F Filing*

The average company in the US is forecast to have 5% annual Uniform Accounting earnings growth over the next 2 years. The Driehaus fund is identifying companies that are growing 31% a year the next 2 years, on average. The fund is clearly meeting their growth mandate on a Uniform Accounting basis.

For context, this is even above their average as-reported EPS growth forecast, of 28% a year.

But not only is Driehaus Capital identifying companies that have stronger EPS growth than the average US company on a Uniform Accounting basis, they're finding companies where the market is mispricing that earnings growth.

On a median basis, the market is pricing these companies to have a 9% earnings growth number. On both an average and a median basis, the market is massively understating how much earnings growth these companies will have.

These are the kind of companies that don't just double, they produce 7x returns or more.

One example of a company in the Driehaus portfolio that has massive growth that the market is mispricing is Kratos (KTOS). Kratos is forecast to have 115% Uniform earnings growth, but the market is only pricing the company to have 30% earnings growth each year the next two years. That is a massive pricing dislocation the market is going to have to react to.

On the other hand, there are some names we'd recommend Driehaus review in their portfolio if we were meeting with their PMs. Two that jump out are Five9 (FIVN) (again) and The Trade Desk (TTD).

For Five9, not only are they a low return business, but the market is pricing the company for 185% annual earnings growth, when the company is only forecast to have 23% annual earnings growth.

Similarly, the market is pricing The Trade Desk to have 23% earnings growth going forward, when the company is only forecast to have 7% earnings growth. This does not look like the type of company that the Driehaus team would want to be owning once we see through the accounting noise.

But for the most part, Driehaus gets it right. And they get it right because they're not trusting the as-reported accounting statements. Their focus on understanding growth better than anyone else is likely to continue to power strong returns and our Uniform Accounting portfolio review shows it.

# One of the Greatest Hedge Fund Managers Ever Lost His Investors More Than He Ever Made Them

In March 2000, Julian Robertson made the decision to return all Tiger Management's investors' money. He shut down the hedge fund.

One of Tiger's funds, the Jaguar Fund, had dropped 14% in the first 2 months of the year, having lost almost 18% since late 1998. After a $2 billion loss on a bad bet in the Japanese yen in 1998, Tiger had steadily seen investors leaving, and taken on losses, seeing the firm's AUM drop from $20 billion in 1998 to $6.5 billion at the time Robertson decided to close the doors.

Robertson and Tiger had been one of the early stars of the hedge fund world. He took $8 million in capital in 1980 and turned it into over $20 billion by the fund's 1998 peak.

But Robertson was too early to the party of shorting internet stocks. His dogmatic value-based philosophy on investing led him to be long old-economy companies in the late 1990s, in the face of a rampant growth-focused bull market.

It meant that when he reached his peak in AUM, that was just when he started losing money. And because of that timing, many have said he actually lost more money for investors than he ever made them in the prior 18 years.

Ironically, March 2000, when Tiger threw in the towel, was the market peak, and Robertson ended up being proven right.

He made plenty of money after 2000, as he remained short the internet bubble with his own money, but his investors never got to participate.

But that's not that most important thing that came out of Tiger Management. The most important thing was the group of investors that Robertson mentored at Tiger, and sponsored to grow after Tiger's demise.

He had built an all-star team at Tiger. They matured under him at Tiger, absorbing his deep fundamental research perspective. Importantly, with his help, they also learned his mistakes in the dot.com bubble, and understood the importance of timing their investments to avoid being right too soon as Robertson had been.

In the aftermath of the dot-com bubble, Robertson sponsored several of his former employees setting up their own hedge funds. He would provide them with initial capital for a stake in their fund. He would continue to mentor them. And he would help them create a network of Tiger Cubs, that would share ideas and research, much like they had inside of Tiger Management, to maximize returns.

These great investors include brand names like Samlyn, Maverick, Lone Pine, HealthCor, and Coatue. Hedge funds that are amongst the most respected investors today.

However, most would agree the most successful, and largest, of the tiger cubs is Chase Coleman and his Tiger Global.

Coleman and Tiger Global follow in Robertson's fundamental research driven footsteps. Their strategy is not as simple as focusing just on value companies, like Klarman at Baupost, or growth companies, like Driehaus. Their goal is to find great thematic ideas that are mispriced by the market, which can run the gamut of deep value, value, GARP, and growth names, depending on the market context.

When looking at Tiger Global's holdings, anyone using as-reported accounting metrics would likely be scratching their heads. Coleman and his firm are focused on the true fundamentals of companies when they are looking for mispriced firms. Using traditional as-reported accounting metrics, the fundamentals and KPIs for businesses don't line up with the accounting. It is only once those holdings are looked at with a lens that

better represents economic reality, and lines up with the KPIs and real fundamentals, that their investments become apparent.

To show what we mean, we've done a high-level portfolio audit of Tiger Global's top holdings, based on their most recent 13-F (See exhibit 3.0). This is a very light version of the custom portfolio audit we do for our institutional clients when we analyze their portfolios for torpedos and companies they may want to "lean in" on.

**Exhibit 3.0: Economic Reality of Tiger Global Management's Equity Holdings***

| Ticker | Company Name | Tiger Global Ownership Level ($m) | ROA' FY0 | As-Reported ROA | As-Reported ROA Distortion |
|---|---|---|---|---|---|
| MSFT | Microsoft Corporation | 2150.4 | 34.03 | 10.64 | 220% |
| FB | Facebook, Inc. | 1686.3 | 44.96 | 12.99 | 246% |
| JD | JD.com, Inc. | 1646.8 | 17.77 | 0.50 | 3483% |
| AMZN | Amazon.com, Inc. | 1240.2 | 14.15 | 5.22 | 171% |
| BIT:FCA | Fiat Chrysler Automobiles N.V. | 1238.3 | 2.81 | 3.05 | -8% |
| TDG | TransDigm Group Incorporated | 1081.4 | 60.77 | 8.44 | 620% |
| BABA | Alibaba Group Holding Limited | 754.6 | 136.15 | 5.37 | 2437% |
| NFLX | Netflix, Inc. | 594.3 | 38.96 | 5.44 | 617% |
| FLT | FleetCor Technologies, Inc. | 516.2 | 97.81 | 6.25 | 1464% |
| SPOT | Spotify Technology S.A. | 502.2 | 23.52 | 1.34 | 1660% |
| RNG | RingCentral, Inc. | 481.6 | 17.42 | -1.46 | 1296% |
| RUN | Sunrun Inc. | 453.7 | -3.66 | -1.80 | -103% |
| TAL | TAL Education Group | 406.2 | 23.28 | 4.78 | 387% |
| CRM | salesforce.com, inc. | 344.1 | 27.70 | 1.46 | 1800% |
| EDU | New Oriental Education & Technology ( | 284.6 | 16.64 | 4.84 | 244% |
| GDS | GDS Holdings Limited | 238.9 | 2.64 | 0.89 | 196% |
| CVNA | Carvana Co. | 224.3 | -26.98 | -12.32 | -119% |
| UBER | Uber Technologies, Inc. | 218 | -45.01 | NA | NM |
| MELI | MercadoLibre, Inc. | 214.2 | -6.76 | -0.29 | -2233% |
| ADBE | Adobe Inc. | 193.5 | 59.65 | 10.64 | 460% |
| | Average | | 26.79 | 3.47 | 676% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Tiger Global Management's 13-F Filing*

Using as-reported accounting, investors would be scratching their heads at the companies that Tiger Global owns. These don't look like companies with strong fundamental tailwinds that are ready to unlock significant value. The average company in their holdings has a sub 5% ROA on an as-reported basis. Several of their companies have negative ROAs.

But once we make Uniform Accounting (UAFRS) adjustments, we realize that the returns of the companies in Tiger Global's portfolio are much more robust. Once we make these adjustments, the average company has a 27% adjusted ROA. Companies like RingCentral (RNG) don't have a -1% ROA, they have a 17% adjusted ROA, robust profitability. Amazon's (AMZN) ROA isn't 5%, it is 14% and rising. Their investments in JD.com (JD) and Alibaba (BABA) make sense, as these companies don't have 5% or below ROA, JD.com's ROA is 18%, and Alibaba's is a phenomenal 136%.

If Tiger Global was looking at as-reported metrics, they might be concerned that the accounting metrics are warning them that the fundamental tailwinds they think they are seeing aren't actually producing. For the average company, as-reported ROA understates profitability by almost 90%. Uniform ROA is 670% higher than the distorted as-reported metrics.

That being said, there are some companies that Tiger Global might be betting on that aren't actually seeing the fundamental tailwinds they think they're seeing. Uniform Accounting shows these companies are poorly performing companies that may not turn out to be winners.

Two that jump out are Carvana, who doesn't have a -12% ROA, they have a -27% return. Similarly, Fiat is still a below cost-of-capital return business, even after making Uniform Accounting adjustments.

On a Uniform Accounting EPS growth perspective, Tiger Global's ideas look a bit more conflicted. Some of the names look significantly undervalued, while others look overvalued. But this makes sense, when you look at it in the context of their strategy. Often, they are attempting to identify companies with key value opportunities being unlocked that even sell-side analysts are not fully capturing yet. Since forecasted EPS growth is based off of adjusted analyst estimates, it would make sense that if analysts haven't spied the inflections, these names wouldn't all look great.

As Robertson himself has said:

> *"If it's in the headlines, it's in the stock price."*

If analysts already are telling the market what's going on for the company, it's probably already in the stock price.

**Exhibit 3.1: Earnings Growth Expectations for Tiger Global Management's Equity Holdings***

| Ticker | Company Name | Tiger Global Ownership Level ($m) | 2 Year EPS' Growth (FY2/FY0) | Market Expected EPS' Growth | EPS' Growth Spread |
|---|---|---|---|---|---|
| MSFT | Microsoft Corporation | 2150.4 | 12% | 5% | 6% |
| FB | Facebook, Inc. | 1686.3 | 1% | 4% | -2% |
| JD | JD.com, Inc. | 1646.8 | 27% | 12% | 15% |
| AMZN | Amazon.com, Inc. | 1240.2 | 6% | 38% | -32% |
| BIT:FCA | Fiat Chrysler Automobiles N.V. | 1238.3 | -15% | 2% | -17% |
| TDG | TransDigm Group Incorporated | 1081.4 | 20% | 4% | 16% |
| BABA | Alibaba Group Holding Limited | 754.6 | 10% | 9% | 1% |
| NFLX | Netflix, Inc. | 594.3 | 34% | 25% | 9% |
| FLT | FleetCor Technologies, Inc. | 516.2 | 10% | 12% | -3% |
| SPOT | Spotify Technology S.A. | 502.2 | 3% | 46% | -43% |
| RNG | RingCentral, Inc. | 481.6 | -15% | 51% | -66% |
| RUN | Sunrun Inc. | 453.7 | -19% | -219% | 201% |
| TAL | TAL Education Group | 406.2 | 37% | 27% | 11% |
| CRM | salesforce.com, inc. | 344.1 | 11% | 24% | -13% |
| EDU | New Oriental Education & Technology ( | 284.6 | 41% | 21% | 20% |
| GDS | GDS Holdings Limited | 238.9 | -15% | 65% | -81% |
| CVNA | Carvana Co. | 224.3 | 56% | -204% | 260% |
| UBER | Uber Technologies, Inc. | 218 | -26% | -202% | 176% |
| MELI | MercadoLibre, Inc. | 214.2 | NM | -271% | NM |
| ADBE | Adobe Inc. | 193.5 | 12% | 12% | 0% |
| | Average | | 10% | -27% | 24% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, Tiger Global Management's 13-F Filing*

This table shows three interesting datapoints:

- The first datapoint is what earnings growth is forecast to be over the next two years, when we take consensus Wall Street estimates, and we convert them to the Uniform Accounting framework. This represents the earnings growth the company is likely to have for the next two years

- The second datapoint is what the *market thinks earnings growth is going to be* for the next two years. Here we are showing how much the company needs to grow earnings by in the next 2 years, to justify the current stock price of the company. If you've been reading our daily and our reports for a while, you'll be familiar with the term embedded expectations. This is the market's embedded expectations for earnings growth

- The final datapoint is the spread between what the company could do, if the Uniform Accounting adjusted Wall Street estimates are right, and what the market expects earnings growth to be

The average company in the US is forecast to have 5% annual Uniform Accounting earnings growth over the next 2 years. Tiger Global's holdings are forecast to outpace that, growing at 10% a year the next 2 years, on average. They are definitely identifying companies that have tailwinds to drive growth.

On average, the market is pricing these companies to shrink earnings by 27% a year, so it is also identifying companies that are skewed negatively. However, the median company in this portfolio only has a 1% mispricing between forecasted earnings growth and what the market is pricing in.

If analysts are right about these companies, then they are fairly valued on average. Some of them are significantly undervalued, but others appear to be overvalued. What Tiger Global is betting is, they know more than the analysts and market do, and these companies will exceed analyst expectations.

If the market is already pricing the average company in the portfolio to do what analysts expect it to do, and the company exceeds expectations, Tiger Global will be rewarded.

A good example of this is FleetCor (FLT). FleetCor's Uniform Accounting earnings growth is forecast to be around 10% a year going forward. The market is pricing the company for 12% Uniform EPS growth, so if analysts are right, the company is fairly valued. Similarly, Alibaba is priced for 9% EPS growth, and Uniform EPS growth is forecast to be 10%.

There are several names that look materially mispriced even if they just meet analyst expectations. Examples include TransDigm (TDG), which is priced for 4% growth, but forecast to have 20% EPS growth. Similarly, New Oriental Education (EDU) is priced for 21% EPS growth, but they're forecast for much stronger 41% EPS growth.

On the other hand, there are some names that look like they might be fairly valued at best, even if Tiger Global was right, and analysts are wrong,

because market expectations are already so high. Amazon is an example of this, with modest 6% EPS growth forecast the next 2 years, versus market expectations for 38% growth. Similarly, GDS Holdings (GDS) is priced for 65% growth, but analysts are forecasting -15% EPS growth. Even if analysts are wrong about GDS, upside is likely limited.

However, for the most part, Tiger Global is positioned how they want to be. They are positioned in names with winds at their back, strong economic moats. They're also positioned where they want to be, companies that are mispriced if Tiger knows more than the analysts that cover them do, which is where they make their bread and butter.

Just like Robertson, Coleman is comfortable betting against the market, and uncovering unique value. And Uniform Accounting analysis confirms it.

# A Belief Takes Over Europe from the Very Spot A Prior One was Halted

The Muslim conquests following the death of Muhammad in 632 A.D. steadily built over the next one hundred years. The accumulation of victories began to take on an air of inevitability.

From 638-642, most of the Byzantine empire's eastern Mediterranean holdings, including Egypt and Syria, fell to the caliphate. By 648 modern day Libya was under Muslim control. In 698, Carthage fell, and by 709, all of North Africa to the Pillar of Hercules where the Atlantic and Mediterranean meet, was the caliphate's to rule.

Dread in Europe began to take over once the slow trudge of the conquest arrived on the shores of Europe. In 711, the invasion of the Iberian Peninsula, modern-day Spain and Portugal began, and by 714, most of modern-day Spain was under Muslim control.

Christian Western Europe was completely unprepared to stop the advance of the Umayyad caliphate, and some worried that within the century all of Europe would be Muslim. And with reason. By 720, portions of the French riviera were under Muslim control, and in the 720s, raiding parties ranged as far as Burgundy in eastern modern-day France.

To prevent total capitulation of western Europe, the Franks needed to make a stand. Charles Martel, the Duke of the Franks, gathered his forces and came to the aid of the duchy of Aquitaine.

He had an advantage that many of the prior armies that had attempted to stop the Muslim advance did not. His was a professionally trained army that had been doing battle for years, consolidating much of northern Europe under the Franks.

In October 732, the Muslim forces were marching on Tours in central modern-day France, when they found Charles' army in a defensive position not far from Pointers.

After 7 days of preparation and waiting, the battle commenced. The Muslim forces attempted to break the Franks, but they held until Martel's surprise gambit paid off.

He had sent a scouting party to raid the Umayyad's camp, threatening their treasure and gains from the conquest thus far. As this information began to spread, some of the troops decided to retreat to the camp to protect their treasure, and the rest of the Umayyad army perceived this as a retreat, which soon became a self-fulfilling prophecy.

In the battle, the Umayyad general was killed. The rest of the army fled back to Muslim Spain.

While many other attempts were made by the Umayyad caliphate to push deeper into Europe, the battle of Pointers, also called the Battle of Tours, marked the high water mark for Islam in Western Europe, similar to the later battle of Vienna in 1683 for Islam and the Ottomans in Eastern Europe.

That victory is the reason why 1,208 years later, when Jean-Marie Eveillard was born in Pointers, he spoke French, not Arabic. The ideas that he spread as he advanced through Societe Generale's (SocGen) fund management group had significantly more success in crossing Europe.

Eveillard was one of the first value investors outside of the US. He followed in the footsteps of Ben Graham and the great value investors in the US, and many call him the first true global value investor. He was one of the first true disciples of Graham and value investing in Europe, spreading his gospel.

Before Eveillard's career began in 1962 at SocGen, and he took over as portfolio manager of what is now First Eagle, value investing was not viewed as a popular strategy outside of the US. Many of Graham's followers, like Buffett, Munger, Schloss, Ruane, and even Shelby Davis, had been practitioners of value investing for years in the US, but it had not yet caught on.

For the next 40+ years, Eveillard applied the same value investing framework Graham had laid out with amazing success. He was regularly hailed as one of Wall Street's best value investors. In 2003, he was awarded Morningstar's Fund Manager Lifetime Achievement Award.

By that point, Eveillard's value investing beliefs had spread across Europe. Value investing had won the war, the way the invaders of 732 had not.

One of the core principles that Eveillard lives by is that to truly find value stocks, one can't trust the as-reported GAAP and IFRS accounting numbers. As Eveillard says:

> *"I always restate financials when valuing companies."*

Using as-reported accounting metrics can lead to a value investor misunderstanding how cheap a company really is. What is the real intrinsic value of a company, and what are the real assets that back that company's value? What are the real returns of a business, and what is the market really pricing in?

Using as-reported accounting, an investor is likely to pick the wrong companies. The type of companies that guarantee you won't have great enough success to be receive a lifetime achievement award.

To show what we mean, we've done a high-level portfolio audit of the top 30 holdings of one of First Eagle's funds, the First Eagle Global Fund, based on their most recent 13-F (see exhibit 4.0). Of course, Eveillard doesn't actively manage this, or any First Eagle funds anymore; however, the portfolio construction is still focused on his value approach, using cleaned up metrics.

This is a very light version of the custom portfolio audit we do for our institutional clients when we analyze their portfolios for torpedos and companies they may want to "lean in" on.

**Exhibit 4.0: Economic Reality of First Eagle Investment Management's Equity Holdings***

| Ticker | Company Name | First Eagle Ownership Level ($m) | ROA' FY0 | As-Reported ROA | As-Reported ROA Distortion |
|---|---|---|---|---|---|
| ORCL | Oracle Corporation | 1169.7 | 30.08 | 7.50 | 301% |
| CMCS.A | Comcast Corporation | 1042.4 | 11.60 | 5.66 | 105% |
| TSE:6954 | Fanuc Corporation | 845.5 | 9.22 | 4.39 | 110% |
| WY | Weyerhaeuser Company | 835.8 | 10.34 | 2.54 | 308% |
| XOM | Exxon Mobil Corporation | 835.3 | 2.92 | 3.17 | -8% |
| TSE:9433 | KDDI Corporation | 741.5 | 9.32 | 7.74 | 20% |
| SLB | Schlumberger Limited | 710.6 | 7.19 | 2.78 | 158% |
| ENXTPA:BN | Danone S.A. | 674.5 | 20.82 | 4.99 | 318% |
| LSE:BATS | British American Tobacco p.l.c. | 662.9 | 88.41 | 4.35 | 1932% |
| PM | Philip Morris International Inc. | 614.2 | 51.64 | 16.57 | 212% |
| TSE:9735 | SECOM CO., LTD. | 592.9 | 10.62 | 4.80 | 121% |
| TSE:8802 | Mitsubishi Estate Co., Ltd. | 587.6 | 2.12 | 2.47 | -14% |
| SWX:NESN | Nestlé S.A. | 580.6 | 15.84 | 7.50 | 111% |
| CL | Colgate-Palmolive Company | 541.8 | 32.74 | 17.31 | 89% |
| DE | Deere & Company | 528.6 | 10.03 | 3.75 | 167% |
| ENXTPA:SAN | Sanofi | 469 | 13.11 | 3.60 | 264% |
| MSFT | Microsoft Corporation | 451.2 | 34.03 | 10.64 | 220% |
| LIN | Linde plc | 449.3 | 5.44 | 3.17 | 72% |
| TSE:9437 | NTT DOCOMO, INC. | 435.7 | 7.82 | 8.61 | -9% |
| OMC | Omnicom Group Inc. | 421.9 | 421.39 | 5.64 | 7375% |
| MMM | 3M Company | 420.4 | 15.13 | 11.46 | 32% |
| FLS | Flowserve Corporation | 412.6 | 8.23 | 5.42 | 52% |
| CHRW | C.H. Robinson Worldwide, Inc. | 409.7 | 39.84 | 12.44 | 220% |
| SGX:J36 | Jardine Matheson Holdings Limited | 409.4 | 4.66 | 3.33 | 40% |
| TSX:ABX | Barrick Gold Corporation | 394 | 1.11 | 2.61 | -57% |
| NEM | Newmont Goldcorp Corporation | 375.9 | 2.74 | 2.22 | 24% |
| KOSE:A033780 | KT&G Corporation | 375.5 | 12.21 | 8.15 | 50% |
| ENXTPA:SGO | Compagnie de Saint-Gobain S.A. | 357.7 | 6.07 | 4.10 | 48% |
| SWX:CFR | Compagnie Financière Richemont SA | 351.8 | 10.24 | 4.53 | 126% |
| ENXTPA:SW | Sodexo S.A. | 345.9 | 27.19 | 4.00 | 579% |
| | Average | | 30.74 | 6.18 | 432% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, First Eagle Investment Management's 13-F Filing*

Using as-reported accounting, investors would be scratching their heads at the companies that First Eagle owns. These don't look like the companies with good economic moats trading at intrinsic discounts that Eveillard would want to focus on.

But once we make Uniform Accounting (UAFRS) adjustments, we realize that the returns of the companies in First Eagle's portfolio are much more robust. Once we make these adjustments, the average company has a 31% adjusted ROA, not a low 6% a-reported ROA.

Companies like British American Tobacco (BATS:GBR) don't have a 4% ROA, they have an 88% adjusted ROA, showing robust profitability. Omnicom's (OMC) ROA isn't 6%, it is 421% and it has been steadily improving. Their investment in Sodexo (SW:FRA) makes sense, as this company doesn't have a 4% or below ROA, Sodexo's ROA is really 27%.

If First Eagle was looking at as-reported metrics, they might be concerned that the accounting metrics are pointing towards poorly performing companies that should trade at discounts to book valuations, or worse. For the average company, as-reported ROA understates profitability by almost 80%. Uniform ROA is 430% higher than the distorted as-reported metrics.

That being said, there are some companies that First Eagle might be betting on that aren't as robust as they may believe. Uniform Accounting shows these companies are poorly performing companies that may not turn out to be winners.

Two that jump out are ExxonMobil (XOM), whose adjusted ROA of 3% is in line with poor as-reported numbers. Similarly, Barrick Gold's (ABX) returns are actually lower on a Uniform basis, sitting at 1%, versus almost 3% as-reported ROA.

But Eveillard and First Eagle are value investors. The important thing to First Eagle's portfolio managers is that they are buying companies that are intrinsically undervalued first and foremost. Whether they have a healthy economic moat is second to that question.

On a Uniform Accounting EPS growth perspective, it is clear they are finding exactly the type of companies their mandate states they should. While on an as-reported basis a company like Linde (LIN) might look like earnings growth is declining, Uniform Accounting metrics show growth to be much healthier.

**Exhibit 4.1: Earnings Growth Expectations for First Eagle Investment Management's Equity Holdings***

| Ticker | Company Name | First Eagle Ownership Level ($m) | 2 Year EPS' Growth (FY2/FY0) | Market Expected EPS' Growth | EPS' Growth Spread |
|---|---|---|---|---|---|
| ORCL | Oracle Corporation | 1169.7 | 10% | -2% | 12% |
| CMCS.A | Comcast Corporation | 1042.4 | -3% | 0% | -3% |
| TSE:6954 | Fanuc Corporation | 845.5 | -8% | 13% | -21% |
| WY | Weyerhaeuser Company | 835.8 | -25% | -1% | -24% |
| XOM | Exxon Mobil Corporation | 835.3 | -19% | 7% | -26% |
| TSE:9433 | KDDI Corporation | 741.5 | 0% | -7% | 7% |
| SLB | Schlumberger Limited | 710.6 | 14% | 4% | 9% |
| ENXTPA:BN | Danone S.A. | 674.5 | -12% | 6% | -18% |
| LSE:BATS | British American Tobacco p.l.c. | 662.9 | 8% | -11% | 19% |
| PM | Philip Morris International Inc. | 614.2 | 7% | -3% | 10% |
| TSE:9735 | SECOM CO., LTD. | 592.9 | -2% | -2% | 0% |
| TSE:8802 | Mitsubishi Estate Co., Ltd. | 587.6 | 0% | 12% | -12% |
| SWX:NESN | Nestlé S.A. | 580.6 | 6% | 9% | -3% |
| CL | Colgate-Palmolive Company | 541.8 | 1% | 1% | 0% |
| DE | Deere & Company | 528.6 | 21% | 8% | 13% |
| ENXTPA:SAN | Sanofi | 469 | 3% | -6% | 9% |
| MSFT | Microsoft Corporation | 451.2 | 12% | 5% | 6% |
| LIN | Linde plc | 449.3 | 11% | 31% | -20% |
| TSE:9437 | NTT DOCOMO, INC. | 435.7 | -10% | -5% | -5% |
| OMC | Omnicom Group Inc. | 421.9 | 3% | -12% | 16% |
| MMM | 3M Company | 420.4 | 8% | 0% | 7% |
| FLS | Flowserve Corporation | 412.6 | 25% | 9% | 16% |
| CHRW | C.H. Robinson Worldwide, Inc. | 409.7 | 0% | -2% | 2% |
| SGX:J36 | Jardine Matheson Holdings Limited | 409.4 | NM | 4% | NM |
| TSX:ABX | Barrick Gold Corporation | 394 | 477% | 27% | 449% |
| NEM | Newmont Goldcorp Corporation | 375.9 | 70% | 22% | 49% |
| KOSE:A033780 | KT&G Corporation | 375.5 | 18% | -10% | 28% |
| ENXTPA:SGO | Compagnie de Saint-Gobain S.A. | 357.7 | -6% | 0% | -6% |
| SWX:CFR | Compagnie Financière Richemont SA | 351.8 | -32% | 6% | -38% |
| ENXTPA:SW | Sodexo S.A. | 345.9 | 4% | -1% | 4% |
| | Average | | 20% | 3% | 17% |

**Portfolio holdings as of August 2019*
*Source: Valens Research Analysis, S&P Global Marketing Intelligence, First Eagle Investment Management's 13-F Filing*

This table shows three interesting datapoints:

- The first datapoint is what earnings growth is forecast to be over the next two years, when we take consensus Wall Street estimates, and we convert them to the Uniform Accounting framework. This represents the earnings growth the company is likely to have for the next two years

- The second datapoint is what the *market thinks earnings growth is going to be* for the next two years. Here we are showing how much the company needs to grow earnings by in the next 2 years, to justify the current stock price of the company. If you've been reading our daily and our reports for a while, you'll be familiar with the term embedded expectations. This is the market's embedded expectations for earnings growth

- The final datapoint is the spread between what the company could do, if the Uniform Accounting adjusted Wall Street estimates are right, and what the market expects earnings growth to be

The average company in the US is forecast to have 5% annual Uniform Accounting earnings growth over the next 2 years. First Eagle's holdings are forecast to outpace that, growing at 20% a year the next 2 years, on average. First Eagle is not just finding value companies, because of their international focus, they're able to find intrinsically undervalued companies that still have growth characteristics.

On average, the market is pricing these companies to only grow earnings by 3% a year. On a median basis, it is even lower; the market is pricing these companies to grow earnings by 1%. While these companies are growing robustly, they are intrinsically undervalued, as the market is mispricing their growth by 17% on average.

These are the kinds of companies that can make peers call an investor one of the first great global value investors.

One example of a company in the First Eagle portfolio that has growth the market is mispricing is Deere (DE). Deere is forecast to have 21% Uniform earnings growth, but the market is only pricing the company to have 8% earnings growth each year the next two years. Another company with similar massive dislocations include KT&G Corp (033780:KOR), with market expectations for a 10% decline in earnings, with the company actually forecast for Uniform EPS to grow by 18% a year. Yet another is the fund's largest holding, Oracle (ORCL), which is priced for a 2% decline in adjusted earnings, when they are forecast to grow by 10% a year.

On the other hand, there are some names we'd recommend First Eagle review in their portfolio if we were meeting with their PMs. Two that jump out are Danone (BN:FRA) and Fanuc Corp (6954:JPN).

For Danone, the market is pricing the company for 6% annual earnings growth, when the company is forecast to have 12% annual earnings declines going forward.

Similarly, the market is pricing Fanuc to have 13% earnings growth going forward, when the company is forecast to have 8% earnings shrinkage. This doesn't look like an intrinsically undervalued company, if anything the market looks significantly too bullish.

But for the most part, First Eagle gets it right. And they get it right because they're not trusting the as-reported accounting statements. Their focus on understanding growth better than anyone else is likely to continue to power strong returns and our Uniform Accounting portfolio review shows it.

## About Valens Research

In 2009, just as the dust was settling from the last major equity and credit market crises, we launched a boutique research firm with the intention of breaking Wall Street's biases and broken incentives.

- GAAP and IFRS have failed to provide rules for reliable financial statement reporting
- As-reported macroeconomic analysis is not grounded in economic reality
- Stock analyst recommendations are not based on disciplined financial
- Credit agencies have been set up to grossly fail in their responsibilities to investors and the public markets

We sought to provide investors and company analysts with a source of information that changed all that. The integrity of Valens Research is founded in our disciplined processes and analytics. No "star" analysts. No corporate advisory relationships.

No-nonsense opinions and recommendations. We provide industry expertise and proven, back-tested data, with offices worldwide, a team of over 100 trained accounting analysts, and a comprehensive online database with over 8,000+ companies and growing.

**Our Methodology and Results**

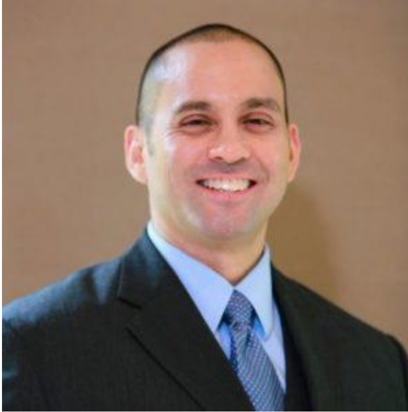
Today's largest broker/dealer organizations do not provide adjusted, forensically audited research to Wealth Advisors and Financial Planners. They give advisors what everyone else on Wall Street gets; research that is put together based upon REPORTED financials from companies, not ADJUSTED financials that have gone through extensive screening and forensic accounting.

GAAP accounting guidelines allow companies to do all sorts of things to their books. Unfortunately, most, if not all research is produced based upon misleading figures. You know it. We know it. And Wall Street knows it.

Valens Research rips apart the financial statements of over 8,000+ companies globally, line by line, to uncover GAAP and IFRS distortions using UAFRS principles. We apply over 130 individual adjustments, cleaning up distortions related to R&D, Operating Leases, Stock Options, Excess Cash, M&A PP&E and Earnings, Goodwill, etc.

The results of this process are telling. Since we started highlighting our conviction long ideas three years ago, the average weekly idea has outperformed the S&P 500 by 2.6% quarterly, or by nearly 11% annually.

## About the Authors



**Professor Joel Litman**
Chief Investment Strategist

Professor Joel Litman is the Chief Investment Strategist advising institutional and individual investors in equities, corporate credit, and macroeconomic strategy. He is also the President and CEO of Valens Research as well as a member of the Board of Directors of COL Financial Group, a leading brokerage firm in Asia.

Litman has been on CNBC, quoted in Barron's and Institutional Investor, and interviewed in Forbes. He has published in Harvard Business Review, is a top contributor to SeekingAlpha, and co-authored the highly-acclaimed book, DRIVEN: Business Strategy, Human Actions, and the Creation of Wealth.

Litman has taught or guest-lectured at Harvard Business School, University of Chicago Booth, Wharton, LBS, SAIF Jiao Tong, and others. He is a Professor at Hult International Business School, a Financial Times and Economist top-ranked international MBA program. He conducts seminars regularly for financial and industry conferences around the world such as CFA and CPA chapters.

Litman is chair of the UAFRS Advisory Council, which spearheads usage of Uniform Adjusted Financial Reporting Standards (UAFRS) – also known as Uniform Accounting. He helped build Credit Suisse's HOLT University and the Center for S.E.V. and MBA Concentration at the Driehaus College of Commerce at DePaul University.

Past employment includes Credit Suisse, Diamond Tech Partners (now PwC), Deloitte, and American Express. He is a member of the CFA Institute, the global association for investment professionals, and the Association of Certified Fraud Examiners. He is a Certified Public Accountant (CPA), received a BS in Accounting from DePaul University,

and an MBA/MM from the Kellogg Graduate School of Management at Northwestern University.

Litman's philanthropy is focused on community development through scholarships, job training programs, and extensive microfinance lending–particularly in the Philippines.

# About the Authors

**Rob Spivey**
Director of Research

Robert Spivey is the Director of Research at Valens Research. He is actively involved in delivering credit and equity analyses, idea generation, and client servicing based on UAFRS.

He is heavily involved in the development and management of the Valens Research application (app.valens-research.com), a tool Valens has developed to allow investors to integrate the UAFRS framework for investment analysis into their process on a daily basis to improve investment insights and decision making.

Spivey has held Assistant Portfolio Manager and Analyst positions and has experience at The Abernathy Group, Legacy Capital Management, Credit Suisse, and Gillette.

Spivey has leveraged his experience on both the buy-side and sell-side of finance and opportunities to work in both the credit and equity markets to gain a unique perspective of how markets work together and can offer contrary signals. His experience in communicating analysis to some of the largest investment managers in the world, working as a generalist analyst at a hedge fund, and to helping manage portfolios on the buy-side has helped give him a wide-ranging perspective on investing and identifying market mispricings.

Spivey is a CFA Charterholder and member of the CFA Institute. He received a BS in Business Administration with a concentration in Finance and a minor in Philosophy from Northeastern University in Boston.