**Transcript:**
**Brian Yacktman Interview on MoneyLife Market Call with Chuck Jaffe**

**Chuck:** And then, our MoneyLife Market Call. Well, we know you like new managers, and new guests in the Market Call. But today we have kind of a new-old guest, because my guest is Brian Yacktman. He is the president of the YCG funds, or Yacktman Capital Group. He's never been on the show before. But Yacktmans have been. His father is Don Yacktman, his brother is Stephen Yacktman. They have both been on the show multiple times, and Brian is in the family business. He worked for the family business for a long time, and then basically sort of spread out on his own. In part, because the family business was so big that they couldn't bring in smaller customers. About three years ago, he started the YCG funds, and YCG Enhanced has a great track record over that time as a value fund. The apple hasn't fallen far from the tree; he's a manager in the mold of his father and his brother – same kind of style. However, he's doing it on his own, and he's making his maiden voyage. So maybe that's the best of both worlds. I'm hoping we're going to have some fun.

Today, it's kind of interesting, because you're getting new perspectives from someone who's making his maiden voyage in the MoneyLife Market Call, but it's a name that you're at least partly familiar with because my guest is Brian Yacktman. He is the founder and president of the YCG Funds. YCG for Yacktman Capital Group. But that is different from the Yacktman Funds, and if you are a long-time listener to the show, well, Brian's father Don has been on the show many times. His brother Stephen has been on the show a couple of times. And ultimately, Brian went from working with them, to creating a separate fund company. They have the YCG Enhanced Fund. That's YCGEX, a fund that's been around for about 3 years now with a terrific record. If you want more information, it's ycgfunds.com, or ycginvestments.com. Brian Yacktman, welcome to MoneyLife!

**Brian:** Thank you for having me.

**Chuck:** We always start this segment of the show with methodology. Because a buy, sell, or hold recommendation means nothing until we know where it is coming from. You obviously have what might be the family methodology, but I'm curious as to A) whether there are twists in it for your company, and B) obviously, my audience needs to understand how it works because you are a value manager, but value means different things to different people.

**Brian:** Well, obviously with my father being my mentor there are a lot of similarities. And I'd say that, if there is any twist, it would taking a little bit of what I've learned and focusing in on it, and that is the strategy of buying high quality businesses. Surprisingly, a lot of academic research supports that owning boring, stable businesses, while it provides downside protection, it actually generally outperforms over the long-term. And so we tend to focus in those areas in most environments. But then there are occasional times when you deviate from that, where opportunities present themselves and you might be willing to go down on the quality curve if the spread between a high quality company and a low quality company widens enough to make it attractive to venture elsewhere. But in most environments we tend to be very high quality oriented.

**Chuck:** So it's high quality at the right price...

**Brian:** Sure...

**Chuck:** ...And making sure you can get the right kind of valuation. Value hasn't been working all that well when it's been broadly defined. When we say, OK, let's look at growth vs. value; you look at value and say, eh not so great. Value has been working out pretty well for you. Where's the disconnect there?

**Brian:** Well, I think that when we talk about value, there's something that creates sort of a systematic underpricing of high quality companies, and a systematic overpricing of low quality companies. So, there are some predictable human tendencies. In general, people tend to be very greedy, impatient, so they're looking to make a quick buck. And despite there being all this research that demonstrates that high quality outperforms over long periods of time, people are in general overconfident. And they believe that, "Oh I know how to pick a stock that will double overnight." But they recognize that by owning a really boring business, something like Colgate, is not something where you are going to double your money over night. And so that desire to make a quick buck and overconfidence to find something else means that you almost get paid a premium to be willing to own boring businesses. So as I say, in most environments that's the case, is that generally the prices are much more attractive in the high quality space.

**Chuck:** OK, so let's talk about how that plays out. Because, obviously with your definition of value it's not something where you are looking at sectors and saying, "Oh, let's go buy sectors," it's all very bottoms up, kind of research-focused. So, who comes though the process and is that kind of stock?

**Brian:** Sure. Well, I mentioned Colgate. I think that's a good example to go through. So, let me kind of give the general concepts, and then show how Colgate fits in that. We love businesses that produce an essential, non-fad like, short repurchase cycle product, or service. What that does is it leads to a consistent, less cyclical cash flow regardless of the various economic scenarios you find yourself in. And in the case of toothpaste, people brush their teeth regardless of what's going on in the economy. It's a very short repurchase cycle. It is essential to the health of your mouth. Definitely not fad like, at least I hope it's not! So, now you follow that up with these consistent, evergreen cash flows. We like businesses that have a very high return on tangible assets, that it doesn't require a lot of capital to produce that. This definitely fits the bill. The opposite would be something that requires a lot of metal, or real estate, or smoke stacks, often times in mining or commodity spaces. Making toothpaste does not require a lot of capital, so you get a very high return on tangible assets.

Another piece that we love is that the cost of the good is a very small percentage of the budget, but it still adds a lot of value. So, you think of the small cost it takes to brush your teeth, but think of the value that it does to preventing tooth decay. And when it is a small price like that, it allows you to raise prices over time much more easily because you're not as concerned. You know, toothpaste in America is like $0.69/oz is the price, and in India it's like $0.16/oz. So, over time as they countries become wealthier you can charge more, and nobody really goes into the aisle and says, "I don't want to pay for my toothpaste this week because it's $2.06 instead of $2.05." So, that gives you some more pricing power. And, speaking of pricing power, is often times due to a branded product, which many times comes from something that confers a relative advantage. So, a great example of that is social status. People ascribe a premium on attractiveness. So on something like having white teeth, they're willing to pay for what they have confidence in will give them white teeth, as opposed to saying something that's like a deflationary pricing category, like computers. So, we're looking for a branded product that ideally can do something like social status that is very enduring, to continue with that pricing power.

High market share is important to us. Colgate's 45% market share, versus 15% around the rest of the globe for the next biggest competitor. And that outsized market share leads to scale advantages; it leads to first mover advantages. And, if you have a lot of market share, you might think, "Well, you've already penetrated," so it is important to look for a long runway for growth. There is about seven billion people in the world. One billion in the developed world, and one billion in the developing world are avoiding the tooth decay. But that still means you have five billion people suffering from tooth decay, and over the next 50 plus years there's going to be several billion more of unborn, potential customers. So, when you've got this brand that has such high market share, and billions and billions of people. Where this shows up is you can see in the US, I think it's around 500 grams per person is consumed per year. You go to India and China, and it's like 100 to 200 grams. Well, a little growth in those countries, as they become wealthier they are going to want to brush their teeth as much as we do, that will lead to this higher number. A little growth in a country like India and China, where they are five times the size of the US, goes a long way to moving the bottom line in Colgate. So that's kind of an outline of different things that we're looking for.

**Chuck:** Let's talk about sell discipline. What makes you move away from a stock?

**Brian:** Well, typically what we're doing is, we look at the current price of the stock and say, "If we buy it at this price, what is the forward rate of return I can expect to achieve from this price level?" So, we're looking at a world of businesses that we want to own, and what causes us to sell is that typically there is a better opportunity in another great business that we want to own relative to the other business that we currently own. So we're just constantly comparing these forward rates of returns.

**Chuck:** That means that ultimately you are always looking for opportunity. That, even if you have something good, if you can find something that you believe is better, you're not afraid that perfect is the enemy of the good. You're always going to be looking for better.

**Brian:** Correct, and I should also clarify here. There's a group of businesses that are in the stable that we love. But I will also comment that while we love high quality companies and seek to maintain that core, that during market shakeups, loss aversion rules. So, fear ends up overwhelming that greedy impatience and overconfidence characteristics that I spoke about. All the sudden, they fly to quality, which makes these businesses' forward rates of return not look as attractive relative to other businesses that maybe are lower quality or more cyclical, and it's sort of like throwing out the proverbial baby with the bath water. You're able to find great opportunities. So there is definitely, right now in this market shakeup, certain areas where opportunities are surfacing.

**Chuck:** Let's take one more example of where you think there is that opportunity?

**Brian:** We're finding it in lots of different areas. Financial, health care, media – there's things popping up. One that I'd maybe point out is Richemont, because Richemont is not as well-known name. The China fears have really created an opportunity. It is a cyclical business, that has been getting cheap during this market downturn. And as I was mentioned about social status, this is an ideal company that really conveys that social status. It is a luxury good maker, you know operates in a great industry, social status and luxury goods. There's probably no other category that's more pure to talking about that desire for people to have a positive impact on their appearance by sending the social signal that, "Hey, I control more resources than someone else" by wearing these luxury goods. What's interesting about Richemont is that, normally I mentioned we like short repurchase cycles, but this is very clearly a long product cycle. But in this case, we actually think that, while that does create a more cyclical business, that disadvantage becomes outweighed by the extra brand loyalty that a long repurchase cycle engenders. Because most customers can only afford to purchase an expensive piece of jewelry on rare occasions, and so if they're going to go do it, they want an established brand instead of taking a risk on some startup brand. And so here you have a company that's very high quality, but it's a cyclical company that's going to probably struggle in the short- to medium-term, but on a valuation basis, about 15%-17% of the company's market cap is in cash, this is a business that will be around for decades to come. They've been around for about 170 years; I expect a lot of growth.

**Chuck:** Yeah, it's Richemont; it's CFRUY, the ticker symbol. And now we're going to turn our attention to some ticker symbols that we know my audience is concerned with. (Know when to hold 'em, or when to fold 'em music)

**Chuck:** It's hold it or fold it time with my guest, Brian Yacktman. He's founder and president of the YCG funds. The YCG Enhanced Fund, YCGEX, the ticker symbol. For more information, ycgfunds.com or ycginvestments.com. You know how hold it or fold it works. If you want to participate yourself: name, hometown, ticker symbols –

send that to chuck@moneylifeshow.com. First up today is Joe in Colorado Springs for Delta Airlines, ticker symbol DAL.

**Brian:** Well, Delta Airlines is the opposite of what I just described that we're looking for. It's a very capital intensive, very cyclical business. If you sum of the profits of the airline industry going back to Kitty Hawk, they're actually negative. It's a constant story that everyone believes the industry is now finally consolidated enough to finally make good profits and returns for their investors. But that's been said of other industries. I wouldn't bet on it, I'd fold it.

**Chuck:** We sent you the list of tickers the same time we sent it to all of our guests this week. We talked about Delta Airlines earlier this week, and when you're selling it, we know who's buying it. That was Craig Hodges, who earlier this week he made it a buy, but we just had it as a sell on Delta Airlines, DAL.

Larry in Louisville and Dave in Beaver Dams, NY both wanted to know about Marsh & McLennan Companies, MMC.

**Brian:** So we actually own their competitor, AON. I think Marsh & McLennan's a great business in a great industry. Insurance broker, it's essentially a toll taker on Gross Domestic Product (GDP) over time. And so as GDP continues to increase, so do insurance needs around the world, and that means their commissions continue to grow on this growing pie. It's priced well, and if the insurance market actually starts to harden in their pricing, this could look really good. So hold it, for sure.

**Chuck:** Would you be buying it, or you're not buying it because you got AON, which is AON, and so AON is your preferred pick.

**Brian:** That's correct.

**Chuck:** So, it's hold it if you got it on Marsh & McLennan, MMC. But AON Inc., AON, that was his real pick in the space. Dave in Beaver Dams, NY had another request, this for 21st Century Fox, the class A shares, trade under FOXA.

**Brian:** So 21st Century Fox is very interesting right now. The media industry in general is interesting. The proliferation of content, all these different methods of viewing content, and the concern about how cable cord cutting is going to affect things, it's created a lot of uncertainty, but that's also creating a lot of opportunity. Fox looks cheap, and we believe content is still king, someone needs to produce it, and I think that high quality content is the key here. That high quality content will become more valuable over time. What I love about Fox is, fitting into that model that we talked about, it essentially creates this disposable content in news and sports. So, it's a short repurchase cycle, where people keep coming back for the live news and the live sports. We own Fox, and to me it's a definite buy.

**Chuck:** That's a buy, on 21st Century Fox class A, FOXA. Josh in Petaluma, CA wants to know about Comstock Resources, CRK.

**Brian:** This is an industry where, you have to decipher is this an industry that's suffering because it's supposed to, or is it the right place to be because it's being overlooked and there's a lot of fear. You know, as Buffet says, "Be greedy when others are fearful." We believe that Comstock's in an industry that is deservedly suffering. It's a long-term deflationary category, speaking of commodities and energy-related stuff in general. That happens because there's upward pressures supply on innovative methods of extracting and downward pressure on demand from alternatives and better recipes that mean you might need less of commodities over time. So in other words, if you look at a chart of industrial commodities over time, these downward pressures on demand and upward pressures on supply means real prices in the commodity category is deflationary, and you're talking about a lot of leverage here. It's essentially like buying an option at this price, it's like buying a lottery ticket. So if you want to feel free, but for me I'm not a speculator. I just wouldn't touch this industry, so I'd fold it.

**Chuck:** That's a sell or an avoid on Comstock Resources, CRK. And last, for Al in Caledon, Ontario Canada it's MasterCard, MA.

**Brian:** We love MasterCard. We actually own it ourselves, and now's a great entry in our point of view. When you look around the globe, 85% of the world still uses cash. Someone's going to have to process these transactions. It's also like a toll taker on GDP like I was mentioning with Marsh & McLennan. There's a long runway of growth here. It fits our model perfectly for a low capital-intensive business. This is a definite buy in my mind.

**Chuck:** So that's a buy on MasterCard, MA. And speaking of good buys, unfortunately we have to say ours to Brian Yacktman. Brian, this was a great maiden voyage. I hope you'll come back and do this with us again in a couple of months.

**Brian:** I appreciate it. Thanks again for having me.

**Chuck:** Again, Brian Yacktman from the YCG Funds. It's ycgfunds.com, ycginvestments.com.

**Definitions:**

Spread – the difference between two numerical or qualitative factors.

Cash flow - the cash generated by a business from operations that is left over after spending on maintenance capital expenditures and acquisitions that are required to protect the business. In other words, it's the cash flow from operations that is free and clear to be distributed to shareholders in the form of dividends and share repurchases, and/or to be allocated towards ways to grow the existing business through means such as "growth" acquisitions or new capital expenditures, and/or simply to pay down debt. Typically, we calculate this by looking at a normalized view of net income plus depreciation and amortization minus the maintenance capital expenditures and acquisitions that are required to protect the business, adjusted for often overlooked items such as pensions, stock option expenses, and leases.

Market cap – the aggregate valuation of a company based on its current share price and the total number of shares outstanding.