

12-13-2016 MoneyLife Interview of Brian Yacktman by Chuck Jaffe Transcript

Chuck: That's right, it's MoneyLife Market Call time, and I'm very pleased to be joined right now by Brian Yacktman. He's the founder and president of the YCG Funds. And if you are not familiar with them, well, get familiar by going to YCGFunds.com, also YCGInvestments.com. Now, if the Yacktman name sounds familiar to you, that's because Brian is part of the only family where we've had three members on. We had one or two others that I can think of where we've had father-son or brothers on. But his father, Don Yacktman, one of the legendary stock pickers - value investors - I'd call him really a legendary value investor more than I would stock picker, is the founder of the Yacktman Funds. And then, Stephen his brother has also been on the show. But Brian left the family business, started his own firm. And again, it's YCGfunds.com. Brian Yacktman, welcome back to the show.

Brian: Thank you for the invitation.

Chuck: Now, we start with methodology. It's particularly important because, well, you have a value bent, your father and brother have a value bent. But we talk to a lot of people with value bents. In fact you're not the only value manager who will be on the show this week. Value means different things to different people. So let's start there. What does value mean to you, and how does that translate into here's what you want to buy, here's what you want to leave to everyone else.

Brian: Well, let's start by saying I don't know a value guy that hates growth, and I don't know a growth guy that says he loves to purchase overpriced stocks. But to me, value, since you're purchasing an asset that's valued based on its cash flows over the coming decades, has a very long duration if you will. If you were to view it as a bond, that long duration means that you need to have, to be purchasing an asset that's predictable, so that those cash flows are predictably there over the life of which you're purchasing this asset. I know a lot of people think short term, day to day, week to week, month to month, but these assets are valued over a decade's worth of coming cash flows, so we want to be aligned in industries or businesses that we can really understand that will predictably produce excess cash flow for shareholders for decades.

Chuck: What is your value metric? I mean, you're not really looking for the cigar butt kind of stock. And you're not necessarily saying, "Let me wait for the blood to be running in the streets," but what is the basic proposition that you're looking for out of any company that you're ready to buy.

Brian: There's lots of different valuation metrics that you can look at, but for us the main thing that we like to zero in on is we feel a little bit like Sherlock Holmes, trying to figure out what is the true excess cash being generated by a business. Then, once we have that, and there's a lot of detail that goes into that part, but once we figure that part out, then we want to figure out based on the price on which we're buying it, what's the shareholder yield, what can I hope to compound at based on

this cash flow at this price, and then you add to it a growth rate. But again, it comes back to really trusting in the predictability of that cash flow. Just to give you like a sense of what I have going on in my mind right now as I'm talking about this predictability, I read a stat - in the office here we do something each week where we kind of step back and look at the world, and my business partner, Elliott Savage, he brought up that over ninety percent of the world's scientists since the beginning of time are alive right now. That means there's more creation of ideas than ever, and those ideas are being mixed and shared at a more and more exponential rapid pace. If there's one thing I can count on, it's going to be a lot of rapid technological change and innovation. And so, our focus would be to find a portfolio of reasonably priced businesses that are going to be robust to technological change, that we can count on being around years from now.

Chuck: That being the case, at the levels of the market that we're seeing, post-election rally, etc. are you able to find a lot of valuations right now that look attractive? Because you're able to buy businesses that you can take that long-lens view on, or is everything a bit frothy, so maybe not so much?

Brian: So, there are some that we believe we can compound at a healthy rate in, but I'll tell you that it's certainly getting more and more difficult. But there are some businesses that we believe are priced to benefit from. What'd I'd say is the long-term, worldwide wealth per capita growth that will happen, the world's becoming wealthier. So the implication of having more and more information and more and more education and this sharing of ideas is not just creative destruction and innovation, but it also means we're going to have a lot of wealth growing. And as wealth grows, it means that we'll get to other parts of the world. And so, if you can find businesses that will benefit from this long-term worldwide wealth per capita growth, and are still immune, and not - maybe immunes the wrong word, but they're robust in the face of rapid technological change, then you're going to do well in it. So there's a fair number that have actually become, looked attractive to us just recently, where they're businesses that we believe have pricing power. They tend to sell mission critical products that are a small price of an overall person's budget, or perhaps lead to social status that leads to pricing power. That's kind of the key, is you want businesses that have pricing power. Because we're going to be in a very deflationary world with all that change. All that change means deflationary, so you need to focus in on investing in inflationary categories.

Chuck: So, what's a name or two that personifies that?

Brian: So one that's surprising to me at just how - at its valuation, it's not necessarily cheap, but given the certainty and the predictability of the business in a world where there's a lot of change, I would say boring is beautiful. And Nestle is the largest packaged food and beverage firm in the world. They have over 90 billion revenue annually, they are in over 200 countries, and they have a diversity of over 20 brands that generate a billion dollars each in revenue. They're recognizable of course - things like the baby food, Gerber, confectionary, you know - they have

Nestle and Kit Kat, bottled water, I think it's the Poland Spring bottled water, Perrier. They have packaged foods like Stouffers and Dreyer's ice cream, DiGiorno pizza, Lean Cuisine, Purina pet foods. So a lot of household names with this very vast global reach, and keep in mind when you have this massive distribution network, and you get all this shelf space. That's what allows to give you the scale and this ability to test new products, and having that shelf space is very valuable. And the scale gives you cost advantages. So, while there's a lot of fear about, due to the election, maybe there will be problems with global trade, emerging markets may suffer, it's creating this real opportunity in what I would consider a AAA bond in my mind. When I say bond, it's an equity, but I view it like a AAA bond.

Chuck: Right, and that's the safety edge, that's the dividend edge. All those other things.

Brian: Correct.

Chuck: Now, let's go the other way for a second. Because, when somebody hears you talk about - OK, you view it as a bond, and that is something you've said on this show before. And that's something that you're looking for, you're looking for stocks that give you that bond-like safety and security and what have you. So what makes you sell something, and what's something that you had to move away from recently?

Brian: First of all, if you've job has been done right, hopefully you'd sell never. You'd never sell. I think there's - high turnover to me is indicative of one of two things. Either you made a mistake or the market has made a mistake. Meaning the market's mispriced something giving you an opportunity to take advantage of what it's offering you. And hopefully, our turnover is more the latter - the market made a mistake and is giving us opportunities, not the former that we want out. But one that comes to my mind that we've exited recently - when I say recently, it was back in February - so the market was collapsing in February, Verizon actually was going up, and it'll be yet to be determined how this one will shake out, but our theory is we felt like Verizon, there's only so much spectrum you can have, and the old Verizon business was the wire lines where you can have all basically unlimited capacity on these wire lines, and all of this cut throat competition led to razor thin margins. But the new Verizon wireless business, they command all this spectrum, and there's limited spectrum available by definition, and data is growing at an exponential rate. So, that would lead to pricing power, and we felt confident in that. But the problem is, we realized why are we counting on this when overall our theory is there's always innovation and change that leads to progress, and at what point will these technologies become leapfrogged or perhaps some new technology comes along that there are - it's just completely obsolete. Combine that with the valuation was getting richer while everything was getting cheaper, and then we were concerned that management, we weren't sure what they were going to do with the excess cash that was being made available to shareholders. They started to go after various acquisitions, and so we felt uncertain that we would ever see the cash flow

ourselves, and so we decided to sell and move on in other things that appeared more interesting at the time, such as Charles Schwab.

Chuck: That was Verizon, you're out of. Charles Schwab you were in to. Now we're going to find out how you feel about some stocks that my audience is particularly interested in. (It's hold it or fold it time) with my guest, Brian Yacktman. He is the founder and president of the YCG Funds. And if you want more information, ycgfunds.com, ycginvestments.com. Hold it or fold it - you know how it works. But, if you want to get involved directly, send your name, your home town, and the ticker symbols you're interested in to Chuck@moneylifeshow.com - hopefully they will get into an interview soon. Joe in Colorado Springs wants to know about Intuit Incorporated, that's INTU.

Brian: Intuit reminds me a bit of Microsoft, where there's high switching costs. When I say Microsoft, I'm not thinking about the cloud side, I'm thinking of the Office suite side. They're the maker of Quickbooks, Turbo Tax, and they basically are like a backbone or an operating system behind small businesses. It's a recurring revenue subscription business with high switching costs. You have all your data, and it's difficult to move from one to the next. And there's network effects there where you want to communicate and share these files, so I like the business long term low capital needs, high recurring revenue. There is no net debt there, so it should trade at a bit of a premium. I would say though that I probably wouldn't be interested at this price, so I would call it a Hold for the long run.

Chuck: A hold it if you've got it, if you are interested in it, well, you're waiting for a better price. On Intuit, ticker symbol INTU. Craig in Bellville, Texas wants to know about Seadrill Limited, that's STRL.

Brian: Seadrill's in a, as we were talking about deflationary industry, and here the marginal cost to extract oil is getting worse over time, and the depleting resource. And I think for the first time now, alternative energy sources are really becoming viable. Keep in mind, these are renewable. We're finally able to capture the power of the sun at a rate that has unprecedented. Cost curves are coming down there. The issue is still being able to store that power, but as we're learning to harness that power of the sun, I think that oil in general is in for it over the long run, and so in the short run here, OPEC's agreements lead to this skyrocketing in oil and the oil-related stocks, but long-term I don't see much promise here. It's very heavily levered, so the downside's huge if it doesn't work out. So, in my opinion, this is an opportune time to get out.

Chuck: That's a sell on Seadrill Limited, ticker symbol SDRL. Kirk in Huntsville, Alabama and Donald in San Mateo, California both want to know about Solar Edge Technologies, SDEG.

So as I was saying about solar, you know - just to give you an idea of the power of this. The earth absorbs more energy from the sun in one hour than all humanity

uses in a year. And the bonus is it's clean, and continually renews. So solar I think is going to be a game changer. However, I think the users of technological improvements tend to benefit not so much the investors themselves. So, I personally would not be making investments in solar companies, despite my belief that solar is going to be a big game changer, and lead to a lot of growth at various industries.

Chuck: And if you've got 'em, well you've been hammered at this point to some extent.

Brian: Yeah, no I just would not invest in something technological like this at all. I think solar will be great for its users, not for those who invest in the industry.

Chuck: So, that's sell on Solar Edge Technologies, SDEG. You can have you dreams, just separate them from the money. That's the message. Our last two requests come from Mark in Mitchell, South Dakota. The first is for Netflix, NFLX.

Brian: Netflix is interesting. Media in general has been a very interesting place, a space that is going through a lot of change right now, and could be accelerated if we have a recession/depression-type scenario, who knows what will happen. But right now, there's just this proliferation of content and ways in which to view it. Netflix, we came across this statistic recently, where, they're spending basically as much on original content as content producers. So, it used to be they had four shows in 2012. Netflix now has more content than any one network or cable channel in existence. And that exponential growth is likely to continue, so their content advantage will surely increase over time. And the key here is they're a global player. So for example, HBO owns domestic rights, not international. Whereas Netflix owns worldwide rights. So in my opinion, there is a threat here, it's the Amazon threat, and I have to say that the price is tough for me to wrap my head around, but from a business model perspective looking decades down the road, I think Netflix is in a very strong position.

Chuck: So, basically it's a hold looking for a better price, right?

Brian: Yeah, in my opinion.

Chuck: Good company, not yet a great stock. So that's you're issue, because you've got to get that better valuation, on Netflix, NFLX. And last, again from Mark in Mitchell, South Dakota, Goldman Sachs. Ticker symbol GS.

Brian: Well, this is, reminds me of the old adage of the IBM effect - you can't get fired from picking IBM, you can't get fired for picking Goldman. They're basically the crème de la crème of brokerage, and so with all these network connections across the globe, connecting all these people, you're in an oligopolistic industry that gives them very long-term pricing power. So, yes, recently the price has been a huge run up, but still it's at 1.39x tangible book value, which means that before the run up it

was super cheap before - kind of wish I had owned it! But, because I like to get things on the cheap, I'd wait, but I'm confident in it as a long-term business.

Chuck: OK, so again - it's "Good company, not yet a good enough stock to make it a buy." It's hold 'em if you got it, not buying more at least until you get a better price on Goldman Sachs, ticker symbol GS. And really, no money has changed hands at all here today, we keep looking for better prices. But that's part of the valuation picture that Brian was talking about. Brian, this has been great. Thanks so much, we'll talk to you again in the not too distant future.

Brian: Sounds good, thank you.

Chuck: Brian Yacktman is the founder and president of the YCG Funds. And if you want to learn more about how they work, you're going to go to ycgfunds.com or ycginvestments.com. Hey, we're just about done with the December 13th edition of Moneylife, but we'll cross the finish line together, get you set up for tomorrow and beyond before we send you home right after this message.

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Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.