February 28, 2017

# Value Investor INSIGHT

The Leading Authority on Value Investing

# Traditionally Modern

*In a world where the "cutting edge" often gets the most attention, traditional value investors Tweedy, Browne continue to prove that new isn't always better.*

For those seeking portfolio managers who "eat their own cooking," Tweedy, Browne Company LLC would certainly fit the bill. At year-end 2016, current and retired principals and their families, as well as employees, had more than $1.1 billion in portfolios that were combined with or similar to client portfolios.

Investors inside the firm and out have been quite well served. Since its 1993 inception the flagship Tweedy, Browne Global Value Fund has earned a net annualized 9.35%, vs. 5.93% for the MSCI EAFE Index (hedged to US$).

Following a tried-and-true process developed over the firm's 97-year history, principals Thomas Shrager, John Spears and Bob Wyckoff see opportunity today in such diverse areas as auto parts, insurance, IT distribution, agricultural equipment and Chinese real estate.

**INVESTOR INSIGHT**

**Tweedy, Browne**
(*l to r*) Thomas Shrager, John Spears, Bob Wyckoff

**Investment Focus:** Seek companies whose stocks are statistically cheap and the "issues" causing the cheapness are deemed temporary or cyclical in nature.

Tweedy, Browne Company LLC
*Established in 1920*

*Global Value Investing*

www.tweedy.com

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# Investor Insight: Tweedy, Browne

Thomas Shrager, John Spears, Bob Wyckoff, Jay Hill and Olivier Berlage of Tweedy, Browne Co. describe how value investing is like duck hunting, why today they focus more on non-U.S. companies than U.S. ones, how valuation for them is a "two-part test," and why they see mispriced upside in Hyundai Mobis, Hang Lung Group, E-L Financial and Avnet.

**Your firm's compendium, *What Has Worked in Investing*, is a must-read for value investors, young and old. We imagine its findings are a good place to start in talking about your basic strategy.**

**Bob Wyckoff:** We are quite price-driven in our orientation as value investors, so our process often begins with screening across value metrics that allow us to cut a global universe down to what are likely to be more-interesting ideas. Most of our investments have characteristics that have been associated empirically with above-average investment rates of return over long measurement periods: a low stock price in relation to book value, a low price-to-earnings ratio, a low price-to-cash-flow ratio, an above-average dividend yield, a low price-to-sales ratio compared to other companies in the same industry, a significant pattern of purchases by insiders, a significant decline in share price. There's a lot more to it of course, and individual analysts here put their own spin on it, but the basic selection criteria described in *What Has Worked in Investing* have been incorporated in Tweedy, Browne's investment process for at least 60 years.

**Jay Hill:** We try to buy companies at two-thirds or less of a conservative estimate of what Benjamin Graham called intrinsic value, with intrinsic value defined as what the business would be worth in an acquisition or by estimating the collateral value of its assets and/or cash flow. As Bob said, the first part of the process is to find stocks that meet a statistical fact pattern we find interesting. Often when that's the case the companies have, shall we say, issues. Our job is to determine if those issues are secular and more permanent, or whether they're cyclical and otherwise temporary.

**Thomas Shrager:** Value investing is like going duck hunting. You sit in a blind and wait for the ducks to come. If they come you shoot them down.

**Can you generalize about what the "issues" tend to be that help create potential opportunity?**

**JH:** Our investment in agricultural-equipment manufacturer AGCO Corp. [AGCO] illustrates one common type of situation that attracts us. We started buying the stock in 2014 at a time when if you looked at long-term average revenues and profitability, you could make a very strong case that the company had normalized earnings power of at least $4 per share, at a time when the stock was in the low-to-mid-$40s. The earnings outlook then was much lower because the #1 determinant of agricultural-equipment demand is farm income and the #1 determinant of farm income is crop prices, and crop prices were – and still are – historically weak. So the near term was uncertain, earnings were declining and it was very difficult to know when that might turn.

But we were very comfortable that the big-picture trends around food consumption were a long-term tailwind that argued for even better than a reversion to the mean. The sell-side in these types of situations tends to value companies at peak multiples of trough earnings, and only shifts to the more mid-cycle earnings and valuation we use when there's clear evidence the cycle has turned. Investing with a longer-term view when that's too uncomfortable for others often provides us with an attractive entry point.

**ON VALUE INVESTING:**

**It's like duck hunting. You sit in a blind and wait for the ducks to come. If they come you shoot them down.**

**Olivier Berlage:** A similar and more-recent example would be LG Corp. [003550:KS], the giant South Korean conglomerate. There has been negative news at many of its key affiliates. LG Electronics has troubles with its smartphone offerings. LG Chem is seen to be facing headwinds in the petrochemical cycle. LG Household has issues to resolve with its cosmetics business in China.

In addition to heightened uncertainty at the company, we're also finding somewhat of a negative halo around Korean companies in general, caused by all the political turmoil in the country in recent months, persistent worries over corporate governance, and ongoing concerns about competition from Japanese companies benefitting from the weak yen. (Incidentally, the current political upheaval may well lead to better corporate governance further down the road.)

We got interested when there were low expectations and systematically looked at the value of each of LG's businesses on a more normalized basis. When we do that work, we arrive at a sum-of-the parts intrinsic-value estimate that is very close to the company's reported book value of nearly ₩100,000 per share. That's compared to a share price of around ₩58,000 when we first got involved and around ₩63,000 today.

**John Spears:** The stock was trading at just 60% of book value and 9x earnings and the company carried very little debt net of cash. For a business that you believe actually has a reasonably bright future, that's very cheap. We may not know the timing of how that all will correct, but we believe it will. If it does we should benefit as shareholders.

**Have any ideas cropped up following the recent administration change in the U.S.?**

**TS:** This is not a new idea for us, but we did have an opportunity to add to our position in Kia Motors [000270:KS] when the stock went down, in no small part due to concerns of it being "Trumped" given the company's plans to expand production in Mexico and export to the U.S.

We don't have a clue what actual policy changes will happen and how they will affect Kia's business. But the company has made great strides on the operating front over the past decade – selling all over the world and improving product quality and reliability as well as customer satisfaction. Markets can make mistakes in taking a snapshot in time and extrapolating that far into the future. Businesses adapt and adjust. Maybe Kia exports to Europe out of Mexico, or it exports more cars to the U.S. from Korea under a bilateral free-trade agreement, or it builds a new factory in the U.S. There are ways it can adapt.

But because of policy-related concerns and other short-term issues, the stock trades at 60% of book, 6-7x earnings, with a 3% dividend yield and backed by a balance sheet with net cash, almost unheard of for a car company. You don't find many businesses with those characteristics around the world today, but in our experience when you do find them the odds are in your favor that things will work out.

**Where do your companies tend to fall on the quality spectrum?**

**JS:** If you look at stocks we've owned the longest and where we have the largest gains versus our entry prices, they have been in high-quality companies that generate spendable cash profits that they can put to good use. Like a Nestle [NESN:VX], or a Philip Morris International [PM] or a Johnson & Johnson [JNJ]. If you buy a quality business at a big discount to intrinsic value, you get the potential of a double dip – the gap to intrinsic value hopefully closes and then you can also benefit from the company compounding per-share value over a number of years.

At the other end of the spectrum, though, we will also buy into highly cyclical, junkier and low-return-on-capital companies. The stocks of these types of businesses often bob up and down, so we're just trying to buy them when they trade at a significant discount to what we think they're worth – in many cases also relative to book value or to net current assets – and then be very sensitive to getting out if and when they reach intrinsic value. At the end of the day the portfolio is a mix in terms of quality, but in every case we're paying a price we believe is well below a conservative estimate of fair value.

**ON NON-U.S. INVESTING:**

**The reality has been that when it comes to entry-point pricing opportunities, we've found more value elsewhere.**

**We see Tweedy, Browne today more as a non-U.S. investor than a U.S. one. Why did that happen?**

**BW:** We examine businesses all over the globe, focusing primarily on the developed world and the more developed of the emerging world. We've always liked the idea of having a bigger shopping aisle of opportunity, and the reality has just been that when it comes to entry-point pricing opportunities, we've simply found more value elsewhere. The equity culture outside the U.S. is still much less developed than it is in the U.S., which appears to us to result in a greater level of inefficiency.

**TS:** Remember what I said about ducks? We go where the ducks are.

**"Small market capitalization" is one of the stock characteristics highlighted in *What Has Worked in Investing*. Given the amount of assets you manage, can you invest in small companies to the extent you once did?**

**BW:** We have fairly broad diversification within our portfolios, with generally no one issue at cost accounting for much more than 3% of the portfolio. [*Note*: The flagship Global Value Fund at December 31, 2016 had 111 positions.] Part of that is our taking a more actuarial approach to portfolio management, focused on minimizing the risk of individual errors we're certainly going to make. We don't want to write just one policy for broken legs, we want to have a lot of them and then count on our underwriting to be more right than wrong over time.

Owning the number of positions we do also allows us to buy smaller and mid-size companies that collectively have an important role in the portfolio. But we take what the market gives us. Before the financial crisis, probably two-thirds of our money was in stocks with market caps less than $5 billion. When the crisis hit in 2008, the whole universe was indiscriminately on sale and we ended up moving toward bigger, higher-quality businesses. If there were any trend today, I'd say it would tilt toward mid-size ideas, although not long ago we were in the market buying a couple auto-dealers in the U.K. with market values of $200 to $600 million.

**How would you characterize today's opportunity set for the global investor?**

**BW:** As a price-sensitive investor, it has been a tough environment. To give a sense of that, we recently did a global screen of nearly 5,800 non-financial companies with market values greater than $300 million, positive free cash flow over the past 12 months, at least an 8% return on equity over the past 12 months, net debt to EBITDA of no more than 2.5x and a trailing EV/EBIT multiple of no more than 8x. Between 2010 and 2012, we would have had 650 to 800 companies meet that criteria. Today the number is 188, concentrated largely in retail, auto parts, homebuilding, airlines and precious metals. The odds are that we're in for a bit more volatility going forward – which can help us find the entry points we need – but it's not easy for us to put money to work right now.

**Has energy been of interest?**

**JH:** We probably have a better-than-market exposure to energy, including big integrated players like Total [TOT] and Royal Dutch Shell [RDSA:LN] and oil-services companies like Halliburton [HAL] and MRC Global [MRC]. Not surprisingly, for E&P companies we try to be active when valuations on a price-per-barrel-equivalent basis are at very wide discounts to the cost of finding and lifting it out of the ground. For the service companies we're of course focused on activity levels and generally are looking to capitalize on normalization of the cycle.

**Is MRC Global an example of a typical smaller-cap holding?**

**JH:** The market cap is just under $2 billion, but it's a leader with a 30-35% North American market share in distributing a wide variety of pipes, valves and fittings to the U.S. energy-infrastructure industry. When we got involved in the summer of 2015 the shares were trading at a steep discount to our estimate of value based on normalized earnings and based on where comparable businesses had been bought out. On top of that, we thought – and still think – the company's market position provides it with a competitive advantage it can continue to build as it buys out at attractive valuations independent mom-and-pops. That gives it a secular growth angle in addition to the cyclical one that is driven by the improvement in U.S. well completions we expect with oil above $50 per barrel. [*Note*: MRC shares traded recently at $20.90, more than double early-2016 lows, but 65% of 2013 highs.]

**Has valuing companies on comparable M&A deals gotten you in trouble from time to time?**

**JH:** Our valuation methodology is a two-part test: Is the stock cheap relative to private-market value and is it cheap on an absolute basis? In general we won't engage unless the owner-earnings yield – defined as net operating profit after tax divided by enterprise value – is in excess of 8%. We include an absolute measure because we don't want to rely solely on what we might consider unsustainable M&A multiples.

This is particularly relevant today. In 2016, according to Standard & Poor's, the average LBO of a target company with greater than $50 million of EBITDA was done at an 11x EV/EBITDA multiple. That's the highest it's been since they started tracking the information in 2000. That's driven primarily by low interest rates, which we don't considerable to be sustainable at current levels.

Last summer I spent a lot of time studying Tiffany [TIF]. The stock had fallen from $80 to around $60, and at that point it traded at roughly 8x EV/EBITDA, 10x EV/EBIT, a 16x P/E and at an owner-earnings yield just below 7%. Not terrible, but also not that exciting. But if you looked at the M&A comps, like Swatch acquiring Harry Winston in 2013, or LVMH buying Bulgari in 2011 or even Samsonite buying Tumi in 2016, you could easily make the case that Tiffany was trading at two-thirds of private market value. But it wasn't cheap enough on an absolute basis so we passed. That's not looking like the greatest decision at the moment, but it tells you something about our process. [*Note*: Tiffany shares trade today at around $92.]

**Do you trade actively around positions?**

**BW:** It varies. Take a position like Nestlé, which we've owned for over 20 years. It's one of those unusual businesses that has been able to compound its intrinsic value at a pretty attractive rate while there's been, in general, a fair to pretty attractive relationship between price and value. But sometimes the share price heads north or south of intrinsic value depending on the noise of the market or on how the business is doing on a near-term basis. For a compounder like this we'll add to the position when given an opportunity and trim from time to time when the price trades close to intrinsic.

Cyclical and slow-growth businesses come and go. They're often bought at a big discount to book value and then traded out at book or a slight premium to book. We tend to go in and out incrementally, based on liquidity, but these are more "rents" than "owns."

**We noticed you recently sold your position in uniform-rental company UniFirst [UNF]. Isn't that a compounder?**

**JH:** It is clearly a compounder, in a consolidated industry with highly recurring revenues and pricing power. But as Bob described, one of the reasons we've held Nestlé so long is that the relationship between the stock price and intrinsic value has stayed fairly attractive. In the case of UniFirst our base valuation was 11x EBITA, which translated into a $123 share price. But the stock late last year went above $140, trading at 13x EBITA on margins that we consider right around peak. We're unlikely to see much further benefit from unemployment coming down, or from energy prices declining. With the stock trading as far above our estimate of intrinsic value as it was, we took the opportunity to sell.

**We have a shared history [*VII*, September 30, 2011 and August 31, 2012] with global security-service company G4S [GFS:LN]. With ups and downs, the stock is about where it was when we first spoke about it and we see you recently added to your position. Lessons?**

**TS:** It was my idea so I should own up to it. In hindsight, it has been a mistake. We're better than breakeven in the stock, but what we missed was how poorly the company was being run prior to changing management two and a half years ago. It was growing nicely around the world, but that masked how loosely run it was, which is a problem for a company with more than 600,000 employees and operations in more than 100 countries. New management is focused both on doing the little things right and on more strategically building out an integrated product mix that goes beyond just providing security guards. Operating margins increased last

quarter, which we haven't seen for some time. It's not the cheapest stock in the portfolio, but hope springs eternal and we do believe the company is moving in the right direction.

**How do you handle your portfolios' currency exposure?**

**BW:** We concluded a long time ago that while we can read a company's balance sheet, we're not nearly as capable of assessing a country's balance sheet. So as a general rule we don't make currency bets in client portfolios. Clients choose whether to be hedged or unhedged against perceived currency exposure.

**You've mentioned a couple South Korean stocks already. What's your investment case for Hyundai Mobis [012330:KS]?**

**OB:** The company makes parts for Hyundai Motor and Kia Motors and also handles the logistics and distribution for each company's after-market parts and servicing. While auto-parts manufacturing is a fairly mediocre and cyclical business, the after-market business is quite profitable and a reliable cash-generating machine that now accounts for 19% of Hyundai Mobis's revenues and 54% of its operating profits.

As Tom mentioned earlier in speaking about Kia, Korean car manufacturers have been gaining global market share through building better cars and investing in their sales and marketing footprints both in developed and in emerging markets. They also have the scale to develop technology to compete if and when various autonomous-driving and electric applications take hold. All this obviously benefits Hyundai Mobis, which should continue to grow along with them.

The auto-parts business will move in fits and starts and negative news can impact the company's share price from time to time, as happened in January following the release of what were considered disappointing fourth-quarter earnings. In general, though, we believe the company has proven its ability over time to evolve its product mix to focus on higher-value-add products that better protect margins. As the after-market business continues to grow, that should provide a tailwind.

**Hyundai Motor has been working to simplify its complex cross-holdings structure. Do you have a view on how this plays out for Hyundai Mobis?**

**OB:** The restructuring scenarios tend to change over time, so we don't have a strong opinion on which scenario is most likely. But we do expect whatever happens to improve corporate governance across the group and make the individual and collective entities more transparent. That should only be positive for Hyundai Mobis's shares.

**At today's ₩255,000 price, how inexpensive do you consider the shares?**

**OB:** We separately value the core business of Hyundai Mobis and the 20% stake in Hyundai Motor that it owns. For the core business we assume a 10x multiple on trailing-twelve-month earnings before interest and taxes [EBIT], which results in a per-share value of around ₩300,000. For the Hyundai Motor stake, we put a 10x multiple on what we believe is its normalized EBIT, valuing Hyundai Mobis's 20% holding at ₩130,000. A few other adjustments offset each other, so we arrive at a total fair-value estimate of ₩430,000 per share, a 68% premium to the current price. If we assigned value to Hyundai Motor's financing business, which is clear-

### INVESTMENT SNAPSHOT

**Hyundai Mobis**
(Seoul: 012330:KS)

**Business**: Manufactures, markets and services a range of automotive parts, equipment and systems, primarily for South Korean carmakers Hyundai Motor and Kia Motors.

**Share Information**
(@2/27/17, Exchange Rate: $1= ₩1,133):

| | |
|---|---|
| **Price** | **₩255,500** |
| 52-Week Range | ₩229,500 – ₩293,500 |
| Dividend Yield | 1.4% |
| Market Cap | ₩25.21 trillion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | ₩37.96 trillion |
| Operating Margin | 8.1% |
| Net Profit Margin | 8.3% |

**Valuation Metrics**
(@2/27/17):

| | 012330:KS | S&P 500 |
|---|---|---|
| P/E (TTM) | 7.6 | 24.8 |
| Forward P/E (Est.) | 7.5 | 18.2 |

**HYUNDAI MOBIS PRICE HISTORY**

**THE BOTTOM LINE**
The market doesn't appear to appreciate either the quality of the company's customer base or the "reliable cash-generating machine" it has in providing after-market parts and servicing, says Olivier Berlage. Valuing its core business and its 20% stake in Hyundai Motor separately, he puts an estimated fair value on the shares of around ₩430,000.

Sources: Company reports, other publicly available information

ly worth something, the estimate would be higher.

**You're valuing Hyundai Motor at a pretty significant premium to its current market value. Do you own it as well?**

**OB:** We do. As of year-end 2016 it was a top-20 holding in the Global Value Fund.

**Turning to the U.S., what interests you in distribution-company Avnet [AVT]?**

**JH:** Avnet's primary business, accounting for some 70% of EBIT, is selling semiconductors and related components to the 160,000 original-equipment manufacturers that purchase 30% of all semiconductors but are too small and spread out to be served by manufacturer direct sales forces. This is an attractive business, where the big distributors like Avnet, Arrow Electronics and WPG enjoy multiple competitive advantages. Their size allows them to purchase products on favorable terms, they have deeper and more-efficient logistics capabilities, and their product expertise is valued by customers and is relied upon for selection and purchase decisions.

Last fall the company announced two deals that we believe position it well going forward. In September it announced it was selling its technology-solutions group, which distributes computer server, storage and networking products, to Tech Data for $2.6 billion. That business has lower margins and lower growth and faces secular risks from cloud computing, so we were delighted to see it go.

Then in October the company completed a nearly £700 million acquisition of U.K.-based distributor Premier Farnell, reinforcing its biggest business and making Avnet pretty much a pure play in semiconductor-related distribution. The deal wasn't cheap at an EV/EBIT ratio of 14x, but there are significant cost synergies available and we think over the next 18 to 24 months operating income attributed to Premier Farnell can double.

**Does the cyclicality of the semiconductor business worry you?**

**JH:** The business is cyclical, but in our view is nowhere near the cycle peak. Gartner estimates semiconductor sales should increase 3-5% annually through 2019. We think we're still in the early innings of rapid growth in more-connected devices – what people call the Internet of Things – which need semiconductors to capture and process data. Again using Gartner numbers, there are five billion connected devices today and that number is estimated to hit 20 billion by 2020. That should be good news for Avnet, which with a 13% global market share in semiconductor distribution is #2 behind Taiwan's WPG.

**At a recent $46.25, how are you looking at valuation?**

**JH:** On a pro-forma basis, including expected deal synergies but subtracting $40 million of restructuring expenses that Wall Street analysts are willing to ignore, we think Avnet within two years should generate annual EBITA of around $780 million. Applying a 10x EV/EBITA multiple – where a number of comparable M&A deals have been done – and subtracting pro-forma net debt of $359 million, we estimate fair equity value at more than $7.4 billion, or $57 a share. Adding in an-

**INVESTMENT SNAPSHOT**

**Avnet**
(NYSE: AVT)

**Business**: Distributes and sells electronic components, data-storage products and embedded subsystems, and provides value-added information-technology services.

**Share Information** (@2/27/17):

| **Price** | **46.24** |
|---|---|
| 52-Week Range | 38.16 – 51.50 |
| Dividend Yield | 1.5% |
| Market Cap | $5.96 billion |

**Financials** (TTM):

| Revenue | $25.92 billion |
|---|---|
| Operating Profit Margin | 3.2% |
| Net Profit Margin | 1.5% |

**Valuation Metrics**
(@2/27/17):

| | AVT | S&P 500 |
|---|---|---|
| P/E (TTM) | 15.4 | 24.8 |
| Forward P/E (Est.) | 11.7 | 18.2 |

**Largest Institutional Owners**
(@12/31/16):

| Company | % Owned |
|---|---|
| Vanguard Group | 8.9% |
| BlackRock | 7.2% |
| Blue Harbour Group | 4.2% |
| Pzena Inv Mgmt | 4.0% |
| Artisan Partners | 3.5% |

**Short Interest** (as of 2/15/17):

| Shares Short/Float | 2.6% |
|---|---|

**AVT PRICE HISTORY**

**THE BOTTOM LINE**
Two M&A deals in recent months – one purchase and one sale – have positioned the company as a pure play in a semiconductor-distribution business in which it has important competitive advantages, says Jay Hill. Applying a 10x EV/EBITDA multiple to his estimates two years' out, he arrives at a near-term price target for the shares of $59.

Sources: Company reports, other publicly available information

other $2 for Tech Data shares Avnet now owns, our price target looking out 12 to 18 months is $59.

**Back to Asia, describe the potential you see in Hong Kong-based real estate developer Hang Lung Group [10:HK].**

**OB:** Hang Lung specializes in luxury shopping malls in China and we got particularly interested in early 2016 when the shares were beaten down by pessimism over a number of things, from a decelerating Chinese economy, to the anti-corruption crackdown in China that was hurting demand for luxury goods, to increased Internet retail competition. Valuing the net assets at even very high cap rates of 7-8%, we thought the shares at around HK$20 were priced at half what they were worth.

It's not as if the pessimism was without foundation, but in cases like this where the share price gets so removed from intrinsic value we generally find that if you believe in the management and the assets, value eventually wins out. Even with no discernible catalysts, time tends to be your friend.

**Talk about your belief in management.**

**OB:** The company is controlled by the Chan family, which built the business in China practically from scratch in about 15 years. They have a great eye for location and then step-by-step develop the mall and often surrounding real estate with an eye to attracting high-profile retailers and high-quality office tenants that drive additional traffic to the mall. The results have been objectively quite good: Over the past ten years the company's book value has grown from just under HK$19 per share to over HK$55 per share.

Currently the company's malls in Shanghai and Shenyang are performing very well, while additional properties in Jinan, Wuxi, Tianjin and Dalian are all at various stages in the value-add process. If they can replicate their successes in even one or two more cities it would materially impact operating performance and drive significant shareholder value.

**How do you assess the broader political risks of investing in China today?**

**OB:** Hang Lung is based in Hong Kong, where corporate-governance safeguards are fairly well established. While trouble could erupt in China as it deals with a number of macroeconomic challenges, the fact remains that the middle class continues to grow rapidly there and they have proven to have an affinity for luxury goods like those sold in Hang Lung's malls. We believe that ultimately drives the investment case here, not the shorter-term ups and downs of the economy or political situation. That said, would we want half of our portfolio assets in China today? No.

**With the shares now at just under HK$32, do you still see plenty of upside from here?**

**OB:** Hang Lung Group is the parent company of Hang Lung Properties [101:HK], which makes up the bulk of its assets. So first we have to value Hang Lung Properties, using a much more conservative cap rate than the company does on its current rental income of HK$7.8 billion. Using a 7.5% cap rate we arrive at a value for Hang Lung Properties of HK$23 per share. That translates into about HK$42 per share for Hang Lung Group. We try to be conservative as well by assigning minimal value to properties still under development that do not yet generate significant operating income.

## INVESTMENT SNAPSHOT

**Hang Lung Group**
(Hong Kong: 10:HK)

**Business**: Develops, manages and invests in high-end commercial, office and residential properties in Hong Kong and mainland China, with key focus on luxury shopping malls.

**Share Information**
(@2/27/17, Exchange Rate: $1= HK$7.76):

| | |
|---|---|
| **Price** | **HK$31.95** |
| 52-Week Range | HK$20.05 – HK$32.80 |
| Dividend Yield | 2.5% |
| Market Cap | HK$43.16 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | HK$13.60 billion |
| Operating Margin | 63.3% |
| Net Profit Margin | 27.2% |

**Valuation Metrics**
(@2/27/17):

| | 10:HK | S&P 500 |
|---|---|---|
| P/E (TTM) | 11.6 | 24.8 |
| Forward P/E (Est.) | 9.4 | 18.2 |

**10:HK PRICE HISTORY**

**THE BOTTOM LINE**

Macroeconomic concerns about the company's business in China are not without foundation, says Olivier Berlage, but he expects its long-term prospects to be driven primarily by rising incomes translating into higher demand for goods sold in its luxury malls. Using a 7.5% cap rate on the company's current rental income, he values its shares at HK$42.

Sources: Company reports, other publicly available information

**Just curious, do you own Hang Lung Properties as well?**

**OB:** Here we chose just to invest in the parent company. It trades at a larger discount to our estimate of net asset value and we prefer to be closer in the ownership structure to the level of the shareholder family.

**What do you think the market is missing in Canadian investment holding company E-L Financial [ELF:CN]?**

**JS:** The company's assets fall into two primary buckets. Much of the value is in a stock-and-bond portfolio held at the parent-company level and managed by a number of outside value-oriented managers. The remaining 25% or so of the value consists of an investment in Empire Life Insurance Company, which is a run-of-the-mill life and health insurer that typically earns a 10% return on equity.

**Why would this be mispriced?**

**JS:** We think it's neglect. There are large minority interests and complicated accounting and it takes some work to deconsolidate Empire Life from the balance sheet and see clearly the C$890 per share pile of cash and securities that are left upstairs in the parent holding company. In addition, Empire Life includes realized investment gains and losses in its reported earnings, which can make it look extremely volatile.

**How have the company's controlling shareholders, the Jackman family, treated minority shareholders?**

**JS:** They've done an excellent job managing the business. Since 1969 the holding company's book value has compounded at an annualized rate of 12.5%. They've also bought and sold businesses with a seemingly good eye for price. At the end of 2015 they paid approximately book value to increase E-L Financial's ownership stake in Empire Life to just over 98%. A couple years earlier they sold another held insurance company to Travelers for about a 40% premium to book. Overall we're very comfortable with the family's stewardship and keep track of their own trading in E-L stock. They've been buyers of late, paying between C$650 and C$695 per share for more than C$100 million worth of shares.

**How cheap are the shares at today's C$735 price?**

**JS:** At the current price the stock trades for close to 60% of the latest reported tangible book value per share. One of the great things about buying so cheaply is the return leverage. If book value grows 10% and we paid 60% of book, we're earning a 16.6% return on our entry price. On top of that the shares in the past have traded as high as 1.4x book value, so it's not out of the question that they could again trade at book value or higher in the future.

**One final question: Has the ongoing rise of passive investment strategies and algorithmic trading at all impacted how you do things?**

**BW:** Breaking that down a bit, there's no question that well-constructed quantitative models can be tough competitors, but it hasn't impacted our process or strategy. Automated buying and selling can impact how securities trade, but behaviorally things haven't fundamentally changed. Investors still overreact on the upside and the downside, and if anything, algorithmic

### INVESTMENT SNAPSHOT

**E-L Financial**
(Toronto: ELF:CN)

**Business**: Toronto-based holding company with primary operating segments focused on investment management (E-L Corporate) and life and health insurance (Empire Life).

**Share Information**
(@2/27/17, Exchange Rate: $1 = C$1.319):

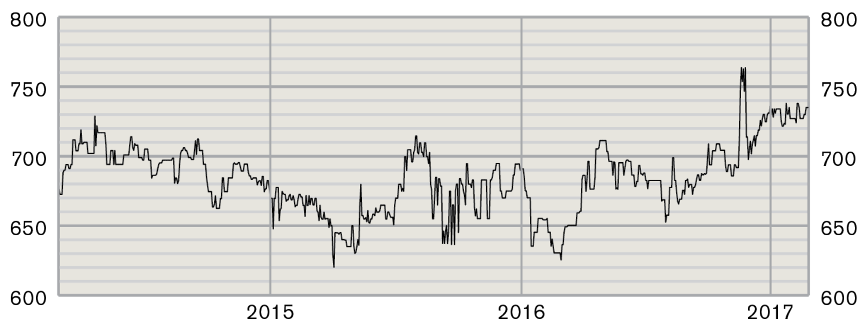
| | |
|---|---|
| **Price** | **C$735.00** |
| 52-Week Range | C$630.00 – C$768.99 |
| Dividend Yield | 0.7% |
| Market Cap | C$2.95 billion |

**Financials** (TTM):

| | |
|---|---|
| Revenue | $2.30 billion |
| Operating Margin | 27.7% |
| Net Profit Margin | 19.0% |

**Valuation Metrics**
(@2/27/17):

| | ELF:CN | S&P 500 |
|---|---|---|
| P/E (TTM) | n/a | 24.8 |
| Forward P/E (Est.) | n/a | 18.2 |




**THE BOTTOM LINE**

In deciphering the company's somewhat complex financials, John Spears believes the market is significantly mispricing the value of its assets and of the ongoing stewardship of its founding family. At today's price the stock trades at just 60% of tangible book value, for company that has increased book value at a 12.5% annual rate for nearly 50 years.

Sources: Company reports, other publicly available information

trading often accentuates those moves and creates pricing opportunities for people like us to exploit.

We view rapid flows into passive strategies as a cyclical phenomenon which invariably distorts equity valuations in the later stages of a bull market. When we do have a difficult time in the equity market, as we invariably will, you'll see a comeuppance for index funds and you'll see active managers attract much more interest. A great "unwind" typically inures to our benefit as value investors due to relative out-performance.

Even John Bogle is lamenting the massive flows of funds from traditional index mutual funds into specialized ETFs that can be traded on a minute-by-minute basis. This may all seem a bit unsettling, but think back to 2009 when market commentators were hailing the "death of equities." Stay tuned, things have a way of changing. VII

This reprint is furnished for general information purposes in order to provide some of the thought processes and techniques that Tweedy, Browne Company LLC uses to make investment decisions. It is provided for illustrative purposes only. This material is not intended to be a formal research report and should not be construed as an offer or recommendation to buy or sell any security, nor should information contained herein be relied upon as investment advice. The opinions and views expressed herein are those of the individual portfolio managers indicated as of February 28, 2017, and are subject to change without notice. There is no guarantee that these opinions and statements will prove to be correct, and some of them are inherently speculative. None of them should be relied upon as statements of fact. This article has been modified from the version originally published to make necessary corrections.

The investment performance of the Tweedy, Browne Global Value Fund (the "Fund") presented in the attached article is as of February 28, 2017, and is subject to change. The average annual total returns of the Global Value Fund for the 1-, 5-, and 10-year periods ending December 31, 2020, were -1.00%, 5.25%, and 5.78%, respectively. Total annual Fund operating expense ratio as disclosed in the Fund's most recent prospectus was 1.37%.

*The preceding performance data represents past performance and is not a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data shown. Please visit www.tweedy.com to obtain performance data that is current to the most recent month end. The Fund does not impose any front-end or deferred sales charges.*

As of December 31, 2020, the Fund had invested the following percentage of its net assets in the following portfolio holdings: AGCO Corp. (0.0%); LG Corp. (1.1%); Kia Motors (0.0%); Nestlé (5.2%); Philip Morris International (0.0%); Johnson & Johnson (2.6%); Total (3.0%); Royal Dutch Shell (0.0%); Halliburton (0.0%); MRC Global (0.0%); UniFirst (0.0%); G4S (0.0%); Hyundai Mobis (0.8%); Hyundai Motor (0.0%); Avnet (0.0%); Hang Lung Group (0.6%); and E-L Financial (0.0%).

Earnings before interest, tax, depreciation and amortization ("EBITDA") is a measure of a company's operating performance. EBITDA is a way to evaluate a company's performance without having to factor in financing decisions, accounting decisions, or tax environments. Enterprise Value ("EV") is the sum of the market value of common stock, the market value of preferred equity, the market value of debt and minority interest, minus cash and investments.

Current and future portfolio holdings are subject to risk. The securities of small, less well-known companies may be more volatile than those of larger companies. In addition, investing in foreign securities involves additional risks beyond the risks of investing in securities of U.S. markets. These risks include economic and political considerations not typically found in U.S. markets, including currency fluctuation, political uncertainty and different financial standards, regulatory environments, and overall market and economic factors in the countries. Force majeure events such as pandemics and natural disasters are likely to increase the risks inherent in investments and could have a broad negative impact on the world economy and business activity in general. Value investing involves the risk that the market will not recognize a security's intrinsic value for a long time, or that a security thought to be undervalued may actually be appropriately priced when purchased. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Diversification does not guarantee a profit or protect against a loss in declining markets. Investors should refer to the prospectus for a description of risk factors associated with investments in securities held by the Fund.

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**This material must be preceded or accompanied by a prospectus for Tweedy, Browne Fund Inc.**

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