

When asked how he became so successful, Buffett answered: "we read hundreds and hundreds of annual reports every year."



Edited by the
**Manual of Ideas
Research Team**

"If our efforts can further the goals of our members by giving them a discernible edge over other market participants, we have succeeded."

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About Portfolio Manager's Review

Our goal is to bring you investment ideas that are compelling on the basis of value versus price. In our quest for value, we analyze the top holdings of top fund managers. We also use a proprietary methodology to identify stocks that are not widely followed by institutional investors.

Our managing editor John Mihaljevic is a member of Value Investors Club, an exclusive community of money managers, and has won the Club's prize for best investment idea. John is a trained capital allocator, having studied under Yale chief investment officer David Swensen and served as research assistant to Nobel laureate James Tobin. John holds a BA in Economics, *summa cum laude*, from Yale and is a CFA charterholder.

THE EUROPEAN VALUE ISSUE

- ▶ Snapshot of 100 European companies
- ▶ 24 companies profiled by *MOI* research team
- ▶ Proprietary selection of Top 5 candidates for investment
- ▶ Plus: Exclusive Interview with Don Fitzgerald
- ▶ Plus: Exclusive Interview with Professor Max Otte
- ▶ Plus: Exclusive Interview with Adam Steiner
- ▶ Plus: Exclusive Interview with Robert Vinall

European companies mentioned in this issue include
ABB, Acergy, AEGON, Alcatel-Lucent, Allianz, Allied Irish Banks, Altana, Anglo American, ArcelorMittal, ARM Holdings, AstraZeneca, AXA, Babcock & Brown, Banco Bilbao Vizcaya, Banco Santander, Bank of Ireland, Barclays, BG Group, BP, British American Tobacco, British Sky Broadcasting, Cadbury, Carnival, CGG Veritas, CNH Global, Commerzbank, Continental, Credit Suisse, CRH, Delhaize, Deutsche Telekom, Diageo, DSME, Emerson, Flamel Technologies, France Telecom, GlaxoSmithKline, Heineken, Hochtief, International Power, KPN, LVMH Moet Hennessy, Novartis, Novo Nordisk, Portugal Telecom, Roche, Rolls-Royce, Royal Wessanen, Siemens, Smith & Nephew, STMicroelectronics, Tate & Lyle, Telecel, TOTAL, Turkcell, Unilever, and Verano.

Inside:

**Exclusive Interview with
Robert Vinall, Founder and
Managing Director of
RV Capital**

*With compliments of
The Manual of Ideas*

(profiled)

Exclusive Interview with Rob Vinall

Rob Vinall is the founder and managing director of RV Capital, based in Zurich, Switzerland. His prior experience includes investment analysis-related roles with Goldman Sachs Asset Management, DZ Bank, and CDL Principal Investors. Rob graduated with an honours degree from Cambridge University.



Rob Vinall
RV Capital

MOI: Describe your investment vehicle “Business Owner Fund.” What goals have you set for yourself and what are your operating principles?

Rob Vinall: The Business Owner Fund is an onshore hedge fund which I set up just over a year ago with the support of Norman Rentrop. Norman is a German-based entrepreneur and investor with whom I have had a long-term partnership. The fund’s operating principles are very much reflected in the name business owner. I endeavor to invest like a *business owner* in companies run by a responsible and engaged *business owner* with the capital of investors who act like *business owners*. The principles arose from three main observations.

First, I found that I allocate capital best when I think like a business owner. Thus, I imagine that I own 100% of a company and that it has been in my family for many generations. This helps me to focus on what is really important: the kind of people I will be associated with and the company’s long term compounding potential — and blend out a lot of the noise, such as short term earnings expectations or whether the sector is “in.”

Second, I found that companies with responsible ownership tend to have superior returns on capital at lower risk, yet despite this they tend to trade at a discount to peers with an open shareholder structure due to the lack of an excitement factor (“catalyst”) such as the potential for a change of control.

Thirdly, I found even the best capital allocation skills will come to zero if you have the wrong type of investors, i.e., investors who withdraw capital at the worst possible time when things are cheap and the market is panicking. For this reason, I seek investors who share my investment philosophy and have a similarly long time horizon. In terms of investment goals, my ambition would be to deliver a 15% annual return over a very long time period.

MOI: You have stated that your investment checklist includes four primary criteria. You seek out companies that 1) are within your circle of competence, 2) are great businesses, 3) have honest management and engaged owners, and 4) offer a compelling valuation. Can you explain in more detail how you apply the criteria using an example of a company you invested in or rejected in the process?

Vinall: Yes — there is one really big one: Is the business in my circle of competence? By this I mean, can I look my children in the eye and assure them that a business will be around and flourishing in ten or more years? This

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involves answering a number of questions in the affirmative such as: Is the industry sufficiently slow-moving that I will know what it will look like in the future? Is there a good owner there who will not over-leverage the business or move it into the unknown through dumb acquisitions? If I can get comfortable that a business is within my circle of competence, I then ask myself is it a great business, by which I mean is there long-term sustainable competitive advantage? Is the management honest and talented? And do I like the price?

This investment process will be familiar to all of your readers, as it is the one followed by Warren Buffett. It is of course widely known — and I think you would be hard pressed to find a money manager whose philosophy is to invest in expensive companies run by crooks. However, the point is that most investment managers are not able to rigorously apply Buffett’s approach for a plethora of reasons including short-term performance pressure, the wrong capital structure, and the manifold and well-documented mental biases identified by behavioral finance research. I seek to develop an edge by creating an environment for myself which frees me of these pressures, and by developing habits to keep myself disciplined. One of those is the annual pilgrimage to Omaha.

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An investment case that well illustrates my approach is a German company called GrenkeLeasing, which is the largest position in my fund. The company provides small-ticket IT leasing to small and medium-sized businesses. The business was started by Mr. Grenke in his bedroom 30 years ago, and to this day he remains the CEO of the business and its largest shareholder. His track record is unblemished, including throughout the “one-hundred year storm” which the financial services industry has just experienced, from which you can deduce considerable talent and integrity. GrenkeLeasing’s long-term sustainable competitive advantage is its low-cost approach, its proprietary scoring system and its access to distribution. Mr. Grenke’s insight was that the entire process of providing and servicing a lease can be automated through intelligent software and a credit scoring system. As a result, Grenke can operate at a fraction of the cost of his main competitors. The returns on equity in the seasoned markets are up to 30% despite the fact that Grenke operates with a tangible equity ratio of nearly 20%, which is substantially higher than its peers. The price is highly attractive – the company can be bought at approximately its run-off value. It is a great company run by an honest and talented manager at a very attractive price.

MOI: To expand on the previous question, have you ever had to compromise on your investment criteria, and, if so, what are acceptable versus unacceptable trade-offs?

Vinall: I don’t think I have ever made a capital allocation decision that did not involve a tradeoff of one kind or another, so the calculation of opportunity costs is something I give a lot of thought to. The reason why I only have a checklist of four questions although there are certainly more than four things that are valuable and relevant to analyzing a company is that it makes it much easier to calculate opportunity cost.

In terms of trade-offs, I would never knowingly buy a company that I felt I did not understand or whose management I did not consider to be honest. This really only leaves weighing price against quality. I personally feel much more confident about my ability to assess whether a business has competitive

advantage than my ability to value a company, so I am more likely to compromise on price.

MOI: It strikes us as interesting that so many “blue chips” have fallen by the way-side or remain tarnished. Even among great businesses it is rare that investors realize the returns they have come to expect from such companies over time. If almost every blue chip sooner or later falters, shouldn’t we invest in great businesses only after they hit a bump?

Vinall: Yes. I don’t think it takes much intellectual brain power to identify a great business which is run by honest and talented managers. The real trick is to pick them up when they are cheap. This might be because the business has hit a bump, or it might be for reasons beyond a company’s control such as belonging to an out-of-favor sector. Ideally, one wants to buy a great business before it is widely perceived as being so.

MOI: When do you sell a great business?

Vinall: I don’t think you ever need to sell the truly great business. The nature of compound economics is such that even if the price temporarily gets ahead of itself, the intrinsic value can catch up the difference fairly quickly. Of course, nearly all businesses’ economics deteriorate over time, and there is definitely a case for selling a great business before it evolves into an average one.

MOI: How do you generate your investment ideas? Is your circle of competence static in this regard or have you been able to expand it over time?

Vinall: I generate ideas by speaking with like-minded investors, screening (in particular for 52-week lows) and reading newspapers. I am particularly keen also on referrals from competitors and suppliers of investee companies.

I do not view my circle of competence as static. I am permanently trying to expand the edges of my circle of competence to encompass new companies, sectors and countries. For example, I have felt for a long time that China is beyond my circle of competence as I am unfamiliar with the culture and frankly the issue of property rights scares me. But Buffett has made a few investments there and stated categorically that all investors should have it on their radar screen. You ignore Buffett’s advice at your peril, so I have started ordering annual reports for some Chinese companies. I hope that one day I can claim that certain Chinese companies are within my circle of competence.

MOI: What is the single biggest mistake that keeps investors from reaching their goals?

Vinall: I think the single largest mistake is having too short a time horizon. If I look back on the mistakes I have made in the past, they were all different superficially, but they had a single common denominator – the prospect of a large dollop of short-term cash. Analysts and investors alike obsess of short-term catalysts or “share price” triggers. I think it is a mistake as it blinds you to a business’s longer-term prospects, which are far more relevant to a company’s intrinsic value.

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MOI: Are you finding more companies that meet your investment criteria in any particular geography? Is Europe a fertile ground compared to other markets?

Vinall: I think you find a very high proportion of the world's best-run businesses in Europe, however nearly all the great business franchises originate in the U.S. If I take Germany for example, which is the market I am most familiar with, I would argue that there are probably only a handful of truly great franchises. In the U.S., by contrast, there are hundreds. As such, I would describe the U.S. as the most fertile hunting ground.

MOI: You are a big believer in meeting face-to-face with company management before making an investment decision. Based on your experience, how do you tell a good manager from a bad one?

Vinall: I am a big fan of meeting with management, as the easiest way to build up an understanding of a business is to go and see it firsthand. In terms of distinguishing from the good, the bad and the ugly, I think you have to dig a little deeper. I look at a manager's track record, I obtain character references, I look at the kind of people he/she associates with, I check out compensation, I read the annual letter. In short, I do all the kind of checks that you would do before hiring a new employee, which, as a business owner, I imagine myself to be doing in any case.

I often hear other investors state that you cannot judge a manager as they are too well-rehearsed in "giving the right answers," but I disagree completely. Of course, as with all decisions made under uncertainty, there will always be mistakes, but in general there are plenty of tried and tested methods for working out somebody's character. What is more, I think that this is the area which is most ripe with inefficiency. I have never read a broker report that comments on a management's integrity, unless of course they are already behind bars. The reason is that it breaks all kinds of societal taboos to do so. I find it very exciting that there is so crucial an area to the capital allocation decision that many market participants are not bothering to look at.

MOI: Determining whether a manager or a business is "good" relies to a large extent on qualitative judgment. Describe what are some of the more quantitative valuation methodologies that you have found particularly useful when evaluating what price to pay for a great business?

Vinall: The main valuation methodology I use is to calculate what I term "the owner return." This is the sum of dividend yield and the growth in earnings power. I think that if a business has been in your family for many generations and you have no plans to sell it, what really interests you is the amount of cash you can take out each year and the amount by which the earning power increases over time. For publicly listed companies, this corresponds to the dividend (or share buybacks) and the growth in free cash flow. What I am aiming for is an owner return of at least 15% in order to get to my long-term investing goal. As a rule, though, I am quite skeptical of my ability to value a company's common equity with any precision. The single most important concept for me in valuation is a qualitative one: margin of safety.

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MOI: What books have helped you become a better investor? Are there any non-finance books that you found particularly insightful and applicable to investing?

Vinall: My favorite “non-finance” book that has nevertheless greatly improved me as an investor is [*On the Psychology of Military Incompetence*](#) by Norman Dixon. Norman Dixon analyses a number of military fiascos and finds the root cause to be in certain character traits of the generals. The parallels between military and corporate failure are hugely instructive.

MOI: Rob, thank you very much.

About Rob Vinall

Rob Vinall is the founder and managing director of RV Capital. He is based in Zurich, Switzerland where he lives with his wife and two children. Rob is from the UK and was born in May 1973. He graduated with an honours degree from Cambridge University in 1996 and was awarded the CFA designation in 2000. He began his career in April 1997 at Goldman Sachs Asset Management where he participated in the graduate trainee program. In October 1998, he joined DG Bank which later became DZ Bank where he was a sell side analyst covering the telecoms sector. In October 2004, he moved to Switzerland to join CDL Principal Investors, a boutique consultancy where he sourced investment opportunities in public equity markets which required active ownership. In 2008, Rob set up the Business Owner Fund with the support of German-based entrepreneur and investor Norman Rentrop.

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