Oldfield Partners

Panel Discussion – 29th June 2015

Oldfield Partners (OP): *Claus Anthon (CA), Jamie Carter (JC), Harry Fraser (HF), Richard Garstang (RG), Juliet Marber (JM), Tom Taylor (TT), Nigel Waller (NW), Robert White (RW), Sam Ziff (SZ)*

JC: Welcome to The Goring everybody, thank you very much for coming. For those of you who were expecting Richard Oldfield to be chairing this discussion I'm afraid he's needed at a funeral this afternoon so I will be playing the role of Dimbleby.

My name is Jamie Carter and on the panel here we have nearest to me –

- Tom Taylor who manages the Emerging Markets portfolios
- Nigel Waller who manages Global Equity Income
- Harry Fraser who manages Smaller Companies
- Robert White and Juliet Marber who manage Japanese equities, and on the far side,
- Claus Anthon who manages the European portfolio.

As most of you know we're value investors. We are contrarian in our thinking and believe we can always find interesting ideas and places of value so over the next hour we're going to try and give you some insights into what we're thinking at the moment and where we're finding the best value opportunities. The aim is to finish no later than 5pm for a short break to give some of you a rest, to get a cup of tea, and then we'll carry on afterwards when hopefully the panel will be into their stride.

The format will be that I will start with some questions, but we'd like this to be as interactive as possible so if you do have a question related to what's being discussed please raise your hand and I'll try and get you involved as soon as I can. Then as we go through a number of the questions I'll stop and have breaks and take any questions on any subject. The panel have assured me they can answer absolutely anything put to them. I apologise to both the panel and the audience if I push you to hurry up and move on quickly.

First question then, let's start with the topic du jour - Greece – Harry how have you thought about the kind of stop/start - yes/no events in Greece and have there been any investment opportunities coming from it?

HF: Well clearly Greece is very difficult but as you know what we do is look for very good quality companies at very, very low valuations and Greece is clearly an area where you're going to find low valuations. Last week we invested in a company called Jumbo which is probably one of the best retailers in the world in terms of its market positioning. It has 70% market share of toys and little mini monopolies in many of the areas it operates in. It uses giant 8,000 square metre stores and has huge economies of scale advantages over the mom and pop stores around Greece. This has meant that over what has been by any definition a depression within Greece over the last five years it has actually grown revenues every single year and in fact since its founding by the current Chairman Vakakis Apostolos, who founded it in 1986. Clearly within the current environment there are difficulties. It imports a lot of the toys that it sells and if Greece were to drop out of the euro there would be an increase of their cost of goods sold. But the Greeks are obsessed with toys - they spend twice as much as the average of the western European countries. It's hugely embedded within their culture and it's not going to go any time soon and of course we've got this company with a dominant market share.

We bought this last week and we bought it on 6 x operating profits. These are profits we think are hugely depressed given the high percentage of unemployment in Greece. Over the long run we think we're going to get very good returns. That's our latest adventure in Greece.

JC: And you say latest adventure because I believe you've invested in Greece before, so do you want to say a word about how that played out last time?

HF: Well just to be clear, these are considered in our high risk bucket of investments, so the position in Jumbo is 1 ½ % of the portfolio. Given that it has net cash the worse that can happen is it's going to be somewhere between losing half the money and where we are today. It's not going to be worse than that because we're going to have a business, and they own most of their property as well. To answer your question, in 2011 we were going through a very similar environment to what we're going through today and the valuation of OPAP, which was the lottery provider in Greece, got down to a point where it had a dividend yield of 20-odd percent and was trading at 2 ½ x earnings. It had a monopoly on various different types of gambling, not just the lottery and so it had an extremely dominant position. At 2 ½ x earnings and a 20-odd percent dividend yield, a hell of a lot had to go wrong for you to lose much of your money. Within a year it had doubled, and at that point we felt that the valuation was probably still cheap but we didn't feel it was cheap enough for the risks that remained.

JC: So your track record of investing there is good so far. Any questions on Greece before we move on?

Q: A question on Jumbo – what's a normalised operating profit margin for these guys?

HF: Their profit is extraordinary, 28% operating margins, which fluctuates by a few percent depending on the euro because they are buying in dollars. Incidentally that is one of the highest margins in the entire world of retail, it's extraordinary.

JC: Okay, let's widen the discussion to Europe as a whole then. Claus I've got this chart for you (pg. 2) which plots the operating margins of the US against Europe. You can see a big gap has opened up there. What do you think the chances are that Europe can close that gap by improving and are there particular areas where you think that's more likely? Can you give us an example?

CA: It's quite clear we have a crisis in Europe and I think we will slowly see recovery taking place but it will take some time. The reason we're getting more and more confident, is that first of all we have now seen QE in Europe and we have seen a sharp devaluation of the euro. That should start to help a lot of the European companies in our portfolio like Siemens, Ericsson, ABB and Renault. On that I'm quite confident.

We're also noticing at the same time these companies have been through this period of very low margins and therefore have had to go through major restructurings, which they will start to benefit from. Again, companies like Siemens are an example. I think the gap in the chart will start to close over the next two to three years so I think it's a good opportunity to look into some of the European companies.

JC: And it's company specific or are there wider areas?

CA: This recovery is mainly coming from the more cyclical companies and that's the reason if you look at our portfolio we are well placed for that. You see the industrial sector is now 27% of the portfolio (pg. 3) and we have nothing in healthcare, we have very little in utilities or telecommunications. We're not really in defensive sectors, we're waiting for this recovery to take place in the industrial sectors.

JC: And on that subject of recovery and improvement we turn our thoughts to Japan. Obviously those of you that have attended our sessions before know we have talked at length about Japan, about improving corporate governance, about improving the focus on shareholder returns. Robert, on that subject we've just had the proxy season in Japan, can you give us an example of where a company's taken quite significant action that you think is a very positive? And perhaps Juliet if you can take the other side and talk to us about a company where absolutely no action has been taken but perhaps where there therefore might be an opportunity?

RW: Yes. We bought Dai Nippon Printing about three or four months ago, Japan's largest printing and packaging company. It's very old fashioned, with a big board, the average age of the directors must be in the 70s, it has return on equity of 2 ½ %, and a very low dividend but it's got some fantastic assets. We bought it because it was very cheap and we could afford to wait in case pressure mounted on them to change. In fact, in May they announced that they would buy back stock for the first time in 7 years. Return on equity looks as if next year it will be up to 5% from about 2.7%. They are consolidating the business and using some, but not all, of their cash to invest in one or two new growth areas. So they seem to be responding to the pressure that is mounting on companies to use their capital more efficiently.

JC: Yes, and on the flip side Juliet?

JM: I think I would mention Kyocera, which is the world's leading ceramics company. When we bought it the core business was on a price to earnings ratio of less than 5 times and about 70% of the market cap was in equity holdings and cash. So the shares were very cheap, but the history with this company is that it has grown its top line mainly through acquisitions and although it holds a large amount of cash, it has always been reluctant to return it to shareholders. At the most recent shareholder meetings, we did not see any response from the senior management about improving shareholder returns but we certainly think that the quality of the business is strong enough, and the shares are cheap enough, to wait. With all the corporate governance changes in Japan the pressure will mount on the company and that there's a good chance we will see a shift in attitude.

JC: And in the recent proxy voting season there's been nothing to put you off of what you were saying just a couple of months ago,? Having visited Japan, things were moving, the pressure is building?

JM: In Japan, change is often three steps forward and two steps backwards. In fact in June ISS did recommend voting against Japanese companies that had a history of poor shareholder returns, and a low return on equity, but in fact most of the votes where ISS voted against management were passed despite the ISS protestations and this gives us some indication that it's not going to be a quick fix. We will see some companies respond quickly but for the majority this is just the beginning of mounting pressure. So in terms of opportunities it's still good.

JC: Okay. I'll have a quick break see if there are any questions from the audience?

Q: One on Japan: The last time the Japanese stock market was high Japanese companies were phenomenally good at making really daft acquisitions and I think the good ones only went down about 80 or 90%, and they would say 'we're not supposed to pay dividends, we're not supposed to do any buy-backs at all'. Is there a complete change in the psychology?

RW: Yes I think there actually is, and without re-running everything we've said before on corporate governance I think there's a contract between the government institutions and companies to make the whole corporate world more efficient in terms of balance sheets and shareholder returns. The Stewardship Code is designed to get domestic institutions more involved in putting pressure on management to raise dividends because they need it to improve pension returns and the government needs higher dividends to help fund state pensions. The corporate governance code is designed to get independent directors to play a more active part in companies, and as Juliet said ISS is targeting a higher return on equity and higher capital efficiency. So I think there is a difference, between now and the period you were referring to.

Q: I have a question on Europe. I think quite a lot of intelligent people out there say that first of all it's not going to lighten up, QE itself is not good, and that what's really worrying about Europe is the demographics and the lack of growth, and I wondered if there were other reasons?

CA: I do think we are seeing signs of recovery in Europe, not a mass recovery, but we're definitely starting to see manufacturing output improve. We've seen new car registrations have improved. We have slowly seen small areas improving and for these companies I'm not saying that QE in itself is good but the devaluation that's taken place should help many of these companies. Most of the companies in the European portfolio are not what I would call European, they're international. It takes time. Everyone wants recovery to happen overnight, but as we saw in Japan, it takes a long time before the recovery will start. We saw for instance with a company like Ericsson, the Swedish Kroner has collapsed 25% so it should have seen the benefit but unfortunately these companies have hedging policies which need to roll out. But it will come and that's the reason we should have some patience.

Q: A quick follow up on telecoms because there are people that are making a case for a more friendly regulatory environment for consolidation, is the valuation not right?

CA: At the moment we don't hold anything in telecoms.

JC: And not much in the periphery either?

CA: No. It's difficult to find companies where we feel at ease.

Q: What about energy stocks or oil stocks where it might be just as nerve wracking?

CA: We have PGS, and we have Eni.

Q: Can you speak to the Lukoil position, a 5% position in Lukoil is intriguing. Can you justify that for us?

CA: I have to say it's done quite well for us. We'd love to buy more of Lukoil, but we do think there's a risk, of course there's a risk, but they're trading at around $2-3 a barrel of reserves. On that basis it's the same risk we see in Greek stocks. So we don't have too much in the portfolio in that riskier element, but it is a very cheap stock and they're doing all the right things. The main thing is it's not really a state run company, it's a privately owned company with management that own significant shares and pay out dividends, so I'm quite happy with that position.

Q: Can I just pick up on the point you mentioned, looking at that list (pg. 8) Exor and Investor are the obvious two (with significant family/management ownership) but there are other stocks there with substantial positions in them. Do you look at stocks where they have that characteristic in a slightly different way?

CA: Those two companies, they've fantastic families. The Agnelli family, or John Elkann, is running the company. He's focussed on shareholder value. He's done fantastically, and been part of the whole restructure of the Chrysler and Fiat deal. He sold SGS, about a year and a half ago. They've got net cash of €2 billion on the balance sheet. I know they're now trying to move into reinsurance, but I'd much rather be on the family side knowing they're not going to try to do anything to hurt the family. I think in the long run he'll manage one way or another to get hold of Ferrari and I'm not sure that Fiat will stay within the company forever. It's the same with the Wallenbergs. I've had Investor for many years and they've also done well, although they may not be so active with some of their companies.

Q: A question on Japan: The reporting season, what are companies saying about wages both in terms of salaries and bonuses and what they're intending to do, is there more evidence of wage growth?

RW: Firstly there has been wage growth in the past year in line with Mr Abe's suggestions, and we would expect further wage growth, but not dramatic.

JC: More on the bonus side than the salary side?

RW: More on the bonus than the salary, but the most important thing is that companies are starting to switch away from part time workers to full time workers, principally because there is a shortage of workers as the economy picks up in a number of industrial areas and that switch is really important because they don't just get a salary and a bonus, they get all sorts of other benefits, too.

Toyota has actually indicated that it's not expecting its parts suppliers to cut their prices this year, certainly not in the first half and probably not in the second half as they would normally do, in order to allow the parts companies to pay higher wages to their workers. So you get the trickle-down effect.

JC: I'll take you back, Nigel and Tom, to the question on energy. There are some value investors who don't tend to invest in commodity related stocks so how do you, Tom, from an emerging markets perspective (we had a brief talk about Lukoil) think about the extra risks to investing in those companies? And then Nigel perhaps if I turn to you after that - if you can talk about it from an equity income perspective as well. Tom?

TT: Well on the whole, I don't like investing in commodity type stocks, unless you get these big equity disconnects like we had in 2009 when these sorts of stocks get absolutely bombed out and you can pick them up very cheaply. On the whole what we're looking for are either a very strong balance sheet or a really good asset base to invest in and lock that in and then wait for the upturn to come. So on the whole for commodity stocks we're using the consensus view on prices unless we think differently. It really comes from the valuation and the valuation opportunity. As we are in a pretty difficult world at the moment, we still have quite a lot of these cyclical, quite a lot of commodity stocks in the portfolio now.

JC: Do you think the risks are any different in emerging markets to developed markets?

TT: Well a lot of these assets tend to be in emerging markets so despite the fact you may invest in a western company you are taking on an emerging market risk with that.

JC: And Nigel?

NW: I was going to add to that, I agree with everything that Tom just said and to his point, we own Rio in the Income portfolio, in the global portfolios and in Europe. Its largest asset is in Australia, but after that yes, we're talking about emerging market exposure. And the view from an income perspective is that when I bought it originally my calculation was how much do iron ore prices have to fall to impair the dividend? Did I imagine that they would fall quite as much as they have? No I didn't, but here we are with commodities trading at their marginal cost and we've got a 5% yield on the lowest point of cash flow over the next 12 months and that's still covering the dividend. That's a 70% payout ratio at the current situation. So we feel comfortable that the dividend will be paid, they've obviously talked at length about wanting to commit to it and so the growth they see in volume should help improve the coverage ratio further going forward. The advantage of something like Rio is that the balance sheet is so strong, it's net debt to EBITDA at is at 5.5-6x, it's a very, very strong balance sheet so you've got time, you're paid to wait.

JC: So if we just expand on that. I think of many equity income funds as holding high dividend, slow growth, boring businesses and just hanging on for a very, very long time but it sounds like you're doing something different?

NW: Obviously, this is a value fund first and foremost and therefore while there are lots of fantastic businesses out there from Coca Cola to Unilever to Pepsico, they're just too expensive now. Terry Smith was in the FT this weekend talking about the fact that you just buy these stocks and forget about them and 40 years from now it's great. If you've got 40 years to wait that's fine but you're paying a very high price for these stocks today. We're just looking for a mixture of dividends from different places and we're trying to diversify the portfolio across sectors. Where we're investing in commodities we're looking for the most diversified player we can find in order to protect ourselves. We are open to all ideas in terms of where we can find income that we think is protected.

Q: Just one question: On the emerging markets side...currencies continue to be very volatile, how do you incorporate the relative strengths of currencies into the analysis that you undertake on whether to make a buy or not?

TT: Well we're pretty long term investors so typically turnover going back to 2001 for the emerging markets portfolios has been around 35%. What we try to invest in foremost is a stock that we believe in and we can get a re-rating from that valuation. On the whole we're not taking currency views at all. They tend to move around over multi year periods and we just believe the currencies will come out in the wash. We don't hedge them.

JC: So if I can just go back to this chart (pg. 4), Nigel you were saying that certain parts of the market, the Terry Smith type companies, have done very well. We can see here that value massively underperformed growth over the last 8/9 years now so what does that mean in terms of finding opportunities? And perhaps same question for Harry?

NW: Well as you said we've had 8 or 9 years of this, unprecedented through the history, so we're a due a long period of feast having had the famine and I look forward to that. In terms of geographically, where that's really showing is the US, where valuations have just reached levels that we find difficult. There's definitely a much smaller pool of opportunity in the US and certainly against the franchise companies as I call them, almost none exists, not helped by the recent deals with 3G Capital and Berkshire hoovering up those companies that were interesting.

Q: Do you find anything in the "dividend aristocrat" universe in the US that is of appeal?

NW: Originally in this portfolio when it started we had big positions in Heinz, J&J, Pfizer and PepsiCo from that list. Now we've only got 2 ½ % in J&J and 2 ½ % in Pfizer so they've been reduced steadily over time as we found other things to invest in. They are the only two at this point where we see any upside at all, but they're very close to the exit.

JC: And Harry how about you on the opportunities given the chart there?

HF: In the smaller companies fund our preference is to buy wonderful companies at low valuations as I'm sure anyone would prefer but we have recently sold Sonic which is a franchiser in the US. It's a wonderful business, effectively they just get a percentage of all of their franchisees' revenues. We were able to buy Sonic on 10x cashflow and that was because we knew that three years out all their franchisees were going to roll over and were facing a 30% uplift in what they had to pay. We were able to buy that about 3 or 4 years ago when valuations were much cheaper but unfortunately it got to 20-odd times cashflow so we sold it.

More recently we've been buying Dundee Corp which has assets like small mining companies, real estate in Canada, agriculture and energy assets. They're all individually assets that one wouldn't particularly like but the company is trading at half of the valuation of those assets, and those assets are probably undervalued because they're so unpopular. We have protection in assets but the growth might be a bit slower. We still find some growth companies. For example we share with the European portfolio Wetherspoons, which trades on 11x free cash flow and is growing that cash flow every single year and has a wonderful market position. So we do find good companies that are growing but perhaps more in a deeper value segment.

JC: And of course you're only looking for 20-25 companies.

HF: Yes. In our particular universe theoretically there are 50,000 companies so there are lots of opportunities out there, I've just got to find them.

JC: Any questions from the floor? No?

Okay, let's go back to emerging markets. Tom, China's had a huge roller coaster ride - does that mean anything to the rest of us? What does it mean to you? Can you perhaps talk about your exposure and what you think has been happening there?

TT: Yes, the local Chinese market has pretty much doubled since last summer. Currently the A share market excluding financials is trading on a P/E of about 50x so it's pretty highly valued and some of that has flowed through into the Hong Kong market so you've seen those share prices move up quite rapidly as well. I think it's been pretty clear over the last few years that the Chinese Government wants to re-adjust the economy, move it away from fixed asset investment and towards the consumer, hence you've seen the economy slowing. It was growing at 12% a few years back and is now down to 7% growth and the next couple of years it'll be a little over 5%. So as an investor you would probably want to be heading towards the consumer stocks. Unfortunately that's happened, so the valuations are very expensive for Chinese consumer stocks - plus 30 times earnings. What we've looked at in that context is Lee and Man Paper, it's a containerboard manufacturer on a P/E of about 12x and about 1.3x book value. There is a misunderstanding about where their product ends up. A lot of it is thought to be going into industry for export but actually 70% of the end demand is the Chinese consumer and therefore consumed internally. There is very strong growth now in internet shopping in China and that's sucking in demand for cardboard boxes. It's in indirect play, but a cheaper way of getting exposure to the Chinese consumer.

JC: And more widely in terms of emerging market valuations, emerging markets have lagged developed markets and the valuation gap has opened up. Are there particular areas that are cheaper, where are you are finding more?

TT: We're below the long term historic average valuations for emerging markets, it is a pretty reasonable valuation given the uncertain world that we're in at the moment. It's not any great surprise that the two main countries that are cheap are the ones that have been cheap for quite a while, Russia and South Korea, and we have our exposure there. We have Lukoil in Russia and then in South Korea we have Samsung and SK Telecom.

JC: Okay, any questions?

Q: Can you discuss your thoughts on the merger with SK Telecom?

TT: Like a lot of Korean companies there is a whole structure that sits above them, so SK Telecom won't do much, that's kind of one of the jewels of the SK Group, it's actually SK Holding and SK C&C and whether they are merged or some sort of combination comes about. I think just recently the National Pension Fund voted against that, so it was rather embarrassing for the family. Whether or not anything happens there, there's a very similar story happening in Samsung Electronics but these are the jewels in the crown and typically the families don't do anything against those crown jewels. So we don't see there being any longer terms impact.

JC: Harry, many small cap managers are regional, you're obviously global. You've already said that the possible investment universe is 50,000 companies, do you think it's a good thing to be global or do you think you should be more specialised?

HF: There are huge advantages in not being tied down to a particular market or region. As Tom has just said in emerging markets you've got South Korea and Russia which are very cheap, there's always a country that's out of favour at any given time. We just invested in Greece, and for example today in America the Mid-Cap Index is trading on 26x earnings, 2 ½ x book value. Valuations in aggregate are very expensive in the US and we've only got about 10% exposure to that market, but we can look elsewhere.

Q: But Harry when you bring your universe down from the 50,000 companies, historically how big is the universe really in terms of an acceptable level of valuation? It compresses rather rapidly doesn't it?

HF: It compresses very quickly. We have two things working at the same time. We look at wonderful businesses that we would love to own and have a watch list of around 40-which are not at the valuation we would like, some are quite far from it, but we know the company and the industry extremely well and we would just love to buy it if it gets to that point where we can make the returns work for us. Then in terms of finding companies that are extremely cheap, they might not be phenomenally high quality companies, but they're going to give us very good returns because of where they are on the valuation. We find them all the time. For example in the Japanese portfolio they had Canon Marketing Group which we knew because we held Canon in our global portfolios. We can find these immensely attractive opportunities because we know the whole market of Japan. We know the large cap stocks which have these small subsidiaries that are just unheard of, but in this instance, trading less than the cash on its balance sheet. Even if the market was to double there will still be these opportunities that just spring up around the world. It's not a problem finding them, it's a problem fitting them within the portfolio of 20 stocks, but that's a nice problem to have.

Q: Can I ask a broader question? This is philosophical. I know you have some very smart analysts sitting up at the front of the room, but how are you guys thinking about value traps because one of the great problems being a value investment shop as you guys are is that you can get caught, there are a lot of value traps. What are you doing internally to hone the process to question yourselves and veer away from getting caught in that value trap problem that we've all experienced so many times?

JC: I'm going to ask for two volunteers rather than pick on someone. OK, Nigel why don't you go first? And then Robert.

NW: I suppose the first thing is we'd love to have worked out a list of how to avoid all value traps. We look back at what we've done well and what we've done badly and try to understand whether there are common themes to the value traps that we may and may not have fallen into in the past. I'd love to say there was a consistent answer but there just isn't. The only way to approach it is doing the work and constantly re-assessing and looking at that gap between price and value. One method to mention is the three bites of the cherry rule, which is to stop us forever putting more money into stocks which we are convinced are wonderful but the market doesn't agree with us. We're realistic to know that we will fall into value traps, but the key is obviously to keep them to a minority and to succeed more often than we fail.

Q: Nigel, you made a comment the other day about not wanting to combine operational gearing and financial gearing?

NW: That's true, although we will do it from time to time, we avoid this combination because if we get it wrong we know we're in real trouble. However, we did it with Fiat which was probably one of the best investments we as a group have made in a decade. It is one of our controls of risk not to combine the two.

RW: For us in Japan there are a lot of value companies particularly in the small and mid cap universe. The great thing is to understand management, but some people don't visit companies and management teams. We do and we think it helps us in Japan. Juliet and I have been going to Japan visiting companies longer than we care to remember and often you can just get a sense of whether something different is happening. The interesting example is Kyocera. It was very much part of the team discussion: was Kyocera a value trap or wasn't it? However, it was sufficiently cheap and the general atmosphere in Japan was moving sufficiently quickly towards greater shareholder returns that we could take the plunge.

On the point about balance sheet leverage combined with operational leverage, we had the same thing with Hitachi because that did not have a particularly good balance sheet but they were restructuring the board, they had very definite targets about ROE and competitor position and were making the whole thing more capital efficient.

JC: I want to go back to a point that Harry made about the advantages of being global, because we've got three people sitting here running regionally-focussed mandates.

So from running a European portfolio Claus and from running a Japanese portfolio Juliet what's the advantage of being in a global team?

JM: I think you get lots of things from it. Often we're looking at an industry, I can think of telecom, airlines, where there's a huge advantage of being able to discuss Japanese companies with global colleagues. For example when we started to look at Komatsu, it was a huge benefit to be able to talk about Caterpillar with Harry who was very familiar, so we could make those global comparisons. In terms of management, I think that Robert's mentioned that the importance in Japan of assessing the management or having a view but sometimes it is a disadvantage because if you've been visiting the management for 30 years then sometimes you can have your own pre-conceptions, you can have baggage which is not always helpful. So where colleagues are doing valuation screenings and a name emerges and the valuation is compelling, that's fantastic.

CA: For me of course it is the constant communication with colleagues. If I look at Siemens, others know Hitachi well for comparison, when I look at ABB in detail, we compare with Fanuc in Japan. What I also think is important is getting ideas from the team, it's not just me focussed on Europe, the team is also looking at global companies, including European ones and it throws up ideas .

JC: Any questions from anyone?

Q: Given as we constantly hear and we know how incredibly globally connected everything is nowadays, does it actually make any sense to have regional mandates?

JC: Some people think on a global basis and others do still think regionally, think they can asset allocate, and so we are well matched with those people. There are people who will see an opportunity in Japan as there is at the moment, and that will see an opportunity in Europe, as there is at the moment, and we have something there to talk to them about which is obviously part of the purpose of today. The recent paper that Robert and Juliet put out about six or seven weeks ago was just to draw attention to the fact there has been a big change in Japan because, and I'm sure you've noticed it, many people have had nothing in Japan for a very, very long time and it becomes very difficult to dislodge that mentality that you shouldn't be investing there. So part of our purpose is to make sure the message gets out there and we talk to people about this.

We don't want to have one of every kind of regional mandate, that's not what we do. As people have joined us, if they have a particular speciality we start a fund for them because it's the best thing for us to do because we get their best insights. I know from working with Claus for many, many years that if you got him to run a paper portfolio it would be rubbish. He needs real money, he needs clients and colleagues asking him questions and that's the only way to see exactly what he thinks - look at a portfolio of real money. It's exactly the same for Juliet and Robert and so that's what we do. We're not going to go out and try and fill all the gaps.

Q: That's the ultimate compliment you've just paid to Claus.

JC: Well it's true. I've known him for a very long time and I know that he just would not have the same energy or focus unless he's got real money at stake.

In summary I'm basically saying either way, global or regional, because we know there are lots of people who allocate either way.

I think we'll finish with one last question before the break. There are many Brits in the room, which means most of us are obsessed with house prices. I know that Harry and Claus, and I think Nigel, you all own Bovis Homes so why don't you give us a word on the UK housing market and tell us all how much money we're going to make over the next five years?

CA: It's a fantastic stock, we've had it for a long time. When we went into it, we were in the middle of the crisis and at the time we were seeing all the larger house builders in the UK collapsing. They had terrible problems. Bovis stood out, because they were concentrating on strategic land, they did not really get involved in buying big areas of land and at that time had net cash on the balance sheet. With strategic land it takes much longer to get planning permission so we have to wait to see if they manage to get that through. They can now achieve returns on capital employed of over 20% or margins over 25% on the land they've been buying. So they have done very well, they are up from 3000 to over 6000 house plots. They've started generating positive earnings again and we know houses have to be built in the UK.

HF: Just to add to that, the UK housing market in particular is an incredibly attractive industry. They tend to focus in their own areas and so it's not very competitive. They actually have incentive schemes which restrict them from growing too fast. There have been a number of reports done over the last decade which have suggested we should be building 250,000 to 300,000 houses every year. We have been building about 100,000. Last year we got to about 140,000 but there's huge pent up demand. So we have an industry that's fairly uncompetitive and its return on equity as Claus was saying over a cycle is about 20%, we're buying it on 1 ½ x book value, well we bought it at less but it's now at about 1 ½ x book value, and almost a single digit P/E. Bovis is aiming to almost double its annual production of houses. As long as your competitors are not growing you can and the strategic land becomes better in a market where the government wants planning permission obtained more easily.

Q: Just thinking aloud, couldn't there be some risk given that this is quite a big issue, the Government claim to have been doing it and really all they've done is spike the market a bit more?

HF: I think the thing that probably does need to happen is the Government needs to become a house builder again, the last time we got to the point where we were building 300,000 houses a year was when the Government was the largest house builder. I think it will start again. Something has to give. With Bovis you've got five years of land supply, the Government can't just suddenly make up the difference, it'll take time and they'll need the expertise of these house builders. I think you're right something has to change. But we're not paying very high prices for what should be a very valuable business...

NW: I think there are free market advocates, but when you see the incentive schemes that Sam was highlighting to us two weeks ago, and that Berkeley and Persimmon are focussed very much on returns to investors, not on driving volume at all, because of course they benefit hugely from rising prices, you could imagine a Government in the future targeting companies like that who are not growing volume. At least with Bovis you're doubling volumes over the next three years. They're already above their previous peak in terms of volume. So this is a company that's doing exactly what the Government wants, meanwhile earning lovely returns and by the way paying out a 3.6% dividend. This is a business we think that in the sector is the most defensible, but in five years' time if we have a Government with a different stripe then certainly the sector could be in for more cajoling, particularly those that are focussed very much on driving shareholder returns rather than necessarily providing housing.

HF: They're making these returns on unlevered capital. If you go to the US, they have to lever it a couple of times to make the same kind of returns. In theory Bovis could get some debt out and make even better equity returns so I think they're just in a wonderful position.

SZ: Just to address your regulatory concerns. I think there have been various views over history and there's been talk of taxing land banks for example but what has clearly been the biggest obstacle has been the planning system in this country, and they're trying to start to reform that which will help drive house building. I think the other problem is the listed builders account for about 50% of total production, historically it was smaller than that so there are a huge number of smaller builders that went bust in 2008 and the Government effectively has to attract that capital back to the sector. By taxing or behaving in a non-favourable way towards the economics they're not going to attract that capital back, but I think these returns should attract that capital back and then hopefully you will trend towards the 250,000 homes in the next few years.

JC: Okay. We've reached 5 o'clock so as promised we can have a break for a cup of tea for 10 minutes.

If you're going to stay the teaser I'm going to leave you with is I'm going to ask each of the people on the panel to talk about their most exciting idea or their latest purchase.

Thank you to the panel.

[BREAK]

JC: Perhaps if we start at that end, with Sam Ziff talking on behalf of Claus.

SZ: Our most recent purchase was Jumbo, but the other recent purchase has been Lloyds Bank, which hopefully has less risk associated with it than the past. We started purchasing it before the election, before their results, so the beginning of the year. I think Harry touched on the point about looking for higher quality stocks at good and attractive valuations, it's not a screaming valuation, often banks become available at well below book value but we paid just over book for it. I think the attractions are the UK market is enormously concentrated and Lloyds is the best player amongst them. They've got some opportunities over the next couple of years in terms of expanding their interest margins, predominantly as a result of resetting their cost of funding back in 08, 09, 10, when they had to borrow money at quite a high rate. In addition to that there is excess capital within Lloyds so they're running off their Irish book which will provide a source of capital we hope to see returned through buy-backs and dividends. Their tier 1 ratio is about 13 ½ % - amongst the best in Europe. Their leverage ratio is 5% which is again amongst the best in Europe. We expect it to generate good returns on equity, mid-teens over the next few years, driven by a better funding position and a low cost-income ratio. It's got an advantage relative to its competitors on the deposits that it holds. That's our recent purchase.

JC: Juliet or Robert?

RW: I'd like to talk about a terrific company called Ushio. We bought that stock in October of last year and the reason we bought it was that it had more than 30% of its market cap in cash, and between 30 and 40% of its market cap in equities. It's a light bulb to lasers company, in other words a light source company. The trigger for us buying it was that the president changed. Now that normally wouldn't matter except normally the president of a company changes at the full year end and the president in this case changed at the half year, which was pretty unusual and so we noticed. The president had been the CEO of the American business which was doing very, very well compared to the Japanese business, and so him coming back and taking over the whole company we saw as an interesting opportunity. They have subsequently announced share buy-backs, raised dividends, all the things we like to hear and the business is beginning to turn. It wasn't a bad business, earnings were not bad, but things are looking up. There's still a fair way to go in the stock I think.

JC: How much roughly?

RW: About 30%. And we value it on 1.2x book. I think it's on about 15x earnings and the earnings are improving. The cash will be used for share buy-backs.

JC: Harry?

HF: To go for one that's got very limited downside and plenty of upside would be Oslo Børs, the Norwegian Stock Exchange. It's trading at a huge discount to other stock exchanges because it doesn't meet the requirements to list on its own exchange, so effectively most people can't buy it. It does have liquidity over the counter, but lots of funds can't access those kinds of stocks. A stock exchange is obviously a wonderful business in the sense that you've got this revenue base that effectively gives you guaranteed cash flow and it slightly fluctuates with volumes but they don't incur much capex and the earnings become cash and so once built you can just keep paying these huge dividends. In Oslo Børs' case it's one of the best capitalised, I think it's *the* best capitalised stock exchange apart from Hellenic Exchange in Greece which if you're feeling very confident you can dip into. It pays a 9% dividend every year and they have just in the last six months got rid of the clause that said it couldn't be taken over. So it's now in play and if it isn't taken over you'll just keep getting 9% every year, maybe even more, maybe they'll raise the dividend. So a very low downside and large upside.

JC: Nigel?

NW: My most recent purchase was Bovis, which was just over a month ago, and we've talked about that. We were speaking earlier about the portfolio being different from the usual suspects and when I look at the stocks with the most upside in the portfolio and which therefore I am most excited about, we've got Lukoil, with 130% upside to fair value. I've got two retailers, Staples and Tesco. Staples I think is 50% upside, Tesco 45%. Tesco has the other unique attribute for a dividend fund of not paying dividends at the moment but there's plenty of upside which is why we still hold it. But it means the fund is yielding about 3.2% net, 3 ½ % gross of withholding taxes from around the world and that is carrying the largest holding which pays no dividend. The other stocks that we hold with lots of upside are Rio Tinto which we talked about, with 40% upside to fair value, and HP with 40% upside to fair value. So nothing traditional about those names in an income fund. We've talked about those, Staples is the only one we haven't talked about recently. Richard Garstang covers Staples for us, so if you would like to say something Richard?

RG: The main point at the moment and where you get the upside from is they've announced a proposed deal with Office Depot which is the number 2 player, Staples is number 1, Office Products in the US and in Europe as well. That deal combined gives them 1 billion of free cash flow and then with all the cost savings and closing lots of stores they can gain another billion, combined that $2 billion is worth about $28 a share and the current price is at $16. The one question at the moment is whether it goes through the competition authorities and even if we're assigning a 50/50 chance you're still in the mid-20s. We see the downside below the current share price - there is some risk if the deal fails but at a 50/50 chance you're mid 20s and that's where the upside comes from. And while we're waiting we've got a 2 ½ % dividend. When we bought it, it was paying a 4% dividend.

Q: Do you speak to the sell side on the name?

RG: We did speak to some after the deal was announced to see what they were thinking.

Q: I'm trying to get an understanding of the consensus of how it'll be treated by the FTC?

RG: A couple of brokers are at 70/30 it gets approved, lots at 50/50 because it's just unknown. There was a recent merger which has just been declined.

Q: That was Sysco and the US Foods.

RG: Yes, that's right and now there's obviously a bit of concern that that could be a read across. The general consensus is they are OK on the retail side, so on the shops that you see on the high street, that's not a problem. People can go to Amazon, they can go to Walmart, they can go wherever they want. On the commercial side where large companies have three to five year contracts it's more sticky and that's where they're concerned that the pricing is held within a few competitors and obviously merging number 1 and 2 concentrates the power and that's the concern.

Then the next question on the valuation side is the cost savings where some people think some of it will be given back in price, because that makes them more competitive against Amazon. So number 1, you can increase your cash flow, but secondly you become more competitive against Amazon.

JC: Tom?

TT: I'm going to choose Samsung Electronics because it's the largest holding in the portfolio. I think people spend far too much time on the handset part of it but just to run through it quickly, it is only half of the business. They went through an inventory correction last Autumn, they just really had the wrong strategy there, particularly in the mid and low end phones. They addressed the pricing issues in China, have come through that so from a trough of 7% operating margins that they got in that division, they've now bounced back to low double digits, and then with the launch of the Galaxy S6 high end phone, we should see that coming through so we should get to 12-13% operating margins overall for the handset business. So really the recovery of that has come through over the last six months.

Then the bit that I think people spend less time on is the semiconductor part where Samsung is very, very strong. So in DRAM they're clearly the world leader, they're about two years ahead of the competition in technology. We're going through a very, very good DRAM cycle at the moment and we'd argue that that cycle is sustainable.

Q: That's where they compete with Micron?

TT: Micron are much more focussed on basic commodity PC DRAM, a much higher percentage than Samsung, Samsung's only about 15-20% in PC DRAM. Where you really want to be in DRAM is in mobile and then server DRAM. Then if you can, which Samsung can, moving over to DDR4 as well which is a premium type of product. They're really cleaning up in DRAM, it's going to be an extended and less volatile area, less cyclical than it has been in the past because that whole area has consolidated to three players and it doesn't really make sense for them to upset the apple cart as it were. Then in NAND flash they've pulled off a bit of a coup and have moved to 3D NAND. They were really the weaker of the three main players, but that'll allow them to move up there and start making much better margins out of that business. Then the real kicker that will come through is in their logic chip division. They're winning Apple back so what was an under-utilised area will now be full, partly because of their own internal demand but also because of the wins with Apple, so you should see that coming out of a loss last year, break even roughly now, coming up to maybe mid-teens operating margins towards the end of the year.

So everything going very well, these two are the main divisions, I'll skip the rest because it's small and less interesting.

Q: Do you have a sense of what the sum of the parts is? Do you have your own target?

TT: Yes it's good because the price target we get to wit P/E valuation, the sum of the parts and also price to book all get you to roughly the same valuation, roughly 65% upside from where we are. The main parts of the business are going very well. You've got a company there that's sitting on roughly 30% of its market cap in net cash, a more shareholder friendly movement is slowly trickling its way through Samsung. They've increased the dividend, there's some buy-backs, so that helps. Hopefully over the rest of the year, and as we sort of touched upon earlier, the wider Samsung restructuring story will pass. How that pans out, we're not entirely sure, but we do believe that the main Samsung Electronics business will be unscathed by that. It doesn't make sense for the family to impair the longer term value of that company.

NW: I'd like to add one thing on the point about Micron which we addressed slightly. It was the thing that really struck us is that Micron is working at what they call 30 nanometer and Samsung is now 25% on 20 nanometer, something like that. The economics come down to how many chips you can get off of one wafer and you get 80% more chips on a wafer at 20 nanometer than you get at 30 nanometer and Samsung are two years ahead of Micron. So Micron needs a lot of help because there's no hope of catching up at this point with the advantage, the cash flow and the investment profile that Samsung have.

Q: If you put Samsung's DRAM business on Micron's valuation and you get an interesting jump towards your price target. And one other point – do you feel you can get the information you need from management?

TT: Samsung has always been opaque. One of the problems with Samsung is getting in front of the management and they tend to come out once every five years and then don't answer a huge amount of questions, but the next level down are much better. On the whole you can get the answers that you need.

Q: Is Chaoda a problem stock?

TT: Well Chaoda is making its way back up hopefully. 2011 was an awful year for the portfolio thanks to two Chinese stocks. They accounted for all the under-performance that we had in that year.

Chaoda had a short seller note, coupled with the fact that there was also an insider trading scandal which they were cleared of and a western fund manager was implicated in. Then the auditor also resigned, so the company was left suspended by the Hong Kong Exchange. It went through the wilderness for a couple of years while they had to find a new auditor, produce the accounts and then get relisted onto the Hong Kong Exchange which is what they've done now. So we still hold that small rump that we had then. You may ask why don't we just sell it? We don't believe it's a fraud, we do believe that those assets are there. If you take the most recent valuations, most of that sector has now been taken out, gone private or been bought by private equity. And if you use those valuations you get 10x the current share price.

Q: I wanted to ask a more general question about how you deal with overlaps in your portfolios. Is there any danger that you might just not challenge the reason for a colleague buying a stock because one or other of you thinks it's wonderful and you just pop it into your portfolio because it fits?

JM: That's not what happens.

HF: Each portfolio is autonomous but anything that could be invested in another portfolio would always be put in front of people that can invest in it and discussed. Our most recent one is a great example, Jumbo, which I've been following since my first adventure into Greece. Then it was a choice between Jumbo and OPAP but we started doing more and more work on Jumbo. When the time came, which was a week ago, when Tsipras looked like he was going to move, we made our investment on that day. There were three portfolios that could invest in it and one of them didn't.

Q: So how many portfolios hold Jumbo?

HF: It's in the European portfolio and in Smaller Companies.

Q: When there is commonality do you enter and exit positions on a pro rata basis or do the managers have discretion as to how quickly they act or is there a centralised decision?

How do you go about apportioning to the appropriate portfolio?

NW: As Harry said, when he's got an idea, he'll discuss it with those that could buy it so they have an opportunity to buy it with him. If multiple portfolios buy together it is pro-rata'd depending on the size of the portfolio etc. The same process happens on the way out. Portfolio managers have to say they want to sell and discuss why with the other portfolio managers that own it and then they have the opportunity to participate or not. As Harry said, we're autonomous so each portfolio manager makes the decision about whether to join or not, there is not a centralised decision reflected across different strategies.

Q: Can they buy it from him directly at a discount?

All: No!

JC: And that's true of the global accounts as well. If it's one of the stocks which might take a few days to liquidate, it's completed pro rata on a daily basis as well. It's all pre-allocated.

Q: Can I ask an operational question that's completely different from all of these, how are you guys dealing these days? And how are you rewarding the other side of the street for whatever little input they may give you that's credible?

RG: We're fully CSA now, we have no bundled research and we have execution only rates with all the brokers we use which are between 4 and 5 basis points in developed markets, which is pretty good for a company of our size. We split trading across eight or nine brokers and each one of those we have a CSA with. During the year commission contributions are made into the CSA from which research is then paid. Once we reach the research budget which was agreed at the start of the year we then stop accumulating commission for research and move all dealing to execution only rates.

JC: The budget is set at the start of the year, and everybody on the investment team is involved. Given what's happened in the previous year people have views on a broker which may be good or bad, so they are moving up or down on our list depending on the quality of their output. Over the last few years we've been relentlessly squeezing on execution rates and research and keep bringing that budget down. As Richard said, we've just moved to execution only rates so everything we do from now to the end of the year will be at 4, 5, 6 basis points, with no payments for research. Then we start the process again for next year, with a new budget.

Q: Who's allowed to vote?

JC: Everybody in the investment team, and then the CIO and Head of Research have an additional allocation to deal with any gaming or oddities that are thrown up.

Q: Is there any pushback from the sell side with how you guys have moved to relentlessly driving down costs? Do they feel as if they're being under compensated?

RG: Yes and no. On the trading side less. When we moved to the CSA we reduced the number of counterparties we used, so that actually increased their flow, which helped on the absolute dollar commission coming through so we reduced the basis points per trade and those that we execute with don't have a problem. Those receiving a research payment where there is no execution, despite the idea that it's fully unbundled, do squeal now and again. Trying to get a price from them, on what they determine is the value for their research is impossible, there's no menu and so we have an ongoing discussion on this.

JC: Yes I think that's fair. One other thing that's happened is that for any corporate access, Oldfield Partners pays from its own budget. If there was any question about whether we are going to a company meeting or a conference or a combination of both, rather than worry about mixed use interpretation, we just pay for our attendance and write a cheque. If we meet company management through a broker we just write a cheque because we don't want there to be any question about what's allowed or not, we want it to be clear that research commission is not used for corporate access.

Q: Presumably there might be a time in the future when it's fully unbundled?

JC: That's what MIFID II is suggesting. I think the issue as far as the FCA and the European regulators are concerned is that if you're a very large fund management firm you may want to push for this and can just write a $1million cheque to a dozen brokers from your own budget and then put smaller firms like us in difficulty because we cannot do that.

The one thing they don't want to do is ensure a very strong and flourishing industry in London is under too much pressure, particularly being a European directive, because the US-based firms are not under the same rules in the US so can subsidise.

JC: Okay, great thank you very much for coming. Thank you very much to the panel.