Hiding in plain sight

As a fund manager in global equities, we're often asked about stock selection, especially at times like now when there has been a frenzy of investors that have piled into relatively few stocks such as Amazon, Apple and Tesla.

I've written about the risks of buying these stocks at the top of the market, so here I'd like to share what we feel are some of the many other opportunities out there with a much greater chance of a return on investment over the medium to long term.

One is **Loews** – a diversified US based holding company operating in energy, hospitality, insurance and packaging, essentially a mini-Berkshire Hathaway.

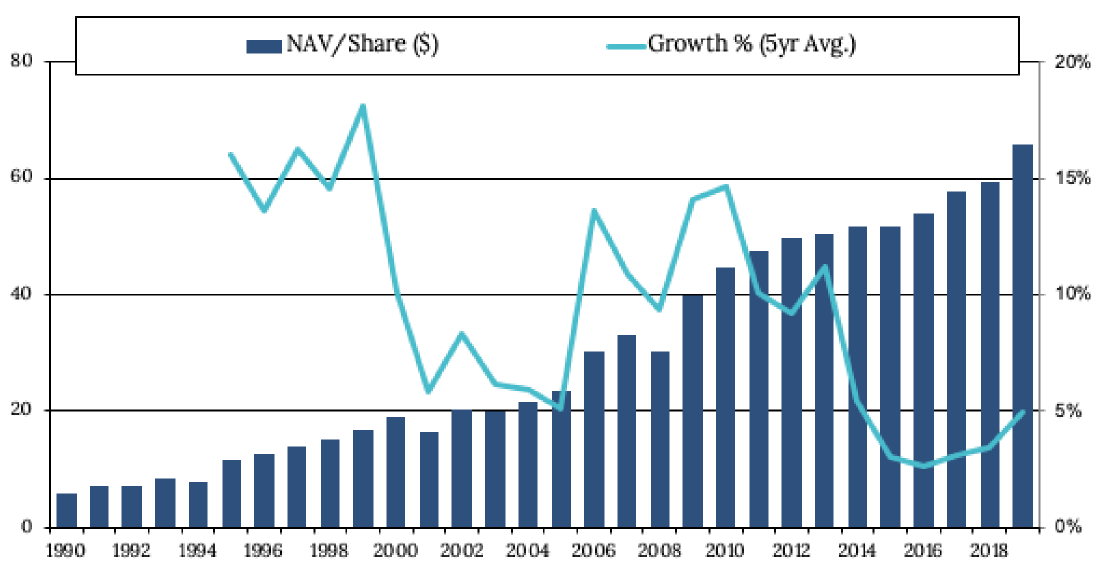
Key holdings include:

- 89.6% interest in CNA (a large NYSE listed commercial and casualty insurance company)
- 100% interest Boardwalk Pipeline Partners (transportation and storage of natural gas)
- 100% interest in Loews Hotels (luxury hotel operations)
- 99% interest in Altium (rigid plastics packaging manufacturer)

Given its holding company structure, one of the key metrics we look at to determine the success of management's ability in generating shareholder returns is the growth in the Net Asset Value/share (NAV/share).

In the case of Loews, NAV/Share has been growing steadily over the long term and is now ~$60/share

Loews Corp. - NAV/Share ($)



Source: Bloomberg

Even if we use the market value of listed securities, rather than the book value, (which themselves are trading at a discount to NAV) Loews consolidated NAV is $50/share. Furthermore, within Loews we are buying a business alongside a very aligned family with a transparent strategy and strong track record.

Our process of using put options to enter stock positions means we are looking to buy Loews at $35/share, a level we believe has little downside from that position. So that leaves the upside. While the Hotels business won't be delivering in the short term, the diversified nature of the business means other parts continue to perform and even increase their profitability. So a share price outcome in the mid/low $50 over the next few years is a realistic upside based on an expectation that Loews can continue growing Net Asset Value of ~7% p.a. while still applying a ~20% 'holding company' discount.

In short, we are buying a series of good quality assets at very attractive prices.

Another similar company is **Booking Holdings.** Booking has both driven and benefited from the move to online travel management. In 2019 they sold over 800 million room nights.

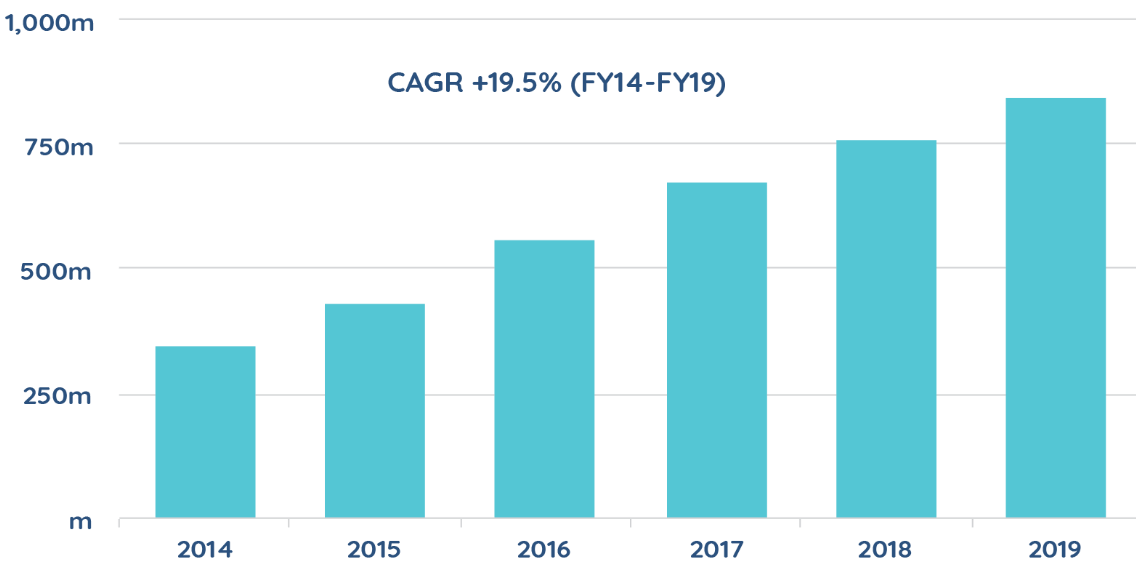
Booking Holdings Share Price

Source: Bloomberg

The business model is very profitable with Booking keeping approximately 15% of the room sale, a percentage that has been stable despite growing market share. This has allowed the company to earn operating margins of approximately 35%, which substantially flow through to cash given the very low capital requirements of the business.

The travel industry has been among the worst affected by COVID-19 and Booking has not been spared. Revenue this year will likely be down over 50% and profits closer to 80% lower. As expected, this has had a negative impact on the share price; with weakness providing an opportunity to get exposure to the stock at an attractive level.

Booking Holdings - Room Nights (mil)



Source: Booking Holdings Inc, Talaria

In our assessment, the negative revenue impact will be transitory as the business model is very much viable. Furthermore, during the current challenging period, we expect weaker online and offline competitors to exit the industry, often through lack of scale and balance sheet weakness.

In terms of resilience, Booking has no net debt, and liquidity of US$14.5bn which compares to estimated ongoing costs of $6.9bn. This provides sufficient capital to operate for years, even if low activity were to persist. Approximately 60% of costs are variable and thus will fall in line with sales, and there is medium term flexibility on the remaining 40% of costs.

In June we placed options that agreed to buy Booking at approximately 15% below the then current price yet still generate around 20% annualised return. At our entry price we believe the shares offer up to 50% upside based on normalised earnings which we expect to be realised in the next three years.

With investing, as in life, it's always nice to get something in return for the effort, so while Booking appreciated over 15% by the time our options matured, we still received the premium for taking it out.

These are just two examples of how we are paid for taking market risk.