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Mauricio's Monthly Letter

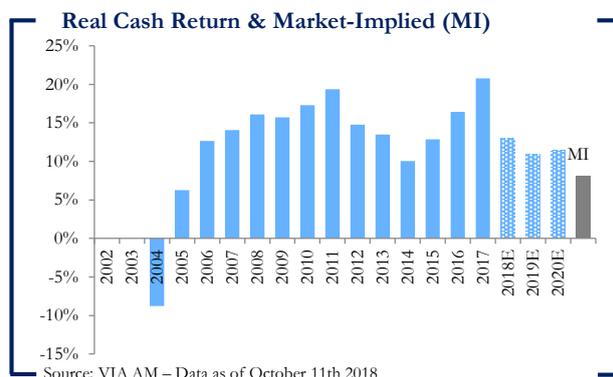
In these letters, I intend to raise awareness of problems, mistakes, and limitations in using accounting data while selecting stocks. This month, I assess SoftBank and Auckland International Airport – two large caps from different countries, sectors, and accounting norms. These two cases are meant to illustrate the importance of using corporate economic data instead, which definitely lead to very different conclusions. I'll also detail VIA's current fundamental statistics on our main investment universes (US, Europe & World).

SoftBank – It's not only telecom, what about Alibaba, Arm and Yahoo Japan?

- SoftBank provides telecom services, fiber-optic high-speed Internet connection, e-Commerce, and Internet based advertising and auction.
- We see **higher economic than accounting profitability** as we exclude goodwill and similar intangible assets from past acquisitions (e.g. Sprint and Arm Holdings – *totalling \$89bn.*!) from the Economic Capital Invested. Conversely, we include in the **ECI (or the replacement value of assets)** what acquired companies had actually invested in innovation and advertising (invisible capital), or \$12bn.
- It does not mean that goodwill is ignored!** In acquisitions, cash paid, equity issued, and economic debt assumed or issued are all taken into account in the construction of the **Full Enterprise Value (or the market value of assets)**. One of the main setbacks in using accounting data is the **lack of differentiation** between the replacement value of assets (relevant to profitability *and* valuation) and their market value (relevant to valuation).

SoftBank

Japan	
Telecom.	
Market Cap.	¥ 10,401 bn.
Accounting RoE	10.7%
Economic RCR	13.0%
Accounting PE	13.6x
Economic PE	11.2x

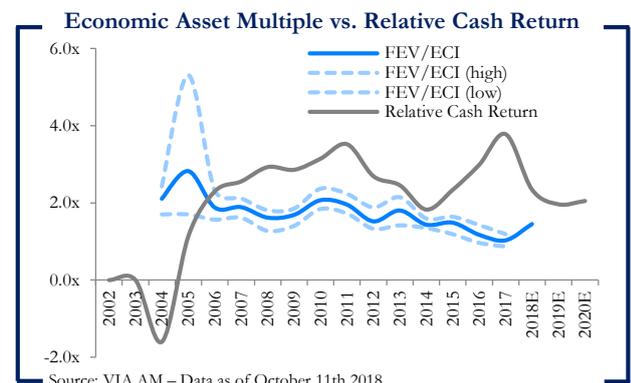


From Profitability...

- Overall, **the invisible capital invested accounts for nearly 33% of the total ECI!** including assets associated with off-balance sheet operating lease contracts. It means that the **corrected book value**, or ECI, makes the cash return measure far more precise.
- Moreover, within the Real Cash Return inflows, there are a number of **corrections to revert expensed key investments** in R&D, brands, and operating leased assets. Hence the need to add them back to the post-tax EBITDA used in the RCR inflows.

...to Valuation.

- The Full Enterprise Value is 41% above the market cap, as the market value of **29% Alibaba stake (\$104bn)** and 43% in **Yahoo Japan (\$7.4bn)** only partially offsets that of minority holdings (\$15.9bn) such as **Sprint (85%)** plus the total economic debt.
- However, the asset multiple at 1.5x is the same in both economic and accounting versions, as the invisible capital invested is **neglected in the book value**. The stock is traded at a discount as the relative cash return is higher than the economic asset multiple – see chart.



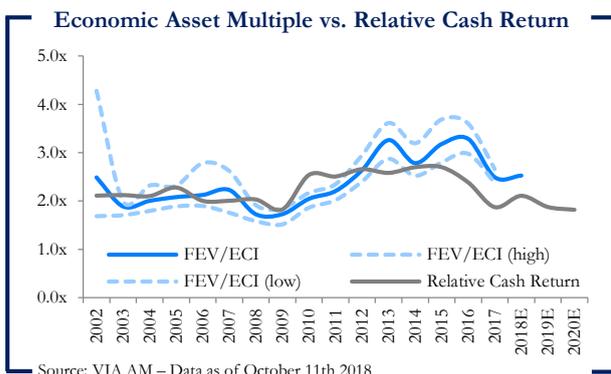
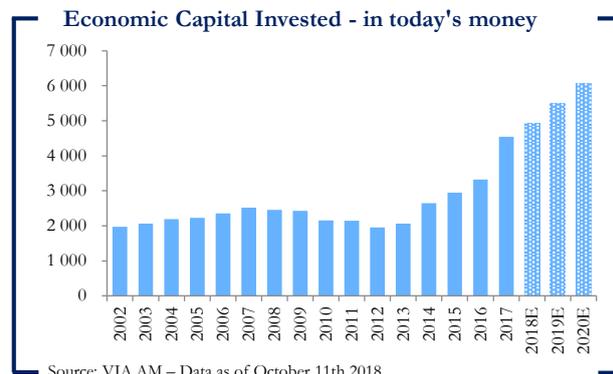
Auckland International Airport – Revaluation and replacement value must not meld

A Auckland Airport	
New Zealand	
Transport Services	
Market Cap.	NZD 8.2bn
Accounting RoE	4.8%
Economic RCR	11.6%
Accounting PE	29.8x
Economic PE	20.8x

- Auckland owns and operates an international airport comprising a single runway, an international terminal and two domestic terminals.
- There is probably no better quotation than Philip Fisher’s on the sheer scale of misunderstanding and confusion involving two very different variables - **price** and **value**: “The stock market is filled with individuals who know the price of everything, but the value of nothing”. In accounting terms, **asset revaluation** can be used as an illustration of this issue, and Auckland has applied it, before and after adopting IFRS in 2010.
- Here is why (2018 10-k): “Land, buildings and services, runway, taxiways and aprons and infrastructural assets are carried at fair value, as determined by an **independent registered valuer**”. Then on note 16: “Property, plant and equipment revaluation reserve: \$3.2bn”, or **60% of total assets!** It may represents the **market value** of those assets, but certainly not their **replacement value** – or, in other words, *the true capital invested*.

From Profitability...

- In order to pursue the true profitability, the first step is to correct “property, plant and equipment” by removing the “revalued” portion - \$3.2bn in 2018, \$2.4bn in 2017...Then, we must inflation-adjust those assets based on their average economic age. **The ECI is free from revaluation and inflation-adjusted.**
- It’s also equally important to verify that there are no revaluation gains or losses tampering with the EBITDA. This material “revaluation” removal mostly explains the gap between the RCR and the RoE.



...to Valuation.

- Auckland is less expensive on economic PE. In order to better understand why, we must look at its breakdown: (FEV/ECI) divided by the RCR.
- On the asset multiple side (FEV/ECI 2.4x vs 1.4x P/B), the FEV includes **on & off-balance sheet debt (\$2.5bn)**. On returns, the RCR is higher than the RoE, as explained above, more than offsetting the gap in the asset multiple. But the stock is traded at a premium as the FEV/ECI is above the Relative Cash Return – see chart on the left.

The conclusions in both cases are contradictory indeed. It does not necessarily mean that the transformation from accounting to corporate economic data will lead to such differences for each and every case. However, in “agglomeration”, the spreads linked to fundamentals are wide, as shown in the following section.

Universe Statistics

UNIVERSES FUNDAMENTALS*

	PROFITABILITY ²		VALUATION ³	
	Accounting	Normalized ¹	Accounting	Normalized ¹
US Universe	16.9%	20.4%	17.1	21.0
European Universe	12.7%	15.1%	13.8	17.3
World Universe	14.4%	18.4%	15.6	18.8

*Sources: VIA AM, Bloomberg – universe fundamentals as of September 30th 2018
To be noted that the three universes exclude financials.

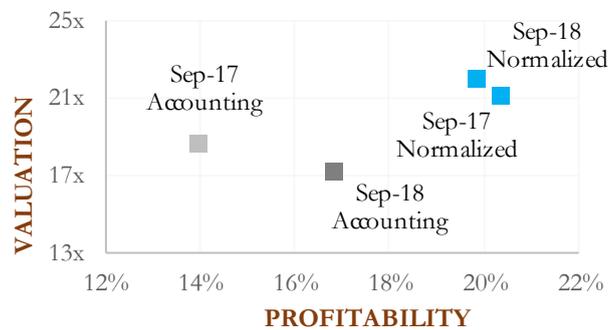
Notes

1. Normalized Data aim to reflect the economic reality of corporates on a comparable basis
2. Normalized and accounting profitability is calculated using the Real Cash Return (RCR) and Return on Equity (RoE) resp.
3. Valuation is measured based on the economic and accounting Price to Earnings Ratio (P/E)

PROFITABILITY/VALUATION – Today* vs. 1 year ago

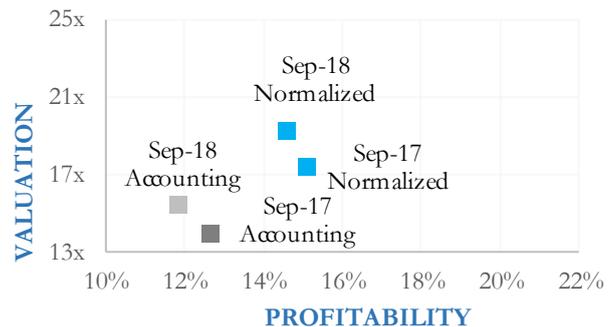
US UNIVERSE

- The US Universe is composed of 1,150 US companies making up the VIA Smart Equity US fund selection universe, weighted by market cap



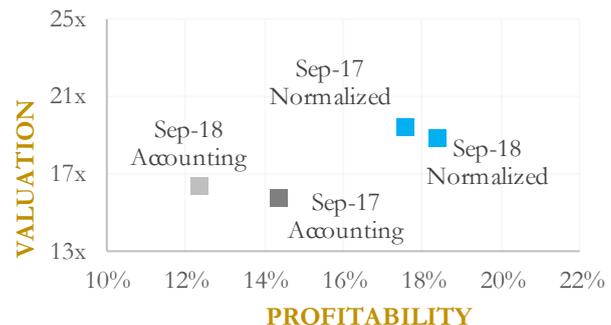
EUROPEAN UNIVERSE

- The European Universe is composed of 700 European companies making up the VIA Smart Equity European fund selection universe, weighted by market cap



WORLD UNIVERSE

- The World Universe is composed of 3,040 companies from developed and emerging economies worldwide making up the VIA Smart Equity World fund selection universe, weighted by market cap



Source: VIA AM and Bloomberg
*Data as of September 30th 2018

Glossary

Accounting Asset multiple	Market Cap/Shareholders' Fund or Price/Book Value
Accounting Book Value (Bk)	Shareholders' Fund or Net Worth as given on the balance sheet
Accounting Enterprise Value (EV)	Market value of equity (market cap) and net-debt
Accounting Intangible Assets	Assets that are not physical in nature. Corporate intellectual property, patents, trademarks, copyrights, and goodwill are examples of intangible assets
Accounting PE	Market Cap/Net Income
Accounting Return on Equity (ROE)	Net Income/Shareholders' Fund
Book Value of Associates	Investment in affiliated companies as given on the balance sheet
Book Value of Minorities	Non-controlling interests as given on the balance sheet
Competitive advantage period (CAP)	Competitive advantage period (CAP) is the time during which a company is expected to generate returns on incremental investment that exceed its cost of capital
Corporate Economic Data	Outcome of VIA's accounting normalization process, whose aim is to unveil the companies' economic reality of profitability and valuation on a comparable basis
Cost of Capital (COC)	Real long term return of equity assets, estimated to be between 5.5% and 6.0%
Current Cost Accounting (CCA)	A method of accounting in which assets are valued on the basis of their current replacement cost, and increases in their value as a result of inflation.
Deferred Revenues	Deferred revenue, or unearned revenue, refers to advance payments for products or services that are to be delivered in the future. The recipient of such prepayment records unearned revenue as a liability on a balance sheet
Economic Asset Multiple	Full Enterprise Value/Economic Capital Invested (FEV/ECI)
Economic Capital Invested (ECI)	Replacement value of assets, including inflation-adjusted tangible assets, net working capital, other long term operational assets, and the "invisible capital invested" - or capitalised intangible assets such as investments in advertising, R&D, and operational leases
Economic Earnings	RCR x ECI. ECI is calculated in today's money
Economic PE	(FEV/ECI)/RCR
Economic Value Created	(RCR-COC) x ECI. If positive, value has been created, otherwise destroyed
Financial Leverage	Degree to which a company uses fixed-income securities such as debt and preferred equity. The more debt financing a company uses, the higher its financial leverage
Full Enterprise Value (FEV)	Market value of equity (market cap), net-debt, financial provisions, pension deficit (-) surplus, operational leases, market value of minorities less market value of associates
Historical Cost Accounting (HCA)	Record transactions appearing in both the balance sheet and the profit and loss account in monetary amounts which reflect their historical costs
Intrinsic Value	It is the discounted value of the cash that can be taken out of a business during its remaining life
Invisible Capital Invested	Economically capitalised intangible assets such as investments in advertising, R&D, and operational leases
Market Value of Associates	Market value of investment in affiliated companies
Market Value of Minorities	Market value of non-controlling interests
Operational Gearing	Relationship between fixed and variable costs. Higher fixed costs mean greater operational gearing and vice versa
Real Cash Return (RCR)	Real cash return on the economic capital invested, calculated as an internal rate of return of inflation-adjusted capital invested and cash flow over the average economic life of depreciable assets
Relative Cash Return	Real Cash Return/Cost of Capital (RCR/COC)

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