

Knowing When To Sell Starts Before You Buy

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www.SatherFinancial.com

July 27, 2012

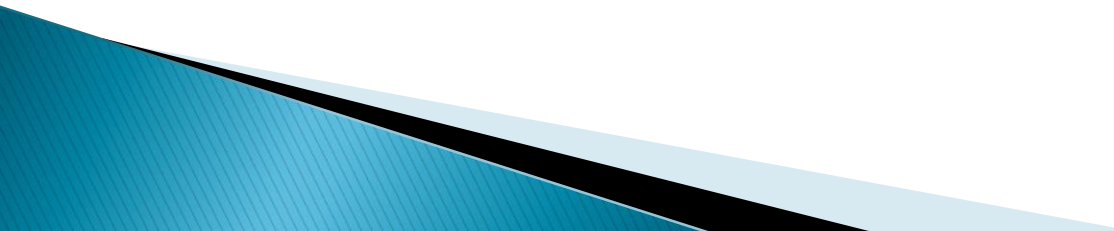
The Sell Process

- ▶ Is as much “Art” as it is “Science”.
- ▶ Reverse engineering the Margin of Safety.

What Is The Goal?

- ▶ Is it a long term hold or.....
- ▶ Is it just a trade?

If It's A Trade....

- ▶ The valuation gap can close quickly.
 - ▶ Once you get to full/fair value—you are just speculating beyond that point.
 - ▶ Be prepared to move on.
 - ▶ AIG—trading for 40% discount to tangible book value. As the discount to book value closes, you must determine if book value is climbing enough to continue holding or has gap closed enough to warrant moving on.
- 

Don't Get Greedy

- ▶ Even great companies can become overvalued.
- ▶ Coca Cola traded at almost 48 times earnings and \$87 per share in 1998—still has yet to return to this value.

The Coca-Cola Company (KO) - NYSE

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76.49 ↓ **0.54 (0.70%)** 11:29AM EDT - Nasdaq Real Time Price

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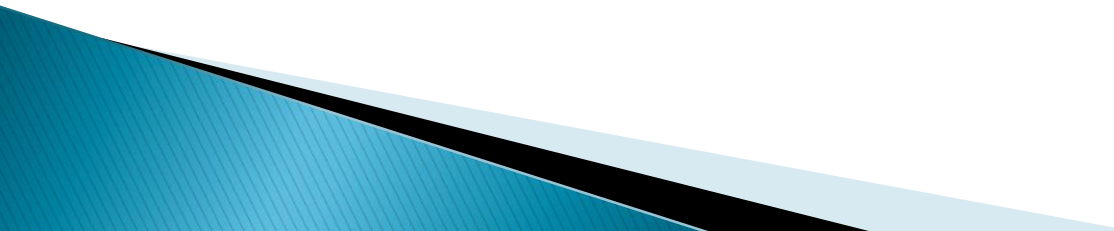
Week of 12, 2011: ■ KO 71.23

KO sells for 48 times earnings

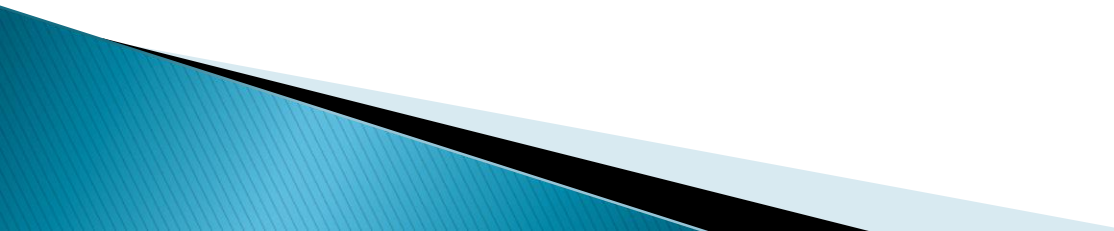


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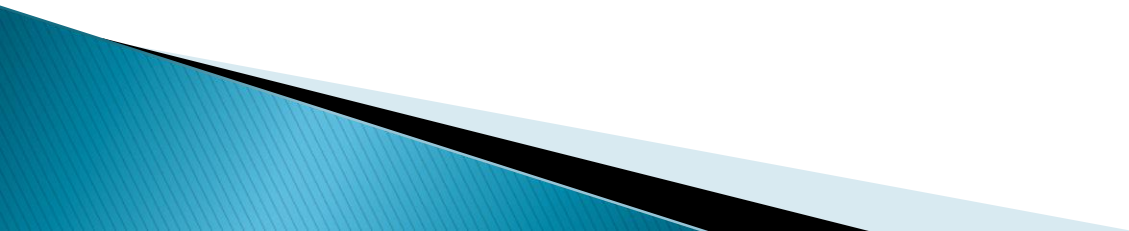
Don't Fall In Love

- ▶ Although Coca-Cola is our example, the same can be shown with Wal-Mart, Microsoft and many other great companies.
 - ▶ Reversion to the mean is powerful.
 - ▶ Klarman, Grantham and many other successful value managers routinely liquidate as securities approach “fair value”.
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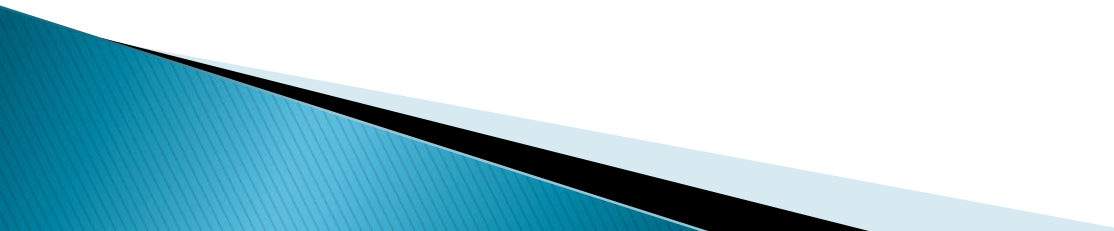
If It Is A Long Term Hold.....

- ▶ Identify the competitive moat.
 - Low Cost Producer
 - Brand Name
 - Technology/Patent
 - ▶ Is the moat sustaining or growing?
- 

What Are Your Sell Triggers?



Change In What Created Success

- ▶ Fannie Mae/Freddie Mac in early 2000's altered credit standards.
 - ▶ They began lending on mobile homes and depreciating assets—as well as to people with lower credit.
 - ▶ This was a stark departure from lending on traditional single family homes to people with high credit.
- 

Federal National Mortgage Association (FNMA) - OTC BB

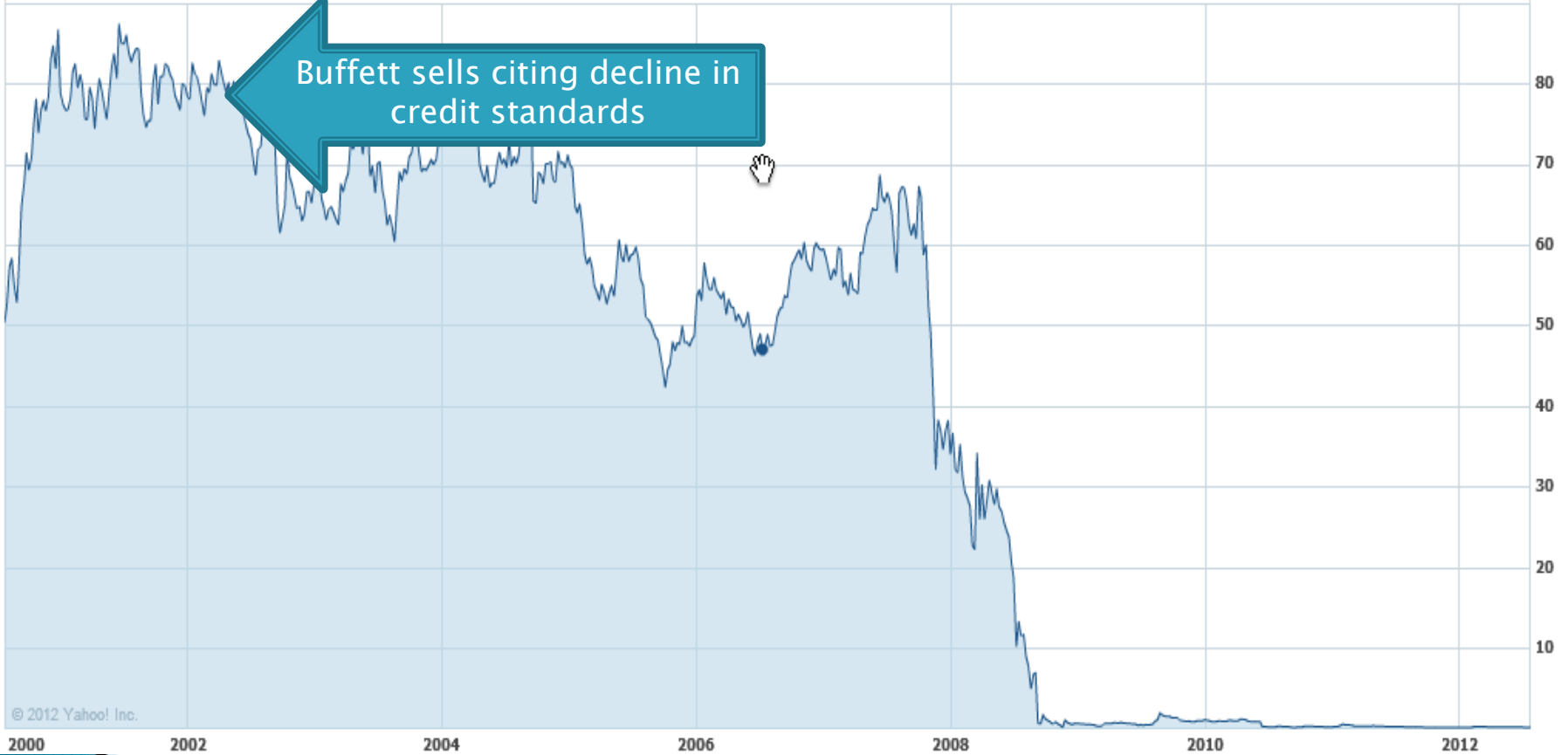
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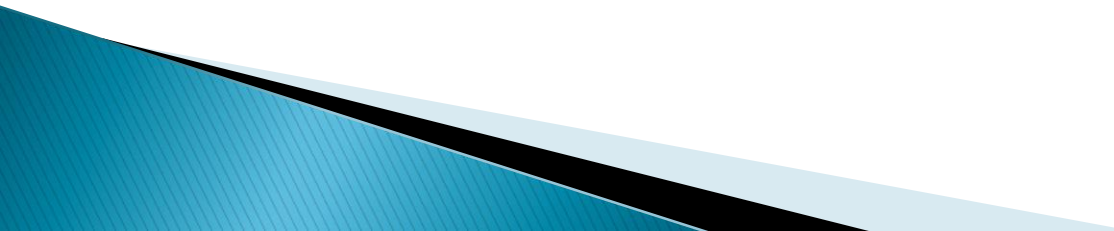
0.2368 ↓ **0.0032 (1.33%)** 11:25AM EDT

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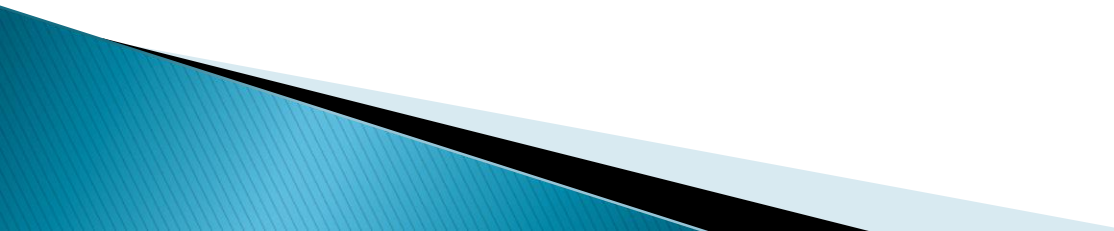
Week of Jul 10, 2006: ■ FNMA 47.09



Debt

- ▶ Greatest business failures have come from too much debt.
 - ▶ Debt does not make you right or wrong—it simply magnifies the amount by which you are right or wrong.
 - ▶ In order to finish first, you must first finish.
 - ▶ Avoid “game over” situations that wipe you out.
- 

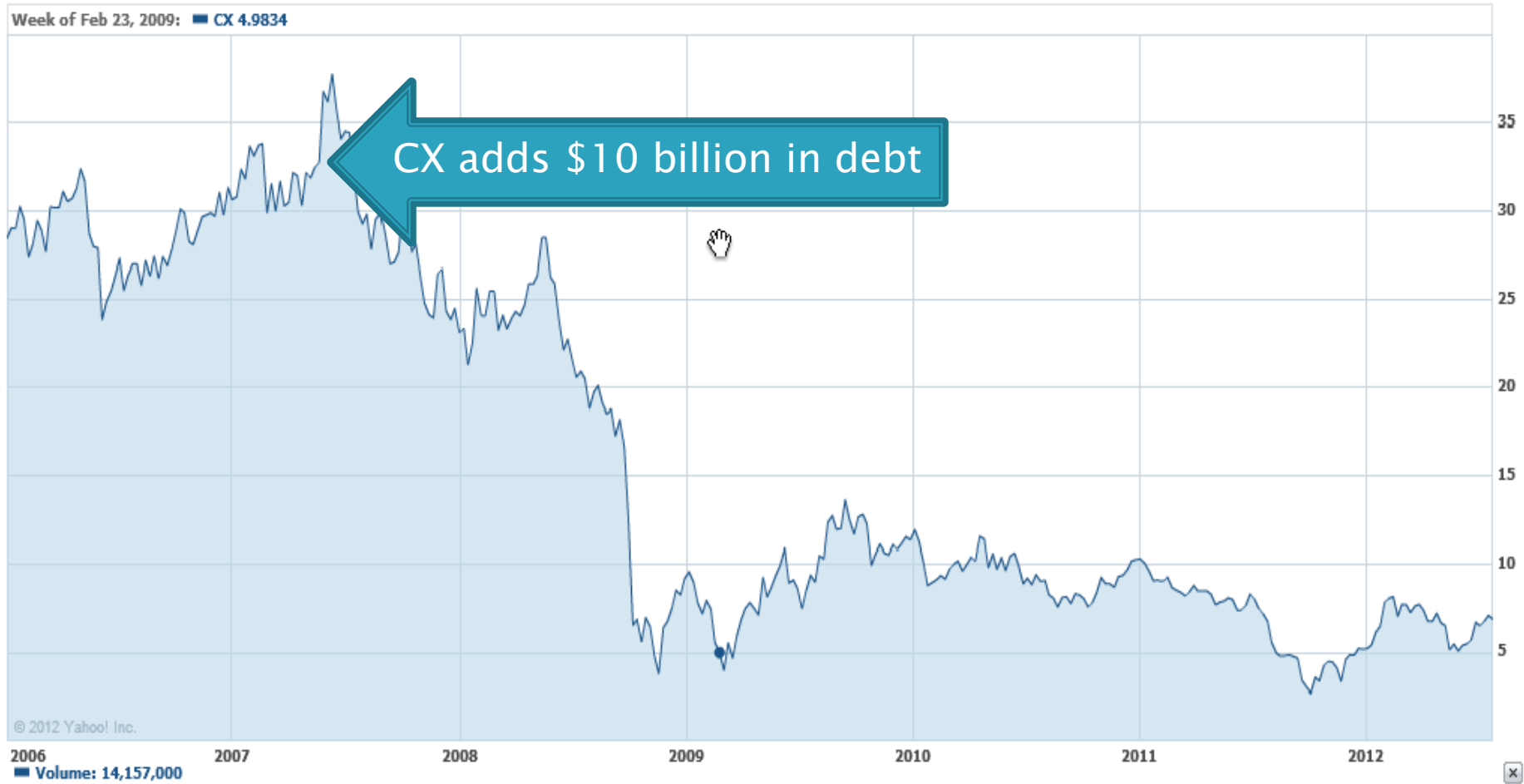
Debt: Cemex

- ▶ Leading cement company. Regionalized monopolies due to mines and transport costs.
 - ▶ In 2006 CX had \$6.2 billion in long term debt and net income of \$2.3 billion—a 2.7 to 1 ratio.
 - ▶ By 2007 CX had \$16.6 billion in long term debt and net income of \$2.4 billion—a 6.9 to 1 ratio.
 - ▶ Making matters worse, it was the peak of the construction boom.
 - ▶ Credit markets will lend you money when you don't need it—and yank availability when you desperately need it.
- 

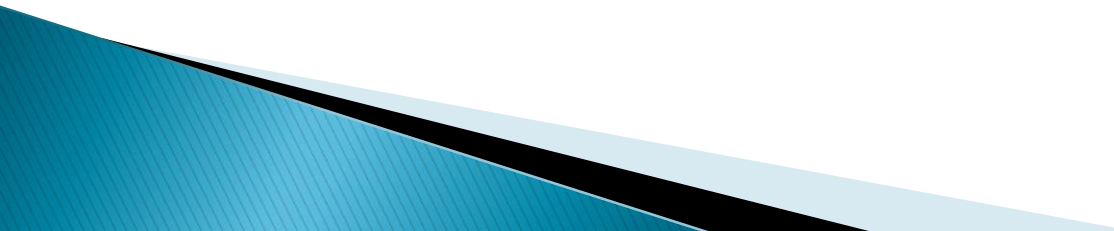
6.91 ↓ 0.20 (2.88%) 11:37AM EDT - Nasdaq Real Time Price

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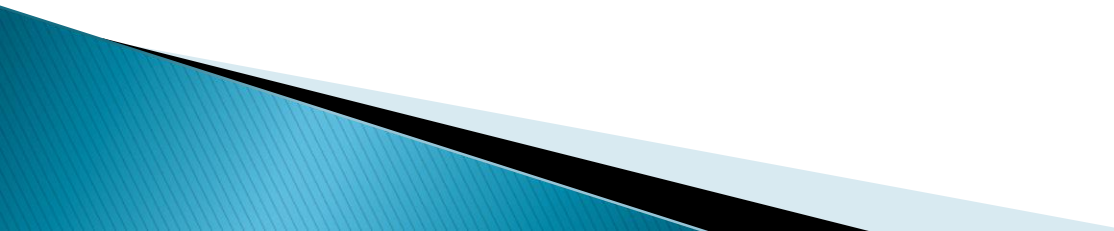
Week of Feb 23, 2009: ■ CX 4.9834



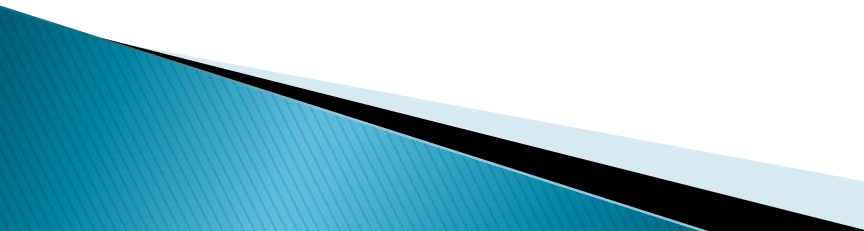
Other Credit Issues

- ▶ If some debt is good....more debt must be great—right?
 - ▶ Not enough net income to cover long term debt.
 - ▶ Pension short falls need to be added to the long term debt calculation (autos, airlines).
 - ▶ Too much short term debt—need to lengthen maturities and match obligations (General Electric).
- 

Dividend Management

- ▶ Paying dividends through financing operations—not earnings (Avon, REITS).
 - ▶ Paying out more than 60% of earnings in the form of dividends (Paychex).
- 

Paychex Dividend Analysis

- ▶ In 2007 the dividend is increased from \$.61 per share to \$.79 per share.
 - ▶ Not only is this a 30% increase, but it takes the dividend payout ratio from 50% to 59%.
 - ▶ By 2008 the dividend is increased from \$.79 to \$1.20 per share.
 - ▶ The 2008 change is more than a 50% increase and takes the dividend payout ratio to 75%.
 - ▶ Since 2008 the dividend payout ratio has exceeded 80%.
- 

Paychex, Inc. (PAYX) - NasdaqGS

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32.17

Jul 23, 4:00PM EDT | Pre-Market: **32.22** ↑0.05 (0.16%) 8:43AM EDT - Nasdaq Real Time Price

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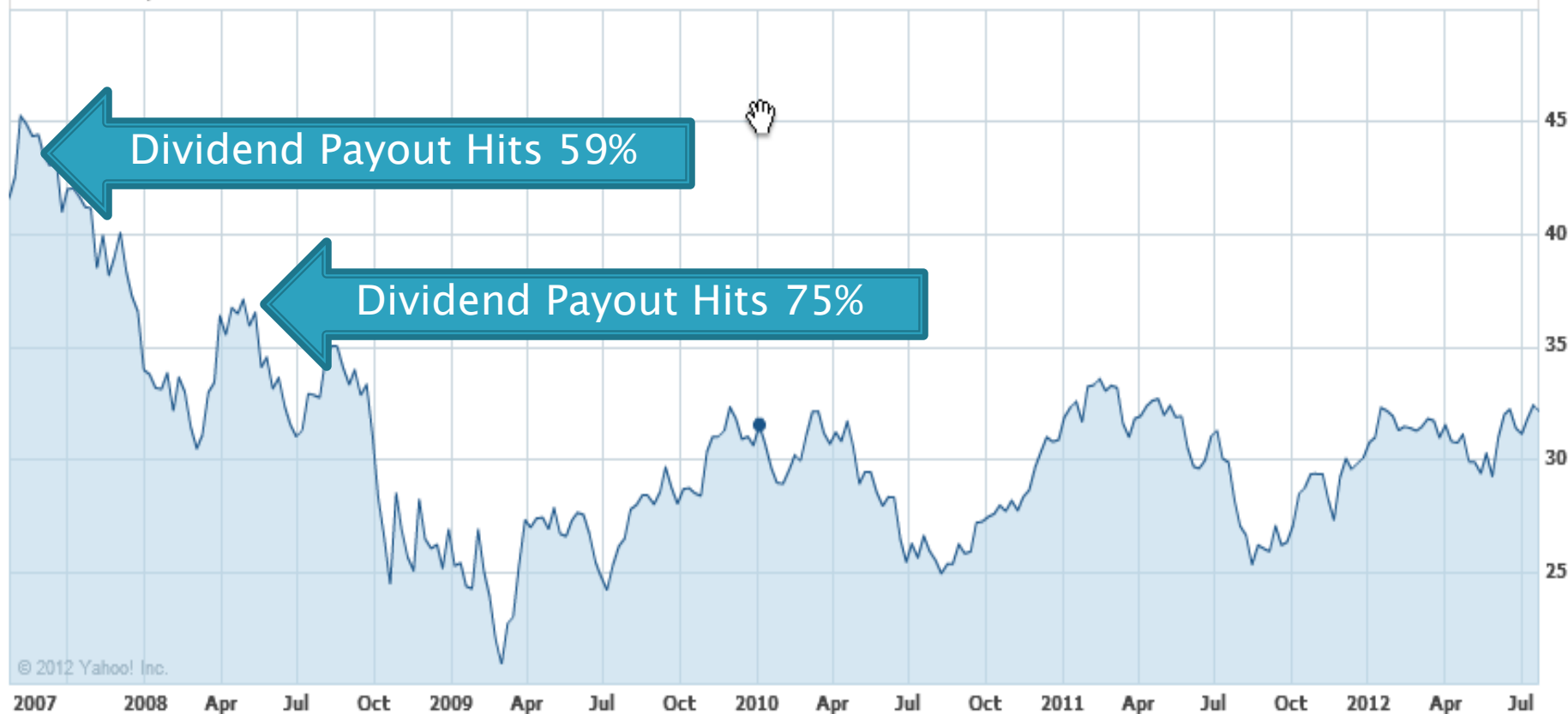
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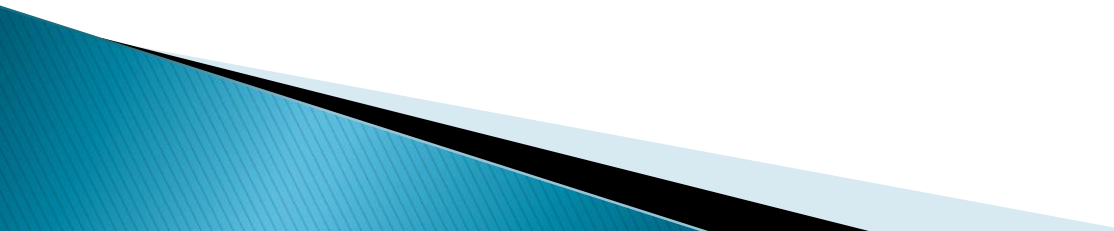
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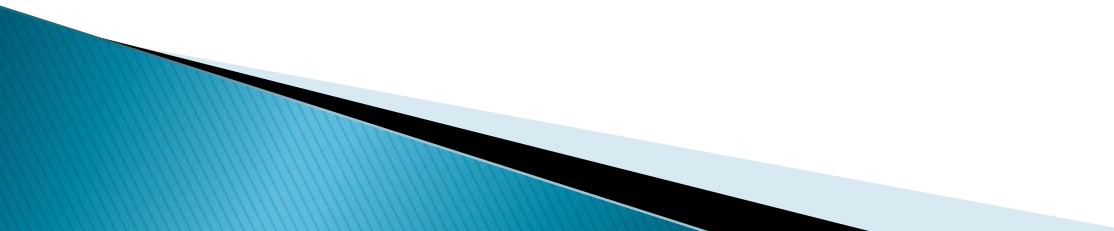
Week of Jan 4, 2010: ■ PAYX 31.56



Arrogant Management

- ▶ Carly Fiorina, as Hewlett Packard CEO, determined to buy Compaq at all costs.
 - ▶ Irene Rosen, Kraft CEO, selling good assets (frozen pizza business) to finance Cadbury purchase.
 - ▶ Make sure your CEO is looking out for shareholder wealth creation and not just bigger bragging rights.
- 

Gannett: Erosion of Moat

- ▶ Prior to early 2000's it was the largest print news distributor in the US.
 - ▶ Distribution of news, and associated advertising, weakened by the internet and online news sources giving information away for free.
- 

Gannett Co., Inc. (GCI) - NYSE

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14.35 ↓ **0.46 (3.11%)** 11:53AM EDT - Nasdaq Real Time Price

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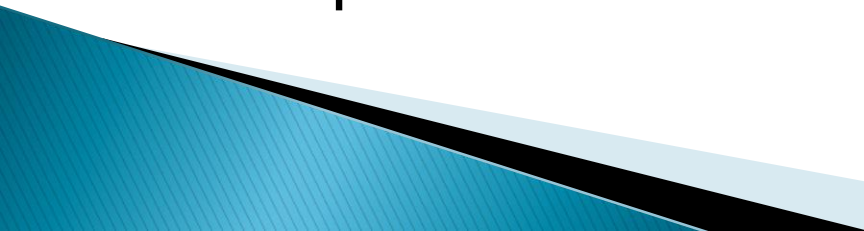
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Week of Mar 31, 2008: ■ GCI 29.48



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Schwab Yield Plus: If It Sounds Too Good To Be True

- ▶ While the average money market was yielding 3%, Schwab Yield Plus was producing 4.5% yield. This was 50% higher than the average.
 - ▶ We questioned why and how.
 - ▶ We were told portfolio only had 5% in credit default swaps.
 - ▶ Could not come up with a plausible scenario by which the yield could be this high—with only 5% CDS exposure.
 - ▶ There is no way you can derive 50% higher return without significantly increasing the risk component.
- 

Schwab YieldPlus (SWYSX)

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4.85 0.00 (0.00%) Aug 22

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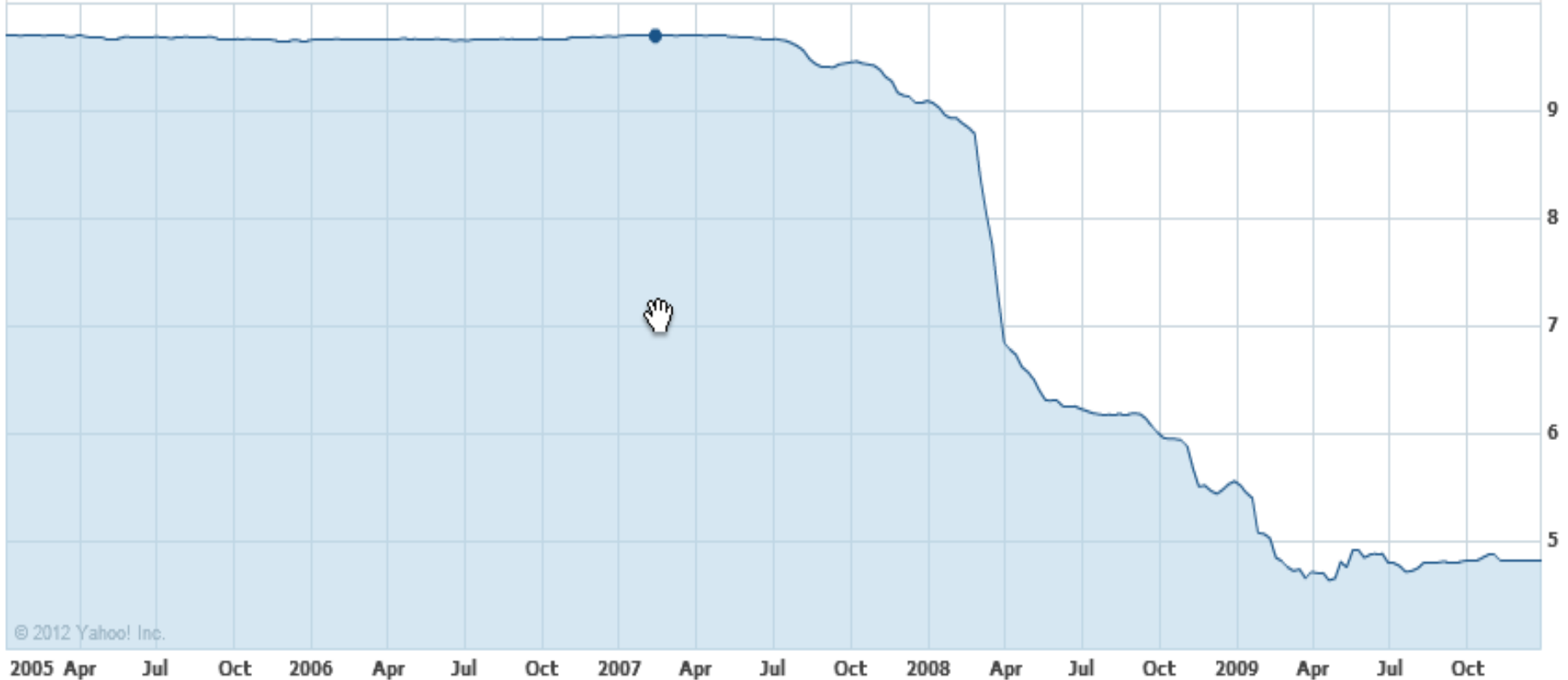
EVENTS ▾

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Week of Feb 12, 2007: ■ SWYSX 9.69



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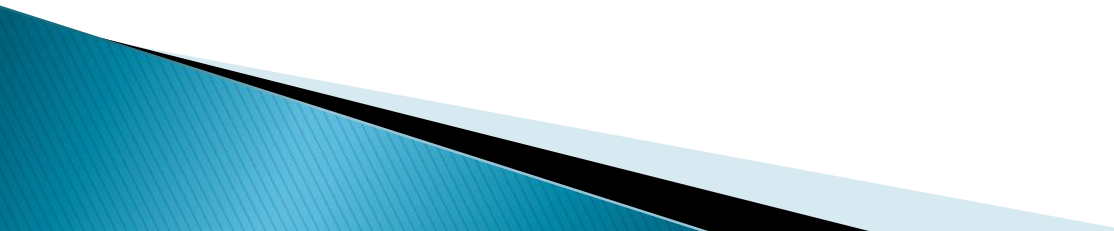
1M 3M 6M YTD 1Y 2Y 5Y Max

FROM: Jan 3 2005

TO: Dec 28 2009

-50.15%

Furniture Brands: Impact of Cheap Foreign Labor & Raw Materials

- ▶ FBN goes from being a top domestic furniture maker to near bankruptcy due to low cost imports from Asia.
 - ▶ The collapse in the housing market didn't help.
- 

Furniture Brands International Inc. (FBN) - NYSE

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1.13 ↓ **0.05 (4.24%)** 11:28AM EDT

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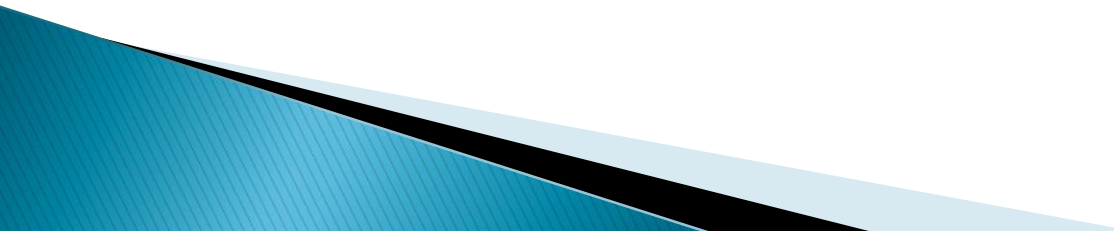
Week of Jun 11, 2007: ■ FBN 14.94



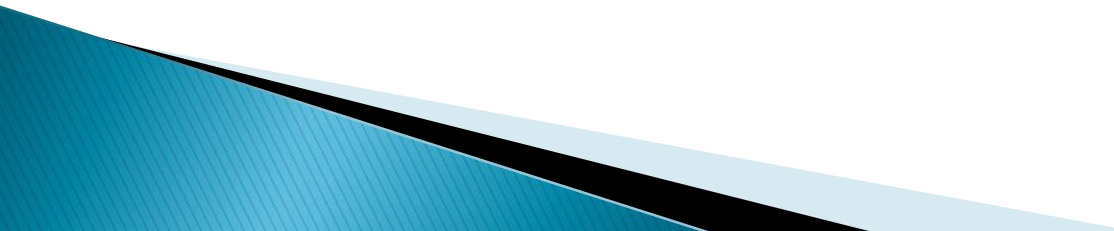
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2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

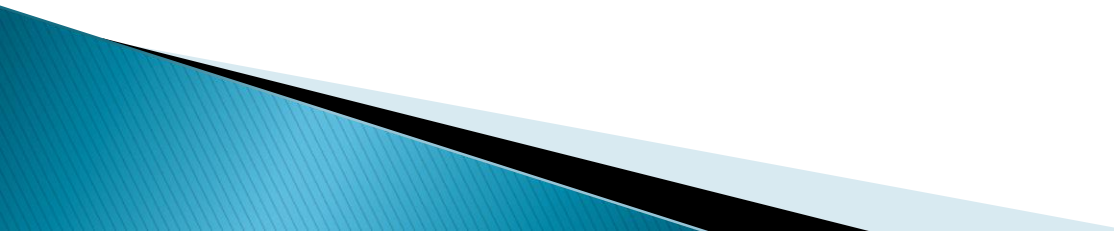
Opportunity Cost & Margin of Safety

- ▶ If other opportunities present themselves that are clearly discounted, therefore offering a larger margin of safety, you must evaluate your existing liquidity sources.
 - ▶ Should you sell one to fund another?
 - ▶ If you hold Kimberly Clark at all time high valuations why wouldn't you sell and buy a discounted asset like AIG?
- 

Kimberly Clark Analysis

- ▶ Free Cash Flow growth of 1.7% over ten years.
 - ▶ Dividend Payout above 60%.
 - ▶ Modest EPS growth over past five years.
 - ▶ ROE down 20% over past five years.
 - ▶ Debt to Equity increasing.
 - ▶ $(\text{Long Term Debt} + \text{Pension Shortfall}) / \text{Net Income} = 3.4$ (not bad, but climbing).
- 

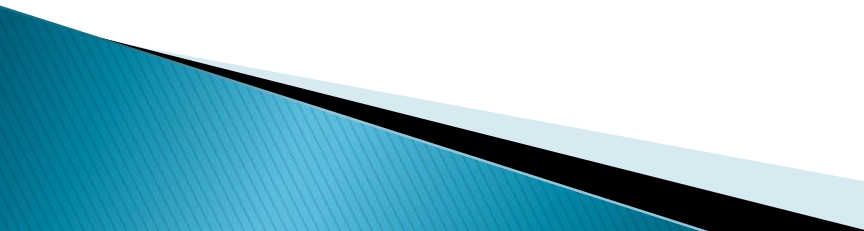
Kimberly Clark Analysis

- ▶ Gross Margin down 15% over ten years.
 - ▶ Operating Margin down 35% over ten years.
 - ▶ Net Margin down 33% over ten years.
 - ▶ Trailing 12 Month PE=21.24; max PE=21.92.
 - ▶ Price to Free Cash Flow=24.59 (five year high).
 - ▶ PE/EPS Growth Rate=2.85.
- 

Kimberly Clark Analysis

- ▶ Additionally, KMB is facing slowing growth and increasing input costs.

Kimberly Clark Analysis

- ▶ Is KMB a high quality, predictable company? Yes
 - ▶ KMB has become very popular with the overall market and especially cash flow starved investors.
 - ▶ KMB's stock price has doubled over past three years—plus a hefty dividend.
 - ▶ Can KMB still go higher? Yes
 - ▶ Is it clearly at the high end of valuation? Yes
 - ▶ Where is your margin of safety?
- 

Kimberly-Clark Corporation (KMB) - NYSE

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84.61 ↓ 0.09 (0.11%) 9:42AM EDT - Nasdaq Real Time Price

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Week of Mar 2, 2009: ■ KMB 43.92



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Valuation

- ▶ No one ratio indicates “sell”.

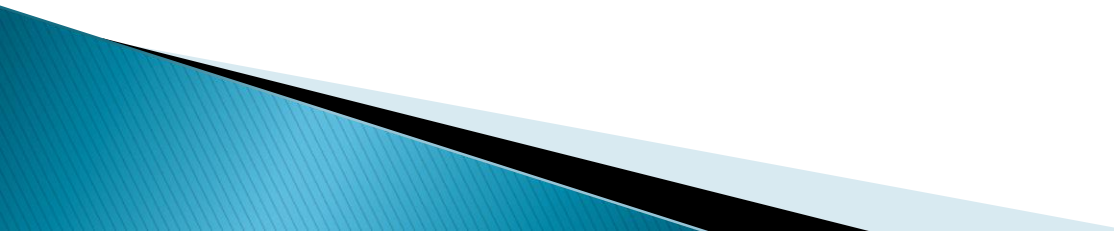
Valuation—Things That Get Our Attention

- ▶ Current PE Ratio hits 10 Year High PE.
- ▶ PE/Earnings Growth Rate of 3+.

Valuation—Things That Get Our Attention

- ▶ Earnings Yield of 5% or less.
 - ▶ Free Cash Flow Yield of 5% or less.
- 

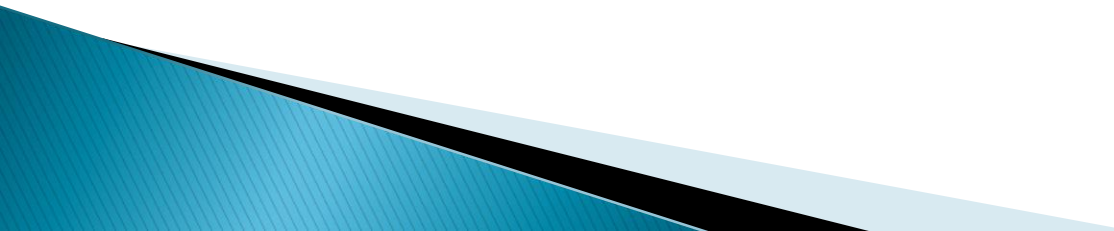
Valuation—Things That Get Our Attention

- ▶ Declining Margins.
 - ▶ Declining ROE/ROC—below 15%.
 - ▶ Sales and Free Cash Flow declining, but Earnings increasing.
- 

Valuation—Things That Get Our Attention

- ▶ Keep your ratios relevant—ie: Price to Sales will mean one thing for Wal-Mart and a completely different thing for a high tech company.

Final Consideration--Taxes

- ▶ Long Term Gains.
 - ▶ Short Term Gains.
- 

Execution

- ▶ Market/Limit Order
 - ▶ Covered Calls
 - ▶ Staggered Blocks or All At Once
- 

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