April, 2021

“***You have to turn over a lot of rocks to find those little anomalies. You have to find the companies that are off the map - way off the map.”*** - Warren Buffett

Value At Any Price
It is all too easy to dismiss the current stock market environment as absurd. We have found ourselves in a powerful wave of new and old variants of Covid as daily counts exceed 2,500 in Ontario alone and predicted to be as much as 6000 by the end of April. All the while, vaccinations appear to be a ‘free for all’, as many under the age of 70 are receiving it while others are being turned away with no apparent rhyme or reason. As such, the powers that be are placing another round of restrictions on the public further denting an already fragile economy and public mindset. Yet the stock market and in particular companies in a lot of those same businesses most affected, continue to see all-time highs. For our accounts, the substantial increase we witnessed in February carried onto in March. Can this continue?

Despite the success of our investment accounts, I believe the valuations of the businesses we hold remain attractive even in the face of the Coronavirus. The art of investing mostly pertains to selling. Buying is the easy part but selling an investment and leaving the potential of exponential gain is what makes it so difficult.

What we therefore need to best understand is the potential value of each business without emphasis of where the stock market is. I often get inquiries suggesting that because the price has increased, should we consider selling existing positions. Who wants to hold something that raises it head, only to come back down in a market sell-off? Peter Lynch famously said, more money is lost anticipating market corrections than in the corrections themselves. Owning investments requires constant revaluation so that we have the best chance to maximize profit.

An ongoing example is our holdings in Leon’s Furniture. Despite double-digit growth of Canada’s largest retailer of furniture, appliances and electronics, the company gets little respect from investors. The few analysts who follow the company have maintained an apathetic view for years and their outlook suggests more of the same. Going into the pandemic, it was believed that few were going to buy their goods, but in the spirit of ‘expect the unexpected’, it turned out they purchased record amounts. Now there is a view that coming out of the pandemic, everyone might be furnitured out. Add to that that the housing market is expected to cool down, and where is the future value?

The company has reported record results for four years straight, paid down over $450 million of debt, built a war chest of over $150 million in cash and owns in and around $800m - $1 billion of real estate outright (over $10/share). Recently, shares have tip-toed to all-time highs and on the surface it could represent an opportunity to sell the position. But its current low multiple to earnings and cashflow despite their dominant position in the Canadian market makes for potential for significant gain, especially when one compares its valuation relative to peers and/or the overall market. We have owned this business for eight years and perhaps our greatest advantage is that we have a better handle on its potential than most. Let’s see if we're right.

Come On Down…

Surfing YouTube one day, its algorithm came up with an old episode of The Price is Right from the early 1970s. Outside of the funny set design, dated clothing and products, I actually had fun watching it. Yet when you look at the prices of the items offered and adjust them for inflation you get a sense of what inflation and deflation looks like. Not surprisingly, things like televisions are valued at $800 in 1972 for a 19-inch colour sTV which would buy you at least an equal quality 70-inch today…in 1972 dollars! Adjusted for inflation, that would be $4,670 in today’s dollars. A microwave oven (fairly new item at the time) was valued at $475 in 1975 dollars, which similarly you would have a hard time paying that much for today. In fact, adjusting $475 in 1975 to today’s dollars equals $2,400. A 1974 Jaguar 12 cylinder XKE (perhaps the most beautiful car ever built) was valued at $10,148. If adjusted to 2021 prices, that car would be valued at $60,000.

I suspect that a car of that ilk today would cost more than twice that price. However, the microwaves and stove-top ranges have actually devalued in price. While we can assign manufacturing efficiencies and scale to these items, its the price we are and/or were willing to pay for these items back in the day. Now, let’s assign this thinking to the stock market. What people are willing to purchase shares of in certain industries changes as do tastes for what is popular.

The valuation of cannabis companies and the new thing, psychedelics (somehow mushrooms and acid can solve the world’s medicinal needs for depression and anxiety) are the rage as anticipation for U.S. legalization have brought speculative share prices. All the while, old school businesses such as retailers, shipping companies or electric transformers which are all pretty vital, are valued at low cash flow multiples in comparison. Would you pay $2600 in today's dollars for a microwave when the best ones are valued under $400? The promise of possibility has captured the imagination of investors plus a speculative environment has brought about even more excitement as dealmakers create more and more product, usually of lesser quality to meet the demand of investor greed. It's been going on as long as markets existed.

Think about Microsoft. Already established by the year 2000 as the go-to technology company, its shares topped $200, however, took 20 years to see that price again, despite continued growth and operating the central nervous system of worldwide computing. It was believed in the first decade of the new millennium that Microsoft would yield to Apple's resurgence. Had you purchased shares in early 2000, you're only starting to make a profit now, but 10 years after its peak (2010), the shares traded at less than 10% of its 2000 highs. Essentially it took 20 years for the company to reach its valuation promise of March 2000…and we are talking about Microsoft, not some other entity that had some potential like say…pets.com, which is now bankrupt.

Growth investing is not for the faint of heart, but it attracts investors due to the promise of spectacular gain. Between sports betting and platforms such as Questrade or Robinhood, a lot of people are in the game of speculation. While it can lead to short-term profits, most will likely end up disappointed.

I see our role is to find the right price to pay for investments and continuously value those entities relative to their potential and to their closest peers, with the idea that should our thesis be correct, or mostly correct, it will lead to meaningful profit. Our long-term track record of success points to continuing this process, its just not as exciting as buying the latest and greatest.

For what it is worth, I continue to maintain that the stock market is telling us that we are on the cusp of conquering this nasty virus. It's usually right with these things. Hopefully we're in the very late innings and better days await.

Thanks for taking a look, and as always,

All Good Things

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