Apples to Apples

Value Investing Congress – April 2014

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CENTAUR
CAPITAL PARTNERS

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About Centaur Capital Partners

- Founded in 2002; based in Southlake, TX

- Centaur specializes in value-oriented investing strategies based on fundamental securities research and analysis

- The Centaur investment process emphasizes risk-averse, reliable returns.

- Investment advisor to the Centaur Value Fund
  - Long/Short (long-biased) private investment partnership
  - Launched in August 2002

- Investment advisor to Centaur Total Return Fund (TILDX)
  - Open-ended mutual fund launched in 2005
  - Long-only equity strategy that seeks to identify undervalued equities and emphasizes income through dividends & covered call options

An Early Investment: Ballard Power

Ballard Power (1998 – Present)

An Early Cigar Butt Investment: Deswell

1999: Ignorance Was Bliss

	AOL (1999)	Netflix (2014)
Market Cap	$160B	$22B
Annual Sales	~$5B	~$4.3B
Subscribers	20 Million	40 Million

Note: Netflix valuation estimate as of March 27, 2014, subscriber estimate as of Dec 31, 2013
AOL market cap, sales, and subscriber estimate as of Dec 31, 1999

Anatomy of a Bubble

US Large Cap Stocks	1926-1999 Average	Starting Jan 2000	10 Year Assumptions
P/E	32	14	17.5
Profit Margin	4.9%	7.2%	6.0%
Sales Growth / Share	1.8%	0.9% (Trailing 10 Yr)	Real SGS Growth = 4.0%
Yield	4.3%	1.2%	2.2% (Avg)

- GMO 10 Year “Real Return” Projection for 2000-2010: -1.9% annualized
- GMO 7 Year “Real Return” Projection for 2014-2021: -1.6% annualized

Source: GMO

Surviving the Bear

Period	Partnership	S&P 500	Nasdaq
2000	-1.9%	-10.1%	-39.2%
2001	+16.0%	-13.0%	-21.0%
2002	-14.7%	-20.6%	-31.9%
Jan. 1, 2000 – July 31, 2002	**-3.0%**	**-38.6%**	**-67.2%**

- S&P500 declined about 45% from peak to trough
- NASDAQ declined almost 80% from peak to trough
- Many value investors did well during the 2000-2002 bear market

Déjà Vu All Over Again

Facebook to Pay $19 Billion for WhatsApp
February 19, 2014

Facebook agreed to buy messaging company WhatsApp for **$19 billion in cash and stock**, a blockbuster transaction that dwarfs the already sky-high prices that other startups have been able to recently command. The 55-employee company, which acts as a kind of replacement for text messaging, has seen its use more than double in the past nine months to 450 million monthly users. That makes its service more popular than Twitter, the widely used micro-blogging service which has about 240 million users and is currently valued at about $30 billion.

Echoes of the Past

Yahoo! Announces Acquisition of Broadcast.com for $5.7 Billion

April 1, 1999

Yahoo Inc. is expected to announce Thursday that it will buy **Broadcast.com** Inc. for stock valued at about $5.7 billion, or $130 a share, people familiar with the matter said. The deal bolsters Yahoo's bid to broaden its Web site with offerings from broadcast.com, a Dallas-based Internet broadcaster, as audio and video begins to be more widely distributed over the Internet. Broadcast.com posted a loss of $16.4 million for 1998, on revenue of $22.4 million. Yahoo, on the other hand, has remained largely profitable. Its stock price has exploded in recent months, rising as high as $222. Its current market valuation is **$34 billion.**

What Were You Thinking?

Scott McNeely, CEO, Sun Microsystems,
2002 Business Week interview

"Two years ago, we were selling at 10 times revenues when we were at $64. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?"

Perils of Paying 10X Sales

Bill Fleckenstein, TheStreet.com article, March 2002

"Just to put the pyrotechnics into perspective, most of the semiconductor equipment companies and chip stocks trade around 10 times revenues. Intel trades at eight times; Maxim Integrated Products, 15 times; Linear Technology, 20 times; Microsoft, 12 times; Applied Materials, eight times; Cisco, eight times; Altera, 10 times; Broadcom, 10 times. Why do I bring them up? Well, for the longest time, I have not been able to understand what drives people to pay 10, 15, or 20 times revenues. The implication of paying ridiculous prices like these is profound."

The Road to Nowhere

- What exactly are the implications of paying 10X sales for a group of stocks?
- The "Fleckenstein Portfolio" would have returned nothing over the next 12 years
- Not one of the eight stocks even managed to double at any time during the period.
- Four of the eight stocks produced negative stock price return

The Usual Suspects

Company	Market Cap	EV / Sales
Facebook (FB)	$171.5B	20.4X
Tesla (TSLA)	$28.0B	13.9X
Twitter (TWTR)	$27.9B	42.0X
LinkedIn (LNKD)	$21.4B	14.0X
Workday (WDAY)	$16.8B	41.2X
FireEye (FEYE)	$9.9B	61.1X
Splunk (SPLK)	$8.7B	28.9X
ServiceNow (NOW)	$8.6B	20.3X
Solar City (SCTY)	$6.1B	43.2X
Yelp (YELP)	$5.6B	23.9X

Note: All Market Cap and EV/Sales figures from March 21, 2014

Opposite Ends of the Value Scale

Tesla vs. BMW – Apples to Apples

	Tesla	BMW
Shares Outstanding	123.2M	602M Common, 54M Preferred
Share Price	$212	€92 Common, €68 Preferred
Market Cap	$26.2B $30.7B (fully diluted @ 145M shares)	€60B ($82.2B)
Vehicles Sold (2013)	23,500	1,963,798 (BMW – 1,655,138; Mini – 305,030; Rolls – 3,630; + 115,215 motorcycles)
Expected Vehicles Sold (2014)	35,000 (50% increase)	2,063,000 (5% increase)

Tesla vs. BMW – Financials

	Tesla	BMW
Revenue	$2.5B (non-GAAP) $2.013B (GAAP)	€76B ($104B)
Net Profit / Loss	$103.6M (non-GAAP) -$74M (GAAP)	€5.34B ($7.3B)
Gross Margin	22.7%	20.1%
Operating Cash Flow	$258M	€9.45B ($12.95B) – Automotive

Tesla's Margin Mystery

Tesla's Regulatory Credit Sales 2013	Amount / %
Revenue from ZEV / Regulatory Credits (2013)	$195M
Regulatory Credits as % of non-GAAP Revenue	7.8%
Regulatory Credits as % of GAAP Revenue	9.7%
Regulatory Credits as % of non-GAAP Net Income	188%
Regulatory Credits as % of Gross Margin	42.7%
Gross Margin excluding Regulatory Credits	12.4%
OCF excluding Regulatory Credits	$63M

- Tesla's "profit" in 2013 entirely due to the sale of regulatory credits.
- Tesla acknowledges that 2013 level of regulatory credit sales not sustainable
- Do Tesla bulls really understand how much of 2013 profits are from credits?
- Tesla is guiding for 28% automotive gross margin without credits by YE2014.

BMW enters the EV Market

BMW i3

BMW i8

BMW in China

BMW Finance a Hidden Asset

BMW vs. M&T Bank	M&T Bank	BMW Finance
Customers	3.7M	4.1M (lending & credit) 2.6M (insurance contracts)
Net Operating Income	$1,175	$2,260
Net Income	$1,062	$1,534
ROE	10.9%	13.6% (after tax) 20.2% (pre-tax)
Loans & Leases	$64,073	$115,560
Total Assets	$85,162	$126,492
Total Common Equity	$10,421	$11,518
Leverage (Assets / Equity)	8.2X	11X
Net Charge-Offs / Avg Loans	0.28%	0.46% (loss ratio)
Provision for Credit Losses	1.43%	2.84%
Market Valuation	$16B	??
Multiple	1.5X BV	??

Note: MTB valuation as of March 27, 2014

Capital Intensive Business

BMW

- Spent $110B in cap-ex over past 10 years
- Spent $41.5B in R&D
- Increased annual capacity from 1.25M to 2.1M cars
- 29 Production facilities in 13 countries
- 6,000 dealerships worldwide
- Can fund growth entirely from cash flow
- Best credit rating in industry, access to low cost debt

Tesla

- Spent $800M in cap-ex
- Spent $850M in R&D
- Will likely need to spend ~$15B to reach capacity of 300,000 cars annually
- Requires more capital through equity and/or debt to fund growth
- Likely to be FCF negative for many years as it invests for future growth

Buy BMW at 25% Discount

Current Share Price = €92

Here’s what you get:

- 2013 Earnings = €8.10
- Growing, high quality finance business with 20% pre-tax ROE
- P/E = 11
- 2.8% Dividend Yield
- 0.8X Sales
- Assuming a 6X Multiple (capital-intensive growth cyclical) to automotive OCF €9-10B per year, equaling €54-60B (ie, €82-92/Share)
- 1.3X to 1.5X Multiple to BMW Finance (€16-20/Share)
- Fair Value = €98-112/Share

Preferred Share Price = €68

- Preferred Shares (BMW3) are non-voting and less liquid (70K vs. 1.8M daily)
- Higher Dividend (€2.62 vs. €2.60 in 2013)
- Voting Shares aren’t as important because BMW is family controlled
- At €68, 8.4X earnings & div yield ~ 3.9%

Note: BMW and BMW3 share prices as of March 31, 2014

Can Tesla Grow into its Valuation?

- Exciting Company, Great Product, Growing Brand Awareness
- Still has to overcome many obstacles to grow to 300,000 annual output w/ 3 models & worldwide distribution
- Will likely require access to significant capital, resulting in likely share dilution (from 145M current to perhaps 200M in 10 years)
- Expect competition from well-capitalized, established players with large historical investments in dealer networks & manufacturing capacity
- If Tesla succeeds & is able to sell 300,000 cars annually in 5 years and is producing 8-10% EBIT margin, then it essentially looks like MINI today. MINI probably comprises 10% of BMW's current valuation, or perhaps $8B US.
- Tesla may be similar to Yahoo! in 1999. The company may do very well & become a successful business, but may take 10-15 years to grow into today's valuation, with lots of volatility in between
- At today's valuation, Tesla can be a very successful company in the long term and the stock would still be a poor probability bet. At $200, the stock is priced for perfection.

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Questions?