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FINANCIAL RATIOS:

BEWARE THE OVERSIMPLIFICATION TRAP

ROBERT LEITZ

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FINANCIAL RATIOS

- ▶ This presentation will analyze oversimplification traps when using the following common three financial ratios
 - ▶ EV/EBITDA & Capital Intensity
 - ▶ Net Cash & Control Premium
 - ▶ Net Cash & Working Capital
 - ▶ Growth of Book Value & Ponzi Schemes

EV / EBITDA & CAPITAL INTENSITY

▶ Would you rather invest in business A or B

□ Business	A	B
□ EBITDA	USD 3.3 bn	USD 4.5 bn
□ EV	USD 37.4 bn	USD 35.7 bn
□ EV/EBITDA	11.3 x	7.9 x

▶ Would you change your mind if you learned that

□ OCF	USD 3.3 bn	USD 2.5 bn
□ Capex	USD 1.0 bn	USD 2.0 bn
□ FCF	USD 2.3 bn	USD 0.5 bn
□ EV/FCF	16.2 x	71.4 x
□ Business	eBay	Liberty Global

EV / EBITDA & CAPITAL INTENSITY

- ▶ EBITDA blends out the capital intensity of a business and is a rather poor indicator of FCF. So why is the whole world (almost only) talking about EV/EBITDA?
- ▶ Is it possible to draw any relevant conclusion on valuation levels of a stock market by using EV/EBITDA without having analyzed the industry weighting of the index over time?

NET CASH & CONTROL PREMIUM

- ▶ Would you go long shares of the following business:
 - ▶ Net cash: 4,000,000
 - ▶ FCF (stable): 100,000
 - ▶ Market cap: 4,000,000

- ▶ Would you change your mind if net cash is held in
 - ▶ USD (cash)
 - ▶ US treasuries
 - ▶ Japanese Yen (cash)
 - ▶ Japanese treasuries
 - ▶ Chinese Renminbi (cash)

NET CASH & CONTROL PREMIUM

- ▶ Would you rather own a business with
 - A. good capital allocation at 5x FCF and 0% cash/market cap
 - B. bad capital allocation at 8x FCF and 50% cash/market cap

- ▶ Would you put a higher value on the control premium in A or B?

NET CASH & HIDDEN LEVERAGE

- ▶ In March 2010, Dart Group, a leisure services aviation and distribution group, was trading at 73% net cash

▶ Net Cash	GBP	51.6 m
▶ Market Cap	GBP	70.0 m
▶ FCF	GBP	41.1 m

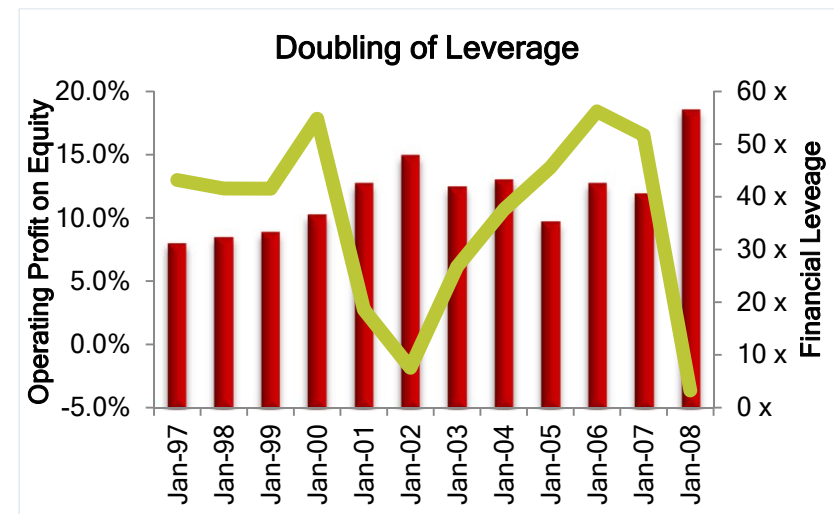
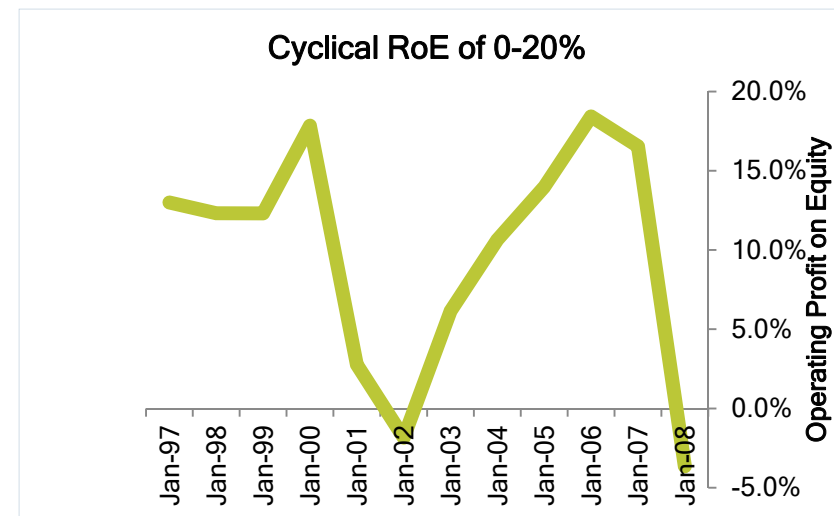
- ▶ Should you discount net cash because working capital is negative?

▶ Cash	GBP	52.2 m
▶ Inventory	GBP	0.3 m
▶ Receivables	GBP	41.9 m
▶ Payables	GBP	-23.9 m
▶ Unearned Revenue	GBP	-121.4 m (advance payments)
▶ = Working Capital of	GBP	-50.9 m

- ▶ And obviously, as with all airlines, there is high operating leverage (leased airplanes, high fix-cost base but volatile demand)

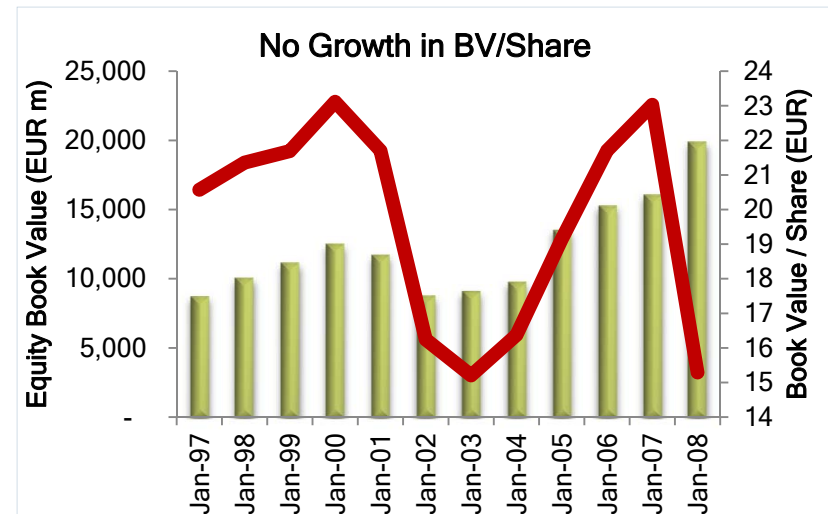
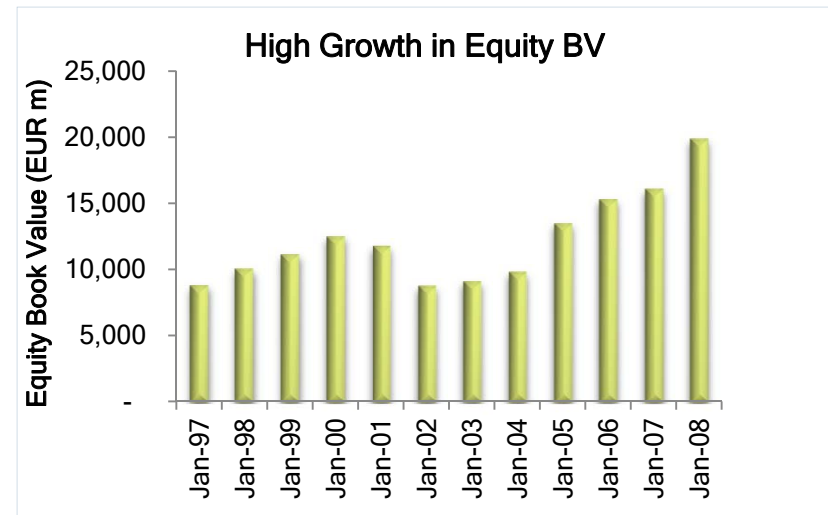
GROWTH OF BOOK VALUE & PONZI SCHEMES

- ▶ Do you think cyclical but always positive annual returns on equity of 0-20% might indicate a good business?
- ▶ Would you change your mind if you learned that the business is a bank, levered 60x with declining profitability despite moderate loan write-downs?



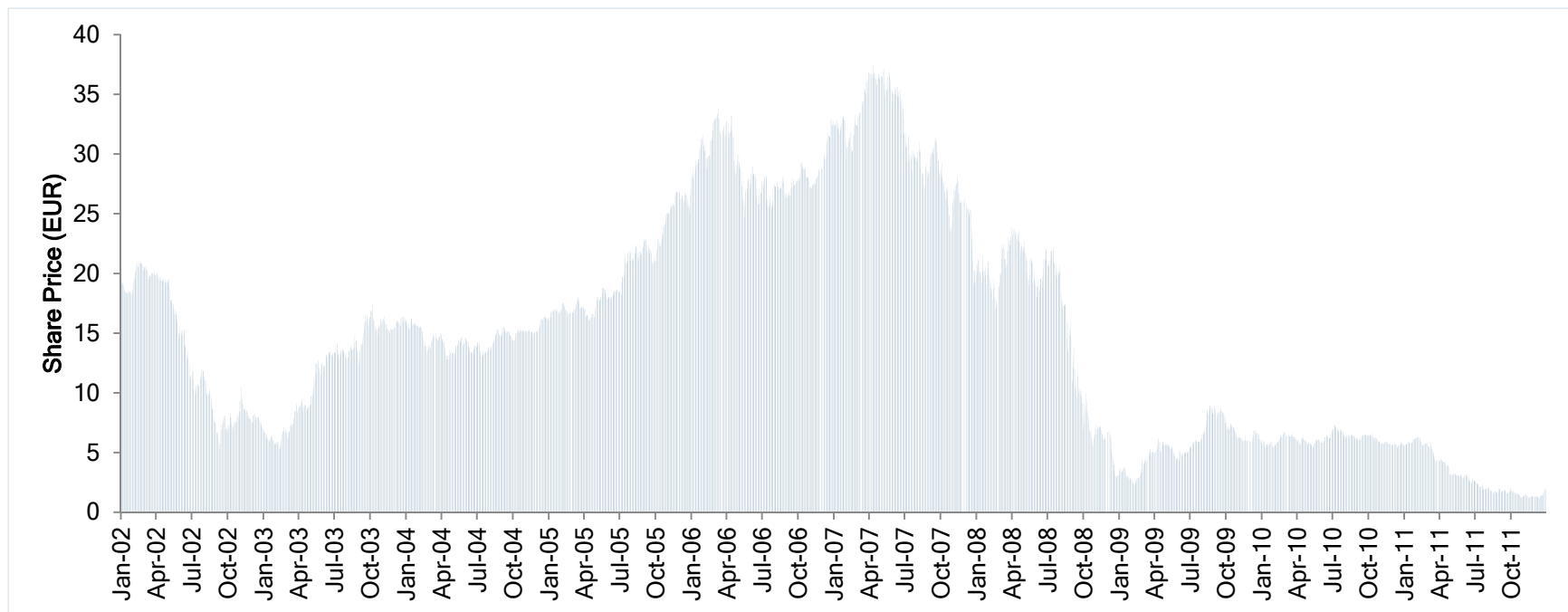
GROWTH OF BOOK VALUE & PONZI SCHEMES

- ▶ Would you take comfort in the fact that growth in equity book value reflects reported earnings?
- ▶ Would you change your mind if you learned that growth in BV/share was negative over a 10-year period, despite the reported profits?



GROWTH OF BOOK VALUE & PONZI SCHEMES

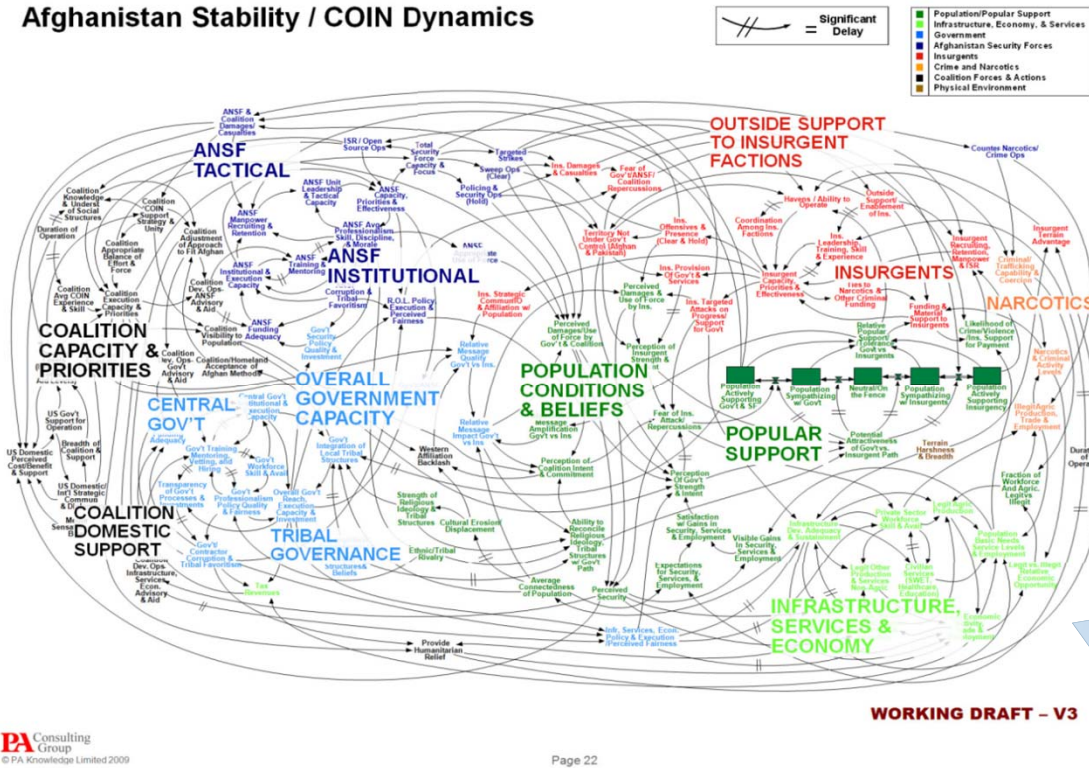
- ▶ We just looked at Commerzbank
- ▶ Given the company's Ponzi-Scheme-like history and now 100x leverage - do you think Commerzbank shares at EUR 1.80 are a speculative or value-based buy?



CONCLUSION & THANK YOU!

So, there is no need to overcomplicate things...

Afghanistan Stability / COIN Dynamics



This PowerPoint slide drove US military General Stanley McChrystal to declare that "When we understand that slide, we'll have won the war" at a briefing in Kabul.

...but it is also dangerous to oversimplify.