Oldfield Partners

Global Equities Investment Update

6th November 2017

with portfolio managers
Andrew Goodwin & Nigel Waller

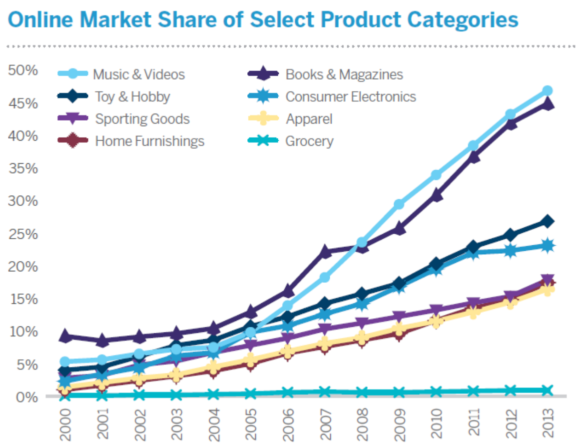
Oldfield Partners (OP): *Abri Fourie = AF, Harry Fraser = HF, Andrew Goodwin = AG, Juliet Marber = JM, Nigel Waller = NW and Sam Ziff = SZ*

AG: Good afternoon ladies and gentlemen and welcome to the presentation on the Global strategy at OP. To begin our presentation we thought we would do something a little different this time and address a topic that we are increasingly questioned upon, that of ‘disruption’. Over the course of the next 25 minutes we will look at industries and companies that have faced disruption, the outcomes and how we as Value investors at OP think about disruption before addressing the more usual reporting format.

Of course, disruption itself is nothing new. There are numerous examples throughout history including the arrival of the railway and its disruption of the canal business in the 19th century and the replacement of the horse by the internal combustion engine just over a century ago. On this slide it shows 5th avenue in New York in 1900 and we ask ‘where is the car?’ and you can see there is just one. But roll forward just 13 years and you ask just ‘where is the horse?’ And in this picture we can see that there is now just one. This shows just how fast disruption can be and how pervasive.

Source: Photos © Copyright Tony Seba.

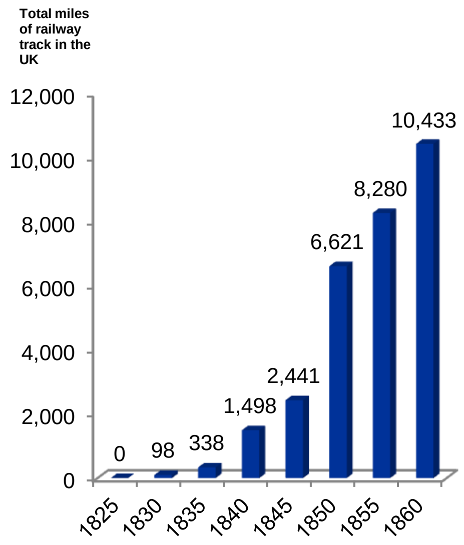
Over the last 40 years, Moore’s Law has transformed computing power and perhaps contributes to continuous disruption today. But we would argue that investors can be too quick to draw straight lines for the disruptors and can mistakenly extrapolate for the disrupted. The internet continues to disrupt an array of industries. History shows that its impact on retail varies, some of these transitions have been relatively fast such as in music and books, but other areas have been much slower and far tougher such as online grocery. What you can see here is this line remains stubbornly at the bottom of the chart.



Source: FTI Consulting, INC.

Disruption is nothing new and nor are the wild swings in investor sentiment that tend to accompany these disruptive episodes. While fortunes can be made for the disruptors and their early investors, history is littered with examples of those investors who are sucked in at the point of maximum optimism which often coincides with the peak of speculation.

One such era has been described as the 'Railway mania' here in the UK. Railways certainly displaced canals as a means of transportation. This led to a boom in their construction, which you can see in this chart and in fact the UK's modern railway network is no more than 11,000 miles today. But the peak of speculation came in 1845 and even though the railway construction continued to boom after 1845, investors that were sucked in in 1845 lost fortunes as the railways stocks hit the buffers.



Source: "Collective hallucinations and inefficient markets: The British Railway Mania of the 1840s" Andrew Odlyzko, University of Minnesota, January 15th 2010.

Today, we think history is repeating itself with the performance of the 'FANGs' where the combined market value gain for just these four companies in the United States (Facebook, Amazon, Netflix and Google) has increased by nearly $600 billion so far this year alone.

This dwarfs the market value that has been lost by the 'disrupted' sectors of the entire US retail, media and advertising sectors at less than $30bn! Yes, these can be fabulous businesses and 'platforms' but we think that the enthusiasm for the FANGS is rooted in an irrational appraisal of the profits being stolen by the disruptors which investors are enamoured with and reward with ever higher market values with scant regard for valuations.

NW: Disruption is a normal part of investment life. It comes in various forms and is just one source of investment opportunities for us as value managers, as well as the usual news and incidents and the raft of the generally forgotten and unloved.

The problem for value investors is that, when it comes to companies or industries involved in disruption, by design, we are drawn to the low valuations of those stocks that the majority think disrupted.

We can thus appear somewhat out of touch; to be disruption deniers.

To be clear, we are not disruption deniers. There are famous examples such as AT&T in the 1980's deciding not to pursue mobile telephony due to McKinsey's forecast that mobile phone subs globally would only reach 900,000 by 2000!

Since it is only with the benefit of hindsight that we know Sir John Templeton's famous statement about the four most dangerous words in investment (that 'this time it's different') holds true, we stick to the simple, tried and tested theory that valuations at purchase are the single most important determinant of returns.

In looking at individual companies we try to be sceptics, taking time to appraise the changing fundamentals but we dispense with our view of valuations only when we see that the company's prospects are indeed permanently disrupted.

So, as to the various sources of disruption:

Technology is the most interesting and the most often discussed, and Andrew mentioned several examples which have had a lasting impact.

However, investors too often seem ready to draw steep straight or parabolic lines for 'disruptors' and pour capital into 'the next big thing' irrespective of valuations as the chart of UK railways and perhaps the excess exhibited today in the FANG valuations shows.

At the same time, investors tend to draw steep straight lines with a downward slant for those perceived to be disrupted, fleeing them regardless seemingly of valuation.

History and our experience suggest that this is too simplistic and that incumbents do not just sit on their hands and we will remind you about HP as a good example of that in a moment.

Product cycles are another source in almost all industries but perhaps the most notable for these is pharmaceuticals where new drug developments mean disruption is inherent in this industry. As a result, in the Pharma sector we are wary of placing too much store in individual drugs and company's reliant on one or two drugs but this area too has provided opportunities, such as Pfizer in 2009 where we bought Pfizer ahead of the expiration of the Lipitor patent when our analysis showed that the shares more than discounted its loss.

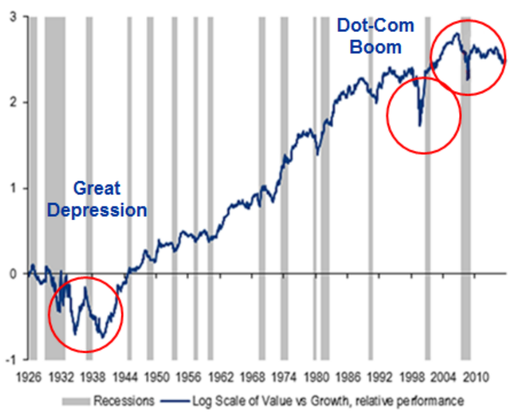
Another source of disruption is **Competition,** a good example for us was the rise of the discount stores Aldi and Lidl over the last decade and their impact on the traditional supermarkets here in the UK. Changing industry dynamics are something that investors must constantly be alert to. We have maintained our investment in Tesco because we see strong margin recovery as it repositions its offering to take on the discounters and has competitive advantages given its scale, and leadership in convenience stores and online, most of which is not reflected in the valuation of the shares today.

Finally, disruption can come from the basic macro-economic cycle but also in the form of the overall cyclicality of the economy but also within this are capital cycles for individual industries. For years the memory chip industry was viewed as hugely value destructive with vast capital investments constantly destroying any demand-led recovery but roll forward 20 years and the industry has massively consolidated and Samsung now makes spectacular returns and is a technology leader in semiconductors and has delivered us a capital return of over 260% on our original investment so far. We were able to buy Samsung in 2011 at a discount to book and on a cash-adjusted single digit price earnings ratio because of general concerns that the capital cycles were unchanging.

One economic factor that is helping fuel disruption today is highly unusual and that is the cost of capital - as policy and long-term rates have dropped and flirted with zero over the last decade, so QE has delivered a tidal wave of cheap capital – witness the number of $1bn start-ups created over the last 9 years, many business models which do not have positive cash flows until way out into the future can and have been financed. With policy rates on the rise in the US and the unwinding of quantitative easing (everywhere but Japan) we think that this period is now coming to an end.

AG: So this chart here we've shown you many times before but it's important and ultimately this is why we at OP are value investors. The chart goes from the bottom left to the top right and that shows the performance of Value versus Growth i.e. over this very long period, since 1926, Value has outperformed Growth and that's why we plant our flag very firmly in the Value camp. But it can be very hard to do because as you can see on this chart, there are periods when this relationship does not hold true and these can be quite extended. We see here we've circled one for the Great Depression there where we had a long period of value underperformance and again in the dot-com boom era.

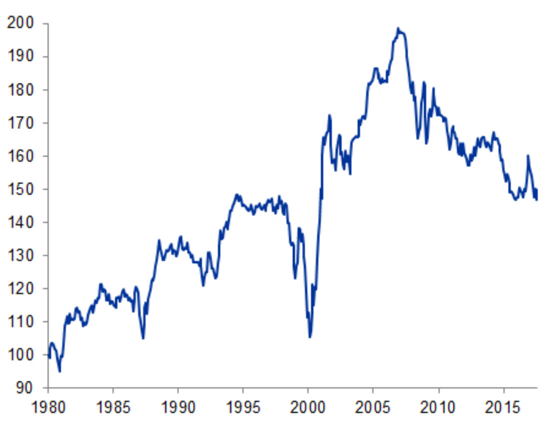
US Value versus Growth since 1926



Monthly data. Average returns of Fama-French Large/Small Value benchmark portfolios. Source: BofA Merrill Lynch Global Investment Strategy 7th June 2016, Fama-French.

And fast forwarding to 2008 and the Great Financial Crash, this has also been a very difficult period for value investing from that point. And actually if we look at the depth of the underperformance and the value side of investing, it's been as great as it was in the dot-com book era. And actually in duration we're now almost as long as we were in the 1930s, you can see this more clearly on this chart and this has been a real headwind for us as investors. In an era of quantitative easing, as Nigel has said, and of free money the business models of the disrupters have been financed. It does make intuitive sense as cash flows that are far off into the distant future, with the discount rate is getting lower and lower they're worth more and more and hence the growth style in effect outperforms.

Value vs Growth since 1979



Source: MSCI and Bloomberg. Date: As at 31st August 2017. MSCI World Value Index vs MSCI World Growth Index (total return indices).

And what we've found over that period is that asset allocation and growth has actually swamped value and stock selection. Now we as investment managers could try to change our philosophy and behaviour, and try to adapt our style, to try and hold on to things longer as they become more expensive, but in doing this we feel that we would ultimately lose our investment compass and that we would be doing things that fundamentally we don't believe in, and actually put at risk our ability to generate long term capital returns and also to protect capital. Because we would have been investing in things that we felt were overvalued and so we don't do that. We invest as a value manager but this isn't just buying statistically cheap companies, as Nigel was outlining we must constantly review the prospects for these companies to see if there has been any permanent disruption in value and ensure that the route to value is still in place, the route to the fair value that we see.

Now we won't get them all right, we will stumble across our fair share of value traps and what we term as ultimately the occupational hazard of a value manager, and we will stumble upon our fair share. We try to reduce value traps through our rigorous research process but also with a laser focus on balance sheets because as Nigel said, what we want is to be able to have patience for our investment thesis to play out. We never know when the momentum will turn, but it's the debt that can often mean that you're stopped out as an equity investor, so we have a laser focus on the debt levels and balance sheets. But we will have value traps and of course if value traps didn't exist then the whole proposition of value investing just wouldn't exist because it would have been the easiest thing in the world to do and the whole opportunity would simply be arbitraged away.

So we remain firmly wedded to the idea that it's the starting valuation you pay for a company that is the key to protecting capital and generating long term capital growth, not the growth you get.

NW: Andrew was mentioning value traps, and of course in October 2012 the Hewlett Packard company, as it was then called, was the focus of much speculation from the press and from other investors that it was indeed a value trap. This is an example as I mentioned earlier on of an opportunity that was presented to us because the market just becomes irrational and produces a very steep line in terms of its assumption about the operating performance and the share price performance of a company. And so in October 2012 the Hewlett Packard company had a market value of only $27 billion. This is after falling 40% that year, and falling 70% from its 2010 peak.

We got on with our work and ignored the noise, staying focused on the cash flows, we did our fundamental research, we went to see the company at their investor day in San Francisco, we went to their customer event in Frankfurt, their HP Discover show where 3,000 of their customers get together to assess the company's latest products. We spent a long time stressing our assumptions around cash flow and discussing them with the company. Our conclusion was to buy more having been presented with an opportunity then in October 2012 of a company which was the second largest IT company on the planet, valued at four times cash earnings, 25% free cash flow yield where the nominal dividend that they'd been paid forever, now giving you a 4½% dividend yield, six times covered by cash flow, it was an opportunity that we could not pass up.

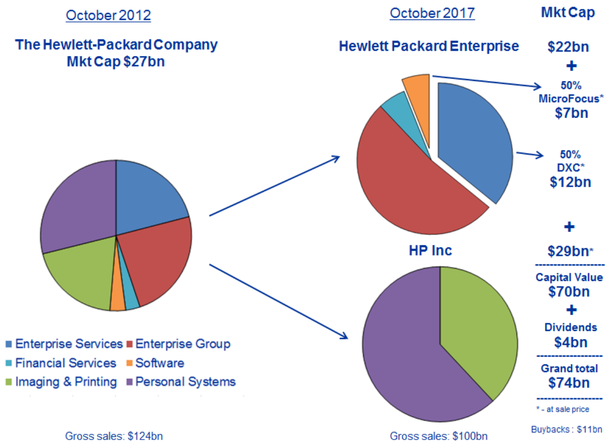
So wind forward to October 2015 and Meg Whitman split the business to provide a smaller focus for each company and to get the market to recognise the value on offer. HP Inc was one half of that, which was the PCs and printers, both of which had seen headlines speculating about the fact that it was being disrupted, that PC and printer use were in terminal decline with the arrival of tablets and smartphones, and the other half of the business comprising the services, software, and enterprise hardware left in Hewlett Packard Enterprise.

Now wind forward to two years further on, October 2017 and what have we got? Well, we have got Hewlett Packard Enterprise with a market capitalisation of $22 billion today. Hewlett

Packard Enterprise has split itself again into several parts. They spun out and merged its software business into Micro Focus here in the UK. HP shareholders received 50% of that combined business and that half was worth $7 billion. They also spun off the services business, and merged it with Computer Sciences in the US to form DXC Technology, again 50% owned by HP shareholders, that 50% is worth $12 billion.

HP Inc on its own was worth $29 billion, so a capital value of $70 billion some five years after the FT headlines and the pit of overly negative investor sentiment. Add in dividends of $4 billion and $74 billion was your total value of the parts that, back in October 2012, was valued at $27 billion.

The other little nuance here, which we like, is the fact that we were well aware in October 2012 that this business was in decline, that it would get smaller, but the valuation made no sense. And you can see at the very bottom of the chart, that gross sales were $124 billion in the year of 2012 for the Hewlett Packard company. And in 2016 the gross sales for all the Hewlett Packard bits were only $100 billion. So this is a smaller business valued 2.7 times higher than five years ago, outpacing the market which grew 65% over that period.



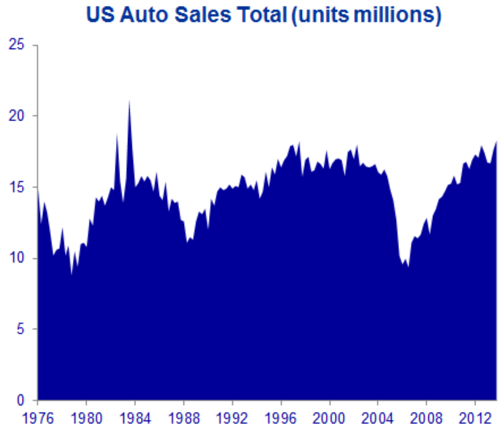
Source: OP.

So this was an opportunity provided by the irrationality of investors as they swung in one direction and against existing players in the market which they've deemed to be disrupted.

AG: General Motors ('GM'), is a company we've talked often about over the years and in this forum. The first time we bought this was in the second quarter of 2013 and what we were very much on the defensive over a number of years because people said that yes, they could see it was cheap, but (1) it's an auto maker and (2) it's ultimately going to be disrupted. What they pointed to was the rise of electric vehicles and so we had the new entrants, like Tesla, which were unburdened with the internal combustion engine production, and we've seen the rise of the Tesla valuation. Then more recently people have started to talk about autonomous driving. Last year Morgan Stanley issued a research report in which they talked about only actually using our cars around 4% of their useful life. It therefore made no sense at all to own a vehicle when we would be renting via Uber or using mobility as a service (one of the key buzzwords), so you didn't want to own something like GM.

Now we saw a lot of attractions in investing in GM. Firstly the chart here shows the rise of the volumes in the US market, so we had a strong recovery underway and that was a positive backdrop. GM itself has significantly restructured and they talked about lowering their break-even point from previously around 14 million vehicles as an overall market size to actually around 11 million showing the level of restructuring that they'd done. This meant their North

American operations were generating over a 10% operating margin over the last few years which we found very healthy.



Source: OP.

Next, they were the strongest in the growing SUV segment, so whereas passenger cars have somewhat struggled in the US, SUVs have actually been strong and GM has a dominant market share there. They have shown that they have changed their behaviour as a management team, they didn't just simply chase volume and they actually wanted to focus on returns on the capital employed. So one of the moves they did was to exit Europe, again not just simply chasing volume.

With GM itself there was a commitment to these new technologies, showing that the incumbents don't just sit on their hands. They were investing in things like Cruise which is autonomous vehicles and Lyft which is ride-sharing, very similar to Uber. But we can see it traded for many of these years on a P/E of less than six times, even though it was growing earnings and it was returning capital to shareholders via the dividend with a healthy dividend yield of over 4%. It made a commitment to buy back around $14 billion of equity from the end of 2015 to the end of this year which was significant given the market cap of around $50 billion. But it was being ignored by investors and it was actually described in June of this year by Barron's as the cheapest stock in the S&P 500. But investors simply didn't want to know, it was all about the disruption, it was all about the disrupter, and in the auto sector it was all about Tesla.

In June of this year, Tesla overtook GM in terms of market capitalisation, it was 13% bigger than GM. That's despite GM having ten times as much assets and producing 100 times more vehicles than Tesla at that point but you can see here the return, year to date to June GM had basically done nothing, Tesla was up 70%.

Then we look at the cash flows, you can see the significant cash flows being generated by General Motors which actually gave it the tools, the ammunition to invest, so it was significantly out spending Tesla in terms of capital, but of course people said you're investing in the old vehicles, you're investing in the internal combustion engine, it's all about the future and hence the rating was completely different on these shares. So it's all about the growth that Tesla's going to deliver. But even if we look three years forward, still on optimistic assumptions for Tesla, GM is 2.5 times larger in terms of operating cash flow, it's actually generating free cash flow at the moment, to you as a shareholder nearly $10 billion over the last 12 months, whereas Tesla is consuming cash to ramp up its production. So we felt that GM was hugely attractive to us, we've been patient with it, and it's only in the recent months that we have had significant share price appreciation from GM and it has once again gained the top spot, now larger than Tesla. Since we've owned GM we've made a return of around

75% which compares to the S&P500 return of around 50%, so we've not done badly by investing in this so-called disrupted stock.

	General Motors	Tesla
Market value ($m)	52,713	59,413
Assets ($m)	230,793	25,054
Production* (units)	9,969,000	93,830
Share price return YTD %	0%	+69%
EBITDA* ($m)	18,750	56
Capex ($m)	9,262	1,618
Forward PE 2019 (consensus)	5.5x	55.0x
EBITDA forecast 2020 ($m)	14,500	5,894
Free cash flow* ($m)	9,488	(1,560)
FCF yield	18.0%	n/a

* Latest 4 quarters, Source: OP and Bloomberg. Date: As at 30th June 2017.

Now we go to a relatively more recent purchase for us, Viacom, a US media giant. It owns the iconic movie studio Paramount, and there is a raft of globally recognised paid TV channels, Nickelodeon TV etc. If we cast our minds back to 2014, this had a share price of $87, it was riding high from the lows of 2008, it had a market value of nearly $40 billion and the stock market rated it on 18 times P/E. Fast forward to today, where we've had the rise of Netflix, one of these 'FANGs', and clearly the way we consume video content is changing, it is being disrupted. We no longer just watch 'linear TV' as it's termed, we do time shift. Using the BBC iPlayer as an example, we download, we watch it when we want, and we can watch it online so we can watch it on iPads or mobile phones, and what this all means is the traditional core paid TV eco system in the US is in decline. It's been in decline at about 2-3% in recent quarters, so investors have fled this sector. They have fled media and they have fled Viacom. And you can see the share price reaction here.

Viacom's share price

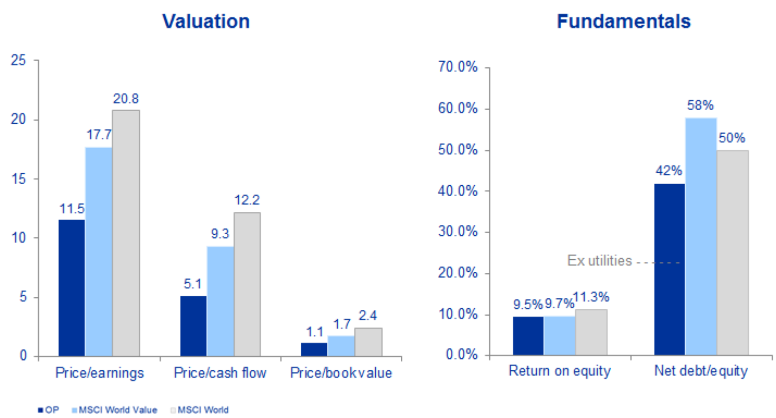
OP, Bloomberg data as at 30th September 2017.

What this means today is that this $40 billion company is valued at less than $10 billion. Now last year Viacom received a bid for just the movie studio business alone of $8.6 billion, that's almost the entire market cap of the company today. Paramount last year lost half a billion dollars, there is no way this movie studio should be doing that and they are now reinvigorating the slate and we see a path back to profitability for that business. But we don't want to value it as high as that, we want to look at the sustainable profits and what it's generated historically, normalise that and put up what we feel is a sensible multiple of 12 times. So we value that business at $3.6 billion.

The real area of value in Viacom is in the TV channels themselves. Interestingly when you look at the market, there isn't huge debate and disagreement about the variable i.e., the operating cash flows of that business that we focus on, because that business is governed by long term contracts. So this business generates around $3 billion per annum and that seems to be a consensus, there isn't a huge debate around it, but clearly what *is* being debated is the multiple you attach to it. Now we feel that this business can be valued at up to ten times operating cash flow. It has been historically, and certainly when we look at transactions, the most recent being the Discovery acquisition of Scripps, those multiples have been well in excess of that ten times.

We then have central cost and debt, but you can see here a huge potential fair value or if we are slightly wrong on these cash flows and multiples, a margin of safety, in our investment in Viacom. Clearly Viacom itself isn't just sitting on its hands as the incumbent, we've had a complete reboot of the management team under new leadership, the well-respected Bob Bakish, the new CEO who's come in from the international side and is getting to grips with the whole organisation, and he's done a full strategic reboot of the company. One of his first moves is actually for the Paramount movie studio to launch a TV channel. It seems ridiculous that they didn't have one, utilising all of that intellectual property, they just weren't doing that in the US. That's being launched next year, and they are also taking advantage of these new technologies. Again, incumbents don't just sit on their hands. So they're looking to launch their own, over the top, so via the internet paid TV package service to directly take on things like Netflix and this will be sub $20, so priced competitively and we think that's a huge revenue opportunity for Viacom which just isn't being appreciated by the market today. If we see a return to growth here we think we will see a substantial re-rating and there are already early indications of this. We are buying Viacom on a two to three year view because it's a turnaround strategy for this business. We're already seeing early indications in terms of ratings etc. that the reboot is taking hold and that it can return to growth.

NW: So let's have a look at the portfolio. This is a chart we've shown you before summarising the characteristics of the portfolio. The valuation, the three sets of bars on the left hand side of which the dark blue bars are the portfolio, shows 11 times P/E, five times cash flow and a little over one times book value. You can see the light grey bar is that of MSCI World, 21 times P/E, 12 times cash flow and 2½ times book. And the one in the middle, light blue, is MSCI World Value. So you can see the portfolio is clearly a value portfolio, much, much cheaper than that of the World Indices. So what happens with regard to fundamentals? Well, as usual there is a small discount that we accept on the return on equity of the businesses in the portfolio, and it's because some of them are having a short term trading issue, some of them we think are going to turn around and grow structurally from here, and therefore we accept the fact the return on equity is lower than the market at this point but it's not a big discount.



Source: OP, Bloomberg. Date: As at 30th September 2017. Representative global portfolio used. Based on MSCI method. Net debt/equity excludes financials and includes only industrial net debt where applicable. The grey dotted line represents the net debt/equity figure for the portfolio excluding both financials and utilities.

The other point is about leverage, which Andrew has mentioned already, a concern about financial leverage when we're buying businesses that are operationally leveraged in some cases. And we always ensure or try to ensure that the financial leverage of the portfolio is lower than comparable indices, here represented by net debt to equity. At the moment, this metric is skewed higher by our exposure to the utilities companies which are regulated or semi-regulated businesses which generally have a high level of debt and less in the way of operational leverage. There are three of them in the portfolio, one in Japan, one in Korea and one in Germany. If you strip them out they end up with a net debt to equity of the remaining portfolio of just over 20%. So we believe the rest of the portfolio is very conservatively financed.

In terms of historical performance our portfolios, as we've said on many occasions before, are concentrated, contrarian and value-driven. They look very different from the index and therefore the portfolio's returns will vary from the index. It is essential, if you want to beat the index over the long term, to look different from the index and that's what our portfolios do. Since inception this approach to value management has in fact produced a +9% per annum return, since 1997, against the index of +6.3%. You can also see that we're struggling to keep up with the MSCI World this year, and that's because 'growth' is the only game in town, and so far this year MSCI World growth is up +24%, whereas MSCI World Value is up only +14%.

In a period where MSCI World Value underperforms MSCI World you should expect us to underperform MSCI World because we are always more 'value-like' than MSCI World Value. And you can see that this works the other way around too with last year's performance being a good example – our portfolios produced a +19.4% return, the index produced +7.5% and that is because MSCI World Value was the driver of the MSCI World last year, up +13%, and MSCI World growth only +3% - all in dollar terms.

Year to date returns mean we're just now shy of the benchmark since the Overstone Global Equity Fund was produced in 2005, we are slightly behind the benchmark but only just.

So what has contributed to performance this year? I'm not going to go through all of these but clearly the stand-outs are Samsung Electronics and E.ON on the positive side, offset by Viacom which Andrew talked about earlier and Tesco.

What have we done in the portfolio? This table just shows you total sales that we've made and new purchases. So you can see, and as I alluded to earlier on the changing shape of the portfolio, we actually added to net our position in financials at the end of last year and reduced our cyclical exposure and energy exposure through the sales of BP and Komatsu, and this year we have bought Viacom which we've been buying all the way through into the third quarter of this year. We have been buying Mitsubishi Heavy Industries ('MHI') which is a large Japanese conglomerate and KEPCO, the Korean electricity utility.

	Purchases	Sales
Q4 2016	Lloyds	BBVA, BP, Komatsu
Q1 2017	Viacom, MHI, Kepco	-
Q2 2017	-	HP Inc
Q3 2017	-	-

Source: OP. Representative global portfolio used.

Q: The sale of BP, is that more due to valuation or is it that you don't like that whole sector?

NW: It was valuation. It hit our fair value in December last year.

Q: How do you feel about the sector?

NW: Well obviously it's a been a major underperformer and it's something that we have thought about, we've been looking at smaller services companies for instance. We are drawn to those sectors that do less well and certainly energy has had a very poor time. The only sector that has done worse than energy this year is telecoms and that's another sector that we're crawling all over at the moment. The only complete sale we've made this year is HP Inc which I covered earlier, again hitting fair values.

So in terms of the look of the portfolio today, we still have 35% of the portfolio in Japan, outstanding value there, with the market still on 1.4 times book despite being at its highest level since 1992 on a Topix basis. And we still have relatively little exposure to the US, our concern being generally about the levels of valuation there. On the sector side as I said earlier we have been looking at telecoms. We've had nothing there, and nothing in real estate and nothing in healthcare, we've crawled all over healthcare and almost got there but not quite, though we looked at several companies there. And for energy as I say we're looking at suppliers to the industry.

Here is the entire portfolio on one page as you're used to seeing from us and the only other thing I would say is that DXC and Micro Focus, both of which I talked about earlier, have been sold this quarter so that's why they don't appear in the transactions in the first three quarters.

	Portfolio %		Portfolio %
Mitsubishi UFJ	6.8	Nomura	4.8
Samsung Electronics	6.6	MHI	4.6
E.ON	6.5	Lukoil	4.5
Citigroup	6.1	Viacom	4.3
Lloyds	6.0	Kyocera	4.2
East Japan Railway	5.8	Eni	4.1
Rio Tinto	5.7	Kansai Electric Power	3.4
General Motors	5.4	Korea Electric Power	2.8
Toyota	5.4	Barrick Gold	2.7
Tesco	5.4	Hewlett Packard Enterprise	2.2

Source: OP. Representative global portfolio used.

Q: I hate to harp on the energy sector again, but could you give any credence to the argument that oil is going to be in declining demand forever now given renewables etc., and you should not have only energy in your portfolio because it's going to be zero eventually?

NW: I'll say no, we don't give any credence to that. I'm going to ask Sam to talk about that, who has done some work on autos.

SZ: As you said, this is something that has given us some concern and so we wanted to look into it in a bit more detail, and to make some long lasting forecasts which we tend to be quite averse to, because there's high uncertainty associated with it. What we did was to basically look across the different major regions of the world, so China, US, Europe and Japan basically make up around 70% of auto fuel demand, at what regulation and regulatory requirements existed in the foreseeable future and what effect that would have on demand, and clearly it tempered the growth of oil demand and expectations were that growth looking forward would be lower than it has been in the past. It's worth noting that demand from light vehicles and cars only makes up about 50% of global demand so petrochemicals, aerospace, shipping and so on and so forth actually make up a huge component of demand and there are less pressures in that space. And this has been a constantly evolving piece as different countries and different auto manufacturers have talked about targets for electric vehicle production, which I think is what we're using as our guidance tool. Although Tesla produces 100% electric vehicles they only produce 200,000 cars a year and we consume 120 million, so what really matters is what VW, GM and Toyota are going to do over the next 10-15 years, because that's likely to be the driver of demand.

So in terms of demand for products from auto consumption we're relatively subdued in our outlook, we don't think it's going to collapse tomorrow but we don't necessarily think there's massive growth coming there, there is however still some growth coming from the other segments that I mentioned. So that's how we've approached the problem.

Q: Could you say a word about your banks positions, particularly Lloyds?

NW: Richard, will you talk about the banks?

RG: I think the news on Lloyds has been incredibly negative over the last few weeks. There are three key areas that we're focussing on at the moment. The first is around funding and the cheap money that exists in the market. A lot of capital has entered the industry and pricing has come under pressure as competition increases. The second area is the increase in unsecured lending; there have certainly been plenty of stories in the press around car loans and unsecured personal loans. And the last area is capital. The regulator has demanded Lloyds hold more capital at this point in the cycle. All of that is putting a pressure on returns. We still think that Lloyds can deliver a double digit return on equity and you are paying just over book value, so the valuation is still relatively attractive against this return profile. But the fundamentals have deteriorated a bit recently. In addition, you're getting a 5% dividend yield at the moment, although the dividend is clearly dependent on the returns and how much capital Lloyds needs to hold.

On Citigroup, we've had lots of good news recently. They held an investor day earlier this year which provided more detail about their strategy and gave a number of targets for the business. They are looking to move most levers in the right direction: revenue will be up; costs will be down; credit stays benign. This will all lead to a higher return on assets. One of the biggest announcements was the expectation that they will return $60 billion of capital through buy-backs and dividends. At the time, $60 billion represented about a third of the market cap and, with the shares trading on about 0.7 – 0.8 times book value, the per share accretion of this buyback was significantly enhanced. The capital return would also lead to a higher return on equity. At the time, the share price was $65 and Citigroup looked extremely attractive to us. The share price has subsequently done well and, although the fundamentals do look better, it is now more expensive and starting to price in these improvements.

Q: In your investment thesis, how do you take into account regulation and government assistance? For instance with Tesla, you get a credit for every Tesla you buy, and Tesla was going to have a lot of money from the US government when it was first starting out. That's not going to happen again. How do you account for that in your analysis?

AG: It's not just the auto sector, we mentioned the utility sector where we have three holdings there and clearly government regulation and involvement has to be totally taken on board and built into our thesis. For instance one of the main ones we would point to is Kansai Electric, where the government policy was, post the Fukushima nuclear accident, to take offline all of the nuclear reactors in Japan, meaning Kansai went from spending around ¥300 billion on fuel to ¥1.2 trillion and went into loss and again investors fled. Again it's the valuation that is the starting point which draws us in, and then we had to do a lot of work in terms of understanding what was the policy of the government at that stage and where they wanted to take nuclear electricity, and this is where, again, having Japanese experts who can speak the local language was very helpful because we could actually get through the regulatory documentation and see that Japanese policy was actually to rehabilitate and bring back these nuclear reactors. But it's definitely a case by case, you have to incorporate that in and maybe apply risks around that, so we had to do a downside, for example what if the policy changes and they never come back on, and we had to assess risk that way, but as long as we had enough margin of safety and we felt it was significant then we could make investments.

NW: I think there are lots of examples, E.ON is another one where we had to factor in the government's stance on waste treatment and waste management. And also to appraise the likely success of an industry-wide court case against the government, going back several years to just before the Fukushima disaster, in Germany they had extended the life of all the German reactors and then as a result of Fukushima the politicians in Germany decided to shut all their nuclear reactors by 2021 so that was a huge change that happened. There was a tax that the government put in place as a result of granting the extension the year before and they didn't unwind that and so we had to factor that into our valuation. We actually decided not to put it in our fair value but it's come through and it has been a nice boost to the share price which is why it's done so well this year.

Q: Is it approaching your fair value or do you still see more upside?

NW: We still see more than 20% upside.

Q: On Japan where you've spoken before about the change in management behaviour, corporate governance and shareholder focus sort of offsetting the rather depressing democratic background and also the flattish economic scene, do you feel that the corporate culture changes are accelerating or the same - are things improving still?

JM: Recently Japan topped the Economic Surprise Index so certainly in terms of the economic data, it is improving. However, there is little evidence of rising inflation and the Government of Japan's 2% inflation target is unlikely to be achieved in the near term. Last week, the Bank of Japan committed to stick with their yield curve control target, keeping the bond yield at around 0%. In terms of corporate governance changes, over the next few months there will be another revision to the corporate governance code. There have been scandals which you've all read about, the most recent one being the fabrication of quality data by Kobe Steel. I just wonder whether five years ago, that scandal might not have come to light. There's definitely much more pressure on companies by investors to increase transparency and improve governance. In terms of Japanese companies' attitudes towards shareholders, we recently saw the senior management of MHI. Historically, the company did not mention the words 'shareholder return' in their presentation material, but this is no longer the case. The fact that the management of MHI is changing is typical of what's happening at the companies we focus on.

Q: A number of your investments are obviously related to the business cycle, do you have a view about the likelihood of a recession in the next couple of years, is that a downside thing do you think or would you just not worry about it?

NW: To say we'd ignore it completely is perhaps not true, but it's certainly not a driver of those. We were talking about GM earlier on, clearly we thought a lot during that investment about where we are in the cycle and therefore we've adjusted the multiple accordingly in terms of fair value, but no we certainly don't start with the world view and decide where we are in the cycle and then slot those shares in around it. We just find value and then we take a sort of relatively neutral view of the world outlook I suppose, but sometime it's very specific where we do adjust our multiple as a result of where it's obvious to us that we're at the peak of a cycle, which is probably autos in the US.

Q: So if there was a sort of a surprising recession that most people didn't expect in the next year or two, would that catch you out?

NW: That would not be helpful.

Q: Rio Tinto was fantastic, I think about them a lot, I really wish we had more. I think it's almost doubled from the low, where do you see it going from here?

HF: Well we still think Rio is attractive at this level. The iron business which makes up about 70% of current profits is the lowest cost in the world and the demand for steel from China should continue to be strong as there are still several hundred million people to urbanise, and then there's India and Africa so Rio's got a long, long trajectory on the iron ore demand side; but aside from that they've built one of the largest and lowest cost copper mines in the world in Mongolia. They've got great other potential copper projects and we believe copper will be in high demand over the next century as electric cars proliferate and general electrification continues. Rio also has a low cost bauxite, alumina and aluminium business– and they've got the best balance sheet in the industry. So from our perspective Rio looks in very good health, on about 9-10 times today's earnings – earnings that we expect will grow and it's paying us a dividend of 4% or so, so we're happy holding Rio.

Q: I suppose it's inevitable, given your introduction and the value focus, that these companies look more to be of the traditional older brands of the world. Is Nomura the bank in Japan for the older generation, in an older generation country, and is there not a danger in all of this that you are backing yesterday's game?

JM: Well, the way we value it is we value it on a sum of the parts basis and we have tried to model how the earnings would grow if Nomura could grow the discretionary portion of the retail business and it became more of a sort of Hargreaves Lansdowne-type model with high recurring income. The opportunity is great for Nomura to grow this aspect of its business but in the latest quarter when the Japanese equity market rose to levels that we haven't seen for 20 years, traditional retail investors sold their equity holdings. But I think we still see great potential for the retail part of the business to grow. In terms of being able to forecast the earnings on a quarterly or a half yearly basis, it is difficult. In terms of the other parts of the business, Wholesale, the brokerage business, which was in loss when we first initiated the position, we didn't assign any value to. The company managed to cut costs and improve profitability outside Japan in the first quarter. In terms of the quarter that's just ended the European business and the Americas slipped back into loss but the cost control was better than we feared. The asset management business is strong. So we think that there's great potential and that the company is not a dinosaur in terms of being able to evolve and being able to take advantage of the high cash holdings of retail investors in Japan.

AG: Thank you for that comment, because if you said that that looks like a really fashionable group of companies and they're all great companies, then in effect I think we'd be doing something wrong with this portfolio. It's amazing how that perception can change, so GM, General Motors, for years post 2009 was talked about as Government Motors, certainly in the last few months everyone now talks about GM 2.0 and with the Cruise and Lyft, it's become sexy and exciting again, we've seen a huge share price appreciation and what we want to be doing as value investors is investing when they're out of favour when people are shedding these stocks, and that's when the valuations typically are the most attractive. And we want to be selling them when they become enamoured, Citigroup recently published a report saying that GM could be worth $124 a share, that's when we want to be selling.

Q: In contrast to that you have one stock in the portfolio that looks like it's in a lot of growth, in Asian tech, which is obviously Samsung, which has also had a pretty good run. So how do you see that stock?

AF: On valuation Samsung still looks very attractive, it's trading at 9 times earnings. Corporate governance is improving, the company has just committed to a 20% increase in dividend this year, albeit off a low base and next year is where they do a doubling in dividend to get them up close to a 3% dividend in 2018. As far as the tech side of it is concerned, DRAM, specifically in the 2000s there were about 20 companies and by very violent cycles now it's consolidated, there's three companies in the sector. Samsung by far being the leader in terms of volume but also in terms of node migration and the ability to produce smaller nodes at much cheaper prices. So DRAM at the moment is making a 65% margin, at the previous downside in DRAM in the middle of last year Samsung was still making in DRAM 35% operating profit margin. So going forward, the earnings of the business we see being much more stable than it was in the past. The other piece of memory is NAND, which is shifting to 3D NAND. Samsung is leading in terms of it being able to stack more layers on the same chip so making very good margins there as well.

On the mobile side, the concern two or three years ago was are we going to see the same effect as we are doing in PCs, where the margins are just a continuous trend to low single to mid-single digits? This sector is also increasingly being consolidated, only Apple and Samsung are really making money in smartphones, so it's still making in excess of a 10% operating profit margin in smartphones as well.

One of the strong growth areas although the business is still not that big, but it's got a significant part of growth going forward, is in the display side. In OLED, small screen OLEDs, Apple just started to use Samsung OLED technology, and Samsung in that business has a 90% plus market share. So we see into next year we expect it can make up to 20% operating profit margin in OLEDs.

So although the share price has increased a lot, its multiple hasn't expanded, it's based on earnings increase, and as I mentioned we see much more stable earnings going forward than in the past.

Q: With a company like Samsung, where you see big changes, are you still reviewing the fair value much? Or when you set out with your price target, is it more set in stone?

NW: We are constantly reviewing the valuation targets of the companies that we have and our valuation targets are a mixture of variable and a multiple, and as is the case with Samsung, as Abri said, the variable just keeps going and going. We still have the same fair value multiple that we had when we started and that's normal for us. We are loath to change that fair value multiple. We actually did adjust it down with GM during the period that we held it because we realised that we were rolling on through a cycle which couldn't go on forever and wanted to be more cautious, but generally we are loath to increase the multiple because you fall in the trap of falling in love with the company and you think it's worth more than you did before.

Thank you very much for coming.