HollAnd Advisors

Holland Macro Views: Meta – Price: $285; MCap: $750bn

Know when to hold 'em…

We rarely revisit our successful ideas. This is for a number of reasons that include the knowledge that pride comes before a fall and a tempting of fate. Also because we try to write actionable pieces. Once a share price has moved higher to better reflect its growth prospects or quality it might still be a good stock to keep owning, but it is a less compelling 'buy' that it was. We do however try to be life-long learners and have tried to take clients/readers on that journey with us. We learn a lot from our failures, but occasionally there are learnings in the odd successful idea too.

"You can't win anything with kids"

Later this month your author's son will graduate from university with a degree in finance and accounting (a feat not achieved by his father). He may well go on to gain accounting or investment analysis professional qualifications. His lecturers throughout will be experienced, the topics well researched and hopefully he will/has worked diligently to learn what was put in front of him.

Sadly, however none of this will prepare him at all for the real world of investing as we experience it. His economics modules will have informed him of the economic cycle. But how much time did they spend on the market cycle….? Additionally, did those teaching him do extensive exchanges with the psychology department to learn about crowd behaviour and when it can get things very very wrong? Sadly, we know the answers to those questions.

The average age of a person employed in analysis or investment management had trended ever lower in the last few decades (we have no evidence other than circumstantial to back up this statement). As such formal financial education, as received by my son, is fresher in the memory of more market operators today that maybe it was in say 1975. The result is mostly good news, with greater efficiency, energy and innovation bought to this industry. Also, better and wider teaching on areas likely Return on Capital have (rightly) led many to the reasonable conclusion that better quality companies make for successful investments if held over long periods. This was a lesson that our stock picking forebears might have learnt through bitter experience but were not taught (except by Munger!).

However, does a younger investor participant age and its greater use of modelling, statistics and frequency trading etc., bring with it some pitfalls? We suspect it does. If so most likely these lie in areas like unusual long-tail pattern recognition (i.e. things you have seen before, but a while ago). Also maybe in intangible areas like assessing people and periods of flux.

> *"To invest successfully, you need not understand beta, efficient markets, modern portfolio theory, option pricing or emerging markets. You may, in fact, be better off knowing nothing of these. That, of course, is not the prevailing view at most business schools, whose finance curriculum tends to be dominated by such subjects. In our view, though, investment students need only two well-taught courses - How to Value a Business, and How to Think About Market Prices."* **Warren Buffett 1996 Berkshire Letter – emphasis ours**

Meta and the psychology of investing

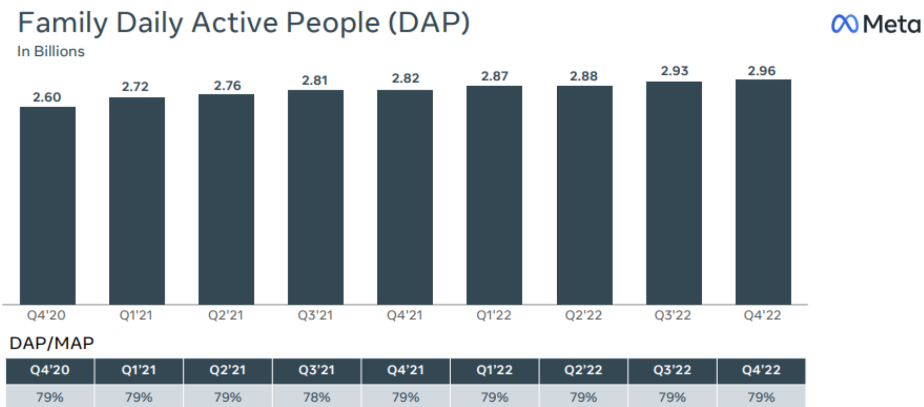
Were perchance a university lecturer to read this piece and ask your author to come and present to his class, this would be chart we would put up in front of them today.

Fig.1: Meta share price chart 2019-2023

Source: Bloomberg

Looked at in a cursory way the chart just shows the value of a company rising and falling, but look closely, do you see anything else? Probably not unless you lived through it each and every day. Between the Meta share price being $280 in February 2022, and then again $280 in June 2023 – a lot happened – and very little! During this period c.$8bn of shares were traded in this company each and every day.[1] Behind each of these transactions was a likely high IQ person (or computer) who analysed the company with diligence, deciding to ether buy or sell the shares. This was no meme stock. Of course, there was investor uncertainty towards the company's future direction and towards its near-term cash flows. But very little changed in its core business – which was rock solid as the chart below demonstrates.

Fig.2:



Source: Meta

Our last two pieces of research on Meta available here and here and some extracts from each follow. We then reflect on what we have learnt from this episode and how it can help our future decision making.

[1] A current Market Cap of $740bn, that got as low as $300bn compared to $8bn of daily trading in the shares tells us the whole company was turned over between 4-10 times during this 18m period!!

Extract from Holland Views: Meta – 'The five stages of grief', November 2022

The five stages of grief

Meta's share price today we think is the function of a spiral that we see occasionally in such owner manager businesses. A problem may occur that hits profit and damages the business in the near term (Apple changes or Nike's 2017 punch up with Frasers). The founder's reaction is decisive and aggressive, being prepared to spend sizable amounts to ensure the business survives and is strengthened, not weakened, in such a period. When asked to moderate such spending founders decline seeing only the long-term game of business repositioning. In time the founders grow frustrated with investor short-termism.

When the period of flux takes longer than expected, founders double down to ensure eventual success. During this time outside investors that thought they owned a cash producer that would grow to the sky are suddenly shocked. They loved their owner manager when he was growing with ease. Soon they come to hate him even as he tries to position the business for a better longer-term future. Arguably as these owner-lead investment phases drag on investors go through the five stages of grief.

- *Denial*
- *Anger*
- *Bargaining*
- *Depression*
- *Acceptance*

Each investor likely has a different attitude towards how they react to bad news when it emerges from their companies. Some will sell early, and some will sell later during this psychological rollercoaster. ***Most sell.*** *It is interesting to note that during such periods there is seemingly very little discussion about the underlying value of the business. This is arguably because investors are a) thinking with their fast-beating hearts and emotions, not their heads and b) deteriorating shorter-term profitability makes it look like the business is in freefall.*

Engine Overhaul

We stick by the engine overall analogy we have made, i.e. that only those close to a company in such transitions have any true idea of its real worth post recovery. We also retain a now seemingly unusual view that Zuckerberg and team will be logical capital allocators in time. Such owner managers as we have studied think nothing of spending a years' worth of free cash flow on a new project. Meta's crime is this regard is that its annual cashflows are c. $40-50bn! But the business that produces these cashflows was built by who…?!

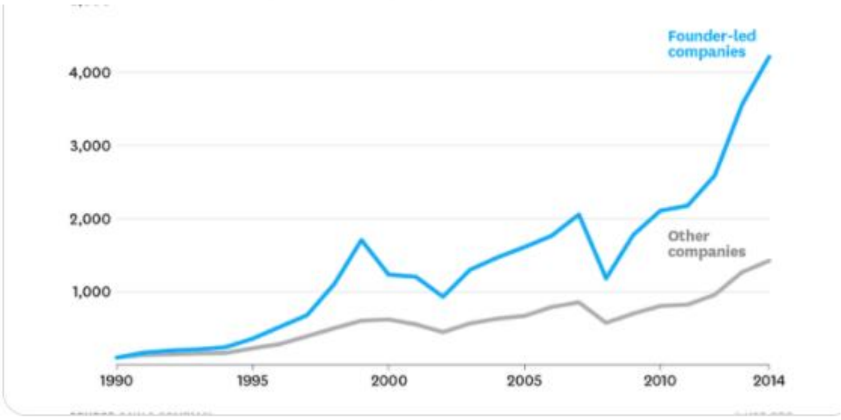
…Investment phases (AI + Metaverse) tend to come along when investors least expect them. Also, when they are led by an owner manager such investment periods tend to be deeper and longer than outsiders expect as the Owner Manager strives for perfection. The events occurring at Meta since we published our Owner Manager Inc piece are consistent with that view. What we did get plainly wrong was the assumption that Apple's privacy change headwinds were already being felt fully by the business when we did our work. This was an unforced error. Clearly there was more pain to come in this area which we should have either foreseen or just waited out a little. Whilst these changes hurt Meta's profitability, we are not sure it changes the idea that this network has huge value to both users and advertises going forwards.

Extract from Holland Views: Meta- 'Owner Manager Inc., November 2021

Do you invest in Entrepreneurs – REALLY?

These days we explain how we invest in owner-managed companies. As we do we see our audience nod a little too easily, seemingly accepting how 'wise' it is to invest alongside those who create the wealth in society. Examples of Founder-led companies are of course Apple, Berkshire Hathaway or Next, but these are 'easy' companies to invest alongside the Owner Manager that will usually give a smooth, stress-free ride for the investor.
But when the ride gets a little bumpy is when investor conviction is tested. This is why we often qualify the owner manager companies we seek with the pretext of 'unloved' for that is how we get great value at the time of purchase.

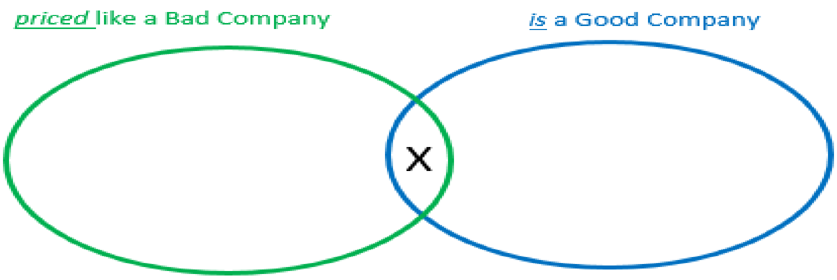
Fig.1 Founder led companies outperform



Source: Bain & Company

Deciding today that Amazon is a powerful business run by a brilliant owner manager or that Tesla is an innovative company run by a similarly innovative leader is maybe a reasonable conclusion. But both are clearly conclusions held by the wider market also. Thus, the valuation of these companies likely reflects these views. As we search for compounding and growth, we do so also with an eye on Margin of Safety i.e. via reasonable starting prices (yes, there are still investors still trying to do this in 2021!). Thus, we are challenging Mr Market's pre-conceived views on Quality vs Price. This is why time and time again we have used the pictorial in Fig 2 below to show the short-cut in our investment process.

Fig.2 Our process super simplified



Source: Holland Advisors

Again, when we show this picture, the nods come maybe a little too quickly. This is the simplest chart in investing but actually one that must be reflected on. ***What is it really like to be an owner manager vs a CEO of large org?*** *and* ***What is it really like to buy shares in a company when everyone around you is telling you are an idiot to do so?***

‘Owner Managers’ and ‘The Five stages of Grief’

One of these research pieces was a little early in its timing and one was pretty near the bottom of the Meta share price. Market timing has never been our thing. What we strive to do is explain the important moving parts of an investment that we think crucial to its understanding. Mostly these involve analysing the fundamentals, but sometimes it is sentiment or psychology oriented. Our early Meta work (*Holland Views: G.A.R.P Fishing, April 2021)* focused on its fundamental attractions i.e. its stable user base, free tailored daily newspaper to billions of consumers and its high ROIC. These later pieces were about two aspects of this investment that we suggest proved crucial as the shares spiralled lower. Neither are taught by academics:

- The importance of Owner Managers
- The psychology of investors during periods of pain

Referencing Buffett’s quote earlier on, these two areas come under the wider subject of *‘how to think about market prices’*.

In the Owner Manager Inc piece, we went on to list traits that we thought distinguish Owner Managers from large organisation salaried CEO types. Many readers have told us how much they liked this list. For brevity we have moved it to the Appendix of this note.

Learnings from Meta’s rollercoaster

The danger of fashion

Buffett’s earlier reflection on what investors really need to know we think is apt as we reflect on the recent Meta investor experience (i.e. how to value companies and how to think about *market* prices). Stock markets and their participants for much of the last decade have been fixated on growth, ROIC and the price you need to pay for their combination. Like all periods of lasting group-think, a truth underlined this belief. Do companies with high ROIC and strong moats outperform throughout history? Yes. But clearly not at <u>every</u> possible starting price paid. Such thinking also seemingly lead to:

- An underestimation of contrarian value buying opportunities as they recently yielded poor returns for long periods
- An unsaid classification of ‘acceptable’ companies under the GARP/franchise mantra and those outside it. The scale of Facebook’s share price fall was likely accelerated by its original inclusion in this list, and then its subsequent exclusion.

Modelling and its dangers

Some readers may be horrified by the admission that follows, but at Holland we not only do not have a Meta model, we don’t have a single spreadsheet on it. The same is true for Netflix! Indeed until writing these words we had not even realised the absence of such files from our records. Clearly modelling companies can be very useful to understand them better and at time to better see hidden value. Sometimes we undertake it and sometimes we don’t. In the case of Meta (and then Netflix) however we just never saw the need. The economics and attraction of Meta’s business and financial model was pretty easy to understand/visible to us from reading its accounts. Understanding areas like the resilience of the subscriber base, core cash generation and likely allocation of future capital were not areas we needed to model. We just needed to think about them.

“sometimes what you can’t measure matter more” **Charlie Munger**

In contrast to ourselves almost all others looking at Meta will have modelled it closely. As a result, the growth it achieved (with ease) up until c.2019 looked like it could continue taking profits and FCF ever higher. Such trends were seemingly easy to extrapolate.

Spreadsheets contain ‘hard’ data and much of it (if using historic information is based on ‘hard’ facts). It is thus very easy to blend the past and future together with future extrapolated figures feeling perhaps more certain than they really are. This is why analysts we think tend to over forecast tops and over-extrapolate downturns. In Meta’s case when the rosy FCF generating future many models expected started to reverse many looked for new trend to follow: This being a declining one. Without a spreadsheet or forecast the businesses core stability was maybe easier for us to see….?

A glance at the Bloomberg ANR function for Meta is telling. It informs us what the c.65 professional sell side analysts covering Meta thought at different points in its history. In mid-2021, with the shares at c.350p all seemingly converged on a price target of c.400p. These ‘target’ prices then moved down in lock step with the actual share price as it declined. The results were that analysts had ‘target prices’ of c.130-150p from October 22-Feb 23. We remind readers, as per the share price earlier, for <u>every day of these last two years</u> these supposed experts were claiming to be thinking thoroughly and independently about Meta. Today the collective price target is 285p (i.e. the current share price). Many are running hard to catch up with its recovering value. For better or worse people, not spreadsheets, turn around businesses. Understanding those people and their motivations is something we spend a great deal of time on.

Story telling and rhetoric framing

Your author has been ‘selling’ his ideas and research for c.30 years now, working in many different forms (both at small and large companies). Also, in specialist or generalist roles. As such he reflects loosely, and generically on what is well-received by the end investor:

- Human beings love a good story, and that fact is no different in the stock market. Compelling stories make people want to respond to them. Large company CEO’s are often charismatic, and post meeting them and hearing their ‘story’ many investors feel inclined to invest.
- Equally investors like an idea that already fits the way they are thinking. A broker confirming their biases is a ‘good’ broker. One challenging them to often is a ‘bad’ one.

In our past pieces we have reflected on Zuckerberg and will not repeat those findings. Whilst we are not US-based we have never found him to be admired for what he has built as some other entrepreneurs are. This is despite decades of strong growth, generating cashflow and allocating it well (smart M+A and buy backs). When he strayed from that path many were quick to revert to maybe a long held personal dislike of him. As such assessing Meta via that view was not founded on its fundamentals. The observation *“no one uses Facebook anymore”* also seemed to create a convenient rhetoric for why the shares were falling. This framing of an ex-growth story by a wasteful, distrusted CEO (#Metaverse spend) fitted very nicely with a collapsing share price. We see this as framing, i.e. finding a convenient rhetoric to match what all others were doing, i.e. selling the shares.

Simply put people love stories. Stories have highs and lows and the best ones have heroes and villains. When a hero becomes a villain, you hate them the most. Why? Because they fooled you into thinking there were a good guy, when actually they were not.

Successful Owner Managers should be looked at this way. They are money makers, fated for the money they have made for so many investors, but were they deeply understood? We observe that when an investor perception changes towards a previously successful Owner Manager the reaction is not always balanced or considered – it is visceral. The money-making hero that made them rich for a while, becomes a villain.

This is what happened with Mike Ashley and to an extent Tim Martin in the UK. While we did not live it real time, we suspect it might also have been the case with Steve Jobs in 1985.

Owner Managers vs Mr Market

In the Appendix we outline our Owner Manager vs large organisation CEO traits. Here is a new list of traits that compares Mr Market with Miss Owner Manager:

Mr Market

- Is high energy – always on.
- Is impressed by a new idea or great story.
- Enjoys extrapolating recent events or new growth.
- Is somewhat fickle in the ideas he enjoys today vs tomorrow.
- Is thin skinned, moderately easy to upset.

Miss Owner Manager

- Is more quietly confident, and potentially a complex character
- Has grit – will stick to a task even if it is demanding?
- Loves winning, but over the long term. She does not look at the scoreboard all the time.
- Is thick skinned, she is used to having different view from consensus.
- Has maverick tendencies and might become steely and removed if pushed?

Like our previous list this is not meant to be exhaustive. However, we do think these traits are worth contrasting. If this were two people that met in real life how and under what circumstances might they get on, or not? We see this contrast more and more in our search for owner managers. Mr Market loves Miss Owner Manager when she is successful and making money for him, i.e. he only focuses on the outputs of her approach. However, when life becomes tougher, he can then seemingly only see the differences between her approach and his own. Rather than seeing that this mismatch always existed, he chooses to overlook this fact. Instead, he sees the Owner Manager in a new light: as difficult, removed and changed. He now cannot relate to her, regrets investing and so sells the shares.

Metaverse spending

Zuckerberg’s Metaverse spending (seen to be obsession) is clearly what lead Mr Market to rail against him so. This to us however was an essayish assessment. Whilst we did not necessarily agree with his outlook, we had chosen to invest alongside him, <u>not to second guess him</u>. As such we had to consider that a) he could be right, or b) if he was not right, in time as the builder of the company and its biggest shareholder he would change direction and spend less. All we had to decide was that Zuckerberg was logical and we saw nothing in the years and decades up to that moment that led us to any other conclusion. The scale of capital wasted if his spending was wrong would be large, but so were the annual profits of the core business. <u>This is what real alignment looks like as we observed in the Owner Manager piece</u>. It is also what it really feels like to invest in a company when all are telling you, you are wrong.

We are minded to think of what Buffett's investment in American Express felt like when a sound financial company got caught lending money against salad oil that never existed. Or what it was like to invest in Coke when they changed the taste of the drink and consumers hated it. Many investors now agree these are 'good' companies, but what would their assessment have been at such moments..? The following quote is maybe appropriate for investors to remember when the odd Owner Manager does something unpredictable or seeming crazy in investor eyes. We concluded that Zuckerberg would in the end 'do the right thing'

> *"You can always rely on the Americans to do the right thing, only after they have tried everything else."* **Winston Churchill**

Compounding capital at the very highest rate we

In the Venn diagram on Page 4 we show again our simplified way to seek out new investment ideas. For some years now we have sought to invest in great companies when they are priced like bad ones. We have never sought to invest in the perfect company, happy to pay any price for it. That to us is akin to art collecting, buying each piece when it is most in fashion. It may be enjoyable for those already with money, but it is not a way to maximise compounding. (NB: Visa and Mastercard are clearly both wonderful businesses, but we note Berkshire's lack of ownership of either).

Our capital compounding ambitions will, of course, be better reached if we own the shares of companies that have high internal compounding characterises. That is of course our aim, but there are many such companies in the world, and not all of them are labelled 'franchises'. We just think it pays to be opportunistic when some great businesses are occasionally offered on sale. Not only will lower purchasing prices aid our long term compounding rate, they will also bring us a margin of safety. Something that is often forgotten during the rosy periods that accompany high starting prices.

> *"The best thing that happens to us is when a great company gets into temporary trouble...We want to buy them when they're on the operating table."* **Buffett: Business week 1999**

Reaching for buckets

> *"Have opinions at extremes and wait for extreme moments"* **Joe Rosenberg**

As a long in the tooth investing outsider your author often sees things differently. Even for him as contrarian by nature this can be a tiring stance to sometimes hold. It is important for us as investors to work out when our contrarian views are best just kept as observations and when they should be acted upon.

Markets are mostly efficient, but occasionally they are not. Those are the moments the very best investors pounce on. In January 2019 we wrote our only ever research piece on Apple '*Holland Views: Apple – Sticky loyal and rich'*. The price of Apple at publication was $42 in today's money. This was around the time of Buffett's purchase of c.$37bn of shares (value now $170bn). Soon after our note's publication we also purchased Apple shares in the investment fund we manage. These we then foolishly sold a little while later. Why?! Because we could not really believe that we were right, and so so many others were wrong! It was/is a lesson learned. Being contrarian on such things is hard. You must be determined and patient if you really believe you are right.

This moment in Apple and the recent collapse and now recovery in Meta are wonderful examples of the long term compounding (even with very large sums of capital) that can accrue to a patient and ready investor.

We close with a short checklist we think such an investor needs to consider to be able to take advantage of such moments:

1. Live and spend time away from investing and financial centres
2. Observe and have an interest in many companies and industries
3. Never be so busy you cannot quickly dedicate time to a new project
4. Be rested and ready to be creative (#John Cleese on creativity)
5. Be open-minded as to where opportunities arise (cycles, management mistakes)
6. Look for signs of trouble in businesses with great economics
7. Wait for the truly fat pitch: Both Apple and Meta shares were depressed for months
8. Be willing to see the opposing view. What are the Owner Managers thinking?
9. Test your thesis, but don't seek others approval
10. Have the right type of patient and supportive capital

Buffett teaches us that Mr Market occasionally throws up a fat pitch. That he has seemingly now done so in two of the biggest and most liquid companies in the world in the last five years is an interesting revelation. It should encourage those that love this job and seek once in a lifetime opportunities.

With kind regards

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The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as managers to.

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Appendix

Owner Manager vs large org CEO

Recently we spent a little more time reflecting on the real DNA differences that will have resulted in a business founder ending up owning and running a company rather than being a CEO running say a government department or a large organisation.

The more we reflected on these personality differences the more we realised and could understand why some Owner Managers ended up in spats or at odds with Mr Market on occasions. Hence why periods of mispricing can occur.

Owner Manager Traits

- Is likely someone who will have constantly challenged consensus thinking
- Will have turned left when all others turned right for long parts of their life
- They will have constantly been told to comply with certain rules. Not done so and likely proved the rule makers wrong
- They probably want to break existing industry norms by **revolution**
- They will have fought bureaucracy every step of the way
- They are **outsiders,** not insiders. They hate the status quo
- They may have been outsiders at a young age, not fitting in and not looking to fit in
- Their success will have emboldened them that such non-consensus actions whilst not always successful, do yield real world results in time
    - As a result, when confronted with future requirements to 'comply' they are brave enough to almost always say no
    - They are likely to remain non-consensus in their thinking for life
- Owner Managers tend to be either quietly influential or charismatic. If their product is working well, then are those around them know it and there is buy in. The 'need' for having to 'sell' themselves stopped many decades ago

Large Org CEO Traits

- In order to have been recognised and promoted in mainstream org. to a high level they need to have excelled academically in a conventional sense
- They had to be able to build consensus views that were popular with those above and below them
- They have to be able to lead in conventional sense
- They have to be able to cope with bureaucracy and compliance and grow despite its burdens
- They probably want to grow and change existing norms but by **evolution**
- They are very much **insiders** of the existing systems, not outsiders
- Crucially large org CEO's have to be good at selling themselves or they would never have got promoted in the first place above the c.45,000 other people whom they now lead
- Also, without self-promotion skill they are unlikely to get their next role

…and our point is…?!

The idea of the above list is not to idolise all founder-led companies and demonise all career CEO's. That is of course foolish. It is instead to try and get inside the head of founder leaders and realise that they are unusual people with unusual driving forces. Some are a little prickly at times and may struggle to articulative themselves. Some whom you may meet as an investor may be rightly bored of meeting short term investors vs their own 25y understanding of their cherished company. Others might not like being backed into a corner by competitors or regulators.

As researchers but also managers of an investment fund with c.90% of its assets invested in owner managed companies we can reflect that all of these managers built something special. Whether they can do it again or keep doing it is always the relevant question for investors. **But as mere investors who did not build a $1bn company from our garage, pub or basement we need to pause sometimes before we so easily ask the questions assuming we are right and they are wrong in terms of what happens next. They have been there, seen it and… got the T-shirt.**