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Value Investor INSIGHT

The Leading Authority on Value Investing

To Each His Own

Horizon Kinetics' Murray Stahl invests with the same long-term, contrarian approach that he wants management of his portfolio companies to employ.

Murray Stahl when talking about stock ideas is as likely to cite how Bank of America founder A.P. Giannini responded to the 1906 San Francisco earthquake than he is to recount financial metrics. "Every perspective I have will sooner or later go stale," he says. "I'm constantly looking for how successful people did things differently."

Stahl's open-minded approach has paid off handsomely for investors. His Horizon Kinetics LLC now manages $8.1 billion and the large-cap strategy he's run since January 1996 has earned a net annualized 11.5%, vs. 7.6% for the S&P 500.

Mining "predictive attributes" of outperformance, he's investing in such areas as movie production, home security, asset management and private equity.

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INVESTOR INSIGHT

Murray Stahl
Horizon Kinetics LLC

Investment Focus: Seeks companies with strong potential earnings growth that may not be imminent, and therefore is inadequately valued by the market.

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Investor Insight: Murray Stahl

Murray Stahl of Horizon Kinetics LLC describes why he often puts more emphasis on the jockey than the horse in targeting investments, why the opportunity in spinoffs hasn't at all abated, why the distortions caused by indexation benefit value investors, and why he sees big upside in DreamWorks, Ascent Capital, Oaktree Capital, Dundee Corp. and Onex.

Value investing strategies have many flavors. How would you describe yours?

Murray Stahl: There are two primary dimensions to it. The first is that I believe stocks have a yield curve like that of bonds, but decidedly steeper. What that means is that investors require a much higher rate of return from a security that may be unlikely to gain in the short term, even if there's a high probability it will gain significantly over a longer time period. That longer-term potential is of little interest to most professional investors, who manifest their expertise by how good their return is over the next three months, six months or one year. They therefore often ascribe little value to any potential outside that time horizon, which theoretically can create great opportunity.

The second dimension is that I believe there are predictive characteristics of investment outperformance that the market systematically pays little attention to. That a company is run by an owner-operator, for example, in my experience is associated with incremental return, while the market often ascribes negative value to it. Or there may be dormant assets in which the market sees little value – because they at the moment produce little return – but I might see considerable value in what they'll produce in the future. Or the company may recently have been spun off, with a future markedly different than its recent past, but with a shareholder base at the outset that by definition probably doesn't want to own it. We spend most of our time looking at companies with these types of positive predictive attributes that we think the market is more likely to miss.

Can you generalize about the businesses or industries you tend to favor?

MS: I like businesses with long product cycles – say, Corn Flakes as opposed to cell phones – where there's less risk of technological obsolescence. I like businesses that are highly scalable, where substantial revenue growth is not accompanied by substantial marginal costs and doesn't require significant capital expenditures. I also favor industries where the competitive environment isn't draconian. We successfully invested in AutoZone [AZO], for instance, as the auto-parts retail business went through a long consolidation phase that benefitted the three or four largest players that drove the consolidation. But now you've got a lot of stores, with more or less the same inventory, and we've concluded that the competitive landscape has gotten a little too intense to be interesting.

One key characteristic of the companies we own is that they are willing to take risks. I just read a biography of A. P. Giannini, the founder of Bank of America. On the day after the 1906 San Francisco earthquake, he set up a board across two barrels in the middle of the destruction and from there made $25 loans to anyone who wanted one in order to rebuild. People thought he was crazy, but he was taking a calculated risk. He knew the worst that would happen was no one would pay him back. That would be his economic loss, $25 times however many bad loans he made. But he also knew that to create a big bank, he needed to be there for his customers, not close up for six months and control risk. If he were there when they needed him, people would never forget that. That turned out to be crucial in making the bank ultimately what it became.

That willingness to take risks is a common trait of every successful person I've ever studied. So we pay close attention to how companies and their management have gone through challenging times. It's important that management has shown evidence of innovation and an ability to improvise under stress. It was a big risk for John Malone and Liberty Media (LMCA)

Murray Stahl

Write Stuff

One could imagine that as his firm's assets under management grew into the billions – they currently stand at $8.1 billion – Murray Stahl would have given up the investment-research business he also started when he left Bankers Trust in 1994 to co-found what is now Horizon Kinetics LLC. After all, publishing research with titles such as *Contrarian Research Report*, *The Special Situations Report*, *The Spin-Off Report* and *The Devil's Advocate Report*, as he puts it, "is kind of like committing to writing a term paper every week for the rest of your life."

So why continue to do it? "We've found it to be integral to the investment process," he says. "Writing things out for public consumption requires that you explain your investment ideas under the assumption that your interlocutor, in this case the reader, has zero knowledge of the investment you're speaking about. Were we just working through something among ourselves, discussions would be far more likely to begin with a certain set of assumptions, which unfortunately, as much as we hate to admit it, are sometimes just wrong. The only effective mechanism we've found to force all of us, including myself, to challenge and re-evaluate assumptions is to require that we write it all up."

to buy into Sirius XM in 2009. We own Leucadia National [LUK] – it's taking a big risk in merging with an investment bank, Jefferies. Risks obviously don't always pay off, but we're buying companies that are willing to take chances.

Coming back to key predictive attributes, explain the advantage you see in investing alongside owner-operators.

MS: As investment management has become more of a risk-management business and less one of creating long-term wealth, it's not surprising that predictability, stability and linear thinking are highly valued by investors. Conversely, companies run by owner-operators – who often built the business and maintain the majority of their wealth in it – are often considered unpredictable and hard to classify, resulting often in their being less highly valued.

Owner-operators tend to make decisions based on long-term return-on-capital considerations. They tend to seize opportunities and shun complacency during periods of uncertainty. Because their own capital is at stake, they're quicker to move in and out of businesses as circumstances evolve. They're flexible in choosing capital structures that enhance returns and manage risk. Often they've developed a reputation and a network over their careers that provides them with an information advantage and that makes their company a highly desired partner. Those are the types of people you want to invest alongside – especially when the market discounts their presence because earnings might be a bit less predictable.

The most obvious example of an owner-operator is Warren Buffett, but there are many others. Look at John Malone, who has been well represented in our portfolios for years. He originally made his name by building the nation's largest cable system through more than 480 deals between 1973 and 1990. Given high interest expense and goodwill amortization, his company, Tele-Communications Inc., produced virtually no taxable income, even as he was assembling an exceedingly valuable enterprise that he eventually sold for more than $30 billion to AT&T. (As an aside, Mario Gabelli came up with the concept of using enterprise value to EBITDA in order to more accurately value TCI, which prior to that time had been shunned on Wall Street as just another highly indebted and unprofitable enterprise.) Malone is a classic entrepreneur, marching to his own drummer, but all in the name of creating long-term shareholder value.

When the owner-operator leaves, are you most likely to move on as well?

MS: Every case is different, but we're cognizant of the fact that history has not been kind to the successors of great entrepreneurs. At Leucadia, the Jefferies deal last November resulted in the naming of Jefferies' Richard Handler as CEO, who as far as we can tell is very competent and will hold a meaningful stake in the company. Given that, and the fact that the company has a cash-rich balance sheet, substantial tax assets and, until recently, was trading below book value, we've decided to maintain our position.

ON THE NEXT JOHN MALONE:

We're always looking, but I can't say, "Here are five people you may not have heard of who fit the mold."

Are you actively looking for the next John Malone?

MS: We're always looking, but I can't say, "Here are five people you may not have heard of who fit the mold." The youngest that comes to mind is probably Eddie Lampert of Sears [SHLD], who's very controversial at the moment, but we're not prepared to say the story there is over. Given that he assumed the role of CEO earlier this year and that he's personally acquired nearly $200 million in Sears shares since the end of 2011, he apparently doesn't believe so either.

What types of dormant assets typically attract your attention?

MS: These are assets within a company that don't produce an appropriate level of profit or that have not yet been monetized. In some cases the value may be overlooked by investors and in others it may be acknowledged but involves too long an investment horizon to be of interest. Common dormant assets include patents or intellectual-property rights, undeveloped land and unused real estate capacity.

The classic example I use is the Alexander's department store chain. Among other assets, it owned one of the most valuable pieces of real estate in Manhattan, the entire block between Lexington Avenue and Third Avenue across the street from Bloomingdale's. For a very long time this was a dormant asset, but one could imagine that any building placed there would be of very high value. I didn't know Bloomberg would eventually make its world headquarters there, but ultimately that happened and it wasn't inconceivable that something like that would happen.

I'd also argue that DreamWorks Animation [DWA], which we'll talk about in more detail later, is in a way a dormant-asset type of idea. It has a film and television library representing intellectual property that can produce a far greater return than is currently the case. But the market doesn't pay a lot of attention to it – it's all about whether the latest movie did as well as the one before it or the one that might come next.

Do you have an opinion on J.C. Penney [JCP] relative to dormant assets?

MS: We don't currently have an equity position in it of meaningful size, but you could argue that retailing is not the highest and best use of the real estate. The path the company has chosen is to reinvigorate the retail business, but it's plausible that it could earn a higher rate of return otherwise deployed.

What are "bits and pieces" ideas and why might they be mispriced?

MS: This refers to the ownership by a publicly traded company of stakes in other public companies or marketable securities. It is occasionally possible to identify cases where, if one subtracts the market value of the public and readily quantifiable investment stakes, the market appears to attribute little or no value to the remaining operating businesses.

Why can this happen? It typically gets back to the need on the part of most investors for definitive, near-term performance results. Many bits-and-pieces companies are run by owner-operators, who have a proclivity for undervalued and often distressed assets. While they have a history of eventually monetizing the value of such assets, the development or turnaround required can take years. Another factor is that the non-public parts of the business may be difficult to value, so to be conservative investors assign little value to them. But that doesn't mean they're not actually valuable.

We have been long-term investors in Brookfield Asset Management [BAM], which is focused on property, power and infrastructure assets. It has a vast portfolio and from time to time separates pieces of it into separately traded entities, in which the parent company continues to hold stakes and from which it continues to earn management fees. But despite the company's record of success, continuing profitability and a well-ordered balance sheet, it can often trade below the liquidation value of its assets, implying it will not earn any future profits, which is clearly not the case.

Are spinoffs still the fertile ground for ideas that they were?

MS: We don't see this anomaly going away. First, the reason a company spins off a division is that the shareholders want that to happen. So they're going to sell the shares they receive in the spinoff regardless, which is clearly not a positive for the share price. It is also persistently true that businesses prior to being spun off bear a disproportionate cost burden from the parent, and are subject to any number of pressures that inhibit the long-term creation of value in those businesses. A spinoff can help shed those burdens over time. Studies I've read show that spinoffs are on average unlikely to produce excess return over the first six months, but within five years have achieved the bulk of the excess returns they typically generate.

Second, I'd argue that the opportunity in spinoffs has become more firmly pronounced in recent years due to large-scale indexation. Not only is the spun-off company divested by initial shareholders, it can be orphaned as well by the relevant index or indexes. Coming back to Brookfield again, in April it spun off Brookfield Property Partners [BPY], which owns, operates and invests in high-quality commercial real estate. BPY owns trophy assets that would stand up well against any entity held by an index of commercial real estate investment trusts. But it isn't included, or included in only a small way, because BAM still owns 90% of it and the float isn't sufficient for the index. So the value-realization catalyst of the spinoff for both BAM and BPY has so far been much less operative than it would have been in the old days.

ON SPINOFFS:

We don't see this anomaly going away . . . I'd argue the opportunity has become more firmly pronounced.

The market has been through a lot since we last spoke [*VII*, November 21, 2007]. Have you rethought at all how you approach valuation?

MS: It's still the same. We estimate what we think earnings can be four to five years out, apply what we consider a reasonable multiple on those earnings, and then discount the result back to today using a 20% annual rate. If the price today implies a discount rate in excess of that 20%, that's something we'll look at closely.

When you're wrong, what tends to be the reason?

MS: Sometimes, hopefully not often, you just miss something important. My worst investment ever was in a company called Oxford Energy, which had this beautiful plan to burn tires to produce electric power. Everything appeared fully in place, except it turned out the company couldn't get enough tires to run its plant in western Connecticut at a high-enough utilization rate to be profitable. It didn't occur to me they'd have trouble getting the tires.

More common are cases where something changes in the business that shortens product cycles or fundamentally challenges my estimate of normalized earnings four or five years out. One of the stocks we talked about last time was exchange operator Nasdaq [NDAQ], which I considered an extremely valuable tollbooth-type asset that would benefit from industry consolidation and global growth in trading. What I didn't foresee was the impact first of the financial crisis and second of the role of indexation, which has resulted in an actual decrease in trading volume that persists today. That had never happened before and it didn't occur to me that it could.

Talk in more detail about your thesis for DreamWorks.

MS: The company is controlled by Steven Spielberg, Jeffrey Katzenberg and David Geffen, who on an economic basis collectively own around 22% of the shares. It has a film library that consists exclusively of DreamWorks-produced animated movies such as the Shrek, Kung Fu Panda and Madagascar series and, after an acquisition last summer of Classic Media, a set of older movies and TV series featuring such characters as Lassie, Casper the Friendly Ghost and the Lone Ranger. The asset base continues to grow, as the company plans to produce three films per year over at least the next few years.

The company also announced last year two significant initiatives in China. One is a joint venture with China Media Capital to produce original Chinese animated and live-action films. DreamWorks owns 45% of the new company, called Oriental DreamWorks, which has been capitalized initially with $330 million. Last month the company announced its first project, based on a wildly popular Chinese series of adventure books called Tibet Code.

The other big DWA effort in China, with local partners, is called The Dream Center, a giant riverfront development in Shanghai that is expected to cover six large city blocks and include theaters, restaurants, shopping, and even an entertainment zone with a Kung Fu Panda theme. That project is underway and is expected to be completed in 2016.

The short interest is very high here. What's the bear case?

MS: The business of animated movies targeted at kids is clearly getting more competitive, which may make some people nervous. There's also concern over the fact that DVDs are becoming passé. Eventually no one is going to buy DVDs and everything is going to be distributed online. On the one hand, a company like DreamWorks may earn less from the marginal viewer on Netflix, but on the other hand, there are likely to be fewer problems with piracy. The DVD issue overall doesn't really trouble me.

The stock also tends to be volatile with regard to movie releases and whether the analyst community is excited or disappointed by how the movie is doing. I've never figured out how to play things like that, but that volatility may attract short sellers to the stock.

The shares currently trade at just under $22. In such a hit-driven business, isn't it difficult to model out an intrinsic value?

MS: In this case I'm basically looking at the revenue the company can generate from its existing library and assuming everything else is worthless. We think the library could generate $200 million worth of revenue per year, against which there isn't a great deal of cost. Generally speaking, we think that the resulting cash flow stream mostly justifies the current market capitalization.

But they are actually doing a lot on other fronts. They're investing cash flow in three new movies per year, and every movie they make adds some value to the library. Just from that we're expecting net asset value to grow at a low double-digit annual rate. That would be an acceptable rate of return, but I'm certainly hoping for a lot more.

In China the market is so enormous that even a very modest success for DreamWorks' efforts there could materially benefit earnings. There's obviously no guarantee they will produce a positive rate of return, but if they do, this will be an extraordinary investment. It speaks to the value of intellectual capital, which is the epitome of a scalable asset.

Turning to a John Malone-related idea, what upside do you see in Ascent Capital [ASCMA]?

MS: Ascent was spun off from Discovery Holding in 2008 and is essentially a home-security company, under the Monitronics brand, along the lines of ADT.

INVESTMENT SNAPSHOT

DreamWorks Animation
(Nasdaq: DWA)

Business: Develops, produces and markets animated films and their characters; key multi-film franchises include Shrek, Madagascar and Kung Fu Panda.

Share Information
(@5/30/13):

Price	**21.98**
52-Week Range	15.90 – 22.98
Dividend Yield	0.0%
Market Cap	$1.84 billion

Financials (TTM):

Revenue	$784.4 million
Operating Profit Margin	12.8%
Net Profit Margin	(-5.3%)

Valuation Metrics
(@5/30/13):

	DWA	Russell 2000
P/E (TTM)	n/a	35.8
Forward P/E (Est.)	22.4	17.5
EV/EBITDA (TTM)	17.9	

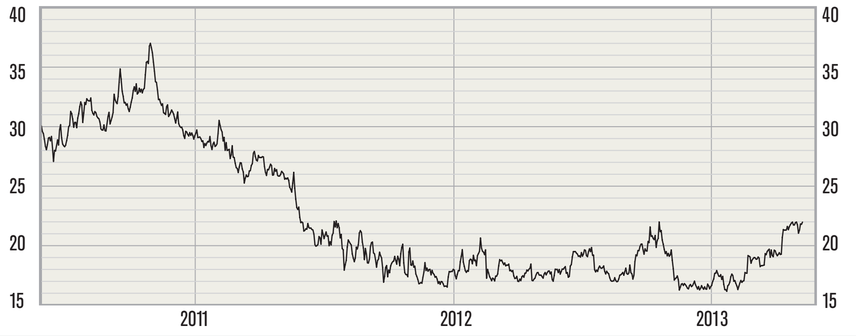
Largest Institutional Owners
(@3/31/13):

Company	% Owned
Horizon Kinetics	13.6%
Wellington Mgmt	11.7%
Primecap Mgmt	11.4%
Fidelity Mgmt & Research	7.6%
T. Rowe Price	5.8%

Short Interest (as of 4/30/13):

Shares Short/Float	42.2%

DWA PRICE HISTORY



THE BOTTOM LINE

While the market tends to focus on how the company's next movie will perform, Murray Stahl in valuing the business focuses first on the potential cash flow the company could earn from full utilization of its film and TV library. That mostly justifies the current market cap, he says, meaning new film and international initiatives promise almost pure upside.

Sources: Company reports, other publicly available information

John Malone remains the largest shareholder, and it's interesting that this business is not that dissimilar to the cable business. There's a wire in place to your home through which data is transmitted, and a company can add value based on what's being sent through the wire at any given time.

Ascent has multiple avenues of potential growth. A lot of people don't have burglar alarms, so there's plenty of opportunity to increase market penetration. The business remains fragmented, so the company is likely to continue making opportunistic and accretive acquisitions. Beyond that, we think there are some very interesting changes going on in terms of the services the company can provide through its existing connection into the home. You can monitor people's vital statistics, possibly obviating the need for a trip to the doctor. You can set up sensors and monitor where people are in the house and whether they may have fallen. The capabilities are evolving and we can imagine a number of value-added services that can materially increase the revenue earned per user. All in all, we're expecting revenue and cash flow growth at least in the low double-digits.

INVESTMENT SNAPSHOT

Ascent Capital
(Nasdaq: ASCMA)

Business: Primary asset is 100% stake in home security alarm monitoring firm Monitronics, with more than 800,000 customers in the U.S., Canada and Puerto Rico.

Share Information
(@5/30/13):

Price	**73.46**
52-Week Range	48.01 – 75.66
Dividend Yield	0.0%
Market Cap	$1.04 billion

Financials (TTM):

Revenue	$363.2 million
Operating Profit Margin	15.4%
Net Profit Margin	(-5.7%)

Valuation Metrics
(@5/30/13):

	ASCMA	Russell 2000
P/E (TTM)	n/a	35.8
Forward P/E (Est.)	163.2	17.5
EV/EBITDA (TTM)	8.1	

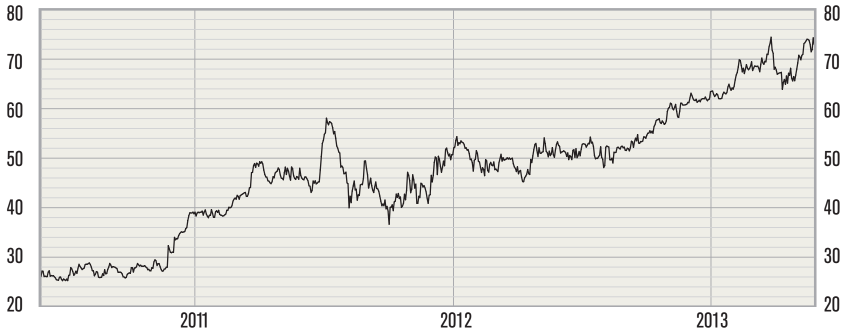
Largest Institutional Owners
(@3/31/13):

Company	% Owned
Gabelli Funds	8.7%
T. Rowe Price	7.1%
BlackRock	5.6%
Principal Global Inv	5.1%
Vanguard Group	4.9%

Short Interest (as of 4/30/13):

Shares Short/Float	2.3%

ASCMA PRICE HISTORY



THE BOTTOM LINE

The company's market valuation doesn't fairly reflect its growth potential from increased market penetration, accretive acquisitions in a fragmented market and the delivery of new value-added services, says Murray Stahl. Even if the company stopped growing, the current 13%-plus free cash flow yield would make the shares interesting, he says.

Sources: Company reports, other publicly available information

Why is the company losing money on a GAAP basis?

MS: The accounting treatment is such that you have to amortize the costs associated with a given contract over a certain number of years. But the experience is that very few people change their burglar-alarm service once they have it. When new customers are coming on at a healthy clip, the necessary accounting charges against earnings for amortization can make it look like the company is not very profitable. But it's actually very profitable from a cash-flow standpoint.

How are you looking at valuation with the shares at a recent $73.50?

MS: The free cash flow multiple today based on forward estimates is something like 7-8x. In theory, the company could stop growing, convert to a master limited partnership and pay out the free cash flow yield of 13% to shareholders. I don't expect that to happen, but if it did, you could imagine the stock at least doubling.

In fact, the company has a lot of attractive possibilities to invest that cash flow and create incremental value. But it's nice to know this could be a successful investment even if it decided not to do that.

Is the debt level a concern?

MS: There is close to $1 billion in debt, for a company with a $1 billion market cap. That's probably one thing that scares people away, especially after the credit crisis when investors are avoiding balance sheets with much leverage. But as long as the cash flow can support it, you can make a lot of money employing leverage. John Malone has done that for decades.

From John Malone to Howard Marks, describe your interest in Oaktree Capital Group [OAK].

MS: Here you have a whole series of predictive attributes. Howard Marks, clearly one of the luminaries of the investing world, is a classic owner-operator and he and his partners retain the vast majority of the voting control in the company. The asset management business is highly scalable, as increases in assets under management often require little increase in fixed costs. The opportunity to invest in the distressed assets on which Oaktree focuses isn't limitless, but the asset base has grown to nearly $80 billion, double what it was five or six years ago.

Maybe the most interesting aspect of the story is Oaktree's 22% interest in DoubleLine, the fixed-income investment firm set up in 2009 and run by Jeffrey Gundlach. This is the bits-and-pieces aspect of the idea, which is also highly scalable. DoubleLine has attracted $60 billion in assets already, but if you look at it against an obvious rival like PIMCO, which has $2 trillion in assets under management, the upside is pretty impressive. Given Jeff Gundlach's track record and reputation, it is not at all inconceivable that DoubleLine could be of comparable size one day to PIMCO. I saw recently that PIMCO took in $50 billion in new assets in a quarter. The only reason DoubleLine can't do that yet is that it has only $60 billion and large institutions don't want to account for too high a percentage of a firm's assets.

INVESTMENT SNAPSHOT

Oaktree Capital Group
(NYSE: OAK)

Business: Global investment management firm specializing in distressed debt, corporate debt, "control" investing, real estate, convertible securities and listed equities.

Share Information
(@5/30/13):

Price	**53.48**
52-Week Range	34.00 – 59.50
Dividend Yield	10.5%
Market Cap	$1.61 billion

Financials (2012):

Assets Under Management	$77.1 billion
Revenue	$145.0 million
Net Profit Margin	74.4%

Valuation Metrics
(@5/30/13):

	OAK	Russell 2000
P/E (TTM)	10.9	35.8
Forward P/E (Est.)	10.4	17.5
EV/EBITDA (TTM)	n/a	

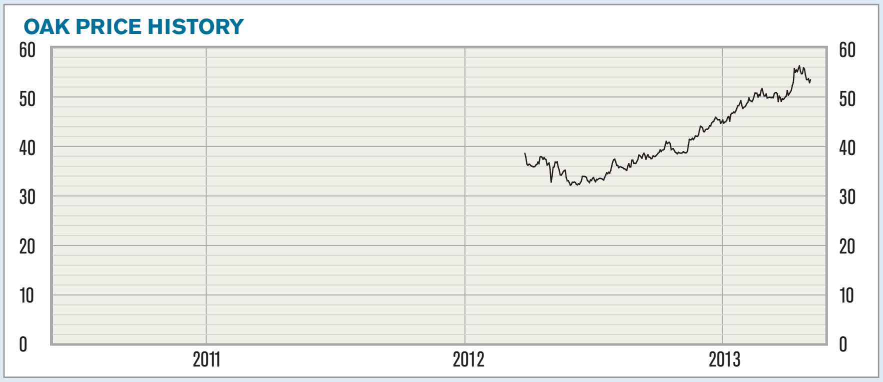
Largest Institutional Owners
(@3/31/13):

Company	% Owned
Hawkins Capital	9.9%
Davis Advisors	6.6%
Greenlight Capital	6.1%
Baron Capital	5.5%
Farallon Capital	5.5%

Short Interest (as of 4/30/13):

Shares Short/Float	0.9%

OAK PRICE HISTORY



THE BOTTOM LINE

Murray Stahl says the company has multiple predictive attributes of outperformance: an owner-operator, a highly scalable core business and a valuable unrecognized asset. At today's share price, he believes the firm's 22% stake in fast-growing fixed-income investment manager DoubleLine, now with $60 billion in assets, is "completely free."

Sources: Company reports, other publicly available information

A recent secondary offering took some air out of Oaktree's stock price after a nice run. At $53.50, what upside are you seeing from here?

MS: There's no guarantee the dividend will be maintained, but at the most recent payout level the yield on the shares is 10.5%. Could the dividend go down? Yes. Could it go up? Yes. But for the sake of argument assume that earnings and the dividend payout are cut in half, so that you're still earning a 5% yield on the current price. I would argue that in today's environment, earning a 5% yield while owning one of the premier asset managers out there in Oaktree would be perfectly satisfactory.

That tells me then that the DoubleLine stake is completely free. You're paying nothing for one-fifth of a $60-billion AUM business that could be many multiples of that in size one day. That to me is certainly an interesting proposition.

What's the investment case for Dundee Corp. [DC/A:CN], a Canadian version of an owner-operator idea?

MS: Dundee would best be described as a portfolio company, analogous to Brookfield Asset Management or Leucadia, with primary investments in a wide variety of tangible assets, including precious metals, real estate, agriculture and infrastructure. It manages assets for its own account and also has a significant investment-management business to invest outside capital. It's been run with exemplary results for shareholders for over 20 years by Ned Goodman, who retains voting control.

Mr. Goodman is deeply and quite outspokenly concerned about the stability of the U.S. dollar, interest rates and other structural risks in the U.S. and Europe. His shareholder letters make frequent reference to black-swan events and he describes Dundee's capital allocation as focused on investments that protect against the ravages of future global inflation. He's very active – investing in mining assets over here, spinning off an additional real estate subsidiary over there – all meant to position the company for the future and to try to realize unrecognized value. That's classic owner-operator behavior, and is particularly interesting if you share his concerns about the implications of global fiscal and monetary policies.

Is this another case in which the market isn't recognizing the sum of the parts?

MS: Dundee Corp. owns a number of stakes in publicly listed companies, including Bank of Nova Scotia, Dundee Real Estate Investment Trust, Dundee International Real Estate Investment Trust and Dundee Precious Metals. It hasn't happened yet, but it is about to spin off 50% of Dundee Realty, which owns a lot of land. There's also a private business called Dundee Securities, which has both investment banking and investment advisory arms.

Give or take, all of the publicly traded pieces add up to the company's current market value [at a recent share price of C$36.60]. That means no monetary value is ascribed to the real estate assets that are about to be spun off, or to the private Dundee Securities business. I don't have precise valuations for either, but I'm quite optimistic the value is appreciably greater than zero.

Mr. Goodman is in his mid-70s. Is that a concern?

MS: His succession plan involves his sons, who are already working in the business. Whether that's ideal or not remains to be seen. The father is quite active and engaged, so it's not a concern right now. But it is something to be mindful of.

Staying in Canada, what do you think the market is missing in Onex Corp. [OCX:CN]?

MS: Onex is a private equity firm that was founded in 1984 by Gerald Schwartz, who has done very well both for the firm's private equity investors as well as its shareholders. Over the past 20 years, Onex shares are up nearly 2,300% – 17% compounded – versus around 440% for the S&P 500. The firm has approximately $16 billion of assets under management, $11 billion of which is third-party capital, with the rest being Onex's own proprietary capital.

We like the scalability of private equity businesses, whether from increasing assets under management or just putting committed but unallocated capital to work. On most of the third-party capital Onex earns management fees, while also sharing in the profits on that capital through a carried-interest participation.

Is there anything to say about the makeup of the existing portfolio?

MS: Unlike some U.S. counterparts, Onex's financials and the description of its portfolio are quite transparent. The investments are across a wide variety of industries. One we find particularly interesting on the publicly traded side is Spirit AeroSystems [SPR], which is a large independent designer and manufacturer of aircraft fuselage, wing and propulsion systems. There's been a dearth of new aircraft built since the crisis, but the cycle is turning and Spirit should be a key beneficiary of that turn. Among other big public stakes are investments in Celestica [CLS], which provides electronics-manufacturing services, Skilled Healthcare Group [SKH], which is in nursing and assisted-living facilities, and Allison Transmission Holdings [ALSN], which makes automatic transmissions for trucks, buses and other large vehicles.

INVESTMENT SNAPSHOT

Dundee Corp.
(Toronto: DC/A:CN)

Business: Toronto-based holding company with primary operating and equity assets in real estate, infrastructure, natural resources, agriculture and financial services.

Share Information
(@5/30/13, Exchange Rate: $1 = C$1.03):

Price	**C$36.61**
52-Week Range	C$21.15 – C$37.88
Dividend Yield	0.0%
Market Cap	C$1.91 billion

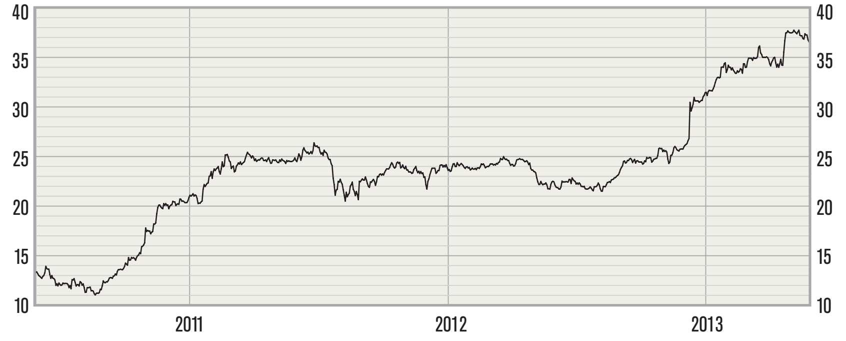
Financials (2012):

Revenue	C$702.3 million
Pre-Tax Profit Margin	9.1%
Net Profit Margin	4.6%

Valuation Metrics
(Current Price vs. TTM):

	DC/A	Russell 2000
P/E	n/a	35.8

DC/A PRICE HISTORY



THE BOTTOM LINE

The holding company's assets are "particularly interesting" if you share the founder's concerns about global fiscal and monetary policies, says Murray Stahl. His sum-of-the-parts analysis indicates that no monetary value is currently being ascribed to non-public – and actually quite valuable – businesses in real estate and investment banking, he says.

Sources: Company reports, other publicly available information

INVESTMENT SNAPSHOT

Onex Corp.
(Toronto: OCX:CN)

Business: Private-equity investment vehicle with interests in such areas as electronics, aerospace, healthcare, personal-care products, movie theaters and financial services.

Share Information
(@5/30/13, Exchange Rate: $1 = C$1.03):

Price	**C$49.47**
52-Week Range	C$36.85 – C$50.58
Dividend Yield	0.3%
Market Cap	C$5.64 billion

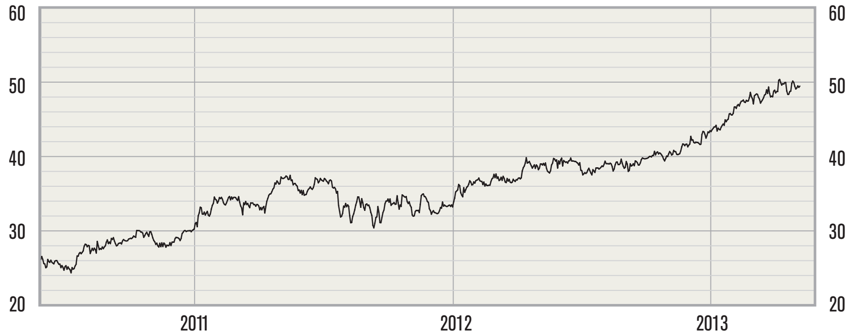
Financials (2012):

Proprietary Capital/Share	C$41.42
Net Profit Margin	(-0.4%)

Valuation Metrics
(Current Price vs. TTM):

	OCX:CN	S&P 500
P/E	n/a	19.2

OCX PRICE HISTORY



THE BOTTOM LINE

A private equity firm with this one's long-term track record of success should not trade at what is essentially the current value of the proprietary capital it has invested, says Murray Stahl. Because it does, the market is mistakenly ascribing no value to the management fees and carried interest the firm earns on $9.5 billion of third-party capital, he says.

Sources: Company reports, other publicly available information

How cheap do you consider the shares at a recent C$49.50?

MS: The company reports the value of its proprietary capital invested based on market values where applicable, and often at cost otherwise. We therefore infer that to be conservative, given that its private investments on average have likely appreciated to a not-insignificant degree. Reported proprietary capital per share at March 31 was C$43.50, and we believe it's reasonable to assume that the actual value of the proprietary capital more or less covers the current market value.

That means that no value is currently being ascribed to the management fees and carried interest Onex earns on roughly $9.5 billion of its third-party capital. You don't have to make wild assumptions based on past history and current reporting to come up with a value for those revenue streams that, if eventually recognized, would significantly increase the share price.

Management is well aware of this perceived gap between market value and what we might call intrinsic value. As a result, the company is regularly buying back stock.

You're on record recently saying the market is likely to produce "uninspiring results for many years to come." Why?

MS: I had one of our analysts compile the latest quarter's revenue growth of the 20 biggest non-financial companies in the S&P 500, which from a capitalization-weighted standpoint kind of is the market. If you take out Google, that number is a whopping +0.43%. These are all great companies, but there's just not a lot of growth opportunity out there for them and they are already operating with record margins.

I considered it a seminal event when Procter & Gamble said recently it was going to save a bunch of money by extending payments to suppliers from 45 to 75 days. Maybe that's a great idea, but is that what they have to do to create earnings? Even if it does bump up earnings, at P&G's size it's unlikely to have that material an impact on the market value. For these types of companies, it's hard to make a case for inspiring investment results.

One thing that tells me is that there should be more opportunity in the smaller rather than larger end of the market-cap spectrum. As big companies squeeze spending on R&D and new products, that can create opportunity for aggressive smaller and more nimble companies to take advantage.

You've written often about the rise of indexation and its impact on asset values and the investment business. Do you think fundamental investors are at risk of becoming dinosaurs?

MS: In a certain sense, yes. But if you think of dinosaurs more as reptiles that adapt and change, that doesn't need to be cause for concern. The rise of indexation means there is less fundamental analysis being done. It can distort prices when stocks enter or are left out of indexes. It can even distort how business is being conducted in an industry as capital moves more quickly and in greater volume from sector to sector. I honestly believe all that will create tremendous opportunities for fundamental value-based investors in the years to come. VII

Disclosure

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