

Truth or Consequences

Focusing on potential downside is on every investor's mind today. For Charles de Vault and Chuck de Lardemelle, it's always been central to how they invest.

Having risen from protégé of Jean-Marie Eveillard to the manager of some \$40 billion in assets at First Eagle Funds when Eveillard retired in 2004, Charles de Vault was at the top of the global investing world. But as he found his attention shifting away from managing his portfolios toward gathering more assets, de Vault left First Eagle last year to reassess his options. "I wanted my sole focus to be on investing properly for the shareholders in my funds," he says.

In May, de Vault joined fellow First Eagle alumnus Charles de Lardemelle at International Value Advisers, where their eclectic focus on "misunderstood" companies is uncovering value in areas such as temporary staffing, uniform rental, silver mining and motor sports. [See page 2](#)

INVESTOR INSIGHT



Charles de Lardemelle, Charles de Vault
International Value Advisers, LLC

Investment Focus: Seek companies whose resilience to adversity – and resulting upside when things return to normal – is misunderstood or ignored by the market.

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Investor Insight: Charles de Vault

International Value Advisers' Charles de Vault, Charles de Lardemelle, Simon Fenwick and Michael Malafronte explain why they focus on worst-case scenarios, how they define "good" and "bad" cyclicals, the key lessons learned from Jean-Marie Eveillard, and why they believe International Speedway, Cintas, Fresnillo and Temp Holdings are mispriced.

You've long emphasized focusing on the worst that can happen in potential investments. How well were you prepared for the market disaster that's befallen us?

Charles de Vault: We ask a lot of questions about what can go wrong, at both a portfolio and individual-stock level. That's consistent with our philosophy that if we're able to limit losses, the gains will take care of themselves. This is hard for young analysts out of school to understand – they're trained to look almost exclusively at upside potential.

As opposed to a benchmark investor starting with a benchmark portfolio, our view is that we start with cash and will only replace that cash with ideas providing enough margin of safety. If we can't find those, we'll keep cash. Our cash level was as high as 38% in October, but after the terrifying first weeks of October that's now down to about 15%.

Did that high level of cash reflect a macro call of some kind?

CDV: Ben Graham always made the point that even if you thought you had a portfolio of very cheap stocks, if the market at the time was fully priced, you should have at least 25% of your portfolio in something other than equities, such as cash or bonds. To do otherwise would be to delude yourself that your stocks, no matter how cheap they appeared to you, would be magically immune if the whole market was to correct. I've always thought that made a lot of sense and given that we thought the U.S. market, in particular, still wasn't cheap, that was a big reason we had so much cash.

Another reason is that we have always and will continue to pay attention to credit cycles. Value investors tend to portray themselves strictly as individual stock pickers, which we are, but failing to

recognize the potential impact that tightening credit can have on asset values can expose you to high risk. We obviously didn't avoid all the risk, but our cash level was higher because of a general recognition of where we were in the credit cycle.

Charles de Lardemelle: In analyzing individual stocks, we put as much emphasis on defining the worst that can happen as on defining the upside. That kept us out of banks, for example. Just looking at what would happen to banks that were leveraged at least 10-to-1 if non-performing loans and loan-recovery rates went to 1991 levels, you could see a lot of potential disasters.

With non-financial companies, we look back as far as possible to inform what would be the worst-case levels of revenues and margins, and then apply what we think are trough multiples to the resulting worst-case earnings. If the worst case is more than 20% below the existing share price we won't buy it, no matter how much the discount is to our intrinsic value. By the way, in doing this kind of analysis we're finding there are a lot of cheap but still unsafe equities in the U.S.

As Charles said, we haven't avoided all risk, but our losses through October have been roughly half of market levels.

Can you generalize about where you're putting money to work now?

CDV: In addition to adding to our existing holdings, the two primary areas of new interest have been high-yield corporate bonds and cyclically out-of-favor companies, particularly those in Japan.

The fixed-income portion of our global portfolio is at a record high, 27%, because that's where we see the most dislocation today. We analyze high-yield debt just as we do equities, focusing primarily on how well our worst-case intrinsic



Charles de Lardemelle, Charles de Vault

French Connection

When Charles de Lardemelle's father received a letter from one of France's largest banks while his son was at business school, he assumed it was an offer to Charles of a coveted internship. In fact, it was a margin call, the result of high-risk investing bets gone wrong that Charles had made with borrowed money. "It was the best 10,000 Francs I spent on my education," says de Lardemelle. "That was money I could not afford to lose, but from then on risk aversion came first."

This emphasis on the downside fit nicely with the philosophy of Jean-Marie Eveillard and Charles de Vault, for whom he worked for 11 years before starting International Value Advisers a year ago. De Vault joined him at IVA earlier this year.

Both credit Eveillard, one of the true pioneers of global value investing, with imparting valuable lessons: "He had an uncanny ability to boil down an investment case to the three or four points that would really make a difference a few years out," says de Lardemelle. "That's key for any successful investor." Adds de Vault: "I always respected that Jean-Marie never showed emotions like anger, fear or panic – and maybe most importantly, greed."

sic value covers the debt. When our views on that are at odds with ratings agencies and the market, we can sometimes find the equity-like returns and the downside protection we require to buy.

Give us a current example.

CDL: We've been buying bonds going out to 2016 and 2017 in the French holding company Wendel, which owns large stakes in the industrial and service sectors in Europe. Their holdings, in companies like Bureau Veritas, Saint-Gobain and Legrand, are trading at depressed valuations, but our sum-of-the-parts analysis still arrives at a net asset value of €1.6 billion against the net debt of €1.2 billion. The company isn't burning cash: it collects dividends today that cover not only SG&A expenses, but also coupon payments on all the debt. Even with all that, the bonds are yielding 18%.

Talk about how you're approaching cyclicals today, in a market in which nearly everything is behaving like a cyclical.

CDL: To that point, one area of opportunity is in companies that aren't as cyclical as the market seems to believe. A good example that we own is Panalpina Welttransport [PWTN:SW], a Swiss company that competes with companies like Expeditors International in the global logistics business. A toy manufacturer in China, for example, will hire Panalpina to arrange for a large product shipment from Shanghai to Chicago. It does things like find the right shipper for you, get the shipment through customs, arrange for rail or truck transport in the U.S., and negotiate all the pricing.

The market treats the company like a transportation company, but it's really just a broker. That makes a very big difference when volumes come down 5-10%. For a high-fixed-cost transporter, a volume decline like that can make profits disappear as prices and load levels go down. For Panalpina, such a decline is far less onerous. In our worst-case scenario, we take its gross profit down 10%, assume a trough 11% operating margin

(on gross profit) and apply what we think is a trough 6x EBIT multiple. Adding back cash net of pension liabilities, that gives us a share price of 50 Swiss francs, which is just under where it's trading today. At what we think a company like UPS would pay to buy the company at normal levels of revenues and profitability, the intrinsic value is closer to CHF 150 per share. But as we described before, we're more interested in the CHF 50 downside (and 6% dividend yield) than we are in the upside.

ON ACCOUNTING:

Believe it or not, there are still countries around the world where accounting standards are actually conservative.

You've made the distinction between "good" and "bad" cyclicals. How do you distinguish between the two?

CDL: In general, we're far more interested in cyclical companies that are well-capitalized, that don't lose money at the bottom of the cycle and whose peaks and troughs are both higher over time. We'd be less apt to buy into something like a capital-intensive pulp and paper manufacturer, which bleeds money at the trough and, when they do generate some cash flow, needs to spend much of it on new or upgraded plant and equipment.

A great example of what we consider a good cyclical (which we'll talk more about later) is Temp Holdings, the #2 temporary staffing company in Japan. The business is growing over time, we estimate trough EBIT margins are around 2% and, because its receivables contract in a downturn, cash flow can actually increase when the economy suffers. In Japan today you can find many companies like this trading for next to nothing. At its current stock price, Temp Holdings' market value is barely above the amount of cash they have on hand.

Have beaten-up energy shares attracted your attention?

CDV: Yes. Even though there was a wonderful bullish case long-term, we weren't comfortable with oil prices at \$120-145 per barrel. Now that the price has fallen way below replacement cost, however, we've started to nibble. We bought France's Total [TOT], which we think is particularly well-managed and has an excellent balance sheet. We hope to add to our energy holdings in the next few months.

Apart from cyclicity, what tends to make the stocks you buy attractively priced?

CDL: Our favorite situations are when we believe the market has fundamentally misunderstood a company or its business. That can happen for a variety of reasons. It may be that the company is relatively unique and the market hasn't figured out how to value it. We believe that's the case with International Speedway [ISCA], which owns and operates many of the venues that host NASCAR races. Its assets to us have the characteristics of prime real estate, in which huge cash outlays are required to create irreplaceable, one-of-a-kind franchises. Nobody looks at it that way today, but in our calculation of intrinsic value for the company we apply the same kinds of multiples you'd see on prime real estate.

A misunderstanding might also have to do with accounting. Believe it or not, there are still countries around the world where accounting standards are conservative. In the Anglo-Saxon world we're used to seeing overstated earnings, but in places like South Korea, Japan, Germany and Switzerland, you can sometimes find earnings that are significantly understated.

The goal with all our accounting adjustments is to arrive at numbers that best reflect true economic reality. We'll increase earnings if depreciation charges are overstated, for example, which is often the case in countries where the tax code tends to govern reporting decisions. We'll decrease earnings if depreciation

charges are understated, as often happens in countries like the United States where earnings per share and/or share prices matter greatly to the compensation of the top executives. We look at everything – pension liabilities, environmental liabilities, restructuring charges, etc. – and make adjustments to arrive at the “true” results. Sometimes those adjustments can make something much more attractive than the market seems to recognize.

CDV: One benefit of being a global investor is in learning how a particular business should be valued – which is often properly done in the U.S. – and applying that in countries where the valuation is different. One good example of that was finding Kuehne + Nagel, based in Switzerland, trading like a trucking company when it was very similar to Expeditors International – a high-quality service business with a higher valuation. Another reason we think Temp Holdings is undervalued is that temporary-staffing companies in Japan – many of which have only fairly recently gone public – are still not well understood.

One aside here is that we’ve always organized our work along industry, not geographical, lines, specifically so we can take better advantage of these types of opportunities.

Do you focus on finding catalysts that will help rectify these misunderstandings?

CDV: Not really. If you focus first on cheap stocks, you can often end up in companies that are laggards in their industries or are in mediocre businesses. These types of companies struggle to see their intrinsic value grow over time. That’s why you often need a catalyst to help the gap between price and intrinsic value close as quickly as possible, because time can be the enemy.

We focus first on good businesses, with high returns on capital, barriers to entry and significant free cash flow generation over a cycle. If you’re right about the business, time should be your friend, so catalysts are not important.

Is spending time with management an important part of your research process?

CDL: No, especially in the early stages of the research process. We’d rather analyze the company, its opportunities and issues, and how it has allocated capital in the past, without first being fed the party line. When we do meet with management, it should be an educated discussion between two knowledgeable parties.

ON INVESTING IN GOLD:

As governments throw money at the crisis, that will eventually push inflation higher. We want some gold as that happens.

How do you arrive at an estimate of a company’s intrinsic value?

CDL: We define intrinsic value as what a knowledgeable investor or corporate competitor would pay, in cash, for 100% of the company. From the ground up we build that by making all the relevant adjustments to the income statement and balance sheet, then applying a multiple that reflects the quality of the business to the resulting normalized earnings. We check the multiples, if possible, against those paid in cash transactions in the industry. We have enough history of portfolio companies being taken over to know that we’ve been pretty good at this – our intrinsic values, on average, come in about 10% too low.

For something to make it into the portfolio, we want the price to be at least a 30% discount to intrinsic value. The discount would have to be much higher if the worst-case downside was at our maximum of 20% below the current price.

How concentrated is your portfolio?

CDL: A 2% equity position is a fairly large position for us. Including fixed income, we expect to eventually build up to around 120 positions.

CDV: People tend to assume that the only form of active portfolio management is through relatively concentrated portfolios. We think there’s an equally legitimate form of active money management in running a diversified portfolio that has nothing to do with the benchmark. In the past, that meant having nothing in Japan from 1988 to 1995, or having no technology or telecom in the late 1990s.

Our mandate is first and foremost the return of capital, which has also so far resulted in above-market returns. With that mandate, we don’t want a concentrated portfolio that bets the farm on a few stocks. This year has been an excellent reminder of how valuable diversification can be as a risk-management tool.

Do you still have an affinity for gold?

CDV: Yes. As governments throw significant amounts of money at the economic crisis, that will eventually push inflation higher. We want to have some gold in our portfolio – it’s now a 4.5% position, virtually all in bullion – as that happens. There’s a saying that you should not confuse a clear vision with a short distance. We’re willing to own gold even though it may not act as a hedge in the near future, because we have a fairly clear vision about what will happen to inflation three, four or five years out, and it’s not a pretty sight.

Describe the broader investment case for International Speedway, which you mentioned earlier.

Michael Malafronte: The company operates a dozen major racetracks around the U.S., whose primary events are sanctioned by NASCAR, the car-racing licensing body. International Speedway’s revenues come from ticket sales, concessions, on-site sponsorships and – the biggest share – from a pro-rata share of overall NASCAR TV-rights proceeds.

To give some brief history, the France family – which owns NASCAR – brought International Speedway public in the mid-1990s and used the proceeds to start consolidating the track infrastructure in the

U.S. They felt that gave them the best opportunity to more fully control the NASCAR franchise and it worked beautifully as the popularity of car racing exploded earlier this decade. It became the second-most watched sport on TV (after the NFL) and International Speedway shares became kind of a favorite among growth investors.

Some of the air originally started to go out of the story in 2005 when NASCAR signed a new TV contract. The previous contract had had such large annual escalators that the new contract actually paid out a lower amount in the first few years. At the same time, the business was clear-

ly maturing. There were few tracks left to buy and *de novo* expansion plans into the few untapped markets left – namely the New York metropolitan area and Seattle – ran into political roadblocks.

Now the big worry is slowing race attendance. People on average drive six hours to attend a race, so high gasoline prices impacted crowds starting earlier this year. Now the bad economy will clearly have an impact on both attendance and the ability to raise ticket prices. Average prices are in the \$80-90 range, and given that people often make a long-weekend trip around a race, the total outlay is quite a bit higher.

That helps explain the collapse in the share price, from above \$40 in September to a recent \$23.40. Why do you think the market's pessimism is overdone?

CDV: One thing we like about the business is that while the model is originally capital-intensive – they need to build or buy the tracks – there's very little maintenance capital spending beyond that. In something like a railroad, maintenance capex over time dwarfs stated depreciation, because they constantly have to replace tracks and railroad cars. That's not at all an issue with International Speedway.

We also like that there are a finite number of weekends in the year and a finite number of tracks that could and should be built around the country. NASCAR already runs 39 weeks of the year and it's unlikely they'll go much beyond 41 or 42. At the same time, building a new track is expensive, politically difficult, and highly speculative without having a race commitment. A new track was recently built in Kentucky with an 80,000-seat capacity – costing something like \$90 million – and they don't yet have a big-time race. All of this creates some fairly high barriers to entry.

CDL: For us the key metric will not be attendance this year and next year, but instead the level of TV viewership. That measures the health of the business, and it's holding up well at about six million viewers per weekend. Our feeling is that this is a television franchise that took 40 years to build and it's not one that will be easily diminished.

How are you looking at valuation?

CDL: In our worst-case scenario, we can fairly easily estimate the TV-rights revenues that are fixed by NASCAR's contract for another five years. We also assume admissions and concessions fall 20%. If that happens, we estimate EBIT would fall to \$170 million, vs. a good year like 2006 when it was above \$280 million. Leverage is not a problem: Given assets they have on the balance sheet that

INVESTMENT SNAPSHOT

International Speedway

(Nasdaq: ISCA)

Business: Owner of 12 U.S. motor-sports venues focused on NASCAR stock-car races. Revenue sources include TV rights, ticket sales, concessions and sponsorships.

Share Information

(@11/25/08):

Price	23.42
52-Week Range	20.76 – 44.75
Dividend Yield	0.5%
Market Cap	\$1.14 billion

Financials (TTM):

Revenue	\$837.2 million
Operating Profit Margin	32.4%
Net Profit Margin	14.7%

Valuation Metrics

(@10/30/08):

	<u>ISCA</u>	<u>Nasdaq</u>
Trailing P/E	9.6	17.6
Forward P/E Est.	8.8	12.4

Largest Institutional Owners

(@9/30/08):

<u>Company</u>	<u>% Owned</u>
Barclays Global Inv	8.2%
Allianz Global Inv	5.7%
Royce & Assoc	5.4%
American Century	5.3%
Vanguard Group	3.9%

Short Interest (as of 10/28/08):

Shares Short/Float	2.3%
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ISCA PRICE HISTORY



THE BOTTOM LINE

The quality of the company's business – GDP-plus growth, low capital spending, irreplaceable assets and high barriers to entry – is not at all being recognized by the market, says Chuck de Lardemelle. At 13x the "normal" \$250 million in EBIT he would expect the company to earn within three years, the shares would trade above \$60.

Sources: Company reports, other publicly available information

could be monetized, including land they bought on Staten Island for a failed race-track bid, they have no net debt. Using a conservative 10x EBIT multiple, our worst case comes to a \$32 stock price, significantly above today's price.

Under normal economic circumstances two to three years out, we expect EBIT of around \$250 million. Given the characteristics of the business – growing at GDP-plus, with low capex, irreplaceable assets and barriers to entry – we think a reasonable EBIT multiple is 13x. At that level, the stock would be worth more than \$60.

Has the company made any efforts to redirect more cash to shareholders?

CDL: The dividend yield is puny and could certainly be increased. The family management has been smart not to buy back stock so far, but we do expect buybacks to pick up considerably. That's wonderful news as long as they pay far below our estimate of intrinsic value.

What appeals to you about uniform-rental company Cintas [CTAS]?

CDL: Cintas is another company in a high-quality but maturing business. Their main business is the sale and rental of corporate uniforms, which they pick up for cleaning and maintenance on a regular basis. They've expanded over time into similar services providing things like dust mats, first-aid kits, linens and restroom dispensers. The most important person in the chain is not the sales person, but the truck driver, who builds and maintains the client relationship.

The revenue is largely recurring and the moat around the franchise is the density of the delivery network. Cintas is the leading player in the market and has the highest EBIT margins – normally in the high teens, vs. the low teens for competitors like Unifirst and G&K Services – because of the advantages of scale from running more-efficient delivery routes.

One hidden asset we see is the company's document-management business, which is growing rapidly and now generates roughly \$200 million in revenues.

This is similar to what Iron Mountain does, picking up documents and then storing them or shredding them for client professional-services firms and big corporations. We actually see this driving much of Cintas' growth in the next few years.

How cyclical is the core rental business?

CDL: The number of uniforms in the U.S. economy grows over time, but near-term job cutbacks will hurt somewhat. The marginal uniform at a given employer is very profitable to Cintas, because the incremental cost to service and deliver it is almost nil. That works in reverse when

a company reduces the number of uniforms it needs.

We're expecting no revenue growth from uniforms next year, but we think overall company revenue can still grow maybe 2%, to just under \$4 billion. Because we think the recession in the U.S. will be sharp, we estimate 2009 operating margins will fall to around 12.5%, resulting in about \$700 million of EBITDA. That's down from around \$765 million for the fiscal year ended in May.

We do make an important accounting adjustment here to determine the true economic earnings of the company. Cintas made a number of acquisitions over the

INVESTMENT SNAPSHOT

Cintas

(Nasdaq: CTAS)

Business: Provider of corporate-identity uniforms and ancillary products, as well as document storage, document disposal and on-site safety-related services.

Share Information

(@11/25/08):

Price	22.39
52-Week Range	19.51 – 35.61
Dividend Yield	2.2%
Market Cap	\$3.42 billion

Financials (TTM):

Revenue	\$3.97 billion
Operating Profit Margin	14.5%
Net Profit Margin	8.4%

Valuation Metrics

(@10/30/08):

	CTAS	Nasdaq
Trailing P/E	10.4	17.6
Forward P/E Est.	9.2	12.4

Largest Institutional Owners

(@9/30/08):

Company	% Owned
A&S Bleichroder	7.2%
Vanguard Group	3.6%
Barclays Global Inv	3.4%
State Street Corp	2.8%
Eminence Capital	2.4%

Short Interest (as of 10/28/08):

Shares Short/Float	2.5%
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CTAS PRICE HISTORY



THE BOTTOM LINE

Even with a deep U.S. recession, the company's well-defended position in uniform rentals and growing document-management business should allow it to weather the storm better than the market seems to expect, says Chuck de Lardemelle. With no estimated downside, he estimates the company's intrinsic value at \$40 per share.

Sources: Company reports, other publicly available information

years and, like all service companies, has to amortize the value of acquired contracts over time. That's akin to goodwill, which we add back in calculating earnings.

How does your intrinsic value estimate compare with today's share price of around \$22.40?

CDL: After \$150 million in maintenance capex, we arrive at an adjusted EBIT estimate of \$550 million for next fiscal year. At a 13x multiple – justified by long-term GDP-plus revenue growth, the recurring-revenue nature of the business and a healthy competitive moat – that gives you a business value of \$7.15 billion. After \$650 million in debt, \$300 million in stock-option liabilities and a \$50 million reserve for discrimination and wage lawsuits, that leaves us with a market value of \$6.15 billion, which is \$40 per share.

For our downside scenario, we use the same EBIT estimate for next year, which we think is a close approximation of trough earnings. With a trough 9x multiple on those same 2009 numbers, we still end up at \$26 per share.

What is the market is missing in beaten-down silver miner Fresnillo [FRES:LN]?

Simon Fenwick: Fresnillo used to be a wholly owned subsidiary of Mexican mining conglomerate Industrias Penoles, which we owned years ago. In fact, we were one of the early proponents of their spinning it off to give better visibility to its assets, which they finally did in May. (Penoles still owns 77% of the company.)

The shares listed in London at £5.55, which was too fancy a price for us. As the share price fell dramatically, we started to take a much closer look.

Step back and tell us first about Fresnillo's business.

SF: Fresnillo is the world's largest primary producer of silver, meaning its silver is not a byproduct from other metals. Its three operating mines are in Mexico and it has development projects there as well.

Although all mining-company shares

have been indiscriminately dumped, we don't believe all mining assets are created equal and that Fresnillo's assets, in particular, stand out. The first attribute we like is the very high grade of silver at the company's flagship asset – the eponymous Fresnillo mine. Because of this, it can produce silver for a net cost of \$1 or less per ounce, after crediting against costs the revenue from other secondary metals such as gold. To our knowledge, these are the lowest net production costs for a primary silver company in the world.

Another big positive is that Fresnillo's mineral reserves will allow it to grow production over the next five years, which is extremely rare among precious-metals companies, most of which struggle to replace production. The company's main development mine is located adjacent to

its existing mine infrastructure, and the grades there are at least comparable to the flagship Fresnillo mine. What often happens in precious-metals companies with high-grade assets is that they can't help themselves from diluting their asset bases by making acquisitions in the name of growth. With Fresnillo, we shouldn't have to worry about that.

The third positive attribute is the company's very strong balance sheet, which is always important in a cyclical business. They have no debt and roughly \$300 million of cash on hand.

How do you value the shares, which at £1.28 are off 75% from the IPO price?

SF: What we do for all commodity-related companies is construct a long-term fair

INVESTMENT SNAPSHOT

Fresnillo
(London: FRES:LN)

Business: Exploration and production of silver and gold. Operating and development mines primarily located along what are considered the silver and gold belts of Mexico.

Share Information
(@11/25/08, Exchange Rate: \$1 = £0.65):

Price	£1.28
52-Week Range	£0.93 – £5.75
Dividend Yield	3.0%
Market Cap	£915.8 million

Financials (TTM)

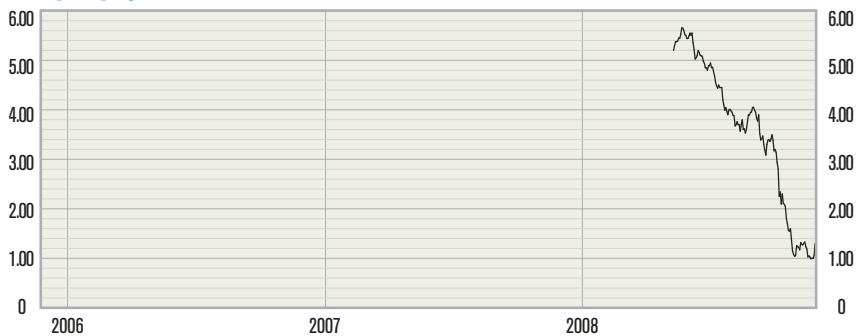
Revenue	\$760.0 million
Operating Profit Margin	38.0%
Net Profit Margin	29.0%

Valuation Metrics

(Current Price vs. TTM):

	FRES	S&P 500
P/E	4.2	16.3

FRES HISTORY



THE BOTTOM LINE

Given the company's plentiful, high-grade silver reserves and industry-low operating costs, Simon Fenwick believes it would continue to operate profitably and invest even if silver prices fell another 50% from today's level. Assuming a long-term fair value for silver of \$9 per ounce, he estimates the company's intrinsic value at £2.20 per share.

Sources: Company reports, International Value Advisers, other publicly available information

value for the commodity, based on the price level that would attract marginal projects into production. While it's somewhat difficult to construct a cost curve for silver because much of it is produced as a byproduct, we think the long-term price of silver is in the range of \$9 per ounce.

If we reverse-engineer the silver price reflected in Fresnillo's current share price, based on its reserves and operating costs, we come to a price of closer to \$6 per ounce. Assuming \$9-per-ounce silver prices and normal production levels, we believe the company's intrinsic value is at least £2.20 per share.

What are the biggest risks?

SF: We think any downside is mitigated because of the company's low costs. Silver trades around \$9 per ounce today, but even if it goes below \$6, Fresnillo can operate profitably and invest while competitors are forced to close mines and slash capital spending.

We also look at political risk, but in this case we believe Mexico will remain one of the most mining-friendly jurisdictions in the world.

One thing I would add is that the company doesn't hedge against the commodity price, which we think is the right strategy. Our downside hedge is the balance sheet and low cost base. With that in place, there's no reason to cap the upside by hedging against a fall in the commodity price.

Turning to Japan, tell us more about your interest in Temp Holdings [2181:JP].

CDL: We've always liked the temporary-staffing business, because of its growth over time, minimal capital spending needs, and the ability of the best companies to prosper in consolidating individual markets. In Japan the industry is relatively young, having been deregulated in the latter half of the 1990s. Prior to that there were a variety of restrictions on when and where temps could be used. Temporary staffing now accounts for only about 2% of the employed population in Japan, versus 4% in the most-

mature markets like the U.K. and the Netherlands.

Temp Holdings is currently #2 in Japan, with around 8% of the market, behind the 15% share of Staff Service. The industry is continuing to consolidate as companies see the advantages of scale. Temp Holdings itself was just formed through the merger of Tempstaff and a smaller rival, People Staff.

What exactly are those scale advantages?

CDL: This isn't a high-moat business, but the bigger companies have two key advantages. One is their ability to fulfill large contracts, simplifying the administrative headaches for customers. They can also gain cost advantages in spreading expenses for things like IT systems and

real estate across a larger revenue base. That allows them to maintain gross profits while pricing competitively.

The CEO of Temp Holdings is the original founder of Tempstaff and has always run a very tight ship. (She still owns 50% of the combined company.) While competitors are lucky to earn 3% EBIT margins in good times, Tempstaff has earned as much 5.8%, with last year probably at a more normal level of around 4.7%. That's on par with the well-managed temp-staffing companies around the world.

Are Temp Holdings' corporate governance practices as progressive?

CDL: Like most Japanese companies, Temp Holdings has far more cash than it

INVESTMENT SNAPSHOT

Temp Holdings
(Japan: 2181:JP)

Business: Provider of temporary staffing and personnel recruitment services primarily in Japan, with focus on clerical as well as more specialized job functions.

Share Information
(@11/25/08, Exchange Rate: \$1 = ¥95.4):

Price	¥526.00
52-Week Range	¥437.00 – ¥722.00
Dividend Yield	4.2%
Market Cap	¥34.46 billion

Financials (TTM)

Revenue	¥268.48 billion
Operating Profit Margin	4.6%
Net Profit Margin	2.2%

Valuation Metrics
(Current Price vs. TTM):

	2181	S&P 500
P/E	5.8	16.3

TEMP HOLDINGS HISTORY



THE BOTTOM LINE

The company's market position and tight cost control should allow it to maintain solid cash flow in a downturn, says Chuck de Lardemelle, but after subtracting cash and securities on hand, the market is placing little value on its operations. At the low-end revenue multiple at which industry transactions occur, the shares would trade at ¥2,000.

Sources: Company reports, International Value Advisers, other publicly available information

could possibly need. It did just declare a dividend which translates into a 4% yield, but we'd also love them to buy back stock and they haven't.

The recent merger with People Staff is a good example of what's dysfunctional about the Japanese M&A market. To buy People Staff, Tempstaff issued shares at a 4x EBIT multiple to buy shares at 2x EBIT, when it could have easily bought the whole thing for cash. Worse, from a People Staff shareholder's perspective, Tempstaff paid 2x EBIT when a large global player like Adecco or Manpower would probably have paid 10x. These are the types of things that make non-Japanese shareholders crazy.

You mentioned that the shares, at ¥526, trade for close to the cash and securities on hand. Why?

CDL: It clearly doesn't make sense to us. They have around ¥450 per share in cash and securities and by all rights should continue to generate solid cash flow in a downturn. We expect revenues to bottom at ¥230 billion, EBIT margins to be no worse than 2%, and we set the trough EBIT multiple at 5x. At worst then, that translates into a share price of ¥800.

For our intrinsic value, we're using the bottom of the range of 40-60% of revenues at which transactions in the temporary-staffing industry typically happen. At 40% of ¥250 billion in normal revenues, that would result in a share price close to ¥2,000.

Couldn't an argument be made that Japan is a semi-permanent value trap?

CDV: I have two responses to that. First, ever since Japan's bubble burst in 1989, there have been major market moves up and down, so you've had plenty of opportunity to make money if you know your intrinsic values and don't get greedy when those values are approached.

Second, I do believe the market dynamics can change. Dividend payout ratios are up, more companies are buying back stock, valuations are at rock bottom, and just recently there has been a big

wave of equity buying from individual investors, which hasn't been seen for a long time. All of those things I consider quite bullish.

The key is to find companies that grow the value of their businesses over the years. As long as the intrinsic value increases, we're pretty confident we'll eventually come out okay.

Describe your general selling discipline.

CDL: We're strict about at least starting to sell whenever a stock is within 10%

ON EMERGING MARKETS:

We do not chase growth, but we like nothing better than to invest in emerging markets on a contrarian basis.

under and over our estimate of intrinsic value. How much and how quickly we sell will be a function of the quality of the business and the quality of management. In general, we'll hold out longer if the business is growing nicely in a non-cyclical way, has a strong balance sheet, and has a strong competitive position. We also may be willing to hold until 110% of appraised value if management, through its strategic decisions or capital allocation, has a proven history of increasing intrinsic value beyond a natural rate. We actually talk more about management when we're looking to sell than when we're looking to buy.

What's a common mistake you make?

CDL: The most common is in misjudging the potential downside. A recent example is Liberty Media Interactive [LINTA], where we just weren't harsh enough with our worst-case scenario. That was partly because its main asset, QVC, was much younger and had grown fairly well in past downturns. But we should have recognized that with so much consumer spending going to housing, food and trans-

portation, the discretionary stuff sold on QVC was much more vulnerable to a lousy economy.

Can you generalize about where in the world you're finding the most opportunities today?

CDL: Until early October, we were puzzled by the fact that foreign markets had come down so much more than the U.S. market. As of today, that disparity is much less, but we still have less than 10% of our portfolio in the U.S. and are taking it slowly here. Leverage is still more of a risk in many U.S. companies than we're finding in Europe, and particularly in Japan. It's hard to find a net-cash balance sheet in the U.S., but of the 25 Japanese companies we own, 23 have net cash.

What about emerging markets?

CDV: We haven't been traditional emerging markets investors because we do not chase growth or glamour, but we like nothing better than to invest in emerging markets on a contrarian basis. Strong economic growth is never steady, so you can find nice opportunities to invest after booms have gone temporarily bust. But I wouldn't say that's a big part of what we're doing today.

You've mentioned you admire Jean-Marie Eveillard's lack of emotion as an investor. How difficult has that been to emulate in recent months?

CDV: On a few occasions in October even I had butterflies in my stomach. But we're well-positioned with our level of cash, our high-yield positions and with the work we've done on the downside and on the staying power of our companies. All that matters to us is our assessment of our companies' businesses and what kind of return we can expect in each over the next five years.

I'm perfectly fine if Mr. Market wants to go down another 15-20% – we'll just buy more stocks. It's not during up years that great investment track records are made! **VII**

Disclosure

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Holdings are as of November 26, 2008 and subject to change. The funds held the following: Cintas Corp. (1.8% of the Worldwide fund), Fresnillo PLC (0.6% of the portfolio), International Speedway Corp. (1.7% of the Worldwide fund), Kuehne & Nagel International AG (0.6% of the portfolio), Panalpina Welttransport AG (0.75% of the portfolio), Temp Holdings Co. Ltd. (2.1% of the portfolio), Total S.A. (2.0% of the portfolio), Wendel bonds (4.3% of the portfolio).

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