2015

To the partners :

Partnership vs S&P 500 Relative Performance

Year	In per share market value of partnership (1)	In S&P 500 including Dividends (2)	Relative Results (1)-(2)
	ANNUAL PERCENTAGE CHANGE*		
2013	16.1	32.8	-16.7
2014	9.3	13.7	-4.4

*in USD

Compounded Annual Gain - 2013-2015: 12.6%

Overall Gain: 26.9%**

**(67.8%; in TL)

On 14th January 2015, Wall Street Journal wrote that Goldman Sachs changed its "forecast" of where crude oil prices will go, from 73.75 USD to 47.15 USD (quite a revision). Investment professionals, possibly as they feel obligated to answer customer questions such as "Will the dollar go up?","Where are the oil prices headed to", offer serious estimates (and do it with a highly sophisticated and technical jargon), when these questions are asked to them. In fact many times the wisest answers to questions like the above should be: "We honestly can not predict.", "We don't know where it is headed to, but we can assure you that it will fluctuate while going there.", "It is highly probable that it will be much higher than what it is today in 10 years time." Let's see if Goldman changes its forecast of where the price of oil is headed to again this year (and whether the revision will again be in double digit percentages). Certain people need such forecasts to make decisions, and Goldman is possibly making that mass happy I suppose.

Although S&P increased 13.7% in the next year, the 1,816 of the 4,210 stocks that we accept as our "universe" ended the year with a negative performance. Prices put aside, almost half of these companies could not increase neither their sales nor their net profit. The US stocks scared "Mr. Market" with 5 deep falls during 2014 (and made us feel happy 5 times). None of these downmarkets became long lasting. Among some of the situations that came to us as opportunities we can count: halving of the stock prices of newly IPOed companies such as Facebook and Twitter; the stand that the American government has taken against the "robotic surgery" leader Intuitive Surgical (ISRG) and related stock price decrease; the accounting scandal at the Ebix company (which offers software and ecommerce services in the insurance industry); the legal developments relating to the mortgage giant Fannie Mae (which is under its way for a closure); the distress that Sea World company had gone through; certain pullbacks in the indices of countries like Ukraine, Russia and Turkey together with some other developing countries; and the big oil crisis that hit the markets towards the end of the year.

Although most of these pullbacks seemed like opportunities, due to the fact that we almost “marry” with the stocks that we buy (we only focus on those companies which we can hold 10 years, and which we can predict the future 10 years of with enough certainty), we approach the business of getting into a new position pretty seriously. Mostly because of this, we purchased into “none” of the the above price falls. Although this conservative approach enables us not to lose money, there are times in which we pull our hair out of our head. The 50% price appreciation to 525 dollars, ISRG made after the 353 dollars bottom in April after some good news is a good example of this. With only this idea, and some courage we could have increased our net worth 1.5 times in 1 year. But we have strict principles on which situations we should stay away from: Things that we can not predict with a high certainty.

Our Method of Operation

We are working under the principles of “Value Investing” *(please refer to The Intelligent Investor; Benjamin Graham, Security Analysis; Benjamin Graham, Common Stocks and Uncommon Profits; Philip Fisher, Annual Letters Berkshire Hathaway 1965-2012; Warren Buffett*). Our motto is “reasonable returns with safety of capital”. We invest in high quality, durable businesses when their price is “cheap” (when they are undervalued). We look at the investment business, as being a partner to a small portion of wonderful businesses. We are not playing the stock market game, but rather we partner with successful companies for the long term buying their stocks.

(1) Price follows profits.

We look at the stock investment business as being a partner to a company. We do the same things that you do while picking up a house, when we select a company to invest in. How much fixed income does it provide? (rent vs. dividends) Would it provide premium when we sell it in the future? How is its price compared to other houses (companies)? etc. The value of a company is determined by its future cash flows, the same way the value of a house is mostly determined by its rental income. Although the day by day “price” of a company deviates from its intrinsic value on a daily, monthly, yearly basis; the price of that company tracks its “net income” on the long run. The hard part of the business, on the other hand, is to see the future performance of a business, looking at its past performance. To do this we apply the the principles of value investors like Warren Buffett.

(2) High quality, safe, and fairly or undervalued companies.

We pay utmost importance to these three criteria while selecting a business to partner with. (a) *High quality*. What we mean by a high quality company is company in a prefarably consolidated[1] sector with high net operating margins/one that has “pricing flexibility”; one that has been increasing its revenues

[1] i.e. 1-2 companies dominating 40-50% of a market; VISA and MASTERCARD;or FEDEX and UPS. This helps us with the predictability.

and income consistenlty (so consistently that it may be labeled boring), in the last 5-10 or even 20 years at compounded rates we target for; one that is built on simple ideas. We want the company that we invest in, to have what value investors call a "moat" around its business model. (b) *Safe*. One of our most important rules is "Never lose money", the second is "Never forget the rule that says never lose money". We target for companies that has at least 10 years of operating history, and that are very likely to be around in 10-20 or even 50 years from now (Even if there is a war, like the Coca Cola company which survived 2 world wars). (c) *Cheap*. As equally important, we pay close attention to purchase these companies, when their stocks are cheap within a "margin of safety". We like to invest in perfect businesses when they are in a temporary crisis. We identify "value" looking at ratios such as "Price/Earnings" and "Price/Book Value" [2]. We know for a fact, that the price of a business, might at times be quite different from the intrinsic value of the business. Following this fact, we pay attention to not being influenced by the "madnesses" of the market, but rather use its "fears" for good buying opportunities.[3]

So, why is it this much important to buy a company when it is cheap? Let's assume we have a time machine in hand. We know for a fact that the ABC company, whose price change we present in the next table, is a company that is capable of increasing its net income by 20% annually, much like the Microsoft company did in the 80s. Assume that the fair value of this company is 100 dollars a share now. Also let the "price" of this company increase 20% annually (scenario in the first column) much like its value. On year 2024 the "price" of this company becomes 516 dollars, increasing **5** times. This is a 20% compounded annual growth.

Why fairly or undervalued?
The change in the stock price of ABC company under different scenarios
20%, 6%, and 30%

2015	**100.0**	**300.0**	**50.0**
2016	120.0	318.6	64.8
2017	144.0	338.4	84.0
2018	172.8	359.3	108.8
2019	207.4	381.6	141.1
2020	248.8	405.3	182.8
2021	298.6	430.4	236.9
2022	358.3	457.1	307.0
2023	430.0	485.4	397.9
2024	**516.0**	**515.5**	**515.7**

In another scenario, let's assume that, pretty much like "Facebook" nowadays, the ABC company is overvalued now, and is trading at 3 times of its intrinsic value at 300 dollars (Column 2). If the price of the company is again the same 516 dollars in 2024; our compounded annual gain falls from 20% to **6%**; when we buy ABC at 300 dollars and wait for 10 years. A huge performance loss.

[2] Please kindly see general Company Valuation approaches
[3] Please kindly see Graham's "Mr Market" analogy

In another scenario, let's now assume that a big crisis occurs in 2015, and the price of the ABC company is halved (Column 3). When the same company makes 516 dollars in year 2024, our annual gain has increased from 20% to **30%**. We scored an annual gain of 30%, by buying the stock at half price and waiting for 10 years by investing into it during a crisis, and increased our wealth by, **not 5, but 10 times**.

This is the very good reason that lies beneath why we insist on being "cheap"!

(3) Gold, oil, and other commodities.

Unlike, many professional investment consultants, we admit that we do not have the power to predict what the prices of commodities like gold, oil, or meat will be; especially in a matter of one, two or even six months (commodities that do not have any "productive value", or whose prices continously change according to demand-supply balances). *The only thing that we know and do right is to estimate, with a certain degree of confidence, the value of companies which generate cash flows, and whether the market over or undervalues these companies*. Therefore, we do not make, espcially our big bets, on commodities, or on stocks whose value is dependent on commodity prices (like companies which sell them).

(4) 15-20% annual performance (in USD).

Attaining compounded returns of 15-20% over periods of 20-30 years, is an ideal, yet very hard to attain target in the stock market investing business (doubling the money every 3.7 years). This rate of return is close to the growth rate of highly successful companies such as Coca-Cola, Microsoft, and Starbucks, when they were spreading their products throughout the world during the 80s and 90s. We head for 20% consistent annual returns, but would be delighted to attain a straight 15% for the next 20-30 years.

2014 Results

Four of our biggest (in terms of investment size) in 2014 ideas were on finance, banking, and technology. This year we continued to invest in the banking sector that we consider still as undervalued; as well as individual companies in the technology sector that we find cheap (those that live their own crises). The changes in the revenues, net incomes, and book values of the 4 top companies (in terms of investment size) that we invested in last year are provided below. <u>*All of the four companies are fastly increasing their intrinsic value (no matter how Mr. Market prices them nowadays).*</u>

1 and 3 year changes in the revenue, net income, and book value of the companies that we are invested in[4]

Visa		2013-09	2014-09	Change 1 year	Change 3 year
	Revenue ($)	11,778	12,702	%7.8	%38.3
	Net Income	4,980	5,438	%9.2	%49.0
	Book V./share	42.1	44.4	%5.3	%15.2
Wells Fargo Co		2013-12	2014-12	Change 1 year	Change 3 year
	Revenue ($)	83,780	84,347	%0.68	%-2.0
	Net Income	21,878	23,057	%5.39	%22.0
	Book V./share	28.8	31.6	%9.72	%15.0
Oracle		2013-05	2014-05	Change 1 year	Change 3 year
	Revenue ($)	37,180	38,275	%3.0	%7.5
	Net Income	10,925	10,955	%0.3	%28.2
	Book V. /share	9.6	10.5	%9.3	%33.8
Mixt		2013-03	2014-03	Change 1 year	Change 3 year
	Revenue ($)	127.3	120.0	%-5.7	%-9.1
	Net Income	13.9	14.3	%3.0	%7.3
	Book V./share	0.3	0.4	%40.3	%33.1

The American banking sector, which is still in the process of recovery, provided high returns this year like it did last year. Although many of the banks are still "undervalued", the profits that investors can attain after this time would be limited in comparison to the profits of investors who established positions in banking much before. We renewed our position in Wells Fargo Company this year, from which we exited last year to a large degree; and we held onto these shares for about 10 months. Wells Fargo's price appreciated about 57% in the last 24 months. The major disadvantage of having new ideas is that they replace other old good ones. Although not all, we turned a great portion of this 57% into profit.

Visa was a stock that we have been following for a while now, and its P/E ratio has fallen to low 20s this year, due to the "price fixing" allegations made against Visa and Mastercard by companies like Kroger, Safeway, and Walgreens. A related court case was finalized with a 6 billion dolar settlement. 67% of this settlement is being paid by Visa, and 33% by Mastercard. The market capitalization of Visa nowadays is around 161 billion dollars. Its net profit margin is around 50%, and despite its size it has been increasing its revenues by 13% in the last 5 years. Taking the depression in price as an opportunity, we invested a large portion of our equity in the company.

Some of our largest stock holdings whose "prices" fell or increased in 2014, and our associated realized/unrealized; gains/losses are given below.

Banking/Finance. 18.2% Visa, 13.1% Wells Fargo Company

Technology. 5.8% Oracle, -40.7% Mix Telematics

[4] Million dollars, last reporting period

Stock	(First) Buy	(Jan 2015)	Notes
Visa	46.2	65.1	We only bought Visa and never sold it. We hope to keep it for long. We might add to our position in case we see good opportunities in the future.
Wells Fargo Company	45.3	52.7	A banking stock we have been going in and out for some time now. The best managed bank in US according to Warren Buffett.
Oracle	36.8	44.3	Oracle was cheap for us and according to some other famous investors when its growth rate is taken into account. We sold in profit, but couldn't catch the 46.0 $ top.
Mix Telematics	12.0	6.4	We bought into this South African star when its price was down about 30%, however the price went further down. We might continue to invest in it not exceeding a certain proportion.

We made a -40.7% "pricewise" in one of our technology bets (thanks to the ZAR/USD exchange rate devaluation). We bought some of this "awareded" company when its price was down 30%, however the company which has been increasing its net income 25% annually (in terms of South African currency) in the past 5 years went down further more. If the exchange rate helps us we think the company might easily double or triple its net income in 4-5 years. If it does not we might think of not holding this position for too long.

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