

Personal Value in Valuation

This letter strikes a more personal note than the rest of the website, because valuation is truly personal to me. There are so many unique ways in which Confluence can help you and your family solve your complex financial needs. Expertise in business analysis and valuation is just one of our many differentiating factors. Please read on to learn more about how I developed a passionate pursuit for the study of valuation and how the skills that followed may benefit you.

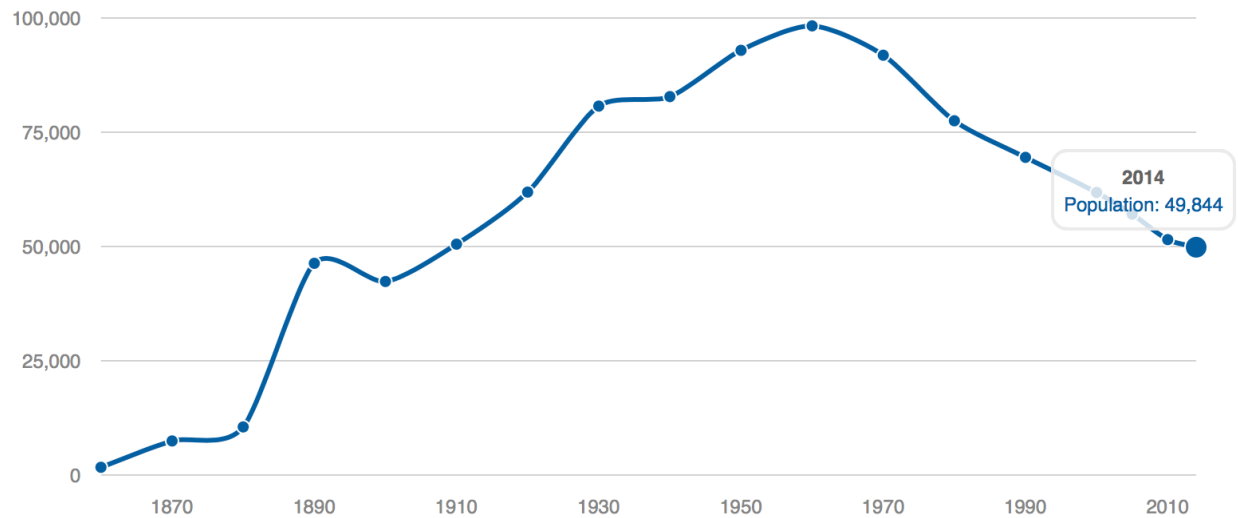
Valuation is just a number. How can that be personal? Investment literature is littered with stories, consistently advocating that successful investors must be able to separate emotion from investment decisions. Does anyone say it better than Warren Buffet?

*“Only when you combine sound intellect with emotional discipline
do you get rational behavior.”*

After all, it is human nature to over-emphasize the most recent data. For example, a sharp downturn in the stock market creates a sudden gut reaction for many - an impulse to sell, at the exact moment they should buy. A field of study has actually developed that is dedicated to such emotions, called behavioral financial. I firmly believe that a good investor is able to overcome such emotions when making investment decisions. I do not argue against Mr. Buffet or the conclusions drawn from behavioral finance – I believe their conclusions are sound. However, the point of my letter draws a distinction between the uncommon attribute of retaining “nerves of steel” when making unpopular investment decisions, versus possessing a passion to pursue the study of valuation itself. I believe there are a couple of early developments that led me down this path.

I grew up in a medium sized city in Michigan. The town and surrounding area thrived for many years, riding the success of the U.S. auto manufacturing industry. The dominance of the domestic players created a virtuous cycle of success for the city and state. Neighbors, friends, and relatives directly employed by the industry benefitted and their good fortunes lifted those around them. However, the past does not predict the future and prosperity eventually crumbled. The result was a slow, grinding decline into bankruptcy for two of the Big Three auto manufacturers (GM and Chrysler). It also left my city with half of its former population (1960-2014). For reference, the U.S. as a whole grew 76% over this same time period!

Population – Saginaw, MI (1860-2014)



Source: *Population.us*

The GFC (Global Financial Crisis) and numerous other contributing factors led to the demise of these companies and to my home town. Some of the other causes took much longer to unfold and included the complacency that developed from a lack of competition surrounding trade barriers, heavy reliance on a single industry, a combative culture between stakeholders (union workers for employers). Instead of taking a difficult and unpopular stand, management caved to union demands that they must have known would be unsustainable in the long-run. Just prior to bankruptcy, the “legacy costs” (costs for health care and the pensions of their retirees) for GM, Ford, and Chrysler amounted to about \$3,000 per vehicle. Maybe that is why GM was often referred to around those parts as “Generous Motors.”

These were difficult but value shaping experiences. In many instances, just taking the exact opposite approach is the best way forward. The lessons learned help to guide how Confluence is run, including the desire to create a true partnership with clients, the necessity of taking a long-term view for investments, and the importance of diversification.

I was lucky to have grown up in a family that owned and operated a family-run business - wholesale meat distribution (here come the Rocky Balboa jokes). As part of the 4th generation to have worked there, I witnessed firsthand the rigors required to run a business. This is also where many of the family values were passed on, including taking pride in your work, and that anything worth doing is worth doing well. It was hard work even for a young man (most of my time there was during my high school years). Loading and unloading trucks, at the warehouse and on the road, demanded heavy lifting and insanely long hours. My role was small in contribution to the overall business, but the rigorous physical exertion pushed me to want to do well in school.

During my time working there, a family member was “bought out” of the family business. It was a stressful and contentious process. Those who wanted to see change ended up paying a premium for it. It was at this time that I naturally started to wonder about value and how it can differ from price – witnessing how emotions can sometimes drive what should be a rational process.

Memories of the Family Business



Source: Shutterstock

Wanting to understand valuation and hoping to someday contribute to my family’s business were major factors to pursuing studies in finance and accounting during college. Adding to my interest was the rapid ascent of technology stocks during the late 1990s bull market. While these business school courses helped build a strong foundation, I was still lacking in real world application. I had an idea of how to approach valuation, but still did not “know” what the family business was worth. This led me to my first professional job, on “Wall Street.”

I landed what was at the time a dream job for me, working in the equity research department of the Swiss investment bank, Credit Suisse First Boston (CSFB). The job was to provide in-depth research to institutional buyers of stocks, mainly hedge funds and mutual funds. I targeted this position because the firm had the best reputation on “the Street” for valuation work, and it just so happened that it was the only firm open to hiring undergraduates for this role. CSFB provided semi-formal valuation training and introduced the book “The Quest for Value,” written by G. Bennett Stewart, and similar works by others. Some of the lessons learned were distinguishing what is a “quality” business, and the important of dissecting management’s presentation of accounting profits to derive an undistorted view of true economic profits.

Within CSFB, I joined a small team with a reputation for building quite large and very detailed spreadsheets that combined historic financial statements of publicly traded companies with our own projections, which fed into the firm’s valuation framework. With quality input, we came up with an estimated value for these businesses (with many assumptions of course, part of what is known as the “art” of investing). Committing to long hours and armed with lots of data,

the team's combined effort led to a rapid advance up the charts and culminated in a high ranking by our clients. It was at CSFB that I also began the pursuit of a CFA (chartered financial analyst) designation. The three-year program reinforced and expanded upon what I had learned through studies and work experience.

Over time, I have built a strong track record, consistently applying a value-based investment philosophy that emphasizes the analysis of businesses and people. This has served as a useful framework for evaluating the stock and debt of public and private companies. It has helped me to assess such items as management changes, restructurings, changes in competition, new product launches, regulatory and tax changes, international expansions, etc. The value-based framework has also proven helpful in the evaluation of real estate as well as in the selection of outside managers, such as hedge funds and private equity. To quote my former boss and mentor, Jeff Bronchick now with Cove Street Capital:

"Whatever the asset class, value-oriented investing remains the only intellectually viable investment philosophy that not only makes common sense, but also has a track record that has stood the test of time."

Rest assured that this common sense, value-oriented investing philosophy is constantly applied to your portfolio. Thank you for taking the time to learn more about Confluence Capital Advisors. I hope that you have gained an understanding of the passion and purpose I have for investing and serving my partners (clients).

Thank you,

Brett Cicinelli, CFA, CFP®