Capital Account

Special Situations and Value-Based Investing Opportunities

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Ryman is a unique collection of assets, managed by an experienced team, positioned for above average rates of earnings growth plus healthy dividend income… and if you like music they got both kinds, country and western!

Ryman Hospitality Properties

Situation: Unique asset portfolio on the cusp of a multi-year earnings cycle

Key Data:

Ticker: RHP

Market Cap: $2,400mln

Div Yield: 4.4%

EV/Ebitda: 11x (trailing)

Return Potential: 50%

Introduction

Ryman Hospitality entered the portfolio as a sizeable position during the quarter. You won't often read of the Grand Ole' Opry in an investment letter, but this is amongst a collection of assets owned by Ryman that we think makes it a unique and quite compelling investment. Ryman is a US listed REIT, have converted itself as such in 2012. Its status as a REIT requires the company to payout 90% of the income generated from their REIT assets in order for this income to be generated free of tax. In addition to the Grand Ol'e Opry, Ryman own 5 marque hotel resort destinations throughout the United States aimed primarily at the large-group travel market. Occupancy at their properties is naturally geared to group bookings and within that, corporate groups, providing a degree of cyclicality to the business. The resort style nature of their venues which on average contain around 2,000 rooms, means that visiting guests spend at least as much money outside the room on food, beverages, entertainment and events, as spent on the room itself. Their reported revenue per average room (RevPar) in 2013 was around $118, versus a total RevPar of $297. This was achieved with overall occupancy across their portfolio of just 70%, a figure that we think likely reflects a cyclical low point. In particular their Washington DC property, the "Gaylord National", saw occupancy decline by more than 3% in 2013, owing to the effects of government sequestration measures as well as the overhang of the 2012 Presidential Election. Occupancy was also impacted by the ongoing general malaise in corporate America, something we expect to gradually abate over the coming 1-2 years. We would expect to see occupancy peak in the low 80's before this cycle is over, which would drive very strong incremental profit for the company.

Having converted itself to a REIT in 2012, Ryman simultaneously transitioned the management of their properties to the Marriot Group. The longer term benefits of this action include expanded reach through the Marriot network, and reduced costs as staff are transferred from Ryman to Marriot. Like any transition of this nature however teething issues emerged in the way new systems and business processes are implemented, and have delayed the recovery in profitability for Ryman. The evidence though from recent reporting is that we are now starting to see the positive margin leverage flow through. In their second quarter 2014 the company delivered much stronger than expected margins, a trend that should continue as the cycle evolves. Our modelling suggests that with occupancy rates improving, driven by the growth in corporate demand, an absence of costs associated with the REIT conversion and stronger outside-the-room spend (a function of stronger mix of corporate bookings), Ryman can grow their cash earnings at a 15-20% over the coming 3 years. With Ryman's payout against cash earnings in the 60% range today, we would expect the dividend to growth significantly faster than cash earnings, such that over the next 3 years we expect to collect 15-20% of an initial investment in dividend income alone.

Then there is the grand Ole' Opry. In addition to their 5 hotel properties, Ryman is the owner of the Grand Ole Opry, one of the most famous live music venues in the United States, and widely known throughout the western world. The Opry's revenue streams today comprise ticket, ancillary merchandise, food and beverage sales. The Opry and Attractions business is already the fastest growth component of the Ryman business with sales growth averaging some 9% in recent years, and margins expanding. While the Opry business today has obvious merits, management we think rightly, are exploring the potential of this asset as a content generation engine. With hundreds of hours of star quality content being generated every year and a back catalogue of some of the finest stage performers in history going back several decades, the potential for this content stream to be delivered beyond a live seated audience holds much potential. In a world of rapidly evolving digital distribution, the potential for Ryman to look at ways of licensing content that is produced seems very real. We've no idea what this could ultimately be worth, other than to say it is much greater than zero, and would carry near 100% incremental margins. We liken it to the equivalent of expanding the seated auditorium from 5,000 seats to a multi-million seat stadium, with very little cost. One only has to consider the value of live sport rights to imagine the potential of such an arrangement. Once this opportunity has been developed it seems likely that management may look to spin of the asset to existing shareholders.

Summing it all up Ryman is an inexpensive, high quality collection of assets on the cusp of a strong earning cycle. We get to collect a healthy and rising dividend stream while the business begins to harvest some of the investments of recent years. Management have laid out a clear capital allocation program that prioritizes shareholders over expansion, and with the Opry asset retains some very interesting long term optionality over and above the core asset story. Ryman should and can trade in the mid to high 60's over the coming 1-2 years, and should give shareholders an additional 15 to 20% in dividends from current prices.

A Stock on the Move!

Amerco once purchased is conceivably a stock you may never have to sell, such is the dominance of their brands and durability of their model… you may even have been a customer at some point.

Amerco is a company few people seem to know, though it's likely if you live in the United States, over the past week you've seen at least one of their assets on the road. With no Wall Street coverage and a dominant family presence on the share register, it is company that flies under the radar of investors in spite of its long history. Founded in 1945 by 29 year old Edward Shoen, Amerco's primary asset is the 'U-Haul' do-it-yourself ('DIY') moving business. With over 18,000 locations across the United States it dominates competitive offerings, and with network density helping to drive market share, the model has an almost self-fulfilling tendency to it. That is, one is more likely to use a U-Haul self-drive vehicle as it offers the greatest convenience as far as pick-up and drop-off locations are concerned. The accretion of market share which follows drives margin dollars, further enabling network density, in-turn driving additional market share.

Amerco

Situation: Unique franchise, owner-managed and underfollowed

Key Data:

Ticker: UHAL

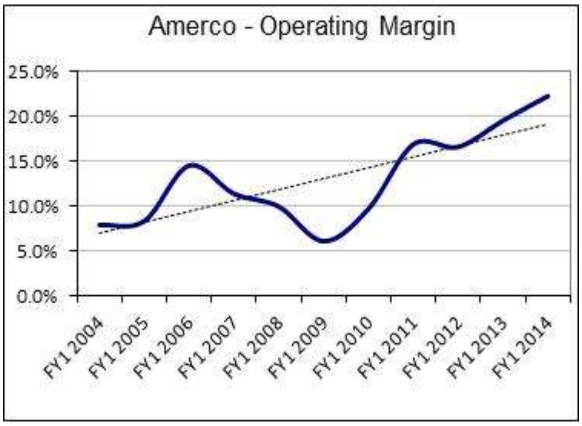
Market Cap: $5,300mln

Price/EPS: 13x

EV/Ebitda: 3.6x (trailing)

Return Potential: 45%

For over 60 years numerous well-financed competitors have attempted to enter the DIY moving equipment rental market and have failed on every occasion, unable to scale the power of the network that the U-Haul business has developed. The Company today have nine times as many hubs across the United States as their nearest competitor. In the year to March 2014, the company added 50 new company-owned distribution points, as well as 1,000 independent dealers to the network, bring total points of presence across the country to 18,940. The power of the Amerco model is evidenced in the two diagrams below with operating margins in the current cycle expanding to decade high levels and a long term history of steady sales expansion



In addition to its vehicle rental operations the Company own a self-storage real estate portfolio totalling some 38 million square feet. This too has been expanding along with the vehicle rental business with the company adding 2 million square feet of storage space over the prior 12 months. Around 30% of the Company's operating earnings are derived from its real estate portfolio and if these assets were converted into a REIT, would stand as the third largest self-storage REIT in the America. Publicly traded self-storage REIT's are valued in excess of 20x EBITDA. Just for fun, if we apply Public Storage's (PSA) market cap per sq. foot multiple (~$211mln) we would get a market value of around $8bn for Amerco's real estate portfolio. Amerco is valued at $5.4bn in total today, thus one gets a sense for the latent value of the self-storage portfolio. It's seem unlikely that the Shoen family would look to spin off the self-storage assets into a REIT, as fashionable as this has become, and with some 40% ownership of the equity the ball is largely in their court. Carl Icahn though may be interested in taking a shot at it.

Over the past few years management have adopted capital allocation policies that benefit shareholders, utilizing free cash-flow to pay down debt and to retire high cost preference shares. With its balance sheet lean and abundant cash generation, the company are well placed to repatriate excess capital back to shareholders. In spite of their impressive track record and the obvious virtues of the business model, Amerco shares can be acquired at a meaningful discount to the broader market at 13x forward earnings. We'd argue that over time, investors will come to reward this business with a valuation "premium" versus the overall market. This may take a number of years, but the long-lived nature of their assets and shareholder friendly actions of management suggest it will be worth the wait. Somewhat uniquely, we also view this as the type of business you may conceivably never have to sell, so long is remains prudently managed and reasonably priced. There are various ways of assessing potential worth here. A blue-sky sum-of-parts, with the real estate assets valued at something near to public REIT valuations results in crazy levels of upside, certainly well in excess of 100% above today's price. A more prudent view may be to use a multiple of 15x earnings, applied to a business generating a 27.5% ROE. In Amerco's case this yields an approximate fair value of $357/share, 30% higher than where we are at present. This multiple perhaps understates the durability of their franchise, for we know off many similar quality businesses that trade north of 20x earnings in the current market. Quite possibly this is a name you can own for yourself, your children and their children. A rare bird indeed.

Other observations….

One is drawn to the news that Stewart Grimshaw, firmly ensconced as CEO or Bank of Queensland, is leaving his post to take up a new role with Austin based EZCorp (EZPW). One wonders at the idea of this highly reputed business leader leaving the prestige of his current role to take up an Executive Chairmanship (read: hands-on) for a struggling pawn broking/consumer lending enterprise whose share price has fallen precipitously over the past 3 years.

Interestingly the best performing part of EZCorp's story over recent years is their 31% ownership in Australian base Cash Converters. It's also worth noting that EZPW is the "B"-class share, with all the voting rights being retained in the "A" share, controlled by former Australian investment banker Philip Cohen. Stripping out the value of cash converters, which is largely the same business model as EZPW, though somewhat more successful, EZPW trades at around 5.5x it current earnings. These earnings also look depressed relative to historic levels. Grimshaw's decision starts to look more interesting, and one can safely assume that he is not moving half way round the world for the salary or Austin's live music scene… as fabulous as this is. There are several permutations with Cash Converters, one of which might involve a reverse takeover of EZPW to install best practices there and dramatically expand their addressable market. Either way it is an interesting development, given EZCorp's recent share price development and valuation at just 1x tangible book equity. It might make for an interesting speculation at current prices. Let's see what unfolds.

What We're Reading….

Intersting article and books from recent reading

1. "Financial Indulgence: Cheap Credit is Tempting Emerging Markets Towards Risk Borrowing" – The Economist, 5 to 11 April, 2014 p. 65.

2. "Monetary Policy with Abundant Liquidity: A New Operating Framework for the Federal Reserve" - Policy Brief, Petersen Institute for International Economics, Joseph Gagnon and Brian Sack, January 2014 No. PB14-4.

3. "Global Financial Stability Report: Moving from Liquidity- to Growth-Driven Markets" International Monetary Fund, Washington, April 2014.

4. "China's Maritime Power Trip", Alan DuPont, The Weekend Australian, 24-25 May, 2014, p 16.

5. "Game of Thrones: How Airlines Woo the One Percent", David Owen, The New Yorker, 21 April 2014".

6. "The United States of Gas: Why the Shale Revolution Could Have Only Happened in America", Robert A. Hefner III, Foreign Affairs, May/Jun 2014, Vol. 93, No. 3 pp.9-14

7. "Briefing Amazon - Relentless.Com", The Economist, 21 June 2014, pp21-23.

8. "A Spy Among Friends –Kim Philby and the Great Betrayal", Ben MacIntyre, (2014)

9. "Voodoo Abenomics- Japan's Failed Comeback Plan", Richard Katz, Foreign Affairs, Jul/Aug 2014, Vol. 93, No 4. pp 133-141.

10. "The Risks of China's Internet Companies on U.S. Stock Exchanges", Kevin Rosier, US-China Economic and Security Review Commission, 18 June 2014.

11. "New World Order", Brynjolfsson, McAfee and Spence, Foreign Affairs, July/August 2014, Vol. 93, No. 4 pp 44-53.

12. "Taper Trouble – The International Consequences of Fed Policy", Benn Steil, Foreign Affairs, Jul/Aug 2014, Vol. 93, No 4. pp 54-61.

Capital Account,

Sydney, December 2013