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THE EUROPEAN VALUEINVESTOR

SPECIAL EDITION

INVESTMENT STRATEGIES BEYOND THE MAINSTREAM

»Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years.« *Warren Buffett*

Value Investors in Trani: 6th Value Investing Seminar in Italy

Once again Ciccio Azzollini, founder and CEO of Cattolica Partecipazioni S.p.A. invited investors from all over the world to a two-day conference on value investing in his home region of Apulia. This year it was held in Trani, 14/15 July.

The annual Value Investing Seminar organized by Ciccio Azzollini, founder and CEO of the Molfetta based value boutique Cattolica Partecipazioni, is a highlight in the European value investing community.

Over 100 attendees had travelled to Trani this year making the event one of the biggest and most important conferences on value investing in Europe. Top investors from the U.S., Europe and Brazil presented their strategies, current investment ideas and their opinion on the stock markets and the world economy. Among the speakers: Guy Spier (Aquamarine Fund), Whitney Tilson (T2 Partners), Lloyd Khaner (Khaner Capitals), Prof. Max Otte (IFVE GmbH) and others. Some ideas discussed in Trani are presented in this issue of EVI.

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Over 100 attendees in Trani 2009

Academic Study: Value anomalies for multi-dimensional strategies

The recent study on value investing anomalies in the European stock market by Dr. Gregor Elze, CFA confirms superior returns for more complex multi-dimensional value strategies.

Empirical academic studies have consistently found that value stocks outperform glamour stocks and the market as a whole.

In his recent study on value investing anomalies Dr. Gregor Elze, CFA evaluates single value strategies as well es sophisticated multi-dimensional value strategies that also include capital return variables and momentum factors.

His study extends prevailing research on existing value strategies and confirms the long-term outperformance of value strategies.

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Don Fitzgerald: Vicat

Strong pricing power, high barriers to entry, high cash generation – three characteristics of the cement industry in which Vicat operates as leader in South East France and one of the big players in Switzerland and California. Tocqueville Finance sees high potential in this company. EVI discussed the idea with Don Fitzgerald, Co-Manager of Tocqueville Value Europe Fund.

Don Fitzgerald, CFA Co- Manager of Tocqueville Value Europe Fund Tocqueville Finance S.A.

Don joined Tocqueville Finance in February 2007 as a Senior Financial Analyst and has been co-managing Tocqueville Value Europe (ISIN: FR0010547067, P Unit/ FR0010600239, I Unit) since February 2008, a fund, that invests in the stocks of European businesses with strong business franchises and strong balance sheets that are down in price, out of favour with investors and trading at a substantial discount to intrinsic value. Stock selection is bottom-up, conducted independent of market capitalization and is based on intensive proprietary research and a disciplined investment process.

He graduated from Trinity College Dublin in 1996 with a degree in Business Studies and German. From 1996 to 2003 he worked for Citigroup in Dublin, London, Frankfurt and Paris in structured finance, as a chemicals banker and as a telecoms banker. From 2003 to 2006 he was an investor in distressed debt for WestLB in Paris. He completed the CFA programme from 2004 to 2006 and is trilingual speaking fluent French and German. ■

EVI: How did you become a value investor?

Fitzgerald: I guess after a few beginner mistakes in my student days I bought a book on different investment styles.

Given I don't have a crystal ball and find it difficult to predict the future trends like macro investors do or read tealeaves like technical analysts try to, I naturally gravitated to the simple common sense of the value approach where you try to buy a euro of assets for less, ideally a lot less.

Then my career in credit and distressed debt investing was essentially all about cash flow, break-up values, identifying risks, minimizing downside and buying with a comfortable margin of safety. These are all core value tools.

EVI: Did you have any mentor?

Fitzgerald: Not really but clearly I've read several books by or about Graham, Buffett etc. I find it interesting to keep refreshed and stay immersed in the value world by going to events like the Value Investing Seminar in Trani and reading thoughts of proven value investors...people like Whitman and Eveillard and the like.

Finally, I've learned a lot from the wisdom of experienced colleagues in the credit world and at Tocqueville over the years.

EVI: Since 2008 you co-manage the Tocqueville Value Europe Fund. In which companies does the fund invest?

Fitzgerald: We are primarily investing in three types of undervalued stocks.

Firstly,
quality companies we understand whose intrinsic value is not fully appreciated by the market. By this I mean companies with unique & durable market position, a history of improving margins and return on capital employed, sound balance-sheets and quality management teams.

Secondly,
stocks which are undervalued in relation to their probable transaction value. These are often companies generating high cash flows, spin-offs, turnaround situations, stocks that trade at large discounts to the sum of the parts or companies with suboptimal capital structures.

Thirdly,
contrarian investments that are undervalued as they are out of favour with or forgotten by the market due to historically weak performance and a succession of profits warnings or illiquid and ill-covered companies.

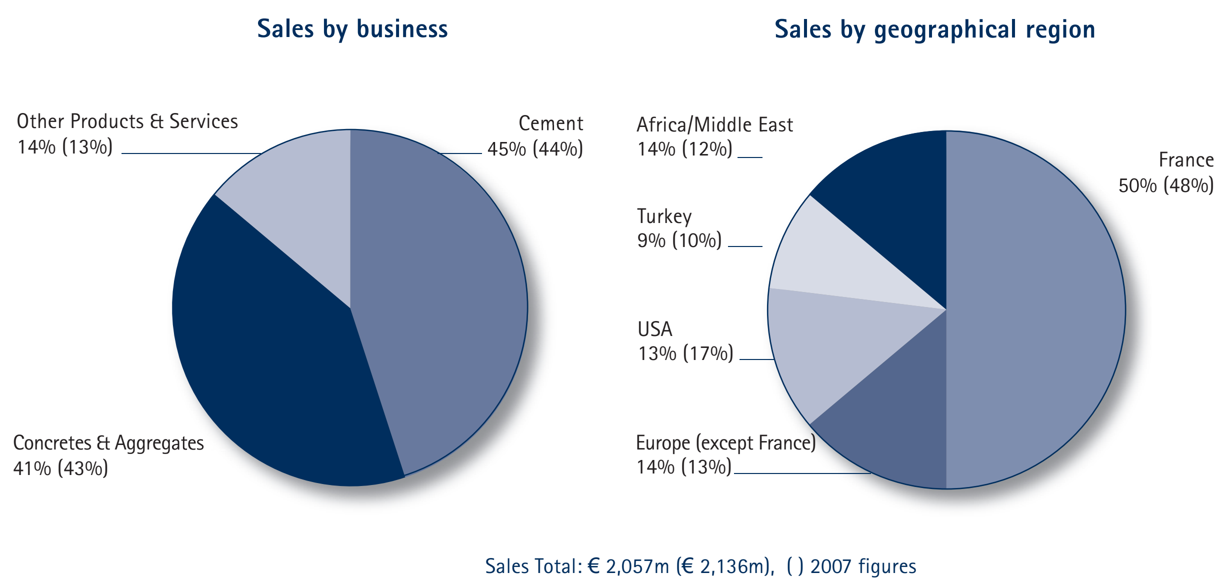
EVI: Do the other funds at Tocqueville follow the same strategy?

Fitzgerald: As Tocqueville is a value boutique all of the funds follow the value philosophy but with slightly different subthemes.

The French value funds are: *Ulysse*, an opportunistic value fund and the oldest fund of the company, *Tocqueville Dividende*, a dividend fund –and *Odyssee* a special situations fund. There is also a European large cap value fund – *Ithaque* and two US value funds.

EVI: How many positions are currently held in Tocqueville Value Europe? Is it a highly diversified fund or do you prefer concentration in the portfolio?

FIG.1 | VICAT – SALES 2008 BY BUSINESS AND GEOGRAPHICAL REGION



Source: Vicat homepage, www.vicat.com

The company is leader in South East France and has strong positions in Turkey, Senegal, Egypt and the mature markets Western Switzerland, California and South East of the United States. 50% of Vicat's sales is generated abroad. As a result of economic crisis 2008 total sales decreased by 3.6% to € 2,057m compared to 2007 (€ 2,136m). Weak economic conditions caused sales to decline in France, the US and Turkey. In Europe (except France) and Africa/Middle East consolidates sales increased. Sales breakdown by activities remains stable: More than 86% of its consolidated sales is in the Cement, Concrete & Aggregates businesses.

Fitzgerald: We currently hold ca. 60 positions. That is probably a little on the high side at present but we like to balance our convictions with a degree of modesty and as a 2-person team we tend to generate a large number of ideas and can follow more investments than a sole investor. Finally, the past has shown that our client base tends to prefer steady returns to more volatile movements.

EVI: At this year's Value Investing Seminar you presented Vicat (ISIN: FR0000031775) a mid-sized French-based cement company as case study. How did you become aware of that business?

Fitzgerald: It's a company that Tocqueville has followed for several years. I believe that our first investment in Vicat dates back to the late 1990s when large cap technology stocks were grabbing the headlines and Vicat had a €50m free float, with 95% of the stock then controlled by the family and Heidelberg Cement (ISIN: DE0006047004), and was not really followed by any sell-side analyst.

EVI: How is the competitive situation in which Vicat operates?

Fitzgerald: Like most players in the industry Vicat has integrated vertically into aggregates and concrete. The company's strategy is to use group cash-flow to strengthen its vertical integration, diversify from home base and increase exposure to faster growing markets. Vicat is leader in South East France and has strong regional positions in some mature markets such as Western Switzerland, California, South East USA and in a few emerging countries such as Western Africa, Egypt & Turkey.

"Vicat is leader in South East France and has strong regional positions in mature markets such as Western Switzerland and California."

Cement is largely a local business so we need to look at the competitive situation on a regional basis. The situation is fairly stable in most geographies where Vicat operates.

The French & Swiss markets are highly concentrated markets with 3 players in Switzerland and 4 in France and in practice the local markets Vicat serves are even more concentrated than the national markets.

For example, although no official statistics are available, we estimate Vicat may have a market share close to 50% in south east France. Concentrated markets like this, where all players act logically with high entry barriers are very attractive.

In Senegal, the company has unique access to limestone reserves needed for cement production resulting in an 80% market share.

EVI: And the situation in the US markets?

> **“We like the cement industry as it is cash generative with reasonable barriers to entry.”**

Fitzgerald: The US markets where Vicat operates are tougher as they are less concentrated and in particular in California some new capacity has been brought on stream by Texas Industries putting pressure on prices.

The Turkish market has had similar problems. The Turkish example is fairly typical of many emerging markets in that, although secular growth is strong, the markets are not as structured as in the developed world and overcapacity, boom bust cycles and irrational market behaviour are more common.

EVI: Why do you see in the stock? What makes the company attractive for value investors?

Fitzgerald: To begin with, we like the cement industry, a cash generative industry with reasonable barriers to entry that produces a basic necessity, currently going through a cyclical downturn. Furthermore, we like the company because it is a quality operator with proven management whose interests are well aligned with shareholders. It has a cautious growth strategy and a good portfolio of cash generative oligopolistic businesses and some fast-growing markets.

The element that the market has underestimated is the company's through the cycle earnings power and the sustainable earnings uplift from its investment programme. This is our principle variant perception, if you like.

Also, the company has a strong balance sheet which places it in a strong strategic position to acquire quality assets close to the bottom of cycle. And most importantly we like the stock as on our conservative valuation metrics we believe the company remains undervalued giving us a reasonable margin of safety.

EVI: Does Vicat have any franchise or sustainable competitive advantage as Warren Buffett always requires for his investments?

Fitzgerald: Cement is an attractive industry with strong pricing power due to barriers to entry that derive from ownership of quarries, capital intensity, high transport costs, control over import terminals (to block imports) and vertical integration into concrete (allows one to lock up part of client base). These barriers often results in concentrated industry structures or local monopolies with strong pricing power. The key competitive advantage of Vicat comes from its cost efficiency. It has continuously and in particular in recent years heavily invested in its production sites to ensure that they have a cost advantage over competitors.

> **“In each local market due to their lower cost production Vicat's margins are higher than those of its competitors.”**

When you closely analyze its margins you notice that they generally earn higher margins than competitors in each local market due to a lower cost, more energy efficient production base. So, when times are tough competitors may be obliged to mothball loss-making production sites and Vicat can continue to operate its sites and generate positive cash flow. To summarize, local monopolies confer strong pricing power and when combined with a competitive cost base, you have an attractive business.

EVI: How do you valuate the joint ventures Vicat has in Kazakhstan and India? What's Vicat's expansion policy?

Fitzgerald: Vicat's strategy is to increase the portion of earnings generated outside of its home base with an emphasis on faster growing markets. Management wisely eschewed making a big bet of on fully-priced acquisitions close to the top of the cycle unlike its larger French competitor Lafarge.

Instead, they focused on expanding production at existing sites in France, Switzerland, Senegal, Egypt & Turkey and finding interesting green-field opportunities. Two of those green-field projects are JVs in India and Kazakhstan.

In Kazakhstan their 1.1Mt cement plant is due to start operations in H2 2010. The country is currently very badly hit by the credit crisis but long term growth prospects are promising given its immense mineral wealth. The 5.5Mt cement plant in India, when completed, will be among the largest in world. The measured approach of the company is demonstrated by the two-phase process with cash generated from first half financing the construction of the second phase. 2.75Mt is due to start operations in 2012 and the balance a few years later. The Indian cement market is fragmented but MNCs are already trying to begin moves to consolidation. This market should continue swift growth due to demographics, infrastructure needs etc.

EVI: Where do you see Vicat's fair value? Why is the stock undervalued by the market?

Fitzgerald: We have valued the company using replacement value of the assets and earnings based metrics. On all measures it appears to be undervalued. For example the replacement value of the assets implies an equity value of ca € 60, it trades at an unjustified discount to the peer group, the free cash flow yield before expansionary CAPEX is ca. 12%, using transaction multiples it could be worth up to €75. The stock is probably undervalued for a couple of reasons - limited brokerage coverage & the free float was raised from 5% to 40% in only 2007 so it may not be on some investors' radar screens. But primarily I do not think the market has correctly taken into account the growth in sustainable earnings driven by its ongoing investment programme.

EVI: What do you think about Vicat's management?

Fitzgerald: Vicat management are good operators and a safe pair of hands in terms of capital allocation. As a family company they share the long term outlook of patient value investors. Interests are well aligned and they allocate capital with care and there are no funny option programmes or the like. They prefer to have growth self-financed and maintain a conservative capital structure (net debt is ca. 1.6x EBITDA). The efficiency of the operations can be seen in above average metrics in production per employee, ROCE and high use of alternative energy.

EVI: Are there any risks?

Fitzgerald: Of course there are and a large part of our job is to weigh up those risks. Related to the general macroeconomic risk of a prolonged deeper recession the risk of price deflation should not be overlooked. However, we think it is largely mitigated by the consolidated nature of the industry, the discipline of most players, many of whom are highly levered and focused on cash generation not fitting for market share gains.

Despite a severe recession capacity utilization levels for the industry are comparable to 1990s as the industry has delayed / cancelled many capacity additions. In the case of Vicat the only markets where price deflation poses a serious risk are the US and Turkey. In fact in all other markets the company has pushed through price increases this year.

Given the consolidated nature of the industry, one can never exclude antitrust investigations / fines and this has been an issue for the industry and Vicat in the past. Finally, CO_2 compliance costs could increase production costs although Vicat with its modern energy efficient production base would suffer less than many competitors.

EVI: The stock price is up over 40% since you presented Vicat in July. Is it still cheap enough to buy?

Fitzgerald: In our view it still trades below our estimate of its intrinsic value but given the value of the business has not really changed in the last 3 months the margin of safety offered by Mr. Market is clearly not as generous as it was on July 14th when trading around €40.

EVI: Thank you for the interview. ■

Contact:
Don Fitzgerald
Tocqueville Finance S.A.
8, rue Lamennais
75008 Paris, France
T: + 33 (0)1 53 77 20 36
F: + 33 (0)1 45 61 05 06
dfi@tocquevillefinance.fr

Note: The contents of this article are subject to the warnings and disclaimer found on page 39 of this issue of EVI.

VICAT SA
ISIN FR0000031775

Business: One of the worldwide leading producers of cement and concrete, market leader in its home market France, strong positions in Switzerland, the U.S, Western Africa, Egypt and Turkey.

Stock Information (10/10/2009):

Price:	**€ 56.72**
Price:	€ 56.72
52 Week Range:	€ 57.13 - € 24.76
Dividend Yield:	(2009e) 2.53%
	(2008) 4.01%
Market Cap:	€ 2,565 m

Financials (2008):

Sales:	€ 2,057 m
EBIT Margin:	19.10%
Net Margin:	11.90%

Valuation Metrics:

	Vicat	S&P 500
P/E	10.83	20.53
P/B	1.52	2.27

Institutional Investors:
60.60 % owned by Vicat family, other stock in free float

Intrinsic Value: ~ € 75.00

VICAT STOCK PRICE

INVESTMENT THESIS
As cement and concrete company Vicat is market leader in its home market of South East France and has strong positions in the mature markets Switzerland and U.S. as well as in the emerging markets Western Africa, Egypt and Turkey. Vicat's key competitive advantages is its cost efficiency. In every local market where Vicat operates its margins are generally higher than those of all competitors. As a family company its management shares the long term outlook of patient value investors.

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Contact Information
for all customer service,
subscription or other inquiries:

Zentrum für Value Investing e.V.

Zentrum für Value Investing e.V., Redaktion The European Value Investor, Aachener Str. 197-199, 50931 Köln, Germany
T: +49 (0)221 - 99 80 19-12, F: +49 (0)221 - 99 80 19-20, info@value-investing.net, www.value-investing.net