ValueInvestor INSIGHT
The Leading Authority on Value Investing
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Navigating the Grey Area

Markets often "shoot first and ask questions later," creating just the type of situation on which Centerstone Investors' Abhay Deshpande has learned to capitalize.

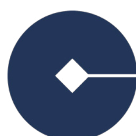
INVESTOR INSIGHT

Abhay Deshpande
Centerstone Investors

Investment Focus: Seeks companies whose business models, balance sheets or management quality hold prospective advantage underappreciated by the market.

After seven years as co-portfolio manager of the giant First Eagle Global Fund – during which time the fund bested its Morningstar-defined peers by 400 basis points per year – Abhay Deshpande at the end of 2014 was ready to go it alone. "Large organizations have a lot of positives, but investment decision-making can be more complicated than it should be," he says. "A more straightforward approach should be a competitive advantage over time."

Thus was born Centerstone Investors, which launched 18 months ago and where Deshpande is the sole PM for the firm's roughly $350 million in assets. Borrowing heavily from the playbook of mentor Jean-Marie Eveillard, he sees opportunity today in such areas as auto parts, grocery, energy services and industrial gases.



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Investor Insight: Abhay Deshpande

Abhay Deshpande, Zachary Dimmerman and James Hounsell of Centerstone Investors explain which industry "rolling bear markets" are attracting their attention, two keys they've found to investing in cyclical businesses, how they compare gold with bitcoin, and why they see attractive upside in Ahold Delhaize, Vopak, Air Liquide and O'Reilly Automotive.

You recently described value investing as operating in "the grey area where potential opportunity and potential impairment risk are more tightly bound than usual." That wouldn't appear to be such a comfortable place to be.

Abhay Deshpande: Which I guess is the point. It's not a comfortable place to be because you're typically surrounded by negative sentiment and headlines and beaten-down stock prices that may very well be justified from a long-term perspective. Individual industries regularly go through rolling bear markets above and beyond normal cycles. The key is to sort out the cyclical from the structural.

Industries such as retail, auto parts and grocery stores are today going through just such rolling bear markets, and the common thread boils down to the Amazon threat. I'm not at all downplaying Amazon's influence, but sometimes bear markets take the good with the bad. In these cases the grey areas are quite large and challenging to analyze, but that's often the best place to look for values.

Describe the typical type of company that attracts your attention.

AD: Our portfolios are generally split into two parts. The top half consists primarily of what we consider long-duration businesses with strong franchises, high free-cash-flow conversion, above-average returns on capital and low debt. In that category I'd put companies like Colgate-Palmolive [CL], 3M [MMM] or Air Liquide [Paris: AI]. We expect to hold these types of positions for the long haul.

There are only so many franchise businesses, however, so we also find value in companies whose industries are in turmoil or in a down cycle and earnings may be temporarily diminished. Here we're looking more at the closing of the discount to intrinsic value than the compounding of intrinsic value itself, and we're more likely to sell as soon as the discount goes away.

On the subject of value, we generally define intrinsic value as what a knowledgeable buyer would pay for the whole business in cash today. For franchise businesses that we expect to compound value at good rates, we might be willing to buy them at only a 10% discount to intrinsic value. For heavy cyclicals or hairier situations, we'd need a much larger discount and try to pay closer to 50 cents on the dollar.

ON PORTFOLIO MIX:

There are only so many franchise businesses; we also find value in industries in turmoil or in a down cycle.

You've historically and more recently found value in luxury-goods companies like LVMH [Paris: MC] and Richemont [Switzerland: CFR]. How do they fit?

AD: The luxury-goods space had been beaten up for the few years prior to the middle of last year, which is when we became interested. There were a number of concerns about things like the Chinese economy and online competition, and well-known industry players like Michael Kors and Ralph Lauren were struggling. Our view was that high-end luxury retail has proven to be a good business long term, where the stores are destinations unto themselves and the companies have better control over their brands, inventory and the selling environment. That's all important in an era when points of sale are fragmenting and constantly changing, so when we saw companies like LVMH and Richemont painted with the same negative brush applied to all retail-dependent companies, we saw that as an opportunity. The market doesn't like nuance, but sometimes the nuance matters.

At the other end of the luxury spectrum, why does something like industrial packaging company Sonoco Products [SON] find its way into your portfolio?

AD: This is a company I didn't know well, but as we started looking into it we concluded it was a lot better business than the market seemed to think. It's the dominant player in the U.S. in composite cans (for things like Pringles) and is the market leader for composite tubes and cores in the U.S., Europe, Mexico, Brazil and Canada. The majority of revenue comes from multi-year contracts with changes in input costs passed through to customers, and the customer base is stable due to pretty significant costs associated with switching packaging providers. We think it has a durable cost advantage from a vertically integrated supply chain and dense operating footprint, and management over time has proven to be good capital allocators, both in making small-scale strategic acquisitions and in increasing the dividend for more than 30 consecutive years.

Do I love the industrial-packaging business? Not really. But we thought this was a unique company trading at an attractive valuation. The stock [at a recent $53] is up nicely, but the company has spent close to $800 million on M&A over the past few years and we don't think we've gotten the payoff on that yet.

How do you approach investing in cyclical businesses?

AD: First of all, if we are going to invest in a cyclical business we're typically do-

ing it through the best player, by which I mean the lowest-cost producer. When the copper market went into a tailspin in the last few years, we found an opportunity in Southern Copper [SCCO], whose position on the cost curve we think makes it the most durable player. We don't expect to get the timing right on the cycle, but something like that we're comfortable holding while we wait because it will have the most staying power. I should add that Southern Copper on a relative basis was among the most expensive from a valuation standpoint in the industry. That's fine with us in such cases.

Second, the opportunity to us in cyclical businesses often comes from looking at the value of the underlying assets when everyone else is looking at cyclically depressed earnings. I've been following the potash fertilizer business for a few years now, as the industry went from being a cooperative oligopoly to an uncooperative oligopoly. Price discipline broke down just as lots of capacity started coming online, so earnings power for the big players like Mosaic [MOS] has been eroded.

Here we are positive on the long-term outlook for agricultural related inputs as people around the world upgrade their diets, driving demand to help bring fertilizer supply and demand back into balance over time. That could take a while, but we expect it to happen. With Mosaic, we run through a replacement-cost analysis and arrive at a net asset value of more than $50 per share, against a current share price of around $24. We know this isn't a franchise business, but we think the stock is too cheap.

With a lower asset base today is your portfolio tilting more toward the smaller end of the market-cap spectrum?

AD: At the moment we're roughly 60% in market caps above $10 billion, 30% between $2 and $10 billion, and 10% or so below $2 billion. We will take what the market gives us, but over time I'd expect to skew small- to mid-cap.

One type of opportunity we like are what I call "small but big" companies. They're relatively unknown due to their small market caps, but they have leading market shares and strong returns typically in a confined geographic area. A good example of that would be Matas [Copenhagen: MATAS], which is the largest health and beauty retailer in Denmark with approximately 40% market share overall and around 60% at the high end. Its size in the market gives it strong negotiating power with suppliers and lots of efficiencies in the supply chain, translating into good returns on capital and very high margins for a retailer. But in a country with only six million people and a market cap in dollars of around $450 million, we think it's just being overlooked.

ON "SMALL BUT BIG" IDEAS:

They're relatively unknown due to their cap size but have leading market shares and returns in a confined area.

Another similar example would be ICA Gruppen [Stockholm: ICA], the leading grocery retailer in Sweden with over 40% of the market, more than twice the size of its nearest competitor. It too benefits from procurement, distribution and other scale advantages, and also has a large pharmacy business that capitalizes on the grocery-store presence. It's a good franchise in an affluent country but the stock today trades at 15x trailing earnings and pays a 3.5% dividend. Something like this, especially given that the free float is roughly half the current market cap, would obviously be harder to own in size in a $50 billion portfolio.

Let's come back to some of your ideas under perceived Amazon threat. Retailers like Target [TGT] have been a minefield for value investors in recent years. Why are you taking a flyer on it now?

AD: In our "Amazon threat basket" we're focused on cash-generative companies with what we believe are good balance sheets, management teams and business models. Target has its challenges, among the biggest being food-price deflation over the past 18 months that has squeezed margins on the grocery side. Despite that, the company still generates considerable free cash flow and is investing heavily in building out its e-commerce capabilities. This is likely a transition year, but we think they're doing the right things to compete both with the Amazons and Wal-Marts of the world.

Of course you have to put all this in the context of how the shares are valued. When Target's stock traded down to $50 over the summer, that was well under 10x operating profit. Given that we believe there's maybe $1 billion in excess depreciation in that EBIT number, the stock was cheaper still. It's also important to us that the company owns the vast majority of its real estate, with free-standing stores not dependent on mall traffic. We believe the per-share asset value of that and the company's distribution center is not far from the current stock price [of around $61], mitigating our downside. I'm not making the case for retail in general, but see Target as a unique case worth the effort.

As is CVS Health [CVS] as well?

Zachary Dimmerman: We think the combination of CVS's pharmacy-benefits-management [PBM] business and its 9,000-plus pharmacies in local markets – the majority of the U.S. population is within three miles of a CVS store – give it unique assets that make competition from a new player like Amazon a challenging proposition. The store footprint is a high barrier in a market where consumers still have a strong preference to go to their local pharmacy and get their medications right away. On the PBM side, it's a complex business in which the three largest players control more than 70% of the market. Could Amazon take all that head on? Yes, but we believe it's unlikely.

What's your take on CVS's overture to insurer Aetna?

ZD: We're still processing it, but while we can imagine positives of adding a health insurer to the business mix, there would probably be a number of pretty stiff regulatory and operational challenges in integrating the two companies. Another big issue is that CVS would likely have to issue a lot of stock to do a deal, and with the shares trading at just over 9x EBIT the valuation is low enough that our per-share intrinsic value estimate for the combined company would likely go down. For the time being, we just don't think they need to do a deal like this to protect themselves from Amazon.

Describe your broader investment case for global food retailer Ahold Delhaize [Amsterdam: AD].

ZD: The company is a leading grocery retailer in the U.S. and Europe. Roughly 60% of profits are generated in the U.S., 25% in the Netherlands and the remainder in Belgium, Luxembourg and central and southeastern Europe. In the U.S. its big brand names are Stop & Shop, Giant, Food Lion and Hannaford and the company has the #1 or #2 share in most of its local markets. Market share in the Netherlands is 35%, twice that of its next largest competitor.

High local market shares and distribution scale are very important in driving unit volumes and minimizing costs in the low-margin grocery business. That was the impetus behind the merger of Ahold and Delhaize last year, and integrating the two businesses is expected to yield €500 million of net annual synergies by 2019. That's critical in the face of aggressive competition from below from incumbent discounters like Wal-Mart and newer discounters like Germany's Aldi and Lidl. Through the period of food-price deflation in the U.S. that started in 2016, Ahold has generally maintained margins and in many cases grown market share. We continue to monitor that at a local level: For example, in Charlotte, N.C., where Lidl has been aggressively expanding, Ahold reported 7% same-store volume growth in the most-recent quarter.

How do you handicap Amazon's entry into the business?

ZD: We actually don't view it as a major threat. Since it acquired Whole Foods earlier this year, Amazon has reduced some prices to bring them more in-line with direct competitors like Fresh Market and Sprouts. But Whole Foods' prices are still materially higher than Ahold's and the two companies really compete in different segments of the market. Also, Ahold's Peapod is one of the largest competitors in online grocery, has been at it for a long time, and is well positioned.

How attractive do you consider the shares at today's price of just over €18?

ZD: The overall expansion of grocery-store square footage is clearly a risk to this industry, but we think the market has overreacted in Ahold's case. We estimate normalized earnings before interest and taxes at around €1.80 per share, so the stock currently trades at only 9.5x EBIT on an enterprise-value basis. We think 11x would be more reasonable for a company with Ahold's market-share positions, strong balance sheet and low tax rate, which would result in a share price of

INVESTMENT SNAPSHOT

Ahold Delhaize
(Amsterdam: AD)

Business: Grocery retailer in the U.S., the Netherlands and other parts of Europe, operating under brand names including Food Lion, Giant, Stop & Shop, Etos and Delhaize.

Share Information
(@11/29/17, Exchange Rate: $1 = €0.84):

Price	**€18.11**
52-Week Range	€14.72 – €20.88
Dividend Yield	3.5%
Market Cap	€22.31 billion

Financials (TTM):

Revenue	€62.44 billion
Operating Profit Margin	3.7%
Net Profit Margin	1.8%

Valuation Metrics
(@11/29/17):

	AD	S&P 500
P/E (TTM)	20.3	24.5
Forward P/E (Est.)	12.7	19.5

Largest Institutional Owners
(@Most recent filing):

Company	% Owned
BlackRock	5.3%
Mondrian Inv	3.1%
Vanguard Group	2.5%
Norges Bank	2.0%
Deutsche Bank	1.9%

Short Interest (as of 11/15/17):

Shares Short/Float	n/a

THE BOTTOM LINE
The overall expansion of grocery-store square footage is a competitive risk, but Zachary Dimmerman believes that risk in the company's case has been overstated. At what he considers a reasonable 11x EV/EBIT multiple on his normalized estimates and assuming merger synergies of half management's expectation, he pegs intrinsic share value at €25.

Sources: Company reports, other publicly available information

€23. That includes no benefits from merger synergies – assuming half of management's expected €500 million in savings, our intrinsic value estimate would be €25 per share.

I would also add that we believe the company's balance-sheet strength – net debt is less than 1x EBITDA – materially reduces our risk on the stock because excess cash can be returned to shareholders. In addition to the current 3.5% annual dividend yield, the company could repurchase nearly 10% of its outstanding shares in 2018.

AD: As with Target, this is a company that highlights the vastly different perceptions of online and "non-line" companies in many industries. Companies like this that generate a lot of cash, with conservative accounting and managed by prudent, shareholder-oriented management teams are often tossed aside by Wall Street due to a supposedly certain future where all business is done online. So while it's endless storm clouds for the Targets and Ahold Delhaizes of the world, it's nothing but blue skies for online competitors. More likely, the outcome will be somewhere in between.

Explain the upside you see in another global Netherlands-based company, tank-storage leader Koninklijke Vopak N.V. [Amsterdam: VPK].

James Hounsell: Vopak's origins date back over 400 years and it is now the world's largest independent tank-storage company – for oil and refined products, chemicals, biofuels, vegetable oils and liquefied natural gas. The majority of the company's revenue is generated from the 66 terminals in which it has ownership stakes, located in space-constrained strategic trading hubs around the world such as Houston, Long Beach, Singapore and Shanghai. About one-quarter of revenue comes from dedicated pipelines that provide continuous product flow to and from customer facilities. It's capital intensive for Vopak and the customer to create that linkage, but once it's established it is almost impossible for a competitor to serve that customer more economically.

Price tends not to be the primary competitive variable in this business because storage costs are typically a very small percentage of the end-product value. More important to the customer are safety and reliability – storage providers must be able to safely blend, heat, cool and apply additives to what can be highly volatile compounds. Vopak has a long-established track record satisfying such customer requirements, which also gives it a significant leg up on the competition. All this translates into high margins – operating margins run around 30% – and very healthy returns on capital despite the fairly heavy capital requirements.

How cyclical is this business?

JH: Vopak primarily serves industrial customers such as refiners and chemical companies, where the demands for storage over time have tended to be relatively stable. Occupancy levels today of around 89% are relatively weak, though, and below the ten-year average of 92%. The primary drag there has been weak demand for fuel-oil storage, caused by what's

INVESTMENT SNAPSHOT

Vopak
(Amsterdam: VPK)

Business: Operator of tank storage facilities for oil, refined products and chemicals; capacity of 200 million barrels of oil equivalent is located in major global trading hubs.

Share Information
(@11/29/17, Exchange Rate: $1 = €0.84):

Price	**€35.47**
52-Week Range	€33.83 – €45.77
Dividend Yield	3.0%
Market Cap	€4.52 billion

Financials (TTM):

Revenue	€1.34 billion
Operating Profit Margin	29.5%
Net Profit Margin	22.2%

Valuation Metrics
(@11/29/17):

	VPK	S&P 500
P/E (TTM)	15.2	24.5
Forward P/E (Est.)	16.3	19.5

Largest Institutional Owners
(@Most recent filing):

Company	% Owned
OppenheimerFunds	4.3%
Maple-Brown Abbott	3.1%
Ruane, Cunniff & Goldfarb	3.1%
Vanguard Group	1.3%
Norges Bank	1.2%

Short Interest (as of 11/15/17):

Shares Short/Float	n/a

THE BOTTOM LINE
While occupancy levels at its tank-storage facilities are cyclically weak, the company's business over time has generated high margins and returns on capital, says James Hounsell. Assuming an 11x EV/EBITDA multiple on his normalized estimates – still a discount to recent private-market transactions – he believes the shares are worth at least €52.

Sources: Company reports, other publicly available information

known as backwardation in the fuel-oil futures market, which has the effect of increasing the cost of storage. The occupancy softness has depressed EBITDA this year, a key reason, we think, why the stock is so cheap.

Now trading at €35.50, how cheap do you think the stock is?

JH: The shares currently trade at just 8x depressed 2017 EBITDA on an enterprise-value basis. That's a significant discount to where private-market transactions have been done in recent years, which has been at closer to 12.5x EV/EBITDA. Vopak itself divested a number of non-core terminals in 2015 and 2016 for 15x, and we believe those terminals earned lower margins than the current assets.

For our base case we assume normalized occupancy of 91% and value the company at 11x EV/EBITDA, which equates to an intrinsic value of €52 per share. At the 12.4x median of recent transactions, the shares would be worth over €60.

You mentioned French industrial-gas giant Air Liquide as the type of business you expect to own for a long time. Why is it interesting today?

JH: Air Liquide is the world's largest industrial-gas supplier, serving a wide range of end markets including steel, refining, glass, electronics and health care. The strength of its business is rooted in its distribution capability – by truck or tanker, or through its massive 9,000-kilometer pipeline network. The distribution network allows for economical and reliable gas transport, the latter of which is particularly important to customers when the cost of unplanned downtime for a refinery, say, can be $1 million per day.

Customers' priority of reliability over cost increases their willingness to commit to long-term, take-or-pay contracts – usually for 15 years or more – that include the pass-through of raw-materials costs. On top of that, Air Liquide usually has trained engineers at customer facilities who are there to find ways to make product delivery more efficient and effective. All that increases customer switching costs and helps limit cyclicality – in the depths of the last recession Air Liquide's gas and services operating profit actually grew 2%.

There are a limited number of industrial-gas pipeline networks around the world and most are owned by one of four companies: Air Liquide, Air Products [APD], Praxair [PX] and Linde [Germany: LIN], which is being acquired by Praxair. The concentration of market share has kept competition rational and returns on capital relatively high.

We still believe Air Liquide will significantly surpass the $300 million of annualized synergies management projected in merging with Airgas last year. The combination also makes strategic sense. In the deal Air Liquide gained considerable packaged-gas distribution capability in the U.S., while Airgas can pull back significantly on having to source products from third parties. We'd argue that management was incentivized to downplay the deal synergies in order to win regulatory approval, and that the market isn't fully appreciating the ultimate benefits. To date, synergies have come in ahead of schedule.

INVESTMENT SNAPSHOT

Air Liquide
(Paris: AI)

Business: Leading global supplier of industrial gases, serving steel, refining, glass, electronics, chemical, food and healthcare customers in more than 80 countries.

Share Information
(@11/29/17, Exchange Rate: $1 = €0.84):

Price	**€105.70**
52-Week Range	€85.64 – €111.60
Dividend Yield	2.2%
Market Cap	€45.10 billion

Financials (TTM):

Revenue	€20.41 billion
Operating Profit Margin	15.3%
Net Profit Margin	9.6%

Valuation Metrics
(@11/29/17):

	AI	S&P 500
P/E (TTM)	22.7	24.5
Forward P/E (Est.)	20.2	19.5

Largest Institutional Owners
(@Most recent filing):

Company	% Owned
Vanguard Group	2.4%
Norges Bank	1.5%
BlackRock	1.4%
Amundi Asset Mgmt	1.2%
Lyxor International	0.8%

Short Interest (as of 11/15/17):

Shares Short/ Float	n/a

AI PRICE HISTORY

THE BOTTOM LINE
The company's global industrial-gas transport network is a unique asset that makes it a "toll-booth-type" business, says James Hounsell. He doesn't believe that quality is fully reflected in the company's stock, which trades at a roughly 8% discount to his estimate of intrinsic value and which he believes can compound at a high-single-digit rate long-term.

Sources: Company reports, other publicly available information

With the shares at a recent €105.70, how are you looking at valuation?

JH: Given the company's excess depreciation and low tax rate, we think 17x normalized EBIT is a fair valuation for such a high-quality business. On our estimates that translates into an intrinsic value of €115 per share.

While the discount to intrinsic value isn't that high, we expect the company's stronger U.S. presence and meaningful exposure to emerging markets to drive top-line growth at 1.5x to 2x the rate of global GDP growth. With operating leverage and higher Airgas synergies than expected, we believe intrinsic value here can compound at a high-single-digit rate over the long term. In today's market, we'd be perfectly happy with that.

What to your mind insulates auto-parts retailer O'Reilly Automotive [ORLY] from new competitive challenge?

ZD: There are some key attributes of O'Reilly's business that we think protect it from online competition. Its do-it-yourself customers, which account for nearly 60% of total revenue, tend to shop in-store where trained staff provide guidance tailored to a particular repair job. O'Reilly's extensive store network – approximately 5,000 stores across 47 states – also doubles as a distribution channel serving its professional customers, who generate the balance of the company's revenues. O'Reilly can deliver many parts to those repair-shop customers in less than one hour, which is exactly what they want in order to keep their revenue per service bay up while limiting inventory investment. Overall, the level of service O'Reilly provides won't be easy for an online competitor to match. It's a different market than selling books or pet food.

Where are we in the business cycle for aftermarket auto parts?

ZD: O'Reilly's core market is for vehicles older than six years, after most manufacturer warranties have expired. The business today has therefore been negatively impacted by the weak pace of new-vehicle sales in the U.S. from 2008 to 2011. Through the first three quarters of 2017, comparable-store sales grew only 1.5%, down from an average of about 6% over the last three years.

While we may have another year or two of constrained revenue growth, we generally consider this a growth industry, driven by vehicle manufacturers' engineering improvements that are extending the useful lives of cars and trucks. In addition, we should see incremental improvement as the worst part of the post-crisis auto cycle has lapsed and the doubling of new vehicle sales since 2009 provides a tailwind for aftermarket-parts demand. Finally, an additional source of growth for O'Reilly is continuing to take market share from smaller, independent competitors. The top ten auto-parts retailers still only account for 50% of the U.S. market.

Even after a recent pop, the shares at $236.30 are down 18% from their August high. What do you think they're worth?

ZD: Based on industry transactions and our own sense of what's reasonable for

INVESTMENT SNAPSHOT

O'Reilly Automotive
(Nasdaq: ORLY)

Business: Automotive aftermarket parts retailer with nearly 5,000 stores located across the U.S. that serve both do-it-yourself and professional-service-provider end customers.

Share Information (@11/29/17):

Price	**236.32**
52-Week Range	169.43 – 286.57
Dividend Yield	0.0%
Market Cap	$20.80 billion

Financials (TTM):

Revenue	$8.77 billion
Operating Profit Margin	19.6%
Net Profit Margin	12.2%

Valuation Metrics
(@11/29/17):

	ORLY	S&P 500
P/E (TTM)	20.7	24.5
Forward P/E (Est.)	18.0	19.5

Largest Institutional Owners
(@9/30/17):

Company	% Owned
T. Rowe Price	8.0%
Vanguard Group	6.6%
BlackRock	4.9%
State Street	4.1%
Polen Capital	3.0%

Short Interest (as of 11/15/17):

Shares Short/Float	5.6%

ORLY PRICE HISTORY

THE BOTTOM LINE

After a recent pop in the share price the company's stock trades at Zachary Dimmerman's conservative estimate of its intrinsic value. But he believes secular industry growth, market-share gains and operating leverage can drive at least high-single-digit compound growth in that intrinsic value over time. "In today's market," he says, "We'll take that."

Sources: Company reports, other publicly available information

a business of this quality, we apply a 13x multiple to our estimate of normalized EBIT and arrive at an intrinsic value estimate of right around today's share price. As with Air Liquide, though, we believe intrinsic value can compound at least at a high-single-digit rate for a long time – from mid-single-digit revenue growth, continued operating leverage and the return or redeployment of excess cash flow. Again, in today's market we'll take that for what we think is a durable growth business that isn't as vulnerable to competitive incursions as many investors seem to think.

You appear to have brought Jean-Marie Eveillard's penchant for gold along with you. What role or roles does it play in your portfolio?

AD: I consider it a hedge against uncertainty, and by that I mean uncertainty related to currency levels more than anything else. I don't believe gold is a reliable hedge against falling equity prices, but it has been a pretty reliable hedge for the U.S. investor over the years against dollar weakness.

We have 5% of the portfolio in the gold ETF, ticker symbol GLD. We will also if it makes sense hold physical gold. But one thing I'm not doing at Centerstone that we did at First Eagle is hold gold-mining stocks. Based on experience, I think gold equities would conflict too much with my message that we're trying to invest only in lightly levered businesses with good management teams.

ON BITCOIN:

Who knows? It could be the next big thing. For my investors I think I'm going to stick to what I know.

People make the case that bitcoin may one day supplant gold in many investors' portfolios. Could you imagine that?

AD: There are some similarities to gold. Bitcoin, like gold, has scarcity value and there is a marginal cost to produce it. That should provide somewhat of a self-correcting mechanism to the price, although that's not particularly evident at the moment. I've read that the cost to mine a bitcoin – the main inputs being computing power and the cost of electricity – is today around $2,600. With the price around $10,000 you can imagine there's a ton of computing power being applied to mine more of it.

The idea of bitcoin becoming a currency I have a harder time with. A currency is a means of exchange and you can't have a means of exchange increasing or decreasing in value by 10% every five minutes. If it's not a currency, what is it? I guess it could be a store of value, but again, the price volatility makes that a pretty dicey proposition. So if it's not a store of value, what is it then? To me it just seems like a speculative instrument.

Who knows? It could be the next big thing. For my investors I think I'm going to stick to what I know. VII

Centerstone Investors is a New York-based, investment management firm founded and led by Chief Investment Officer, Abhay Deshpande. Centerstone is an investment advisor registered with the US Securities and Exchange Commission. Launched to provide our clients with a nimble and flexible, value-oriented investment approach offering niche investment vehicles. We are heavily focused on the fundamental analysis of businesses. The Firm is privately owned and we pride ourselves on our 100% employee ownership culture, creating alignment with our investors.

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