

John Huber, Managing Partner

(919) 610-6809

john@sabercapitalmgt.com

www.sabercapitalmgt.com

February 9th, 2024

Saber Capital Management: 2023 Yearend Investor Letter

Dear Investment Partner:

Our next Saber Zoom call will be on February 28th at 11am ET. We'll send out a link in a separate email as we get closer. Please join us live. I always enjoy these calls and I look forward to any questions you have. Please feel free to email me over questions in advance if you'd like and I'll do my best to fit as much in as we can.

In 2023, SCP gained 49.7% and SCP II gained 45.5%. Please see the attached statement for performance history and portfolio holdings.

Charlie Munger said the "secret algorithm to life is to do more of what's working". As I wrote about last year, after spending time reviewing past investments including some great wins as well as my mistakes, I concluded that what works best for us is focusing on durable companies with a long history of consistent earnings at low valuations. I call these **base hits**, or high probability investments. I think we have a number of them in our portfolio, which I'll outline below.

Current Market Conditions — Growth Engine Firing

Stock price growth comes from 3 possible places:

- **Growth of the business**
- **Change in the valuation** (e.g. change in P/E multiple),
- **Cash that we get from the company as a dividend or buyback** (which has a similar effect to a reinvested dividend)

Value can come from any one of these three places, but in recent years the growth engine has become the one that investors seem to be focusing on above all else.

As I write this, Costco trades at 48 times earnings! A wonderful company without a doubt, but I don't believe a wonderful stock from this level. Let's assume Costco grows at the same 10% rate it did last decade (no easy feat given that its \$250 billion in sales is much larger now than 10 years ago). Even at that same growth rate, if COST trades at a more reasonable (but still historically high!) level of 24 P/E in a decade, shareholders in 2034 will have earned a meager 2.6% CAGR from today's levels — and less than 4% annually including dividends.

I think Costco is the 2024 version of Coke from 1998. Buffett lamented not selling Coke when it reached these levels of near 50 P/E, as Coke stock experienced a sharp decline over the next few years and needed 16 years to get back to its 1998 high. The business meanwhile continued to do

quite well, but the stock went nowhere for 16 years. I fully expect Costco as a business to do quite well. I'm far less confident in the stock.

However, this emphasis of the growth engine has created an interesting opportunity to find value in companies outside of the largest portions of the market — the parts of the market where the growth engine might be more modest but the capital return engine (thanks to very low valuations) is firing on all cylinders: **a stock with stable earnings that trades at a 20% FCF Yield and requires no capital to run its business is going to compound at 20% per year**, even with no growth and no increase in the P/E ratio.

I think we have a few investments where the capital return engine is firing, and I even expect some modest growth over time.

Portfolio Highlights

Going forward in these letters, I'm considering highlighting our new investments and updating a few of our key investments using what Peter Lynch advised: a stock should be explained in a few brief sentences that a 5th grader could understand. My kids are in 3rd grade and so I have a couple years to hone this section of the letter, but in the meantime I'm open to your feedback. As the LP, please let me know what you'd like to know. If you prefer longer form analysis, I still plan to write deep dives on most our investments on [Base Hit Investing](#), our blog. For these letters, I hope to avoid Mark Twain's excuse: "I didn't have time to write a short letter so I wrote a long one instead".

Here's a summary of some core investments I'm excited about:

(please note portfolio weights will vary between the funds and our separate account clients depending on timing of inflows, outflows, and other factors)

Natural Resource Partners (NRP): 21% position in our portfolio

- Royalty business: owns 13 million acres of mineral rights plus a half interest in a valuable soda ash business with 50 years of reserve life; trading at a 25% FCF yield; earnings currently used to pay down debt, which is now low and should be gone within 4-6 quarters, at which point the FCF yield should approximate the dividend yield. NRP also has renewable energy potential earnings through leasing their acreage for wind, solar, geothermal and carbon sequestration — none of which require any capital from NRP
 - [See writeup here](#)

First Citizens (FCNCA, FCNCB): 9%

- Top-tier quality bank that has compounded at 15% for over 30 years.
- Run by 3rd generation family; conservative balance sheet with lots of excess cash. Family/management owns \$3 billion worth of the stock and have bought more recently.
- FC bought Silicon Valley Bank from the FDIC for 5 cents on the dollar!
- Trades at 7.5 P/E and mgmt will resume buybacks this year (they bought back 9% of their shares in 2022). I believe they can earn \$250 per share in the next 3-5 years and probably gets revalued at a more typical 12-14 P/E for a very high quality well-run bank, a value in excess of \$3,000 per share. With the stock at \$1480 currently, I think we have a nice margin of safety.

- [See writeup here](#)

Cinemark (CNK): 7%

- I think movies are much more stable than the market currently seems to think; all the major studios (except Netflix) have retrenched around putting their movies in theaters before sending them to streaming. They realize the facts: movies in theaters earn higher returns, create buzz, and help build valuable franchises. The marketing value of releasing films on the big screen is huge — see the Barbie and Oppenheimer phenomenon last year as an example, which happened to be the biggest box office month ever (a sign that theaters aren't dead).
- \$309m FCF last 12 months: that's \$2.50/share; stock is \$14.50 (5.8 P/FCF). The stock is cheap because of low growth (remember the capital return engine!) and also because of the Hollywood Strikes that will slow the 2024 slate. But I expect CNK to earn more than \$3 per share next year in 2025 as the box office continues its recovery.
- My pitch to Cinemark's management and board (hopefully this spring in Dallas) is to buy back shares instead of paying the dividend. I think they could end up cutting share count in half over 5 years, which means \$6 FCF/sh instead of \$3. At 10-12 P/E, that's a \$60-72 stock vs just \$14 today.

Medical Facilities (DR.TO or MFCSF in US OTC): 6%

- Owner of 4 hospitals; stock trades at 8 P/FCF, buying back shares; mgmt is open to selling; possible sales of similar hospitals indicate a value possibly worth 2x current price and in meantime we get a 12-13% buyback + dividend yield
 - See mid-year 2023 letter for more thoughts; will add a post on this company in the future as well

Small Banks: Citizens Trust (CZBS) and Mid-Southern (MSVB): 5% total

- CZBS: 5 P/E; 40%+ total capital ratio; buying back shares
- Recipient of ECIP funds (see last letter for more details; a future blog post will dive deeper)
- MSVB: a liquidation of the holding company that should range from a cash payout of \$15-\$17; Based on my research, I think the cash assets at the holding company might be overlooked and I believe we may see the high end of this range, which would offer a 26% return from our \$13.50 purchase price
- MSVB is a workout; CZBS is what I expect to be a long term holding. I've spoken to both CEO's and have met with the board and various employees of CZBS, a bank that has been around since 1921 and has been profitable in 100 of its 102 years (including each of the past 30).

Preferred Share Basket: 6%

- We have a small collection of preferred shares yielding an average of 11% on our cost. These stocks are materially undervalued in my view. The companies underlying these stocks have investment grade credit and one company even has other preferreds currently yielding 6% in the same spot of the capital structure as our 11% preferreds, providing evidence of this mispricing.

- They are “fixed-to-floating”, which protects us if interest rates rise. If rates fall, we have a large margin of safety between 11% current yield and what I think these are worth (roughly 6%); plus our shares — like most preferred stocks and bonds — will likely rise as rates fall
- A majority of these stocks are attached to one high quality company with lots of excess cash, strong earning power, and a long history of rising profits. We bought this group at a 33% discount to par value, suggesting 50% upside for our investment if the company decides to redeem these shares. I view redemption as somewhat unlikely given the small dollar value (a positive for us given the dividends we receive are very well covered, but also making it less likely the company cares to refinance these given the small dollar amount).
- I've spoken to the company about the valuation and they agree that these securities are mispriced. They have a buyback in place to buy these in the open market, but the stocks are too illiquid to make a meaningful investment.
- Saber rarely has employed any debt to fund investments, but given the safety I see in these preferred stocks, the contractual-like cash flows, and the relatively uncorrelated nature of these investments, I chose to borrow a modest amount of money at a 6.3% interest rate to fund the purchase of these stocks, whose 11% dividends more than cover our cost of funds. Our partnership is modeled after the Buffett partnerships in fee structure, but also in portfolio approach, and one thing Buffett did with his portfolio is fund what he called “workouts” — uncorrelated arbitrage investments — using a small amount of debt. I view our assets as akin to owning a quality piece of real estate funded with 90% equity and only 10% debt — an overly prudent use of funds that I think will add value. Our separate account clients mostly don't have the capability of using leverage and thus the investment of this preferred basket is much smaller.
- **I like this investment: I view the preferreds as safe, attractively priced with 11% yields and a possibility, however remote, that we get a 50% gain should they redeem.** Getting a nice 11% yield while we wait is not a bad outcome.

These investments represent **54% of our portfolio and are not just very cheap but have an under appreciated quality**(notice the high returns on capital):

	% of Portfolio	P/E	ROIC
NRP	21%	3.7	62%
FCNCA	9%	7.5	14%
CNK	7%	5.7	15%
DR	6%	8.1	13%
CZBS	5%	5.7	12%
Pref Basket	6%	9.0	N/A

I define ROIC has the current earning power divided by tangible capital employed (tangible assets including the operating leases less current liabilities). For banks, I'm using ROE.

Viewed collectively, this is a very high quality investment with a lot of value:

Weighted Average P/E Ratio	5.9
Weighted Average ROIC	31%

The P/E ratio above should really be thought of as distributable free cash flow (owner's earnings). In other words, we're getting around a 15% weighted average yield on this basket. The valuation discount comes from unique situations at a few of the companies where dividends have not yet ramped up (I expect NRP and CNK to begin paying dividends by next year; and FCNCA has announced buybacks will resume this year). The others are currently buying back shares and/or paying dividends (CZBS bought 11% of their shares last year and DR has retired over 20% of its shares over the last two years; both pay dividends as well).

I am finding more and more opportunities currently, and I'm excited about our fund's prospects over the coming years given the undervaluation I see in our portfolio.

Management Conversations

I've had a number of productive conversations with management teams, and I believe even have helped guide some subtle changes in capital allocation at a couple of our investments (in a friendly, cooperative, and suggestive manner — I have no interest (nor capability for that matter) in operations or in telling management how to do their jobs. Saber invests with management teams that are already operating at a high level and who we think are equal parts rational, honest and capable. Any comments we might suggest will be strictly on capital allocation of excess free cash flow, and a few conversations so far have given some evidence that this could prove to be a very nice benefit for our fund over the long term.

Other Core Holdings

I won't highlight every stock in every letter (as there is no need), but to complete the portfolio picture, here are our other core holdings (at least 5% positions):

- **MSFT:** this investment has done well for us, doubling in 4 years but still producing remarkable fundamental results: earnings grew 33% in the most recent quarter and operating profit margins have reached 47%. Enterprise spending on software, cloud, and now AI seem to have a lot of runway ahead
- **JPM:** best management and best balance sheet of the big banks, with 18% ROE and still only trading at 10 P/E, despite a 50% rise over the past 18 months
- **FND:** coffee can stock for the next decade; steadily taking market share as the largest player in a very fragmented industry with small competitors; run by Home Depot executive running the same playbook in flooring; will see ups and downs with economic cycles but a long runway ahead
- **CPRT:** huge moat with barriers to entry and network effects; dominant company in auto salvage with growth potential to use their auctions to sell other used cars outside of salvage
- **Homebuilders (NVR and PHM):** these were surprising winners for us in 2023, up 45% and 112% respectively; both continue to buy back lots of stock (PHM retired 9% of its shares last year and continues to move toward NVR's capital light model); builders are providing supply to a very supply constrained housing market, and though I expect ups and downs as with FND in housing, I think these companies have a long-term tailwind as we need more homes, and I expect these two companies to have more profits and far fewer shares a decade from now

We also maintain smaller positions in Google, Visa and Amazon, though we've begun trimming the latter two to fund some of our other investments mentioned above. I love all these businesses, but

Amazon at 85 is much different than Amazon at 170. To squeeze one more Charlie Munger quote in: “investing is not about picking the fastest horse; it's about picking the horse with the best odds”.

The odds have changed with some of these stocks, and while I still expect great things from all of these companies, we will keep the portfolio positioned in what I think is collectively the best return at our **desired level of risk (read: very low)**.

We saw what can happen to extended valuations of even great companies in the 2022 downturn, and while avoiding volatility is impossible in stocks, giving some attention to extended valuation levels fits nicely with my risk averse nature and you should expect more of this occasional rebalancing.

I expect our current crop of investments to be in the portfolio for years to come, and some (such as NRP and FND) I hope to be holding a decade from now.

Summary

My family — including parents, in-laws, siblings, and other family members — have significant portions of their net worth invested with Saber. As always, Amy and I have the vast majority of our net worth invested alongside you as well. This is a family partnership and it is managed as such — in a way that I believe will yield the best results with a minimum of risk over the long run.

I truly appreciate my partnership with all of you. Thank you for the opportunity to manage your hard-earned capital. I feel compelled to let you know how important this is to me and I give it my utmost effort to ensure that we'll achieve our goals over the long term.

Admin Notes

Maureen Murphy retired last year. Maureen will be missed, but Remi Huth has taken her role and has done a fabulous job for us. Please reach out to Remi with any questions, as she'll be handling the administrative functions that Maureen handled previously.

For those with IRA accounts in the fund, Millennium Trust recently changed their name to Inspira Financial. I have the same team at Inspira, with Tom Kurinsky helping onboard our IRA investors and he's always there to answer questions as well.

Zoom call: please save February 28th at 11am ET if possible. I look forward to discussing your questions live. Please feel free to email me questions in advance if you'd like and I'll try to cover as much as we can.

As always, feel free to reach out to me with questions.

Best,

John