

Holland, David & Larsen, Tom – Beyond Earnings*Wiley Finance*, 2008, [Finance] Grade ★★★★★

I have been an avid HOLT™-user since 2000 when I was first introduced to the company during a valuation seminar. So this review comes with the appropriate disclaimer of a happy customer. To me, HOLT has been like the sensible, objective and accomplished value investor that acts as a speaking partner and also brings consistency to an investment process. The HOLT application is about comparability between regions, sectors and companies over time, making it useful both for valuation work and screening but also as a preparation tool for company meetings as it boils down the capital allocation prowess (or the opposite...) of a company over time.

The authors, David Holland and Tom Larsen both have extensive experience within HOLT. Mr Holland remains a managing director of Credit Suisse – which bought HOLT in 2002 – whereas Mr Larsen has since moved on. Originally this book was part of a larger effort by Jan Viebig et al, whose *Equity Valuation: Models From Leading Investment Banks* was published in 2008. And the authors do accomplish the difficult task of guiding the reader through what HOLT is, the differences between the HOLT-profitability metric CFROI and its subsequent cousin EVA™ (Stern Stewart, 1991) and last but not least – a step-by-step example of the methodology by using Vodafone as a “guinea-pig”.

As a staunch believer of the theory that a company’s decision to fund revenue-gathering via its own balance-sheet (i.e. Tesco owning its stores) or on somebody else’s (i.e. H&M leasing its stores) should not in any way impact a company’s true cash flow returns, I find the part about correcting accounting measures into a true gross investment base especially rewarding and providing immense value to users. Behind the convenient summary-charts of real cash flow based returns lies a painstaking effort not performed by other market participants. The answer to the question “Why does HOLT perform so many adjustments to numbers” should actually be turned on its head.

Henrik Andersson, October 11, 2013

The first questions to companies ought to be “why do you adjust your numbers so much”?

What is perhaps easily forgotten is that HOLT has been in use for over 40 years, first launched by Bob Hendricks and Bart Madden. The vision then – which remains valid to this day – was to provide users with reality instead of abused accounting metrics, while at the same time giving the added benefit to use this for forward valuation purposes. Looking at a massaged non-GAAP earnings number gives you both a distorted view of a company’s performance and a next-to useless foundation for valuation work. So from the very start, HOLT was developed through a practical, evidence-based lens. Not the other way around, more commonly used in finance, having theory pulls the carriage. To drill it down to its core: it was designed to arrive at a cash-flow number that mirrored reality, before companies even produced a cash flow statement and Warren Buffett spoke of “owner earnings”.

Today “cash flow generation” has become quite the vogue, but *“even as people talk about cash flow...they only give it lip service. Our industry is obsessed with earnings and that’s fine...because people aren’t paying attention to measures that gives us an informational advantage”*. This honestly is a fortunate thing, in that HOLT shares the same fate as index funds: it wouldn’t work as well as it does if everybody used it. Because that’s the irrefutable fact; following HOLT’s valuation model actually helps you in the performance derby, confirmed in numerous studies (see this month’s *Enhancing the Investment Process* paper by Axioma for example).

The book only runs to a total of 83 pages, but it is a dense, detail-packed 83 pages indeed. Given the plentiful figures, tables and footnotes, *Beyond Earnings* is not your Sunday-afternoon easy-read. A suggestion would be to spend a few days reading it, then returning frequently and as needed to the book for reference. My scribbles and dog-eared pages tell such a story. But prepare to be involved!