Montgomery, Roger – Value.able

My Cents Worth Publishing, 2010, [Equity Investing] Grade ★★★★

A few years ago I attended a class at Columbia Business School and seated next to me was this very nice Australian. When I at one point asked about his favorite investment book he pointed to *Value.able* by Roger Montgomery. Later on when I read the book my expectations were perhaps set a bit too high. It is a no-nonsense book on value investing, highly influenced by Warren Buffett and mainly directed towards the private investor. It covers the same compounding, margin-of-safety, seek high cash flow, invest with good managers and "only swing at the fat pitch" type of topics that you will have read in many other books.

However, the text grew on me while I read it. The author who is an Australian value investor writes with a passion and pathos that is contagious. Montgomery really wants the reader to understand the power of the well-used value investing tools and abandon faulty and myopic rules of thumb that too often destroy value rather than help create it. A number of case examples from Australian companies bring the concepts to life. Like Buffett, Montgomery's timeline is to first identify the great businesses to own and then wait until they temporarily get cheap enough to add to the portfolio.

The book proposes two methods for valuing stocks to the reader. The first is by using two valuation tables presented in the book where Montgomery basically calculates a fundamentally fair price-to-book multiple given varying levels of ROE, required return and payout ratio and then multiplies this fair multiple with the book per share to receive an estimate of intrinsic value. Unfortunately the tables are scarcely explained with regards to the underlying formulas that generate the fair multiples.

The second method is to assume a purchase of a share year zero and a sale of it in year five and calculate an internal rate of return for the holding. This method requires assumptions about ROE, payout ratio and future PE-ratios but it's quite elegant since it doesn't require a cost of capital. It doesn't produce an estimate of intrinsic value. Instead the investor will have to ask himself if he is content with the predicted IRR. This second way to approach valuation has become more fashionable among value investors and it is, as I understand it, how Buffett approaches valuation. I like the model's simplicity and the fact that it so clearly shows the value creating effects of the compounding of return on capital, the headwind or tailwind generated by normalizing PE-ratios and the fact that giving out dividends either destroy or create shareholder value depending on the level of ROE that the money could have been invested at in the company.

The book could do with some editing. The author's eagerness to explain the virtues of his investment principles makes him return to the same topics a bit too many times in various parts of the book. Also, for the novice reader it is probably a bit confusing when someone presents two principally different methods for stock valuation - especially as the second one isn't discussed much when the author covers his general investment rules.

What are the investment rules? In short the reader is advised to only look to the better half of the investment universe, i.e. companies with an understandable moat, high and sustainable ROE and low debt. Among the remaining stocks the ones that combine improving corporate prospects with a stock price that is lower than its intrinsic value are candidates for the portfolio.

For the long-term investor with the stomach to be greedy when others are fearful Montgomery gives some simple but effective advice.

Mats Larsson, April 10, 2016

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