VIA AM

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Mauricio's Monthly Letter

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In these letters, I intend to raise awareness of problems, mistakes, and limitations in using accounting data when selecting stocks. This month, I assess AbbVie and MediaTek – two well known companies from different countries, sectors, and accounting norms. These two cases are meant to illustrate the importance of using corporate economic data instead, which definitely lead to a better perspective for finding the economic reality of returns and valuation. I'll also detail VIA's current fundamental statistics on our main investment universes (US, Europe & World).

AbbVie – acquired Allergan which had been acquired by Actavis. How to value the patents?

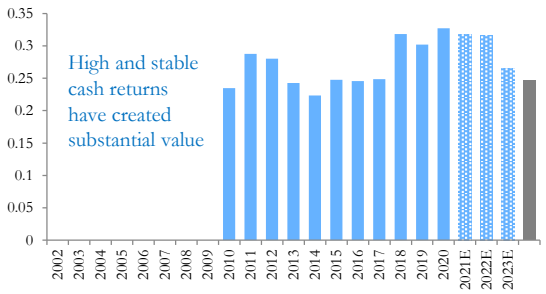
- AbbVie is a global research-based biopharmaceutical company producing drugs for specialty therapies that address complex and serious diseases.
- One cannot see the true profitability if the book value and on-balance sheet assets are misrepresented. Return on equity looks sensible in 2020, but jumps to 83% in 2021E, having peaked at 130% in 2015, and troughed at -96% in 2019. Return on assets is currently at 7% only! How to make sense out of this? **By tackling the limitations of traditional accounting.**
- Event-driven issues are particularly hard to be dealt with in the accounting world. AbbVie acquired Allergan in 2020, which carried $72bn as "product rights and other", mostly arising after being acquired by Actavis for $65bn in 2015, ensued by various smaller acquisitions. That raises two questions from an economic standpoint: does it represent the replacement value of patents? No. Does it include in-house investments to create new drugs? No, again. It represents the market value of **externally produced patents**.

abbvie

United States	
Pharma	
Market Cap.	$198.4 bn

	2020	2021E
Acc. RoE	34.8%	83.0%
Ec. RCR	32.7%	31.7%
Acc. PE	33.4x	11.8x
Ec. PE	12.8x	14.1x

Real Cash Return & Market-Implied (MI)



Source: VIA AM – Data as of June 8th 2021

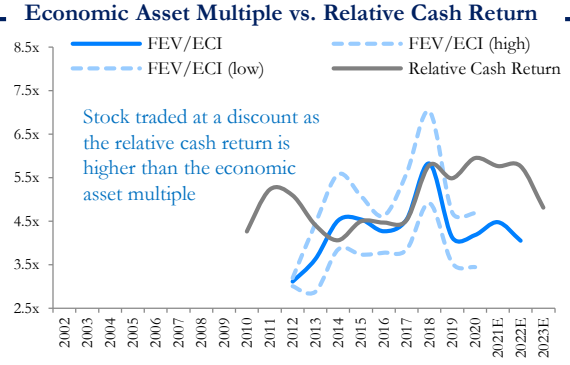
From Profitability…

- But what matters for the economic profitability (Real Cash Return) is **how much cash *each* acquired company invested for creating their patents *plus* how much AbbVie has invested in in-house R&D.**
- It means that AbbVie's $88bn in "Developed product rights" distorts common accounting metrics, as all capitalized R&D, from acquired companies *plus* from in-house investments reached $68bn, or 23% lower than declared. This distortion gets compounded by $33bn goodwill, **which is not an operating asset**.

…to Valuation.

- To make matters even worse on the accounting standards side, the group's $75bn net debt helps to reduce the book value to $14bn only, hence a distorted ROE at 83%. And, by the way, it was 35% in 2020 because of $9bn exceptional acquisition costs!
- So to get valuation right, profitability must be corrected first, based on the economic EBITDA and capital invested. Then the **economic $87bn debt** is added to the Full Enterprise Value, including $18bn contingent consideration and sales rebates obligations.

Economic Asset Multiple vs. Relative Cash Return



VIA AM – Data as of June 8th 2021

MediaTek – the truth mostly transpires through the data meant for investors

MEDIATEK

Taiwan

Semiconductors

Market Cap. $55.4 bn

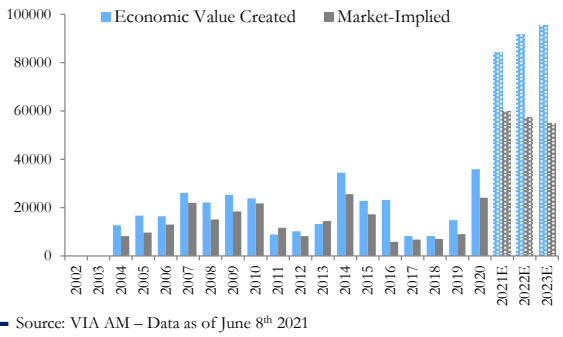
	2020	2021E
Acc. RoE	10.9%	24.1%
Ec. RCR	25.8%	48.4%
Acc. PE	20.9x	16.4x
Ec. PE	13.5x	13.5x

- MediaTek operates as a fabless semiconductor company for wireless communications and multimedia solutions in online games and advertising.
- As the global semiconductor shortage could extend into 2023 due to the limitation of manufacturing space at semiconductor foundries, multiple expansion has already taken place to reflect this in the sector. So how to find hidden or invisible opportunities that still linger without paying unreasonable prices? **Unearthing the economic reality through accounting normalization is an effective solution for this search.**
- MediaTek is a concrete example whose limitation of accounting data prevent valuation multiples and profitability metrics from revealing the full upside potential of the stock. That's because highly lucrative assets, or 80% of its total Economic Capital Invested, are simply not On-balance sheet or in anywhere in the accounting world! The group has a distinctive business model where Research and Development plays its main operating role.

From Profitability…

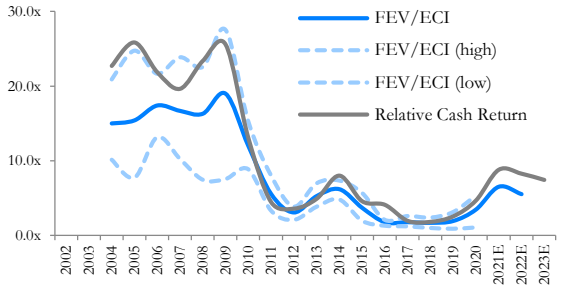
- According to us, it is essential to capitalize the R&D expenditure to treat this as an asset and not an expense, for the reason that it contributes to generate future revenues from new products and product improvements. **That's 24% of revenues invested!**
- All of this investment has clearly had a positive impact on MediaTek's economic profitability, or Real Cash Return, as what is *"expensed"* in accounting standards, is applied to **reveal the true value creation** instead (RHS chart), even more central for a fabless business.

Economic Value Created & Market-Implied $m



Source: VIA AM – Data as of June 8th 2021

Economic Asset Multiple vs. Relative Cash Return



Source: VIA AM – Data as of June 8th 2021

…to Valuation.

- An accurate profitability that is twice as high as that everybody can see through common data preponderantly **leads to the detection of a more attractive valuation**, as seen in the ec. vs acc. PE comparison.
- MediaTek offers another advantage spotted only economically in valuation, through the Full Enterprise Value, which is its **cash richness ($8bn)** more than offsetting $2bn sales returns and allowances (refund obligations) and contract liabilities. The stock is traded at a discount to relative cash returns (LHS chart).

The conclusions in both cases are different indeed when comparing the outcome of economic versus accounting ratios, metrics, and figures. It does not necessarily mean that the transformation from accounting to corporate economic data will lead to such dissimilarities for each and every case. However, in "agglomeration", the spreads linked to fundamentals are wide, as shown in the following section.

Universe Statistics

UNIVERSES FUNDAMENTALS*

	PROFITABILITY[2]		VALUATION[3]	
	Accounting	**Normalized[1]**	Accounting	**Normalized[1]**
US Universe	18.1%	**20.6%**	21.4	**17.6**
European Universe	12.4%	**13.0%**	16.5	**18.4**
World Universe	14.2%	**18.0%**	17.4	**16.2**

**Sources: VIA AM, Bloomberg – universe fundamentals as of May 31st 2021*
To be noted that the three universes exclude financials.

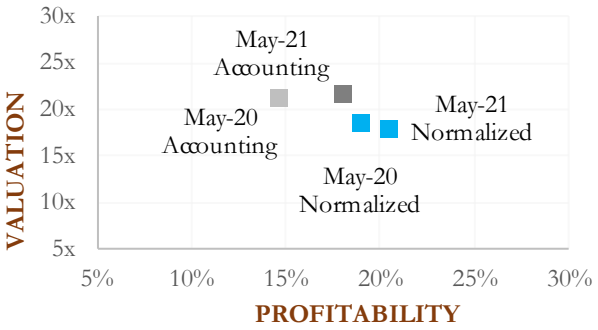
- Notes

1. Normalized Data aim to reflect the economic reality of corporates on a comparable basis
2. Normalized and accounting profitability is calculated using the Real Cash Return (RCR) and Return on Equity (RoE) resp.
3. Valuation is measured based on the economic and accounting Price to Earnings Ratio (P/E)

PROFITABILITY/VALUATION – Today* vs. 1 year ago

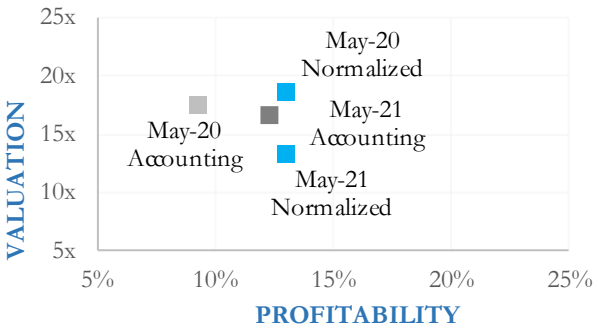
US UNIVERSE

- The US Universe is composed of 1,150 US companies making up the VIA Smart Equity US fund selection universe, weighted by market cap



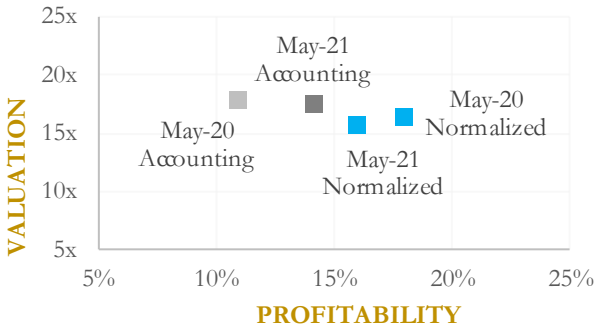
EUROPEAN UNIVERSE

- The European Universe is composed of 700 European companies making up the VIA Smart Equity European fund selection universe, weighted by market cap



WORLD UNIVERSE

- The World Universe is composed of 3,200 companies from developed and emerging economies worldwide making up the VIA Smart Equity World fund selection universe, weighted by market cap



Source: VIA AM and Bloomberg
**Data as of May 31st 2021*

Glossary

Accounting Asset multiple	Market Cap/Shareholders' Fund or Price/Book Value
Accounting Book Value (Bk)	Shareholders' Fund or Net Worth as given on the balance sheet
Accounting Enterprise Value (EV)	Market value of equity (market cap) and net-debt
Accounting Intangible Assets	Assets that are not physical in nature. Corporate intellectual property, patents, trademarks, copyrights, and goodwill are examples of intangible assets
Accounting PE	Market Cap/Net Income
Accounting Return on Equity (ROE)	Net Income/Shareholders' Fund
Book Value of Associates	Investment in affiliated companies as given on the balance sheet
Book Value of Minorities	Non-controlling interests as given on the balance sheet
Competitive advantage period (CAP)	Competitive advantage period (CAP) is the time during which a company is expected to generate returns on incremental investment that exceed its cost of capital
Corporate Economic Data	Outcome of VIA's accounting normalization process, whose aim is to unveil the companies' economic reality of profitability and valuation on a comparable basis
Cost of Capital (COC)	Real long term return of equity assets, estimated to be between 5.5% and 6.0%
Current Cost Accounting (CCA)	A method of accounting in which assets are valued on the basis of their current replacement cost, and increases in their value as a result of inflation.
Deferred Revenues	Deferred revenue, or unearned revenue, refers to advance payments for products or services that are to be delivered in the future. The recipient of such prepayment records unearned revenue as a liability on a balance sheet
Economic Asset Multiple	Full Enterprise Value/Economic Capital Invested (FEV/ECI)
Economic Capital Invested (ECI)	Replacement value of assets, including inflation-adjusted tangible assets, net working capital, other long term operational assets, and the "invisible capital invested" - or capitalised intangible assets such as investments in advertising, R&D, and operational leases
Economic Earnings	RCR x ECI. ECI is calculated in today's money
Economic PE	(FEV/ECI)/RCR
Economic Value Created	(RCR-COC) x ECI. If positive, value has been created, otherwise destroyed
Financial Leverage	Degree to which a company uses fixed-income securities such as debt and preferred equity. The more debt financing a company uses, the higher its financial leverage
Full Enterprise Value (FEV)	Market value of equity (market cap), net-debt, financial provisions, pension deficit (-) surplus, operational leases, market value of minorities less market value of associates
Historical Cost Accounting (HCA)	Record transactions appearing in both the balance sheet and the profit and loss account in monetary amounts which reflect their historical costs
Intrinsic Value	It is the discounted value of the cash that can be taken out of a business during its remaining life
Invisible Capital Invested	Economically capitalised intangible assets such as investments in advertising, R&D, and operational leases
Market Value of Associates	Market value of investment in affiliated companies
Market Value of Minorities	Market value of non-controlling interests
Operational Gearing	Relationship between fixed and variable costs. Higher fixed costs mean greater operational gearing and vice versa
Real Cash Return (RCR)	Real cash return on the economic capital invested, calculated as an internal rate of return of inflation-adjusted capital invested and cash flow over the average economic life of depreciable assets
Relative Cash Return	Real Cash Return/Cost of Capital (RCR/COC)

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