Donald Yacktman's Way (Part I)

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(GuruFocus, January 29, 2010) In 1992, Donald Yacktman founded Yacktman Asset Management. Currently, he and his son, Steve Yacktman (together referred as "the Yacktmans" in this article) manage two mutual funds: The Yacktman Fund and The Yacktman Focused Fund. During the past ten years through December 31, 2009, the two funds achieved an annualized average return of 11.91 and 11.82% respectively while S&P 500 lost 0.95% during the same period.

Last year, Donald Yacktman was nominated by MorningStar as a candidate for the Fund Manager of The Decade, only losing later on to Fairholme's Bruce Berkowitz, whose fund returned about 14%, or 2% more than Yacktman's funds per year during the past ten years.

The press and financial media, GuruFocus included, have given Berkowitz much attention after the announcement of the winner and of course, we think Berkowitz deserves all the honor and praises.

But we think the Yacktmans equally deserve our honor and praises, not just because their 2009 return (both funds returned 60%-ish) exceeded that of Berkowitz's (40%), also because the way they manage money is elegant in theory and simple to practice.

Analyzing and knowing how the Yacktmans manage their money can help us managing our own money more successfully. This article is Part I of the attempt.

The Yacktmans Steered Clear of Both Crises

For many investors, the past decades are two bubble bursts too many. Some unfortunate ones managed to move money in and out of the market at exactly the wrong times and incurred material damage to their net wealth.

Today's Yacktman Funds investors are generally happy with their fund manager. But that has not been always the case [1]. Back in late 1990s, during the tech boom, the Yacktman Funds lagged the market because Donald Yacktman favored non-tech small cap stocks. The fund board even tried to oust him and investors fled. In 2000, the dotcom bubble burst and Donald Yacktman looked like a genius. Yacktman Fund beat S&P500 by large margins three years in a row from year 2000 to 2002 (see table below).

Performance of The Yacktman Fund

Year	Return (%)	S&P500 (%)	Excess Gain (%)
2009	59.31	26.5	32.8
2008	-26.05	-37	11.0
2007	3.39	5.61	-2.2
2006	15.95	15.79	0.2
2005	-1.3	4.91	-6.2
2004	9.93	12	-2.1
2003	33.03	28.7	4.3
2002	11.41	-22.1	33.5
2001	19.47	-11.9	31.4
2000	13.46	-9.1	22.6

Entering the period between 2003 and 2007, when the market recovered, the Yacktman Fund churned out decent but less glamorous return for a couple of years. Then 2008 came and all hell broke loose. How the Yacktmans steered his funds during the crisis is nothing short of being marvelous.

Going into the down turn, they had a good cash position and his portfolio was full of defensive stocks, the Cokes and the Pepsis of the world. They held little financial except a position in AmericCredit (ACF). They were able to take advantage of the downturn by using cash to purchase stocks at bargain prices.

When the cash was gone, they were able to essentially rotate out of consumer staples,the Cokes and the Pepis that had held up well, and rotate into consumer –based cyclical stocks, which were traded at extremely high cash yields and were significantly underpriced based on normal earnings. They bought USG, Williams-Sonoma, and Abercrombie & Fitch. When things get much worse, they doubled down and even bought financial stocks such as Bank of American (BAC) and Barclays (BCS) at doomsday prices.

In the second half of 2009, they have moved back towards consumer franchise companies, the Cokes and Pepsis of the world again. For the same or similar return, they would rather own a more conservative stock, like Coca Cola, than a financial or a cyclical stock with higher risk.

Donald Yacktman summarizes the his maneuvers during the last decade in his 4Q09 Quarterly letter:[5]
During the last 10 years, we witnessed the bursting in technology stocks, panicking over corporate credibility in 2002 and a near imploding of the global financial system in 2008. Throughout this period we objectively and methodically stuck with out discipline of risk/reward, and owning high quality companies at attractive valuations and from time to time, special situations. During the steepest market corrections, our funds provided solid protection and we were able to find many spectacular bargains

"Our Logo is a Triangle"

Yacktman's investment philosophy can be represented by a triangle. The base of the triangle is a **low purchase price**, the other two sides are **good businesses** and **shareholder-oriented management.** [2]

It is perhaps not a coincident that several Gurus essentially have the same criteria to select stocks:

The first example comes from the latest Robert Rodriguez's quarterly letter :
we would like to repeat and reinforce what Bob laid out a quarter of century ago in his first client letter. Namely, our investment strategy is to own a concentrated group of **businesses with leadership positions** that are **trading substantially below their intrinsic value** and hold those investments for the long term.

And with a little variation, here is what Chuck Akre's "three-legged stool" is all about:
The first leg has to do with **the quality of the business enterprise,** and we're looking for businesses that earn high returns in the owner's capital. We spent a lot of time trying to focus on what's causing that better-than-average result, return on capital, to occur, and is it getting better or worse.

The second leg of the stool goes to the issue of **the people who manage the business**. And not only are they terrific managers, but are they honest and do they have high integrity? Do they see that what's happening at the company level is happening identically at the per share level?

And then lastly, the third leg is the issue of **reinvestment**. We call it sometimes the glue that holds these together. That is, is there an opportunity that exists because of the skill of the manager, the nature of the business to reinvest what we presume is excess cash. To reinvest that in a way to continue to earn these above-average rates of return. And then to that, we apply our valuation overlay, which is our quantitative way of saying **we're just not willing to pay very much for it**.
And finally, we have Warren Buffett and Charlie Munger's famous **four filters** as they appeared in Warren Buffett's letter to Berkshire Hathaway shareholders in 1977:
We select our marketable equity securities in much the same way we would evaluate a business for acquisition in its entirety. We want the business to be **(1) one that we can understand, (2) with favorable long-term prospects, (3) operated by honest and competent people, and (4) available at a very attractive price**.
(I added the emphases in the quotes)

OK, Buffett has four criteria instead of three, one more than Yacktman does. But I wouldn't hold that against Yacktman. Buffett only buys business "that we can understand", and for Yacktman, most of the time, he holds consumer franchises companies, which are easy to understand to begin with, so we are covered there. Triangle, Three-Legged Stool, or Four Filters, it is how one practices the strategy that win the day.

Buy Stocks Like Bonds

Donald Yacktman buys stocks like bonds, which means firstly he buys businesses with the expectation that he is going to own them for a long time.

And secondly, he compares the rate of return of stocks the same way as he does for the bonds. Central to Yackman's assessing of investment idea is the concept of "**Forward Rate of Return**". To satisfy his rule number one, the base of the triangle -- to purchase securities at low price, Forward Rate of Return is calculated and minimum annual return is required for different businesses. The return is higher is the business is of lower quality or if it's more unpredictable. **For the best businesses today, Yacktman wants to see a return of at least 10%.**

Rather than coming up with some arbitrary discount rate utilizing CAPM, beta, etc., Yacktman calculates what the implied expected rate of return if one buys the equity at the current price. Simply put, **Forward Rate of Return is current free cash flow yield plus inflation and plus annual growth in free cash flow.**

In the December interview with Value Investor Insight [4], Steve Yacktman illustrated how they calculate the Forward Rate of Return for Coca-Cola (KO):
As and example, Coca-Cola (KO) whose free cash flow is a high percentage of net income, traded at a free-cash-flow yield on our normalized number of about 5.5%. Inflation adds another 3% and we assume another 2% in organic growth, so that gives us an estimated compound annual rate of 10.5%.

Steve also illustrated their view of the Forward Rate of Return of the general market, as represented by S&P 500:
we estimate normalized per share earning for the S&P 500 of about $60, of which you keep maybe 45% as free cash flow. At 1,100 on the index, the resulting $27 in free cash flow gives you a 2.5% free cash yield. Add on 3% inflation and 1.5% for cash flow growth, and we believe the average investor today on a cash basis is looking at a 7% annual return from the market. Calculating the Forward Rate of Return for the general market is as relevant as calculating that for individual companies. If one compares the two, one can assess whether the stock is attractive. In Yacktman's world, just as bonds have different ratings, stocks have different qualities. Different bonds are expected to yield differently so are the stocks required to yield different rates of return.

In the case for Coca-Cola, it is a higher-quality business with lower risk than the average S&P 500 company, so it should trade at a premium to the market, not at discount as it does now. Hence Coca-Cola is attractive to the Yacktmans. As a matter of fact, their current portfolio is filled with brand name, large-caps such as Coke, Pepsi, P&G, Pfizer, and J&J, things that are of high quality and yet traded at Forward Rate of Return higher than the general market.

Hold High Quality Stocks

It is not coincidence that Yacktman is holding the brand-name, large-cap stocks. As the market became fully valued, this is usual place that he would like to be. This is his base. “If you have nearly the same forward expected return among high and low quality, obviously we’d rather take the higher quality”, says Brian Yacktman [2], Donald’s other son who worked with Donald in the past but now manages his own Yacktman Capital Group, LLC.

Gyrating to the high quality consumer franchise companies is a natural move for the Yacktmans in the second half of 2009. Donald explained his rationale in the 4Q09 Letter [5]:
During the latter half of the year, we increased the consumer products company holdings in both The Yacktman Fund and The Yacktman Focused Fund. Our funds are now positioned more like they were a couple of years ago, with an emphasis on very high quality consumer franchise companies, though many of the securities we own are cheaper today than they were then. Cash levels are also lower than a few years back due to more attractive investment opportunities.

As mentioned earlier, PepsiCo, Procter & Gamble, Clorox, and Johnson & Johnson all lagged the market rally as riskier securities which might benefit more from an economic recovery were more aggressively purchased than stable, predictable companies. All of these companies are “old friends” which we have owned off and on since our firm was founded in 1992. They all produce significant amounts of free cash flow, have dominant market shares in many of their product categories, and have the ability to take pricing higher if inflation becomes an issue. Should the economic fears that dominated the last couple of years revisit the market, each of these businesses should offer far better than average downside protection based on the current price.

In the Value Investor Insight interview[4], Donald Yacktman linked business quality to the growth aspect of the businesses he owns:
The growth aspect speaks primarily to our focus on business quality. We’re not usually looking for the scruffy cyclical or turnaround story, but for businesses with high market shares in their principal product or service lines, with long product cycles but short customer-repurchase cycles, and with relatively low capital requirements that allow the company to generate high cash returns on tangible assets while growing. We’ve always considered business requiring enormous amount of capital for fixed assets, especially when they’re economically sensitive, to be at a big disadvantage. That’s why something like the airline industry has been a growth business for most of the past 100 years but doesn’t make any money for shareholders.

Ever wonder why Buffett likes See’s Candy and Coke that much?

“Flexible” Value Investing

The Yacktmans' maneuvering in and out of lower quality stock (so called “special situations”?) earned them not just high return in 2009, but also earned them a reputation as a “Flexible Value Investor” as the title of the Value Investor Insight interview suggests[4], as if given the circumstances they could bend the rules easily. If so, it is a cause of concerns for the Yacktman Funds investors, because the last thing one expects of a fund manager is inconsistence.

However, careful exam of their trading record shows that they operated within the frame work outlined above. In late 2008 and 2009, The Yacktmans bought into USG (USG), Williams-Sonoma (WSM) and Abercrombie & Fitch (ANF), and then into financials such as Bank of America (BAC) and Barclays (BCS), and double-downed on AmeriCredit (ACF) because “some cyclical stocks were trading at extremely **high cash yields**”.

One example is AmeriCredit (ACF), a subprime auto lender. Yacktman Funds owned the stocks since 2003 so they were familiar with the company. Here is a quote from Steve Yacktman [4]:
We have owned AmericCredit (ACF), a subprime auto lender, since 2003. It has a seasoned management team that has been through significant down cycles, and they’ve always provided detailed and transparent monthly data on their loan portfolio. The company was obviously going to be impacted by falloff in the economy, but because it had “subprime” and “lender” in its business description, the market overreacted and pushed the stock below $5, only 1-2 x what we considered to be normal earnings. We thought that made no sense, so we doubled our share position as stock got around $5. We’ve trimmed the position, but still own shares.

Accidentally, rival Bruce Berkowitz also scored big with AmeriCredit in 2009.

In another word, the Yacktmans only traded the quality of his holding for risk when the spread between the Forward Rate of Return of the high quality stocks and that of low quality stocks became large enough to justify the trade.

And when things return to something resembling to normalcy, they came back to high quality consumer franchise stocks, waiting for the next storm to strike the less discerning.

Concentrated Portfolio

Many of the great Gurus tracked by us have a concentrated portfolio. The Yacktmans is one of them. When asked why they tend to be fairly concentrated for a mutual fund, Steve Yacktman answered [4]:
We’d love to be widely diversified if everything had the same return characteristics, but they obviously don’t. There are some rules on diversification for mutual funds, but we basically rank the stocks that meet our minimum-return requirements and try to have as much of the portfolio as possible in the companies with the highest expected rates of return, adjusted subjectively for risk. Right now that leaves us with around 50 positions in the Yacktman Fund, with close to 60% of the portfolio in the top 10. In our less-restricted accounts, we have 75% of the portfolio in the top 10 – we’d sleep well at night with that at 100%, but that doesn’t work for most clients. As a result, we spread the last 25% in names that are typically smaller and with very high potential, but with more expected variance in the outcome.

Warren Buffett talked about over-diversification in his 1984 letter to shareholders by quoting Billy Rose: “If you have a harem of forty women, you never get to know any of them very well.” Buffett has the talent and liberty of delivering his points with a colored joke or two.

Besides the Yacktmans, according to GuruFocus, Warren Buffett's Berkshire Hathaway owns $56 billion in 43 stocks; Bruce Berkowitz owns $8 billion in 26 stocks; and Robert Rodriguez's FPA Capital Fund has $844 million in 22 stocks. All these great value investors typically own a concentrated portfolio and deliver returns that beat the index by a large margin.

Coming up, in Part II of this analysis I will focus on these following topics:

· **When to Sell**
· **What about the Big Picture**
· **Comments on Individual Holdings**

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1. Flexible Value Investing (The Wall Street Transcript, June 1, 2009)
2. Answers From Donald And Brian Yacktman (GuruFocus, October 22, 2009)
3. Catch a high-flying fund - up 56% (Fortune, November 25, 2009)
4. Value Investor Insight Interview with Yacktman Team (www.valueinvestorinsight.com, November 30, 2009)
5. Yacktman Funds 4Q09 Update and Commentary (www.yacktman.com, December 31, 2009)

Read on to Part II.

Donald Yacktman's Way (Part II)

February-4-2010

(GuruFocus, February 4, 2010) This is the second and the last part of my attempt to analyze Donald Yacktman's investment strategy and methodology. In this part, I want to deal with questions such as how the Yacktmans treats the big picture, how they manage cash level, and how they reach a sell decision, and finally, I will summarize their comments on some individual stocks as examples for the methodology in practice.

If you have not done it, please read Part I before reading any further.

What about the Big Picture?

Consciously or not, investors always form their own opinion towards how the economy and the stock market might do in the near future and position their portfolio accordingly. The press is full of such predictions, and good careers have been made. The dilemma for investors is, in any given market, there are always at least two camps, the bulls and the bears, with seasoned and successful professional managers in each camp.

The Yacktmans are bottom-up guys. When asked, their initial response is that they are not distracted by big picture issues. This dialog is from the recent Q&A with GuruFocus users[2]:
Question 16. Although your focus (both) is stock-picking, do you occasionally get caught up with big pictures issues that distract you from your main goal of picking great stocks? How do you deal with it and why do you think it can happen to investors?

Don: I don't get distracted by big picture issues but I think many others do. I think most people have trouble buying stocks that are in price decline either because of lack of knowledge, a short time horizon, or emotion. It is important to be objective.

And the Yacktmans think trying to predict the market is not only useless, it could also be harmful, as illustrated by this dialog in the same Q&A session:
Question 4. At this level of market valuation, how do you think the market will do in the next few years?

Don: We don't predict the market. Frankly I think that most of the time it is a waste of time. Looking at individual businesses and buying them at good value is a much better use of time. If someone correctly predicted the market 10 years ago, they would have been in cash and not our funds. Who is better off?
Indeed, knowing what we know now about how the market performed in the last decade, most of us would be better off to put money in cash in the past decade. But knowing what the Yacktmans know about value investing, one is better off investing in stocks.

So the Yacktmans totally ignore the macro factors in their managing money? Wrong! The Value Investor Insight interviewer was rather persistent and direct on this point. Here is a quote from the interview [4]:
Speaking generally, do views on the broader economy make it into your analytical process at all?

SY (Stephen Yacktman): We spend almost no time trying to forecast things like inflation, interest rates and the value of the dollar, but we do try to pay a lot of attention to cycles in how we normalize earnings. If margins are at a peak, for example, we don't necessarily assume they'll stay there forever. That alone kept us out of a lot of the financials that got hurt the most in the meltdown.

Potential inflation, or the lack thereof, seems to be fairly top-of-mind for investors. What's your take on that?

DY (Donald Yacktman): Over time, we're very concerned about the risk of higher inflation, but we expect that the kinds of businesses we own – those that can re-price their products fairly flexibly and that are heavily exposed to currencies other than the U.S. dollar – will navigate an inflationary period fairly well.
So long term inflation finds its way to **Expected Rate of Return** in the Yactkmans' world of investing.

Manage Cash Level

Keeping the right level of cash is a key decision for individual investors as well as for fund managers. It is important for individual investor, it is vital for active fund managers. When market crashes, the right thing to do is to buy and take advantage of the lower prices, typically what the fund managers have to deal with is all the redemption requests. It is just an inconvenience in a fund manager's life that one has to deal with.

Fearing of lagging behind peers and benchmarks, many fund managers tend to be fully invested. In May of 2009, during the MorningStar meeting, Robert Rodriguez was very critical towards this practice in his speech:
Did the industry try and prepare for this tsunami of a credit debacle? I don't think so. Whether in stocks or in bonds, it seems as though the same old strategies were followed--**be fully invested** for fear of underperforming and don't diverge from your benchmark too far and risk index tracking error. The industry drove into this credit debacle at full speed. If active managers maintain this course, I fear the long-term outlook for their funds, as well as their employment, will be at high risk. If they do not reflect upon what they have done wrong in this cycle and attempt to correct their errors, why should their investors expect a different outcome the next time?

Since the beginning of 2007 Robert Rodriguez, Rodriguez kept an unusual amount of cash (as much as 45%) in his FPA Capital portfolio. The Yacktmans, on the other hand, had as much as 30% in cash at the market peak of 2007. In November 2008, they were “all in”. They even had to swap out some high quality stocks to buy some more cyclical ones. And as of November 30, 2009, they are back to 15% again.[4]

So what drives their cash position up and down? Why 15% now? And why as much as 30% at market peak in 2007? Is it by design or by luck? Careful exam of the Yacktmans's thinking on the matter tells us that the high cash might be a build-in function of their investment methodology. Here we dig into the The Wall Street Transcript Interview[1]:

TWST: What triggers an exit from your portfolio? Do you set sell targets?

…

Donald Yacktman: Think of everything being priced against the long-term Treasury, and we want to see a large spread over what the long-term Treasury yield is.

Stephen Yacktman: But in the present environment the dollar is being deflated and the Treasury rate of return is very low. At some point we say, “Hey, the rate of return of an investment is not acceptable to us.” We walk away. It’s the hardest thing to do because we have to wait for something else to come along. We can’t create something out of nothing.

And in theValue Investor Insight interview [4]:

Are you much less active when markets are calm?

DY: We’re not inactive when markets are relatively calm – there’s always something creating opportunity somewhere – but we do tend to be a lot less active overall. Our turnover has fallen compared to this time last year.

We also don’t let cash burn a hole in our pocket when the number of good opportunities decreases. While we were all in last November, our cash position in the funds today is around 15%.

In another word, the cash level is a result of insisting on minimum **Forward Rate of Return** on the investments and minimum spread between the rate of return and the Treasury yield. If the requirements do not meet, the Yacktmans would rather keep the money in cash.

Nowadays, with market recovered more than 60% from the March 2009 low, GuruFocus noticed that Robert Rodriguez’s fund is hoarding cash; Bruce Berkowitz has upped his cash level to about 20%, more than historical normal level, which has been about middle teens.; and the Yacktmans had about 15% in cash as of November 30, 2009. Since you have made so far in reading my article, I feel obliged to give away this observation. These three managers are not bears or market timers, rather, they are very constructive in managing their money through different market cycles.

When to Sell

Stephen Yacktman answered this one straight-forwardly in The Wall Street Transcript Interview[1]:

TWST: What triggers an exit from your portfolio? Do you set sell targets?

Stephen Yacktman: Many people set a price target by saying, “Okay, I think it is worth $X.” Well, we don’t think that way. We look at what the forward rate of return is, stack it up against other investments and determine which one is the highest and which one is the lowest and what risk we are taking to get that rate of return. We account for things like leverage, cyclicality of earnings, and the quality of the business. An investment that is going to make it into the portfolio with the lowest rate of return would be a company like Coca-Cola that has high predictability and good management. We can just go into autopilot. It becomes our AAA bond.

A sale is triggered by two things. **If the rate of return is not sufficient or if there is a better opportunity elsewhere with a larger margin of safety to get a similar or higher rate of return, we’ll sell it.** The overall market dropped and consumer product names held up and the media companies got killed. News Corp. went from the $20s to $5. That drop opened up a huge rate of return gap and encouraged us to sell some of our Pepsi and buy News Corp. We viewed that decision as going from a low teens rate of return to something that was going to make a 20% return. There’s no price target ever set, it’s just a function of the environment. What ends up happening, unfortunately, in an environment where everything goes up, is fewer of these returns are satisfactory and we end up more heavily in cash. It’s not that we’re trying to time the market; it’s just there’s nothing to buy.

That is the ideal world, in which every purchase is a win. What about if they made mistake and have to sell at a loss? Here is their perspective according to the GuruFocus Q&A [2]:

Question 14. How hard is it to admit a mistake on an investment thesis and what do you do to not repeat the mistake?

Don: It is important to be objective and not let our ego get in the way. As Will Rogers said, “Good judgment comes from experience and a lot of that comes from bad judgment”.

Brian: I agree. In addition, we can’t let our emotions get in the way. When a mistake has been made, you can’t cross your fingers and hope to recoup your losses. You have to ask yourself, where do I go from here? On this day, what are my best options, where are my highest yielding assets? Where would this capital best be allocated now? Once you’ve experienced a permanent loss of capital, there’s only one gear from here and that’s forward. But the key in this business is to avoid the *permanent* losses. And as my father has often said, **“A low purchase price covers a lot of sins.”**

Just be careful next time you place a buy order.

Comments on Individual Stocks

As illustrations of how the Yacktmans use the concept of **Forward Rate of Return,** I include a summary of their comments on some of their top holdings.

Much of this material is from of Value Investor Insight interview found on www.yacktmanfund.com website [4]. You might be better served to read the original document. The document was published on November 30, 2009 and the interview could have happened somewhat before that, so please keep the time elapsed since then when you read it.

1. News Corp. (NWS-A)

· Stock trades half of what it was at the beginning of 2007, yet the business mix and groth prospects are much better than they were back then.

· Company has eight different operating units. The most important business by far is cable network programming. Revenues and earnings in this business have more than doubled over the past five years, driven by increasing subscriber fees from cable and satellite companies, as well as higher rates on the advertising side. Plenty room for growth exists in this line of business.

· Non-U.S. operations is another engine for growth.

· Company is believed to be able to generate more than $1 per share in free cash flow. With the stock price at $11.50 (Now it is $13.67 on Feb. 3, 2009), the free cash flow yield is roughly 8.5%. (Now it is 7.3%).

· On the top of that, the Yacktmans expect a total of 6.5% annual growth on the current free-cash-flow yield.

· So the estimated Forward Rate of Return is in mid-teens per year, double what can be expected from S&P 500 (about 7%, see Part I).

· The age of Rupert Murdoch (78) is not of concern in the time horizon that matters here, especially when one paid no premium for him.

2. Viacom Inc. (VIA-B)

· This is more of a pure-play content company, which owns various cable networks, including Nickelodeon, MTV and Comedy Central, as well as the Paramount movie studio.

· As a content company, Viacom has an upside to demand higher carriage fees from the cable distributor companies over time.

· On the advertising side, Viacom's advertising should more than bounce back when the economy improves

· Paramount is adding nothing in the valuation model as it is not generating any cash, but as a standalone company, it probably worth $5-7 per Viacom share.

· Cable networks alone will generate $2.50 per share in normalized free cash flow. That’s an 8% cash yield. Even if Viacom grew no faster than the average S&P 500 company – and the Yacktmans think it should do better – that produces an expected return of 12-13% per year.

· Internet delivery of content should not be destructive. As long as you have content, you should be able to sell it for something and make a profit.

3. PepsiCo Inc. (PEP)

· Somewhat distinct from Coca-Cola, Pepsi’s fortunes are much more driven by snack foods.

· The distribution and shelf space of Frito-Lay products create a very high barrier to entry.

· Frito-Lay now accounts for roughly half Pepsi’s overall business.

· The snack-food business is a good one. Buyers are not too price-sensitive, margins are high, and unit-volume growth is pretty strong as busy lifestyles prompt people to eat things on the run.

· The second big driver of the business will be continued global expansion.

· On a forward basis, the Yacktmans are estimating $3.85 per share in normalized earnings. They should keep roughly 85% of that, so free cash flow would be around $3.40. That’s a 5.5% free-cash yield, on top of which they are expecting 3-4% annual volume growth, primarily from increased snack-food sales and overseas expansion. Add in some pricing, largely to keep up with inflation, and the expected annual return is 12-13%, 5% better than S&P 500’s expected rate of return.

4. Comcast Corp. (CMCSK)

· Comcast stock performed poorly in recent history because there was never any cash generated. All the earnings needed to be invested for expansion or equipment upgrades.

· Operationally, Comcast is uniquely positioned because it can offer a full complement of television, Internet, and phone services. They’ve been quite successful in rolling out these bundled services in their territories and skimming off profit from phone companies like AT&T and Verizon.

· What sets Comcast apart as an investment is the fact that a lot of the enormous capital spending necessary to build that network is going away. The company now has a platform to meet customer demands well into the future at modest incremental cost.

· That will have a dramatic impact on free cash flow generation.

· Free cash flow should exceed net income by $1-1.5 billion per year as capital expenditures are much lower than depreciation and amortization. On a normal basis, we estimate free cash flow at more than $1.50 per share, resulting in a 11% cash yield. On top of that one would add inflation plus 2% or so, as they continue to take phone and Internet share. That yields an expected mid-teens return for a company that on a fundamental basis continues to perform extremely well.

· The recently announced proposal to acquire NBC Universal, even assumed overpaid, has limited impact on the company's value and do not change the view that the stock is undervalued.

Conclusion

Central to the Yacktmans' investment methodology is the concept of **Forward Rate of Return**, which is **current free cash flow yield plus inflation and plus annual growth in free cash flow.** Macro economy and business cycle find their way in the calculation of rate of return; when minimum rate of return is hard to get, the Yacktmans build a large cash position; when the rate of return become less attractive comparatively, they sell the individual stock.

Finally, it should be noted that the adjective word for the Forward Rate of Return is "**Estimated**". As the examples given above show, the Yacktmans do not calculate the rate to the fifth decimal (not even to the second decimal, for that matter). In investing, they also would rather be approximately right than precisely wrong.

As of now, the compass of Rate of Return points toward **high quality companies at attractive valuations**, and that is where the Yacktman park their money.

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3. Catch a high-flying fund - up 56% (Fortune, November 25, 2009)
4. Value Investor Insight Interview with Yacktman Team (www.valueinvestorinsight.com, November 30, 2009)
5. Yacktman Funds 4Q09 Update and Commentary (www.yacktman.com, December 31, 2009)