FINANCIAL REVIEW

Cash is king for Loomis Sayles Rosenbaum

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Valuing stocks on multiples of sales or earnings is unhelpful in gauging the ability of a business to grow intrinsic value or free cashflow, says Loomis Sayles portfolio manager Lee Rosenbaum, who believes "cash is king".

"For us the right approach is through the lens of a DCF," he says, referring to a discounted cashflow valuation. "A P/E or price-to-sales ratio really misstates the underlying returns on invested capital and the intrinsic value growth of the business and free cashflow growth of the business."

A "static multiple" also doesn't take into account competitive advantage, which Rosenbaum assesses in terms of how a business will look in the years ahead. "Competitive advantage is really how long we're willing to stake a claim, if you will."

"Free cashflow is even better than cashflow," says Lee Rosenbaum. **Nick Moir**

The co-portfolio manager for the Loomis Sayles Global Equity Opportunities strategy and Global Allocation Fund looks at the world through "quality, intrinsic value growth and valuation".

Intrinsic value growth is simply the ability of the business to grow its value over time. That's led him to stocks such as Roper Technologies, AIA Group and Alphabet.

As well as good balance sheets and high returns on equity, Rosenbaum wants to see companies reinvesting. "We don’t want the companies to take shortcuts."

He will also monitor changes in shares outstanding, to determine whether companies are stepping "on the brake or the pedal".

But investors need to stay level-headed too.

"I think the investment community tends to think the time they are living in is the most important or the most relevant," he says. Recessions are inevitable, and best regarded as opportunities for equity investors.

"What we would highlight is the world looks and feels to many like a daunting place right now, but from our perspective it's been a fairly daunting place for the past seven years."

His entire career as an investor has been governed by thinking about businesses in terms of free cashflow. "To us, cash is king, free cashflow is even better than cashflow, and free cash conversion is actually a metric we would look closely at.

"That doesn’t mean high free cashflow is always better, we want our businesses to be generating and growing their free cashflow per share, and that requires healthy free cashflow conversion."

Roper's free cashflow conversion is higher than 100 per cent as the company is able to utilise negative net working capital as a source of free cashflow.

Linde, another stock the funds owns, still has high cash conversion, but below 100 per cent. "That’s ok too, because what they’re doing is spending and investing for customers that have long-term contracts and that capex we believe is going to earn a long IRR," or internal rate of return.

Typically he won't own businesses with free cashflow conversion lower than 50 per cent.