

2020 Free Lunch Portfolio by Mohnish Pabrai

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The Free Lunch Portfolio strategy

I continue looking into what others are doing to find good investment ideas. A good source is always the Free Lunch Portfolio by value investor Mohnish Pabrai. He publishes a portfolio that he creates by looking at what others do each year, therefore the name Free Lunch on his [blog](#).



Using algorithms, the Free Lunch Portfolio looks for 3 types of stocks: uber cannibals, spinoffs and companies owned by good fund managers that fall into the shameless cloning bucket.

Uber cannibals are businesses that aggressively buyback their shares. In that way they lower the number of shares outstanding and increase the value for the remaining shareholders.

Spinoffs are businesses that the parent company decided to spin off into a separate entity and give separate shares to shareholders. This is usually done because the business model is different with the subsidiary than with the parent company and therefore, more often than not, shareholders don't know what to do with the new stock, not many analysts follow and one can really find under-priced bargains.

Shameless cloning is simply looking what others have in their portfolio and buying it.

Back testing showed that the Free Lunch Portfolio beats the S&P 500 by a large margin over the longer term.

Year	Performance				
	S&P 500	Spinoffs	Shameless Cloning	Uber Cannibals	Free Lunch
2000	-9.1%	22.8%	23.2%	30.0%	25.5%
2001	-11.9%	28.0%	43.2%	43.8%	38.2%
2002	-22.1%	-11.7%	3.3%	47.7%	14.3%
2003	28.7%	56.6%	71.1%	32.7%	48.3%
2004	10.9%	54.8%	18.2%	57.8%	46.3%
2005	4.9%	17.5%	15.0%	6.2%	11.1%
2006	15.8%	19.6%	11.1%	2.9%	10.4%
2007	5.5%	-26.7%	13.3%	27.4%	7.8%
2008	-37.0%	-45.1%	-54.4%	-24.9%	-39.5%
2009	26.5%	83.6%	30.3%	29.4%	39.2%
2010	15.1%	16.8%	17.8%	12.5%	15.5%
2011	2.1%	-11.2%	8.7%	1.1%	-0.2%
2012	16.0%	12.7%	31.4%	50.4%	38.0%
2013	32.4%	67.1%	44.2%	43.8%	48.4%
2014	13.7%	-5.4%	15.5%	1.6%	2.9%
2015	1.4%	-8.7%	14.6%	-1.5%	0.4%
2016	12.0%	43.5%	10.4%	-2.3%	11.1%
2017 YTD (11/30/2017)	20.5%	12.9%	29.6%	39.4%	29.7%
Cumulative	155.0%	857.8%	1354.7%	2521.9%	1582.7%
Annualized	5.4%	13.4%	16.1%	20.0%	17.1%

Source: [Free Lunch Portfolio Forbes Article](#)

I figured, given the current situation in the market it would be interesting to research the individual components of the 2020 Free Lunch Portfolio and see whether there are some interesting individual opportunities even if the above performance has a lot to envy. This is the Free Lunch Portfolio for 2020:

Uber Cannibals

- Allison Transmission Holdings (ALSN)
- Asbury Automotive Group (ABG)
- Corning (GLW)
- Quanta Services (PWR)
- Sleep Number (SNBR)

Shameless Cloning

- Alphabet (GOOGL), from Sequoia Fund
- Berkshire Hathaway (BRK.B), from Markel Insurance

- Chipotle Mexican Grill (CMG), from Pershing Square
- Citigroup (C), from ValueAct Capital
- Fiat Chrysler Automobiles (FCAU), from Pabrai Funds

Spinoffs

- Athene Holding (ATH)
- FirstService (FSV)
- Hilton Grand Vacations (HGV)
- RMR Group (RMR)
- Vectrus (VEC)

Free Lunch Portfolio individual holding analysis

Let's start with the analysis one by one. I will first categorize the stock using the Peter Lynch Stock Categorization tool - [6 Categories of Stocks by Peter Lynch](#). (the categorization is part of my summary of Lynch's book One Up On Wall Street withing my free investing course – check it out). When the stock is categorized, I'll take a look at fundamentals, the long-term sustainability of the business model and make a quick valuation. On those businesses that intrigue me from an investing perspective, I'll make a full in-depth analysis.

Allison Transmission Holdings (ALSN)

Summary:

- Free cash flow yield is 12.9%. Likely to change short term but attractive longer term.
- Apart from the coming recession, the other cloud over the business is the EV threat.
- The buybacks are likely to be cut, the debt is relatively high but the business will not go away that fast.

Allison Transmission is the world's largest manufacturer of fully automatic transmissions for medium- and heavy-duty commercial vehicles and is a leader in hybrid-propulsion systems for city buses. The company was owned by GM for a long time and The Carlyle acquired it in 2007 for \$5.6 billion. It went public in 2012.



2012

Allison Transmission Holdings Inc. becomes a public company on March 15 and its shares begin trading on the New York Stock Exchange under the symbol ALSN. At the time of the public offering, the Allison Transmission IPO is the largest U.S. industrial IPO since the third quarter of 2010.

Chairman, President and CEO Lawrence E. Dewey informs investors that the company will demonstrate its "constancy of purpose" by continuing to pursue several strategic priorities: Expanding global market leadership, increasing emerging market penetration, focusing on new technologies and product development, and delivering strong financial results.

Source : [ALST history](#)

The Free Lunch Portfolio defines it as an uber cannibal stock. A look at ALSN's cash flow shows it spent \$2.71 billion on buybacks over the last 6 years. It spent on average about \$90

million for dividends per year. The number of shares outstanding has declined from 188 million in 2013 to the last reported, 123 million.

Financials Income Statement Balance Sheet **Cash Flow** Annual Quarterly As Originally Reported Restated

[Export to Excel](#)

[Back to Summary View](#)

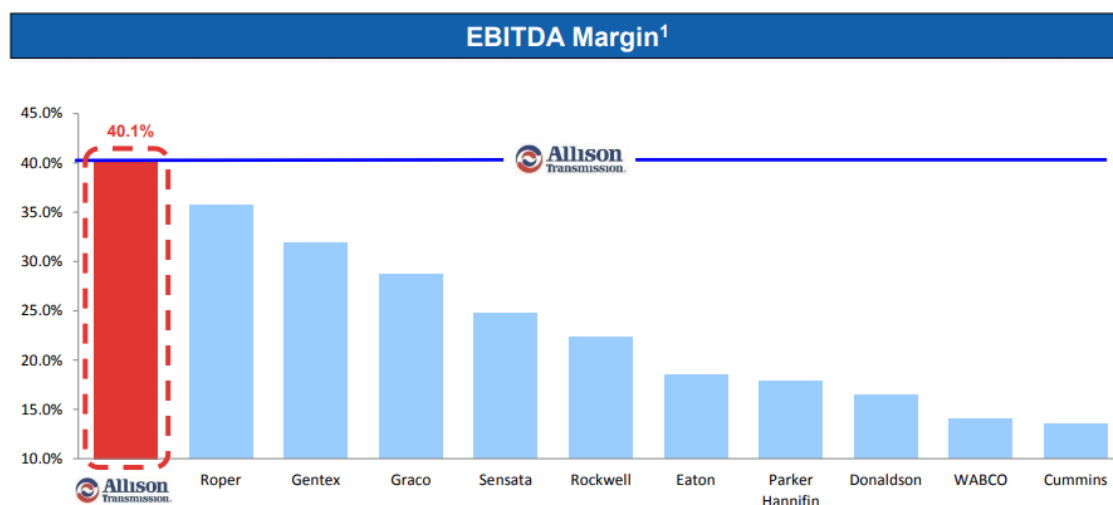
Search for Names

▼ Name USD in Billion except per share data	2014	2015	2016	2017	2018	2019
▼ Cash Flow from Financing Activities						
▼ Cash Flow from Continuing Financ...						
▼ Issuance of/Payments for Com...						
Payments for Common Stock	-0.25	-0.31	-0.26	-0.89	-0.61	-0.39
Proceeds from Issuance of ...	—	—	—	—	—	—
Total Issuance of/Payments for...	-0.25	-0.31	-0.26	-0.89	-0.61	-0.39
▼ Issuance of/Repayments for D...						
▼ Issuance of/Repayments for...						
Proceeds from Issuance ...	—	0.47	1.00	0.82	0.00	1.24
Repayments for Long Te...	-0.16	-0.61	-1.22	-0.43	-0.03	-1.24
Total Issuance of/Repayme...	-0.16	-0.14	-0.22	0.39	-0.03	0.00
Total Issuance of/Repayments ...	-0.16	-0.14	-0.22	0.39	-0.03	0.00
▼ Issue and Financing Costs						
Debt Issuance Costs	0.00	-0.01	-0.02	-0.01	0.00	-0.01
Total Issue and Financing Costs	0.00	-0.01	-0.02	-0.01	0.00	-0.01
▼ Cash Dividends and Interest Paid						
▼ Cash Dividends Paid						
Common Stock Dividen...	-0.09	-0.11	-0.10	-0.09	-0.08	-0.07
Total Cash Dividends Paid	-0.09	-0.11	-0.10	-0.09	-0.08	-0.07
Total Cash Dividends and Inter...	-0.09	-0.11	-0.10	-0.09	-0.08	-0.07

ALSN Stock Analysis – Cash Flow – Source: [Morningstar](#)

Such heavy spending is possible because the company has pretty good margins on its products.

Industry Leading EBITDA Margin



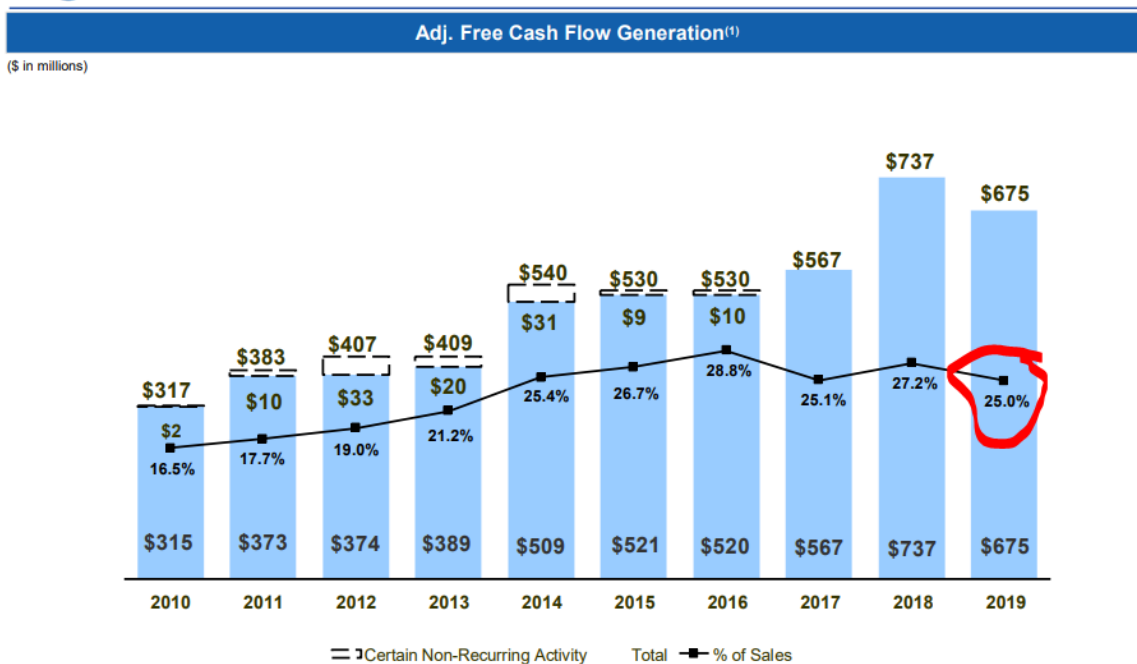
1. Fiscal year 2019 peer EBITDA provided by FactSet. EBITDA included above may not be consistent with such entity's reported EBITDA or Adjusted EBITDA, if available. EBITDA Margin: EBITDA or Adjusted EBITDA divided by net sales.

*See appendix for comments regarding the presentation of non-GAAP financial information.

ALSN Stock Analysis – EBITDA Margin – Source: [Allison Transmission IR](#)

Having good margins also means you have an advantage over other producers which indicates business quality – always a good thing to invest in. Good margins lead to high free cash flows and a high return on capital.

Significant Cash Flow Generation



Note: See appendix for comments regarding the presentation of non-GAAP financial information.
 (1) See appendix for a reconciliation of Adjusted Free Cash Flow.

Allison Stock Analysis – Free cash flow – Source: [Allison Transmission IR](#)

On the current market capitalization of \$3.94 billion, average free cash flows of \$509 million per year over the last 10 years indicate to a free cash return of 12.9%.

I always like to look at the debt structure of a company and they have a significant amount of it, \$2.5 billion. In case of deteriorating cash flows, the debt will become a bigger and bigger issue.

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Allison Transmission Holdings, Inc.
Consolidated Balance Sheets
(dollars in millions, except share data)

	December 31, 2019	December 31, 2018
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 192	\$ 231
Accounts receivable - net of allowance for doubtful accounts of \$1 and \$1, respectively	253	279
Inventories	199	170
Other current assets	42	45
Total Current Assets	686	725
Property, plant and equipment, net	616	466
Intangible assets, net	1,042	1,066
Goodwill	2,041	1,941
Other non-current assets	65	39
TOTAL ASSETS	\$ 4,450	\$ 4,237
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 150	\$ 169
Product warranty liability	24	26
Current portion of long-term debt	6	—
Deferred revenue	35	34
Other current liabilities	202	197
Total Current Liabilities	417	426
Product warranty liability	28	40
Deferred revenue	104	88
Long-term debt	2,512	2,523
Deferred income taxes	387	329
Other non-current liabilities	221	172
TOTAL LIABILITIES	3,669	3,578
Commitments and Contingencies (see NOTE 18)		
STOCKHOLDERS' EQUITY		
Common stock, \$0.01 par value, 1,880,000,000 shares authorized, 118,199,782 shares issued and outstanding and 126,251,266 shares issued and outstanding, respectively	1	1
Non-voting common stock, \$0.01 par value, 20,000,000 shares authorized, none issued and outstanding	—	—
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, none issued and outstanding	—	—
Paid in capital	1,802	1,788
Accumulated deficit	(970)	(1,100)
Accumulated other comprehensive loss, net of tax	(52)	(30)
TOTAL STOCKHOLDERS' EQUITY	781	659
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	\$ 4,450	\$ 4,237

The accompanying notes are an integral part of the consolidated financial statements.

Allison Transmission Stock Analysis – Balance Sheet – Source: [10K](#)

NOTE 8. DEBT

Long-term debt and maturities are as follows (dollars in millions):

	December 31, 2019	December 31, 2018
Long-term debt:		
Senior Secured Credit Facility Term B-3 Loan, variable, due 2022	\$ —	\$ 1,148
Senior Notes, fixed 5.0%, due 2024	1,000	1,000
Senior Secured Credit Facility Term Loan, variable, due 2026	644	—
Senior Notes, fixed 4.75%, due 2027	400	400
Senior Notes, fixed 5.875%, due 2029	500	—
Total long-term debt	\$ 2,544	\$ 2,548
Less: current maturities of long-term debt	6	—
deferred financing costs, net (see NOTE 2)	26	25
Total long-term debt, net	\$ 2,512	\$ 2,523

They still have two years to refinance the \$1 billion loan, but the cost of it will depend on the business environment for the company.

Allison Transmission Holdings Inc
NYSE: ALSN

+ Follow

33,63 USD +0,25 (0,75%) ↑

Closed: 7 Apr, 16:55 GMT-4 · Disclaimer
After hours 33,90 +0,27 (0,81%)

1 day 5 days 1 month 6 months YTD 1 year 5 years Max

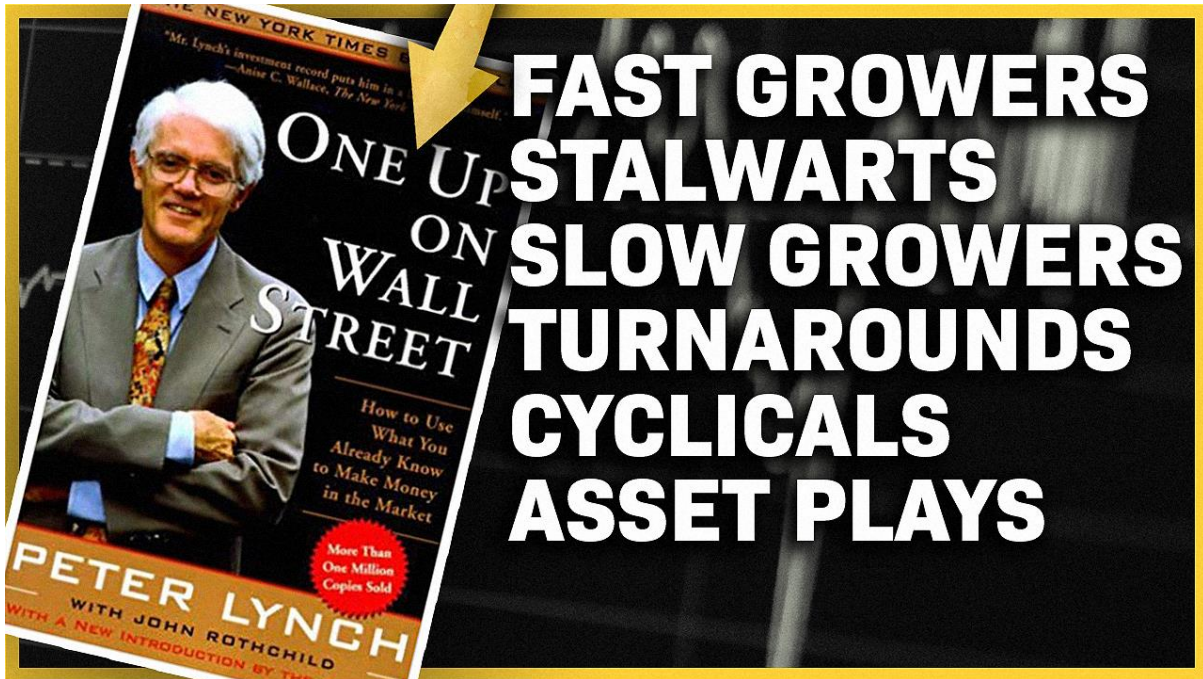


Open	34,41	Div yield	2,02%
High	35,26	Prev close	33,38
Low	33,12	52-wk high	50,46
Mkt cap	3,94B	52-wk low	26,15
P/E ratio	6,85		

We have now discussed the past for ALSN, and it looks really good. However, it is time to discuss the future because investing is about the future, unfortunately not about the past – that would make things easy.

Allison Transmission stock analysis – outlook

For me, categorizing a stock into the [6 categories](#) discussed in Peter Lynch’s book One Up On Wall Street makes it much easier to know what to expect from a potential investment.



I would categorize ALSN’s business as cyclical. Demand for its products depends on economic activity, interest rates and the general sentiment.

ALSN’s market might be less cyclical than the Linehaul Class 8 market but it is still cyclical.

North America On-Highway End Market

	Class 1-3	Underserved Class 4-5	Core Addressable Market				Underserved Class 8 Metro ¹	Class 8 Tractor (Linehaul)
			Motor Home	School Bus	Class 6-7	Class 8 Straight		
Vehicles								
Weight (000s of lbs)	< 14 lbs	14 – 19 lbs	16 – 33 lbs	16 – 33 lbs	19 – 33 lbs	33 lbs+	33 lbs+	33 lbs+
2019 Industry Units Produced	11,843,394	119,464	16,345	35,340	117,624	94,510	77,855	170,091
2019 Allison Share	0%	16%	41%	84%	76%	74%	7%	0%

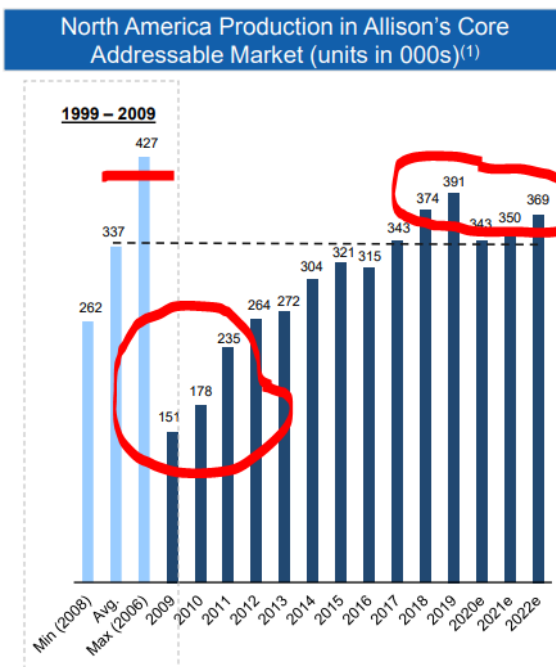
- ~30-40% of Allison’s North America On-Highway market volume is driven by municipal spending, reducing end-market volatility
- Multi-year opportunity to gain share in Class 4/5 with recent medium-duty commercial truck launches by Chevrolet and Navistar, exclusively with the Allison fully-automatic
- New opportunity to further grow share in Class 6/7 with the upcoming launch of the new Mack MD Series commercial truck, exclusively with the Allison fully-automatic
- Growing opportunity in Class 8 Metro¹ and Tractor markets with the new Allison Regional Haul Series™ fully-automatic transmission², with proprietary xFE and FuelSense® 2.0 technology

Note: Analysis excludes Allison’s Transit/Coach Bus and Electric Hybrid Transit Bus volume.
 Source: Class 1-3 from WardsAuto North America Production – December 2020; Core Addressable Market and Class 8 Tractor from Allison and ACT Research.
 1. “Metro” is a term for tractors that are used in urban environments, currently representing ~30% of the Class 8 tractor market.
 2. Beginning in the second half of 2020, the Regional Haul Series will be an available option on the Freightliner M2 112 and the Cascadia

In 2009, the market fell 65% compared to the average of the previous 3 years and it took 6 years to recover to the previous long-term average as it never reached the previous cyclical highs.

Core North America On-Highway Opportunities

- Anticipated return to normal production levels following cyclical high
 - State & local gov't spending along with housing market recovery continue to support demand for medium and heavy-duty trucks
 - Lack of near term significant EPA emission changes tempers cyclicity
- Allison's growth is further supported by
 - Stability of Class 6/7 MD market
 - Growing first and last mile delivery sector
 - Continued demand for fuel efficient vehicles
- Opportunities to penetrate underserved Class 4/5 and Class 8 Metro markets
 - Recent share gains in Class 4/5 with medium-duty commercial truck launches by Chevrolet and Navistar, exclusively with the Allison fully-automatic transmission
 - Allison Regional Haul Series fully-automatic transmission for the Class 8 Tractor market will launch with Freightliner Trucks in 2020



(1) Source: ACT Research, January 2020. Includes: Class 4 thru 8 less Class 8 Tractor & Class 8 Straight with Sleeper. 2019: Total 634,126 less Class 8 Tractor of 247,946 less Class 8 Straight with Sleeper of 3,070.

The question is, will there be more market growth or is it a market destined for a slow, but long structural decline due to the EV danger.

The screenshot shows a CNBC news article. At the top is the CNBC logo and navigation menu with categories like MARKETS, BUSINESS, INVESTING, TECH, POLITICS, and CNBC TV. The main headline reads: "Amazon is purchasing 100,000 Rivian electric vans, the largest order of EV delivery vehicles ever". Below the headline, it says "PUBLISHED THU, SEP 19 2019-3:06 PM EDT | UPDATED THU, SEP 19 2019-5:34 PM EDT" and the author "Elijah Shama". There are social media share icons for Facebook, Twitter, LinkedIn, and Email. A "KEY POINTS" section lists three bullet points: Amazon's order for 100,000 vehicles to run on renewable energy, prototypes expected next year, and Rivian's statement that the order won't affect other EVs. A large image shows Amazon CEO Jeff Bezos in front of a blue Rivian electric van with "Amazon delivery vehicles" and "prime" branding. To the right is a "TRENDING NOW" sidebar with four items: Tesla cutting pay, Boris Johnson in intensive care, US coronavirus cases doubling, and Trump blaming WHO.

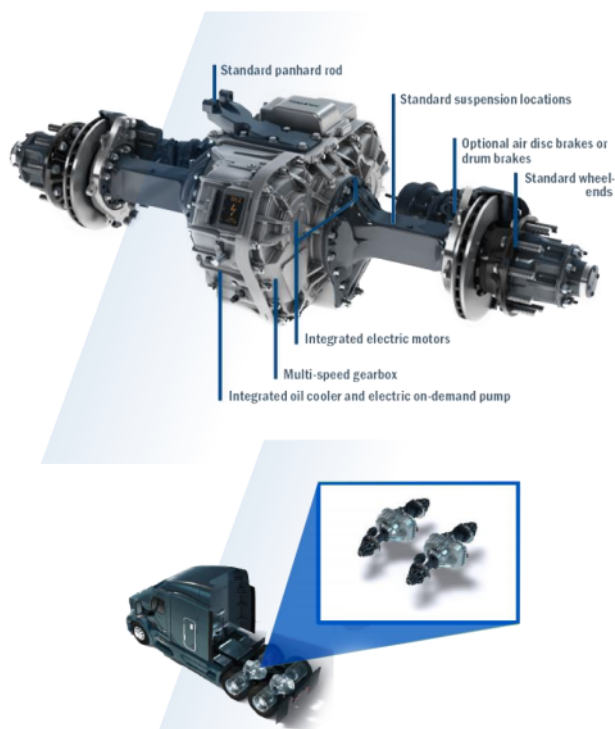
ALSN’s market threat – Source: [CNBC](https://www.cnbc.com)

However, they have two growth opportunities out there. One is to expand globally as they are doing by opening factories in Hungary and India.

The second growth opportunity comes from the hybrid business and new potential EV business. However, that is an area with high competition and they will likely not have the advantages they have in the traditional business thanks to their GM heritage.

Commercial Truck and Bus e-Axle Solutions

- Line of fully integrated electric axles designed to fit between the wheels of medium- and heavy-duty trucks and buses
- Allison's electrified bolt-in solution is compatible within the current vehicle frame, suspension, wheel-ends, and OEM vehicle assembly process
- Features fully integrated electric motors, a multi-speed gearbox, proprietary oil cooling and pump, providing one of the industry's top performing and most efficient solutions
- Ideal propulsion solution for battery electric, fuel cell electric and range extending electric hybrid vehicles



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Conclusion

The conclusion is simple. ALSN is a cyclical stock and the best time, the lower risk and higher reward investment opportunity with such businesses, is when the fundamentals start to improve, not heading into a recession.

Secondly, one must carefully watch the EV threat as it is fancy to buy an EV garbage truck. Maybe it is not feasible now, but going into the second part of this decade, there will be much more supply at lower prices where we don't know how will ALSN fare in that environment.

On a cash flow basis, the company is also still a bit expensive because we can expect it to see slow or even negative growth over the coming decade. On top of that the company has \$2.5 billion in debt that will become a burden at some point in time (it always does in a cyclical industry).

Despite my cloudy outlook, I would say that if someone follows the company over the next decade, carefully assesses the technology, he or she might buy just before ALSN gets to a breakthrough. The positive situation might never materialize, but it might be worth to follow.