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Reminiscences of an eBay Operator

Dear fellow investors,

As our investors are aware, we relocated our company to Phoenix, AZ in July of this year. After buying a home a couple months ago, my wife and I have been getting down to a few of the last remaining boxes. She is getting our house ready for Christmas (my favorite time of the year) right now as well. She brought me a box of ornaments that my mother has given to us over the years. This box is full of ornaments that we've never opened. My wife let me know that I need to get rid of them. I'm an economic minded person at heart, so I decided to check what I could sell them for on eBay (EBAY). Yes, it was interesting to see the Harry Potter and Top Gun ornament with value above what my mother paid for them. It was more interesting to see how many sold for below what she bought them for. What a great way to look at what is going on in equity capital markets!

The retail price of many of these Hallmark ornaments was \$15-20 when they were originally purchased. The most interesting of them all is a Hallmark Heat Miser ornament. The character is from the movie *The Year Without a Santa Claus*. This ornament retailed for \$14.95. Ebay says the average selling price for this item is \$74, before they take their fee of 10%. So, the best potential return of these ornaments has been 495% from a period of about four years ago. This sounds great, and most investors will leave it at that and tell you about their winnings. You may know people who tell you about the money they won.

Charlie Munger teaches us to invert the situation to see how it looks on the other side. Inverting this situation would have you look at all the other ornaments. To pull another one out at random, I looked at the Disney

Hallmark Sofia the First ornament. It originally retailed at \$14.95, just like the prior one. Ebay says that the average selling price is \$15. Here we are, years after acquisition, hoping to get \$15 before eBay reduces that by 10%. To summarize, you're excited to only lose 10% of the value years later.

Heed this advice for the current stock market activities: Fear stock market failure! Wall Street is pumping out IPOs, SPACs and all kinds of neat, shiny ornaments. They are selling what is in season. To name a few of these themes: WFH (work from home), TAM (total addressable market), food delivery, eGaming, remote learning and technology dependence. These are wonderful slogans for selling ornaments to willing buyers.

Sofia the First debuted in 2012. A few years later (2015), Hallmark licensed with Disney to sell the ornament. Sofia the First hasn't aired a new episode since 2018. Why did Hallmark sell the ornament in 2015 for \$14.95 to my mother? Because it was marketable, and the buyers were there. This is what Buffett refers to as a "negotiated deal."

An IPO situation more closely approximates a negotiated deal. I mean, the seller decides when to come to market in most cases. And they don't pick a time necessarily that's good for you. So, it has —

I think it's way less likely that, in scanning a list of a hundred securities that are trading in the auction market, well, in the — a hundred IPOs, if you scan a hundred IPOs, you're going to come up with something cheaper than scanning a hundred

companies that are already trading in the auction market.

...So you're way — in my view — you're way more likely to get incredible bargains in the — in an auction market. It's just the nature of things.

We concur with Buffett and believe there are some incredible bargains in the "auction market" as we speak. However, that isn't what the financial media and the individual and institutional investors are excited about. They are all interested in a "negotiated deal."

Remember that in the eBay cases, there were fees involved (10%). It's no different in a "negotiated deal." The banks love to sell these themed ornaments, because they get financially rewarded. The WFH themed ornament: Zoom. The food delivery ornament: DoorDash. The eGaming ornament: Roblox. You might say that this is a **hallmark** of Wall Street.

To finish the point with the winners, we looked back at a former holding of ours: Booking Holdings. Booking went public on March 29, 1999 at \$16 dollars. It shot to the moon during that year. If an investor had bought that internet-themed ornament and held it for 10 years from the IPO, they would have woken up down 17.94% at the end of the first quarter in 2009. Let me repeat that, it took 10 years to get there. Remember, Booking ended up being one of the winners! The Sofia the First ornament for sale on eBay only losing 10% four to five years later will go down like Booking among the many pyrrhic victories that you can find in a "negotiated deal," years later in an "auction market."

To belabor the point like Buffett did in the 2004 shareholder meeting, Wall Street comes "with an informed seller thinking it's a pretty good time to go



public. And, you know, you'll make better buys, in my view, in an auction market." For us at Smead Capital Management, we are stock market investors that specialize in an "auction market." We think the "auction market" is giving "crazy prices," as Buffett said in that same meeting, in the energy, housing, real estate and financial industries. We advise you to avoid these themed ornaments in the early years of existence. Instead, wait for years to go by and allow them to establish history in the "auction market." We will be waiting to consider investments in the dead bodies left over when the shine comes off today's recently issued IPOs and SPAC offerings. 🦋

Fear stock market failure my friends,

Cole Smead, CFA

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