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MUTUAL FUNDS

Amazon, Alibaba, Facebook: A Top Mutual Fund's Bets

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INVESTOR'S BUSINESS DAILY

Aziz Hamzaogullari is cooking. He has led his $1.6 billion Loomis Sayles Growth Fund to an 11.43% gain this year through Nov. 30. That smokes 94% of the fund's large-cap growth rivals tracked by Morningstar Inc.

And he's consistent. Since taking the fund's helm on June 1, 2010, he's carved out a 17.35% average annual advance through Nov. 30.

That topped 95% of his peer mutual funds, which averaged 14.43%. The S&P 500 averaged 14.32%. In November the fund rose 1.04%, above the average U.S. diversified stock mutual fund tracked by Lipper Inc.

Hamzaogullari has compiled this record by following an old-school investment recipe. He thinks long-term. He seeks companies whose managers act like owners. And he waits for scary stock market news to create buying opportunities.

Hamzaogullari, who is 46 years old, talked with IBD from his office in Boston about the investment style he uses for this top-performing mutual fund.

IBD: What's your investment approach?

Hamzaogullari: We care about three drivers in each business that we consider as an investment. First, we start with the quality of the business. For us, it has to be one that would be difficult to replicate by someone else.

Second, we want these businesses to have sustainable and secular growth.

Third, we want to buy them only when they trade at a significant discount to our estimate of their intrinsic value.

IBD: Must every stock that you buy be trading at a significant discount, or just most of your buys?

Hamzaogullari: We always want that discount. We want to create a margin of safety.

IBD: How big does the discount have to be? Does it vary from one sector to another?

Hamzaogullari: A business must have at least 40% upside. Does that vary from sector to sector? Yes. But it's a minimum of 40%. We also look at the downside. The reward-to-risk ratio needs to be at least two-to-one, ideally three-to-one.

IBD: Did you do a lot of buying from the bargain bin this summer during the downturn?

Hamzaogullari: Yes, we added in the last quarter to five positions in total. We added to **Alibaba**[BABA], **Qualcomm**[QCOM], **Procter & Gamble**[PG], **Coca Cola**[KO] and to **Schlumberger**[SLB].

We sold **Altera**[ALTR], which was in the process of being taken out by **Intel**[INTC].

IBD: The market is characterized by slow growth and the prospect of higher interest rates. Do those conditions help or hinder your investment approach? Or are they irrelevant due to your long time horizon?

Hamzaogullari: Our time horizon is much longer than the next 12 months. We measure success in terms of sustainable free cash flow growth over at least five years.

We believe many investors are too focused on the short term, and they end up overreacting to macroeconomic information that we believe does not impact the long-term fundamental intrinsic value of a business.

IBD: So the impact is that missteps by other investors create opportunity for you?

Hamzaogullari: Yes, we believe short-term focus creates pricing anomalies that create opportunities for long-term managers like us. It requires patience.

We like to take advantage of other investors reacting to macro or short-term changes.

Because we define growth as free cash flow growth, we look for companies growing at at least twice the rate of the overall economy. We tend to invest in companies with above-average cash flow regardless of the environment we're in.

IBD: Your annual turnover rate was 14% as of Sept. 30. Why so low?

Hamzaogullari: We approach investing as if we are buying a private business. We believe a low turnover rate is a competitive advantage. It enables us to take advantage of the short-sightedness of other investors by investing in great businesses at discount prices. Those opportunities arise when there may be a short-term disruption in a perfectly healthy long-term business franchise.

IBD: But don't most businesses fail to sustain above-average growth for a long time?

Hamzaogullari: That's true. But when you find one, it may take a long time for the business to realize its value because the market they address is significant in size.

For example, we owned **Amazon.com**[AMZN] since 2006. When we invested in it, the penetration rate for online retail was in the low single digits. Today online accounts for around 6% to 7% of total retail. We believe it will take a long time before the company exploits the long-term opportunity, which is about 25% of total retail. So they are still trading at a big discount to intrinsic value.

IBD: What's your batting average?

Hamzaogullari: If you look at our history over the past 9-1/2 years (including the strategy's institutional track record), we sold about 40 companies in that time.

Roughly 45% of those sells were because they reached intrinsic value.

Another 25% were sold because we found better risk-reward opportunities.

And about 30% happened because there was a fundamental change in the business drivers, which permanently lowered the value of the business.

IBD: So you made about 30% of the sells because your thesis was wrong?

Hamzaogullari: Correct.

IBD: Facebook's[FB] earnings per share rose 16% and 33% the past two quarters. What's your thesis?

Hamzaogullari: It's a good illustration of our focus on quality, growth and valuation.

Quality is in its competitive advantages — its network, scale, strong brand and platform. With over 1.5 billion global users, the scale and reach are unrivaled.

There's a virtuous cycle between users and advertisers. Those competitive advantages would be very hard for someone else to replicate.

They're also driven by a secular shift from traditional advertising to online advertising.

Now, over the past five years, global ad spending grew 1.5% (on a compounded annual growth rate), while online grew 16.5%. We expect online advertising to continue to outgrow overall advertising spending.

As for valuation, we believe that it still does not reflect the long-term free cash flow growth the company can obtain, so they're still trading at a big discount to our estimate of their intrinsic value.

IBD: With **Visa**[V], you've built your stake in each of several recent disclosures. What do you like there?

Hamzaogullari: The company's advantages include its brand, its comprehensive offering of payment products and its client relationships, which create substantial barriers to entry.

Their addressable market is about $40 trillion in personal consumption expenditure or PCE (a metric for measuring consumer transactions). About 55% of the dollar volume and 85% of the transaction volume is still paper-based, so there's a long growth path for this company.

Also, Visa's 60% of global electronic payments represent only 10% of global PCE, so that also suggests a significant growth opportunity.

IBD: You added to your stake in Amazon last year. What were you betting on?

Hamzaogullari: We took advantage of weakness in shares last year and added to our position.

Their competitive advantages are their grand scale, their platform and their logistics and distribution system.

Those advantages let Amazon offer convenience, low prices and wide selection to consumers. They have lower capital requirements than brick-and-mortar stores. And there's a secular shift from brick-and-mortar to online retail.

Amazon is also growing their AWS (Amazon Web Services).

So overall they're growing more than twice as fast as the traditional retail market and several multiples higher than the overall retail market. And the long-term transition to e-commerce is still in an early stage.

IBD: You've boosted your stake in **Monster Beverage**[MNST] for two straight disclosures. What's your thesis?

Hamzaogullari: They have strong brands, advantages of scale and a strong entrepreneurial culture. And the company's capital intensity is among the lowest in the entire consumer staples sector. In terms of growth, energy drinks are here to stay. Penetration around the world is a key long-term business driver.

Monster's large presence in North America and foreign expansion position it to benefit from long-term secular growth. Consumption of energy drinks is low, and there's lots of opportunity for growth.

Energy drinks are one of the fastest growing drink segments.

There are two leaders: Monster and Red Bull. They represent about 70% of the U.S. market and an estimated 45% of the global energy drink market.

In August 2014, Coke — another holding in our portfolio — bought a 16.7% stake in Monster. We expect Monster to realize faster global expansion and achieve growth and profitability more quickly.

Coke and Monster leverage each other's core competencies. They will help each other.

International markets are the biggest opportunities for Monster.

Red Bull's market share is about seven times Monster's, despite having almost equal shares in the U.S.

With access to Coke's distribution, Monster will be able to increase its global presence and pace of expansion, taking share. And its valuation is very attractive.

IBD: You've increased your stake in **Novo Nordisk**[NVO] for several quarters. Shares have been trading in a tight range since August. What do you like?

Hamzaogullari: In a large and growing global market, Novo has a history of investing in treatment of diabetes.

Their history of formulating and delivering diabetes treatments is unmatched in the industry.

The company has other advantages too, including a large suite of patent protection for both biologic therapies and delivering mechanisms. They have a significant scale advantage in research & development as well as distribution, and a strong pipeline of late-stage and next-generation treatments.

The diabetes market is growing at a low double-digit pace in the last decade. There is an estimated global diabetes population of 400 million. It is estimated that close to 600 million people will have diabetes by 2035. The driver is an aging population and increasing obesity rates. Novo dominates this market.

Novo has over 25% of the $40 billion diabetes market. We expect this company to grow free cash flow at a midteens pace over our investment time horizon.

IBD: Your Alibaba stake has more than tripled over the past four quarters. Is the stock wobbly because of China's overall woes?

Hamzaogullari: The company has been under pressure, and we have been taking advantage of short-term dislocation by increasing our stake.

The company has big competitive advantages, including a powerful network and business ecosystem.

The company also has significant site traffic, which meaningfully reduces its reliance on search engines, which gives them a structural cost advantage.

Its brand is very strong. It is synonymous with e-commerce in China.

It represents over 50% of total package volume in China in the last 12 months.

China's e-commerce growth is its key long-term driver. Within China, ecommerce accounts for 11% of total retail. We expect that to increase to around 25% over the long term. With over 70% of the Chinese online market, we expect Alibaba to be the prime beneficiary of this growth.

And only 668 million of (China's) total population of 1.4 billion people were Internet users as of 2014. We believe this can grow to 805 million.

(Wall Street) expectations for Alibaba are quite low, creating opportunity in terms of its intrinsic value.

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