Banyan Capital Management

April 25, 2019

Banyan's equity composite was up 9.37% in the first quarter of 2019 while the S&P 500 was up 13.65%. Our absolute performance was satisfactory; our relative performance was sluggish. This is fine with us. Caution is warranted, and we are proceeding accordingly.

To that end, we sold our final shares of AT&T and Amazon in February and April, respectively. We made 0.8% on AT&T including dividends and over 150% on Amazon. This leaves us with a large cash position. We will be disciplined in putting this money back to work.

It is worth discussing our reasoning for selling these two stocks. The companies could not be more different. AT&T is a stodgy telco dependent on legacy businesses struggling to adapt to a digital age. Amazon, on the other hand, is a dynamic tech titan at the epicenter of the digital revolution.

Amazon's next decade will undoubtedly be brighter than AT&T's, but their valuations reflect that. Whether buying real estate or stock, you must ask what an asset is expected to *produce* relative to its *price* within the context of other *opportunities*. From that perspective, consider the following:

1. **AT&T** | AT&T's fully diluted market cap was roughly $225 billion when we received the stock as part of the consideration for our Time Warner holding and when we sold our final shares. Yet, AT&T's management expects the company to produce $26 billion of free cash flow in 2019, which equates to an "earnings power yield" somewhere north of 10%.

2. **Amazon** | Amazon's fully diluted market cap was roughly $345 billion when we purchased it in mid-2016. It was valued at roughly $920 billion when we sold our final shares. Yet, Amazon *may* produce $40 billion of *pretax* earnings in 2019 *after* excluding a large portion of its operating expenses, which we assume are better categorized as investments to fund growth. Thus, Amazon's "earnings power yield" *may* be as high as 4.4%.

Due to their vastly different valuations, Amazon and AT&T face vastly different hurdles. To make investors money, Amazon must continue gobbling up market share in retail and cloud computing; AT&T, on the other hand, must simply keep the ship afloat.

Banyan Capital Management, Inc.
2100 RiverEdge Parkway, Suite 1030, Atlanta, Georgia 30328
Phone 770-951-2129 Fax 770-951-8277
www.banyancapital.com

We concluded both hurdles are too high. AT&T's businesses are in worse shape than we thought, and its earnings power may erode materially. In contrast, Amazon's earnings power will continue to grow, but it must produce $74 billion of earnings before it offers owners an 8% return on their money. Both may clear the hurdles before them, but we no longer like the odds.

Our purpose at Banyan is singular – ***building permanent wealth***. This requires more than buying the right stock. It also requires selling a stock when the hurdle is set too high. At times, the height of the bar is the issue. At others, it is the athlete's health. Either way, the result is the same – a heightened chance of suffering a permanent loss. We prefer champion athletes facing low hurdles.

Sincerely,

Drew Estes
Partner & Portfolio Manager

Alek Nabulsi
Partner