Cologne-based **Flossbach von Storch** ("FvS"), founded in 1998 by Bert Flossbach and Kurt von Storch, is one of Europe´s leading independent investment management firms with > 120 employees and TAUM of > $24 billion. They manage global multi asset strategies, equity, bond and convertible funds for both private and institutional clients. They are longer-term investors.

Ludwig Palm is a Portfolio Manager at Flossbach von Storch. He manages the dividend fund and co-manages the fundament fund. He joined Flossbach von Storch in 2012 and was previously with Credit Suisse's Investment Banking Division in London and Frankfurt.

FvS has €23 billion ($24 billion) AUM - is that all managed from Cologne?

"Yes."

Why are you not Frankfurt based?

"The co-founders (both ex Goldman Sachs) wanted to be away from the noise as in Frankfurt there is a lot of noise. We get the information here that we need but it helps when you are investing for the long term to be away from the noise."

Of €23 billion AUM - what is the asset and geographic split?

"Currently around 65 % in equities ($15 billion). Ca. 55% US, 15% both Europe and Switzerland, 5% both the UK and Japan with the remainder the rest of the world."

How many investment professionals are employed at FvS?

"32".

Do you split geographies and sectors?

"We have some sector allocation among our analysts but we make sure that everybody gets a perspective across sectors. I am a generalist, as a fund manager you need to know something about every sector.

Everybody is global but we do have a separate emerging markets team. They run an emerging markets fund and also give us some input for the global mandates. The world is global - China and India depend on the US and vice versa and Europe as well. We have a global interconnected world.

Sectors also merge together. Look at the retail space - it is heavily impacted by technology, so is banking and finance so you can think of us as portfolio managers and analysts but everybody works together. Being a small team is one of our advantages, we all sit on the same floor so the information flow works well."

What is the firm's investment style?

"Risk/reward across asset classes and within the asset class. How do we do that? We have a view of the world. For example, we believe that interest rates will remain low for a long time because government debt and the debt around the world are too high. So central banks will keep interest rates low. So that's asset allocation which leads us to equities and within equities we have a quality bucket. We believe, like Charlie Munger, it's better to buy a great business at a fair price than a fair business at a great price. So we take valuation into consideration but our style is quality biased. Growth for us is part of the value."

Which benchmarks do you use?

"For the global equity funds, we use the MSCI World. But when we build a portfolio, we start with a blank sheet, we don't think about the benchmark. We build it bottom up and think about good companies and if the price we pay is fair. Then we look top down to see if we have some balance between regions and sectors. So we are independent from the benchmark."

What's your active share ratio?

"It's likely to be high. I know the top positions in the MSCI World but for my portfolio it doesn't matter at all. We own stakes in companies like Apple and Microsoft and many of the blue chips but that's not because they have a high weighting in the benchmark. It's because we think risk/reward is good for those companies at the moment. We currently feel some of the small caps are a bit overvalued and the market is paying very high prices for small caps. When the next crisis comes, if small cap prices get crashed and the risk/reward is right, we will be ready to buy them. But at the moment we believe risk/reward for the blue chips is better."

Do you have a target price when you buy a stock – i.e. 20% upside?

"Not really. What we look for is quality and a price that makes sense.

We look at certain quantitative factors like return on capital, balance sheet and growth profile. However, qualitative factors are more important as everyone can focus on quantitative factors on Bloomberg. The qualitative factors include whether the company has an economic moat and how big is it; we look at the business model and whether it is sustainable. We look at management - are they honest and capable of managing the business. And we then grade the company and this grade gives us a required return. It's just like when you buy a bond, if the issuer of the bond has low credibility then you want to have a higher yield and vice versa.

Then we estimate the free cash flows for the next 10 years and take the average and divide that by the enterprise value - which gives me a free cash flow yield. Then we compare this free cash flow yield, to our required yield and this tells us if the risk/reward is attractive."

Average length of a holding?

"Generally a long time. If we buy a business, it's usually a quality business and quality doesn't change too quickly. Obviously valuations can change and that can change the risk/reward so then we might increase or decrease the weighting of a position."

Average market cap? Market cap cut off?

"It depends on the mandate. For smaller funds we'd consider a market cap of $500 million. But to invest across our portfolios we need at least $5 billion better $10 billion. Our biggest strategy, the Multiple Opportunities, has >€9 billion so we need bigger market caps."

Typical size of positions? Value of largest position?

"We have 30-50 stocks in a portfolio. So the typical size is 2.5 - 3.3%. Usually not above 5% but if risk/reward is very attractive we could take a position up to 10%. Nestlé is currently our largest position" (>$750 million)."

Multiple Opportunities Strategy has AUM of €9 bn and you have 4% in Coca Cola - discuss?

"The Coca-Cola Company owns very strong brands. The firm also owns a global distribution network that is not easily replicable. So Coca-Cola clearly has an economic moat. You have some headwinds due to the fight against obesity and increasing health awareness (sugar) but overall it's a good business currently available at a fair price at 20 times earnings.

Why do we have a bigger position right now? It's because things are going in the right direction. In the past, some things went wrong. As it was a very successful business, an easy business; management got a little laid back. Then they faced some headwinds and they realized they needed to change things. So they've moved from a volume-based model to an incidence-based pricing model. Historically, Coca-Cola sold the concentrate at a fixed price to the bottlers. Hence, they were interested to bring a lot of product onto the market and that's why we saw the 1.5 litre and 2 litre bottles which nobody likes. But they changed the contracts with the bottlers and now Coca-Cola gets a share of the operating profit. So the bottlers and they have aligned interests. They are both incentivised to increase margin. Hence, they are doing smaller volumes i.e. 0.2 litre cans but for a much higher price. They are clearly moving in the right direction. Profitability is better for both Coca-Cola and the bottling companies.

Also there's always been a very close relationship between Coca-Cola and the bottlers and if things tend not to work, they acquire the bottlers, fix the business - the operations and marketing and sell it. They have done this in Germany. In the US they acquired the bottling business as well, as it was run inefficiently with too many plants, etc. So they are fixing the business and at some point in time, target is around 2017, they will likely exit the US bottling business. There's mostly a clear path to exit the bottling businesses. The bottling business is very capital intensive and Coke's share price performance was historically good when they exit because it becomes less capital intensive and the market rewards this with a higher multiple. So - a good business at a fair price and things moving in the right direction."

What about MasterCard which you hold in your fundament and dividend funds?

"The fundament is focused on high quality growth companies. The dividend fund is focused on dividend growth and stability which is more important to us than the current dividend yield. MA has quite a low current dividend yield (0.7%) but it is growing the dividend high double digits every year. MasterCard and Visa are one of the biggest oligopolies I've ever seen in the history of capitalism!

It's very high quality growth. I think the business model is safe - they own the network and right now I don't see any new entrants that could build their own and replace MasterCard’s and Visa’s networks. It took them decades to build the network, put the relationships with the banks and IT infrastructure in place. It's an extremely profitable business with pre-tax margins of more than 50%, and growing very fast because of the transition from cash to card. So a very high quality growth business. One of the most profitable businesses in the world."

Any sectors/themes you do/don't favour and why?

"Best we like the consumer space but also technology and healthcare. There are two sectors where we have nearly no holdings - utilities and telecommunications. They both are regulated and very capital intensive. Regulation is actually a risk for us. In the US it might be better but in Europe and other parts of the world one has to be careful. Governments and regulators often feel free to change regulation as it suits them. In the utilities space you also have the uncertainty of commodity prices."

Do you have to meet management before you buy a stock?

"Generally we try to see the management teams of companies we invest in on a regular basis."

Where do you prefer to meet management?

"We are happy to meet people in our offices in Cologne. We also often go to Frankfurt or London to meet management. Conferences are a very efficient way to meet a lot of companies. If we need to meet somebody we'll fly anywhere in the world."

Why should corporates target Flossbach von Storch?

"We run concentrated equity portfolios. We are interested in only about 200 companies around the world which are on our focus list. However, we are always searching for good businesses to extend our horizon. If we take a stake, it's usually a larger position as we tend to invest across our mandates. We have a long term view."

This article also appeared in the IR Magazine.