Sum of the Parts

The multi-business conglomerate is decidedly out of fashion on Wall Street – possibly the best argument for value investors to give them a closer look. One representative example of note: Don Graham's Graham Holdings.

Conglomerates with disparate lines of business are often fertile ground for value investors. High-profile trouble in one area may be masking ultimately more important success in another. The array of different industries represented in such companies can make them more difficult to understand, analyze and value. Through spinoffs and divestitures, their far-flung portfolios of businesses also offer a variety of catalysts for unlocking value.

A recent special report from Boyar's Intrinsic Value Research cites two key reasons for now being a particularly opportune time to seek out mispriced value in conglomerates. For one, it argues that such companies can offer "uncorrelated return potential" in an increasingly volatile and arguably fully priced market. In addition, it expects such companies to attract greater scrutiny from activist investors, who have increased both in number and also in their ambition to go after ever-larger companies. The Boyar report cites as support for that notion a recent quote from activist Nelson Peltz of Trian Partners: "You've got to earn the right to be a conglomerate. The individual businesses need revenue growth similar to or better than their standalone competitors, and their margins better be best-in-class."

Graham Holdings, formerly The Washington Post Co. prior to the sale of its namesake newspaper to Amazon's Jeff Bezos, ticks most of the boxes for an attractive conglomerate investment today, says Jon Boyar of Boyar Intrinsic Value. Its unusual business mix limits Wall Street research coverage. Recent troubles in one business appear to be obscuring strengths in others. Sales of non-core assets have made it flush with cash to invest or to return to shareholders. Last but not least, "the stock is cheap," says Boyar, trading at what he considers a 40% discount to its sum-of-the-parts intrinsic value.

"Diversified" certainly describes Graham's portfolio of businesses. Its three largest businesses by estimated value are its Cable ONE subsidiary, which provides video and Internet services to 700,000 mostly rural customers in the U.S., its Graham Media Group, which owns broadcast TV stations in Houston, Detroit, Orlando, San Antonio and Jacksonville, and its Education segment, which offers degree-granting programs and test-preparation services in the U.S. and abroad primarily under the Kaplan brand name. Its remaining media-related assets include SocialCode, a social-media marketing company, and the online magazine *Slate*. More recent acquisitions have taken it even further afield, into home-healthcare and hospice services, as well as industrial combustion equipment.

The current black sheep of the family is Kaplan, which like all for-profit educa-

INVESTMENT SNAPSHOT

Graham Holdings
(NYSE: GHC)

Business: Formerly The Washington Post Co., now a diversified holding company with primary operations in cable and broadcast television and for-profit education.

Share Information
(@10/30/14):

Price	**770.80**
52-Week Range	604.09 – 773.47
Dividend Yield	1.3%
Market Cap	$4.44 billion

Financials (2013):

Revenue	$3.49 billion
Operating Profit Margin	9.9%
Net Profit Margin	6.8%

Valuation Metrics
(@10/30/14):

	GHC	S&P 500
P/E (TTM)	9.6	18.4
Forward P/E (Est.)	n/a	16.2
EV/EBITDA (TTM)	n/a	

Largest Institutional Owners
(@6/30/14):

Company	% Owned
Southeastern Asset Mgmt	13.9%
Vanguard Group	7.0%
BlackRock	5.0%
State Street	3.2%
Dimensional Fund Adv	3.1%

Short Interest (as of 10/15/14):

Shares Short/Float	1.1%

GHC PRICE HISTORY

THE BOTTOM LINE

Largely neglected by Wall Street due to its hodgepodge of businesses and a reputational hit to its best-known one, the company appears to be reorienting itself to improve operating performance and unlock latent value, says Jon Boyar. His firm's sum-of-the-parts analysis – based on 2016 estimates – values the stock at around $1,260 per share.

Sources: Company reports, other publicly available information

tion providers has struggled with increasing regulation and declining enrollment fostered by prior-years' marketing-related malfeasance. Careful not to call a bottom for the business as enrollment trends remain negative, Boyar's Mark Boyar notes that Kaplan's cash generation has markedly improved – it earned $151 million in EBITDA in 2013, up from $12 million the year before – and that the company is "doing everything possible to hold itself out as an exemplar of proper conduct in the space. We believe it will emerge as best-in-breed when the regulatory environment is more settled."

The Cable ONE business, while highly profitable, is also not firing on all cylinders, with results dampened by decreasing video-subscriber counts and heavy spending on technology upgrades that will result in a fully digital platform by the end of 2015. While Mark Boyar doesn't expect high growth for the business, he does see upside by it improving industry-lagging revenue-per-customer metrics as its mix shifts toward high-speed data customers and as upgraded technology expands advertising revenue potential.

What are Graham's component parts worth? For Cable ONE, Boyar assumes an 8x multiple – in line with comparable transactions – on its 2016 EBITDA estimate, resulting in an equity value of $2.7 billion. For the TV stations, it applies a 10x multiple to its blended 2015 and 2016 EBITDA estimates – bolstered by growth in political advertising and increasing retransmission fees earned from pay-TV providers – to arrive at an estimated value of $1.9 billion. Estimated 2016 cash and securities, at $1.4 billion, are the next-largest store of value, followed by Kaplan, at $1.1 billion, two-thirds of which is ascribed to its international operations. Netting out corporate overhead and debt and adding in all other assets – including the discounted value of the company's $1.2 billion in pension over-funding – Boyar estimates intrinsic equity value at $7.4 billion, or just over $1,260 per share.

The eventual realization of that value rests heavily on the capital-allocation skills of Graham Holdings' CEO Donald Graham, who owns 20% of the company and, through a dual-share structure, maintains full control of its destiny. Ten years ago those skills would have been deemed first-rate, but the precipitous value declines since of the *Washington Post* newspaper franchise and of Kaplan raise legitimate concerns. Jon Boyar acknowledges the risk in betting on Don Graham, but says he believes the company's all-star board of directors – including IAC/InterActive Chairman Barry Diller, Markel Corp. President and Chief Investment Officer Tom Gayner, and Davis Select Advisers' Chairman Chris Davis – provides considerable support. In any event, he doesn't expect Graham to sit on his hands this time around when it comes to realizing value: "Our thesis isn't at all predicated on him selling everything off, but over the past year he's shown that nothing is off limits. That's clearly a positive." VII