



## Toll Bridges

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**William Smead**  
Chief Executive Officer  
Chief Investment Officer

Dear Fellow Investors:

The floating bridge between Seattle and Bellevue in Washington State is being rebuilt and will be paid for by tolls. The Narrows Bridge between Tacoma and Gig Harbor crossing Puget Sound has been rebuilt and folks are paying a toll to cross back and forth. I paid for toll privileges in the rental car when I was in New York in May visiting clients. You can't pass back and forth without using these roads and, therefore, the lock you have on the customer and your pricing power are immense. Warren Buffett used to talk a great deal about toll bridges among companies and why it makes for a great business.

A toll bridge company is one which everyone or a great number of people must cross or do business with and the best ones require very little labor and additional capital investment to maintain. It can be a utility in nature like electricity, phone, prescription drugs or cable service. Or in today's world it can be ESPN or internet search or an internet payment system. At Smead Capital Management we believe that toll bridge companies are being underestimated in the current market. The primary reason for this underestimation is the time frame which most investors operate, the worldwide scope of today's toll bridges and their connection to technologies/futuristic nature.

Toll bridge companies typically involve receiving a small amount of money from millions or billions of people for a long time. They are most rewarding to investors with long holding periods. Since the New York Stock Exchange reported recently that the average holding period for stocks traded on its exchange had fallen below one year and since that is the lowest figure since the late 1920's, we can safely assume there are very few real long-term buy and hold investors out there today. Since there are few long-term investors and very little money demanding these types of investments, we can also assume there are very few people analyzing toll bridge aspects of a business which would lead to long duration success. Under those assumptions, it is safe to assume that there is drastically less than normal demand for the common stock of these companies. Toll bridge companies have a tendency to produce very high levels of free cash flow, have wide moats (barriers to competition) and are shareholder friendly (stock buybacks and dividend increases). It means the supply of common stock shares have a strong possibility of declining. If anything happens to cause a normal or higher level of demand for longer-term investment in common stock, higher prices could follow.

Toll Bridge companies are underestimated because of their worldwide scope. PayPal serves the world as the most popular payment system on the internet. Billions of transactions will pay them a small toll. Most humans have only had 5 to 10 years experience buying and selling online. It is safe to assume that as the population ages and today's

tech savvy twenty something's become the Mom's and Dad's of the future that online transactions could grow exponentially around the world. It is hard for even me to wrap my mind around that fact. It is even harder for investors with 6 to 12 month time frames in mind to even care about considering this. ESPN (80% owned by Disney) controls almost every fan of US sports in one way or another. They have Monday Night Football, the World Series of Poker and mountains and mountains of College sports programming. And they don't have to pay most of the actors and actresses. In the World Series of Poker the actors and actresses pay \$10,000 each to act for free! ESPN then rebroadcasts the main event over and over and over much like Disney resells cartoon movies made by artists from decades gone by without any additional production expense. Like Jack Nicholson's character said in *As Good as It Gets*, "the fact that I understand this makes me feel good about myself."

The best toll bridges might be passing people my age (51) by because they have emerged in the last ten years and have new technologies connected to them. Most of the respected value investors in this country are over the age of 50 and more than likely are not regular users of the future's best toll bridges. I have never personally bought or sold anything on Ebay. Cloud computing sounds to me like something that requires use of psychedelic mushrooms. Ordering whatever you want to watch on TV at exactly the time you want to watch it probably makes a great deal of sense to Brian Roberts, CEO of Comcast, but matters very little to multibillion dollar money managers who read annual reports for a living and live and die by how they do each quarter. Roberts is buying what we believe are deeply undervalued entertainment assets to add to his toll bridge in cable service and high-speed internet access. Short-term oriented money managers and investors think he is a fool for doing it.

In conclusion, we are excited about the long-term potential of investing in toll bridge companies and believe that underestimation equates to undervaluation.

Best Holiday Wishes,

***William Smead***

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