



DISCOVERING VALUE WHITNEY TILSON JOHN HEINS

When to Hold a Winner

As value investors, we have plenty of excuses when a stock we've sold for a hefty gain continues to march higher. We tell ourselves, "We'll leave the higher-risk gains to others," or "Nobody ever went out of business making money." Both of those maxims may be true, but it still hurts to sell too early. // The topic comes to mind as we watch the shares of

SHUTTERFLY (SYMBOL SFLY), a company that lets you manage your photos online and get them printed at retail outlets. Its stock has exploded since September, when Mario Cibelli, of Marathon Partners, recommended it in our newsletter *Value Investor Insight*. He viewed the shares, then at \$26.50, as cheap based on his view that Shutterfly was shaping up to be the leader in a young business poised for explosive growth. He figured that the stock could hit \$63 in four or five years.

Big move. As we write in early April, the stock has nearly doubled, to \$52. In the interim, Shutterfly beat fourth-quarter earnings expectations and raised its estimate of 2011 sales growth to about 20%. It announced the acquisition of its largest competitor, Tiny Prints. In addition, says Cibelli, fears that social networks such as Facebook—which store users' photos digitally—

would diminish demand for photos printed on paper have waned as Shutterfly has continued to grow.

Still, we'd certainly understand if Cibelli were to cash in some of his Shutterfly shares. At its current, elevated price, isn't the stock much riskier? And if momentum investors are jumping in, isn't it better to take profits before they jump out? What happens if a disappointing quarter dashes the higher expectations that are now built into Shutterfly's stock price?

Although Cibelli has considered such unhappy scenarios, he says he's standing firm on his decision—and in doing so, he's straying from his usual investing model. "This isn't true for all the stocks I own," he says, "but in more of a growth story like this, I don't just want to be a slave to the model."

Based on Cibelli's updated analysis, Shutterfly still looks cheap. For example, Cibelli sees profit margins

expanding as the firm grows and benefits from economies of scale. He now figures that capital spending will be closer to 5% of sales, rather than the 9% he'd previously expected. And he's boosted his forecast of annual sales growth from 15% to more than 20%. Even without building in the substantial gains Cibelli expects from the Tiny Prints deal, he predicts the stock will hit \$110 in three to five years.

His conviction is bolstered by his knowledge of Shutterfly's business. Says Cibelli: "We've done

\$235. (Note: A hedge fund managed by Tilson had been short Netflix—a bet on the stock falling in price—but the fund closed its short position in early 2011.) So we asked Cibelli how his experience with the video-rental firm informs his thinking about Shutterfly. One relevant lesson, he says, is that you should be conservative in making estimates but be open to the possibility that your expectations for a company will prove to be way too low. And know that even if you are right about the story over the long term, the

"Be open to the possibility that your expectations for a company will prove to be way too low."

so much work on the company and the business that we have a very high level of conviction that four or five years from now, Shutterfly will be a substantially bigger and more profitable company than it is today. When we have that kind of conviction, we're less sensitive to short-term swings in the stock price."

Cibelli recommended the shares of **NETFLIX (NFLX)** to us at a price of \$28 in October 2006. The stock is now

stock will be volatile.

The takeaway: Don't be afraid to hold your position until the future you envision materializes. In the case of Netflix, Cibelli did hold on to some shares all the way through the first quarter of 2011. But he originally started selling at a price of about \$50. "We hope to handle that better with Shutterfly," he says. ■

COLUMNISTS WHITNEY TILSON AND JOHN HEINS CO-EDIT *VALUE INVESTOR INSIGHT* AND *SUPERINVESTOR INSIGHT*.

PETER ROSS