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The Friday Filter

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Owners matter

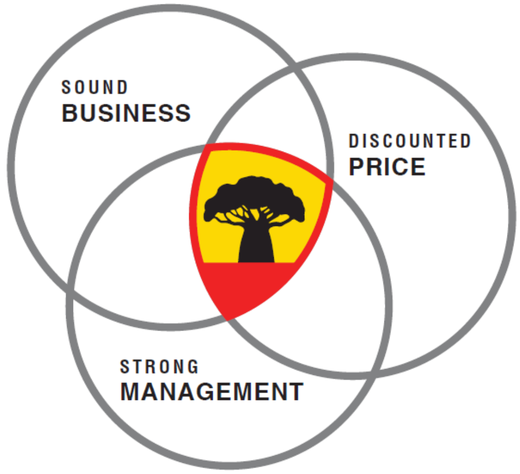
An important qualitative part of our investment process is an analysis of who the owners of a particular business are. In the current environment we are wary of businesses that have excessive passive and ETF ownership as we would view them as weak holders that do not own the companies for fundamental reasons. We have missed out by not owning these large, popular companies in recent years, but the last month or two have highlighted some of the risks of owning what everybody else owns. As risk-averse investors we have a strong preference for companies where ownership is not crowded and where we are able to buy on our terms.

When seeking new investments, we have a very strong preference for companies where excellent management, ideally founders, are large co-owners of the business. This leads to natural alignment of interests, but also promotes long-term decision making in an increasingly short-term focused world. This is well illustrated by professional management teams of large capitalisation US companies that are currently using debt to buy back their own shares at very lofty prices, even if it is unlikely to be in the long-term interests of shareholders. We prefer to invest with the owner operator who buys back shares when they are cheap and likely to enhance long-term value creation.

Within our global portfolio of companies we have significant exposure to what we would deem exceptional owner managers who form an important part of our investment thesis. The list of companies and owners includes:

- Liberty Broadband — John Malone
- Exor — John Elkann
- Oaktree Capital — Howard Marks
- Lindblad Expeditions — Sven Lindblad
- Brookfield Asset Managment — Bruce Flatt
- Fairfax India — Prem Watsa
- 21st Century Fox — Murdoch Family

We think all of these are very good companies that have not necessarily benefited from easy money and passive flows. They all sit squarely in the middle of our Investment Process diagram, being high quality companies, having strong management teams and available at attractive prices. 21st Century Fox may be the exception as the price has run up after a takeout offer from Disney and we would not be buyers at these levels.



In each of these cases our conviction is only increased by the exceptional capital allocators at the helm that are significant co-owners of the business. They are all long-term thinkers that have little regard for the next quarter or 6 months, and very importantly are very unlikely to make ego-driven acquisitions at inflated prices. All of these are businesses with strong growth opportunities ahead of them, with the right owner managers to execute on those opportunities and with whom we hope to partner with for many years to come.

From time to time an investment thesis may be supported and de-risked by institutional ownership that helps underpin the valuation.

Fiat Chrysler Automobiles is a company that we have owned for a number of years and has been a very successful investment, partly supported by the unbundling of their stake in Ferrari. We may have lost an outstanding owner operator in Sergio Marchionne who tragically passed away earlier this year, but thankfully we still have an equally good co-owner in Exor who own 29% of Fiat Chrysler. We do not like the automobile business, but we do like the potential to unlock further value within the group as is very well laid out in the letter linked below. At a time when we are very sceptical of the outlook for automobile sales, we are happy to still own Fiat because we have faith that John Elkann and Exor will unlock some of this value in the years ahead.

Our latest purchase in global portfolios is another business that operates in a very tough industry. Teekay Offshore Partners is an operator of infrastructure assets for deep-water offshore oil producers. It operates a fleet of vessels involved in the storage, production and transport of oil, as well as towing and maintenance services for the offshore oil industry. While the oil industry is very cyclical, Teekay operates under long-term contracts (4-5 years or more) and cash flows are actually very stable. While we think the company is sound and now very cheap, we would not have invested were it not for the fact that Brookfield Business Partners are the majority owners of the business. Brookfield Business Partners is the listed Private Equity arm of Brookfield Asset Management, a company we own separately and whom we rate very highly (see above). Having recapitalised the company last year, Brookfield now own 60% of the business, for which they paid $2.50 per share. Being able to buy a stake in the same company at $1.70 (a 32% discount to what Brookfield paid), creates a very good risk-reward set up in our view and we are happy to be co-owners with the Brookfield team.

It is one thing identifying a good business that is trading at a heavily discounted price. Having the right managers who themselves own a significant amount of the business creates the right alignment, promotes the right behaviour and greatly enhances the chances of long-term success and value creation.

Link to letter from US Fund Manager to John Elkann and Fiat Chrysler Board

https://www.prnewswire.com/news-releases/adw-capital-issues-letter-to-board-to-pursue-value-creation-strategies-300746687.html