Global Moat Strategy

- Concentrated all-cap
- 10-15 positions
- Investing globally in businesses with economic moats & talented managers
- Separate account or partnership structure
- $5 million minimum investment
- 1.0% asset-based fee
The Company: Dorsey Asset Management

- Independent RIA
- Majority owned by Pat Dorsey
- Focused on a single strategy
- Targeting long-term institutional investors
- Committed to capping assets to maintain performance
- $78 million in assets under management
The Strategy: Global Moat

- Invest globally in businesses with economic moats and compounding potential.
- Partner with talented capital allocators.
- Maximize margin of safety, minimize opportunity cost.
- Concentrate in 10-15 stocks.
- Minimize turnover to magnify power of compounding.
The People

- Pat Dorsey, CFA
  - Founder and majority owner
  - BA, Wesleyan University; MA, Northwestern
  - Former Director of Equity Research at Morningstar: Created investment philosophy, built team from 20 to 100 analysts, developed institutional research platform.
  - Author of *The Five Rules for Successful Stock Investing* and *The Little Book that Builds Wealth*. Contributor to *The Valuation Handbook* and to *Investments: Principles of Portfolio and Equity Analysis*
  - Frequent public speaker and media guest
The People

- Research Analysts:
  - John DeMichele, CFA
  - Robert Jackson
  - Matt Libel

- Advisory Board:
  - Brian Bares, Bares Capital
  - Peter Kinney, Acacia Capital
  - Staley Cates, Southeastern Asset Management
First Principles

- A few firms have good economics. Most do not.
- Business values can diverge from market prices.
- Capital allocation matters to value creation.
- The intrinsic value of a company is driven by:
  - The return on invested capital (ROIC) of the business.
  - The ability to re-invest capital at high incremental ROIC.
- Paraphrasing Einstein, “Compounding intrinsic value is the eighth wonder of the world.”
Economic Moats

- Absent a moat, high profits will be competed away.

- Moats are structural attributes:
  - High switching costs
  - Valuable intangible assets
  - Network economics
  - Sustainable cost advantages

- Moats insulate businesses from competition, and allow capital to be invested at a high incremental rate of return.
Management: The Value of A Good Horse

- “Good jockeys will do well on good horses, but not on broken-down nags.” (Buffett)
- Curly wins this race
Management: Seek Positive Skewness

- However, a tiny minority of managers can create enormous value via astute capital allocation – even if they don’t start with great horses.

- For great managers, decision outcomes are not normally distributed – they’re positively skewed.
Investment Process: Idea Generation

- Search globally for businesses with
  - Economic moats
  - Strong compounding potential
  - Good capital allocation
Investment Process: Elimination

- Countries with poor shareholder rights, low disclosure, or capricious legal systems
  - Russia, China, some other emerging markets

- Industries with structurally poor economics
  - Mining, oil & gas, commodity chemicals, etc.

- Managers with a demonstrated lack of respect for minority shareholders
  - Poor disclosure, self-dealing, skewed incentives
Investment Process: Digging Deeper

- Filings, background information, trade shows
- Meet management, visit company site
- Analyze competition & assess economic moat
- Contact industry sources for collateral data
- Contact suppliers & customers if appropriate
- **Goal is to thoroughly understand the competitive landscape and the opportunities for value creation**
Investment Process: Valuation

- Estimate intrinsic value using discounted cash flow
- Triangulate DCF result with other valuation tools
- Avoid false precision
  - “If it takes until line 247 of your spreadsheet to decide whether or not the stock is cheap, you’ve already lost.”
- Maximize margin of safety, minimize opportunity cost
  - The value of a dollar in a high ROIC, high growth business with a moat is higher than the same dollar in an average business.
Investment Process: Adding a Position

Step 1

Step 2

Step 3

Step 4

Step 5

Step 6

Fat Pitch

Wide Economic Moat

Strong Compounding Potential

Intelligent Capital Allocation

Talented Management

Large Discount to Intrinsic Value
Investment Process: Adding a Position

- Unfortunately, “fat pitches” are few and far between.
- When the stars do not align, we have two choices:
  - Pass on the idea
  - Judge that some criteria compensate for others
- A wide moat and strong compounding potential can compensate for a small discount to intrinsic value.
- A high discount to intrinsic value can compensate for a lack of compounding potential.
Investment Process: Selling a Position

- Material weakening of moat? Sell.
- Substantially better idea? Sell.
- Loss of confidence in management? Sell.
- Violation of original investment thesis? Sell.
- Excessive valuation? Sell.
Why Global?

- Significant opportunity set: 60% of global market cap is outside the United States.
  - Many wonderful businesses are listed outside New York.
  - Some high-return industries based outside the U.S. – Flavors & Fragrances; Testing, Inspection, Certification.
- Can be easier to build a moat in smaller markets.
- Moats are often not as well-analyzed outside U.S., leading to better pricing of great businesses.
- Basic principles of competitive advantage apply globally.
- More complexity → more opportunity.
Why Concentrate?

- Institutional portfolios typically consist of scores of managers – concentration at the manager level does not equate to concentration at the institutional level.
- More efficient time allocation
  - Fewer positions leads to in-depth knowledge of each one.
  - No “stretching” for new ideas – only need a few per year.
- Forces investment discipline
  - No “starter” positions.
  - Fewer decisions leads to better decisions.
- Why own your 30th best idea if you don’t have to?
Why Concentrate?

- Because 80% of volatility is diversified in the first 8 stocks.

Source: The Journal of Investing
Why Moats?

- Qualitative processes are hard to replicate and arbitrage. You can’t screen for switching costs.
- Understanding a moat requires deep knowledge of a business – hard to achieve in a portfolio of 50+ stocks.
- The presence of a moat creates an operational margin of safety that lessens the risk of portfolio concentration.
- Moats force a long-term view – an advantage in a market obsessed with quarterly results.
Why Capital Allocators?

- A rich source of market inefficiency.
  - Unpredictable – impossible for the sell-side to model.
  - Unconventional – creating value via acquisitions when most companies destroy value.
  - Lumpy – value creation is financially messy, and comes in spurts rather than a smooth line.
  - Patient – not focused on meeting short-term projections.

- Lowballed market expectations create opportunity.
Why Invest?

- Differentiated and disciplined strategy.
- Shareholder-friendly investment structure with reasonable fees and high transparency.
- We eat our own cooking: The bulk of Pat Dorsey’s personal capital is invested in DAM.
- Commitment to cap assets to protect investor returns.
- Southeastern Asset Management providing operational support.
Our Edge

- Qualitative processes can’t be quantitatively copied.
  - Screens don’t capture management changes, shifts in corporate strategy, or changes to capital allocation.
  - “Quality” is not low volatility and low leverage.

- Process is repeatable.
  - Basic principles of competitive advantage do not change.
  - A framework based on the application of a mental model becomes more robust over time as businesses are added to the collective mental database.
Our Edge

- Pat Dorsey knows moats.
  - Ten years training analysts and building economic moat framework at Morningstar.
  - Analyzed competitive advantages of hundreds of companies, establishing a robust circle of competence.
  - Wrote *The Little Book that Builds Wealth* about economic moats – 50,000 copies sold since 2008 publication, translated into nine languages.
  - Presented on competitive advantage to over 40 CFA societies in U.S., Europe, and Asia.
What About Risk?

- Risk – defined as permanent loss of capital – is mitigated several ways in the Global Moat Strategy.
  - **Operational Risk** is lessened by rigorous competitive analysis. No moat? Not in the portfolio.
  - **Financial Risk** is lessened similarly. Most “moaty” businesses have strong cash flow and minimal leverage.
  - **Valuation Risk** is mitigated by only purchasing businesses at a material discount to intrinsic value.
  - **Macroeconomic Risk** is lessened by avoiding commodity firms that are price-takers, rather than price-setters.
Thank You

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More on Moats: Intangible Assets

- **Brands**: Change consumer behavior by delivering a consistent or aspirational experience. Must increase consumer’s willingness to pay or lower search costs.
  - Sony vs. Tiffany
  - LVMH, Calbee, Amazon, Coca Cola İçecek
- **Patents**: Legal monopoly vs. expiry/challenge/piracy
  - Novo Nordisk, Chr. Hansen, ARM Holdings
- **Licenses/Approvals**: Legal oligopoly vs. regulatory fiat
  - Casinos, some financial exchanges, aircraft parts
  - Often highly dependent on local regulatory framework
More on Moats: Switching Costs

- Does the cost of switching to a competing product outweigh the benefits?
  - Integrate with customer business processes – upfront costs of implementation & training yield payback from renewals
    - Sartorius, Praxair, Silverlake Axis
  - Sell ongoing service relationships vs. one-time purchases
    - Rolls Royce, Oracle, Kone, Howden
  - Provide a product with a high benefit/cost ratio
    - Fastenal, Ecolab, Novozymes, Symrise
More on Moats: Network Effect

- Provide a good or service that increases in value as the number of users expands.
  - Aggregate demand by connecting fragmented groups of buyers and suppliers.
    - Edenred, Henry Schein, Kuehn & Nagel
  - Benefit from non-linear relationship between network nodes and network connections.
    - Visa, Mastercard, Facebook
- Avoid radial networks & favor interactive networks.
More on Moats: Cost Advantages

- Cost advantages are not always tied to size – dependent on specific industry economics.
  - **Process**: Invent a better or cheaper way of delivering a good or service that rivals cannot quickly replicate.
    - CDW, GEICO, Inditex
  - **Scale**: Spread fixed costs for manufacturing or distribution over a relatively large revenue base to reduce per-unit costs. Relative size matters more than absolute size.
    - UPS, Aggreko, Amazon
More on Moats: Valuation

- The value of an economic moat is largely dependent on reinvestment opportunities.
  - If a firm can reinvest large amounts of cash flow in high ROIC opportunities, the moat is very valuable.
    - Fastenal, Amazon, TransDigm, Halma
  - If a firm has limited ability to reinvest, the moat adds little to intrinsic value, but adds confidence to value estimate.
  - We prefer to own businesses with high reinvestment opportunities so we can benefit from compounding.
  - We will purchase businesses with limited ability to reinvest if capital is being returned to shareholders and the business is very cheap.