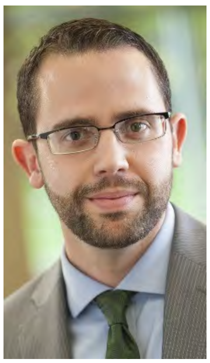

Michael D. Axel, CFA


Jacob D. Benedict, CFA


Ryan A. Kay

Winter is here! For our clients in warmer locales, please send sunshine north. Yet snow and ice won't stop us from hitting the road for research.

Scuttlebutt in Action

Value investor Phil Fisher coined the term "scuttlebutt" – the process of going beyond financial statements and engaging in on-the-ground, investigative research to sniff out investment opportunities. Our experience has shown that scuttlebutt provides valuable context and insight to investment process.

For example, this past year we identified an interesting potential investment in the stock of a construction services company. We've kept a close eye on housing-related companies the last several years given our view that housing starts will eventually normalize at a higher level, something not always reflected in the companies' stock prices. After reading the associated public documents and studying the company and its industry, we hit the road. The first trip was to a nearby city to meet with an individual who had served as an advisor to the company; the second to the company's headquarters to visit with the CEO and CFO; and the third to an actual operation of the company to tour the facilities and speak with the local manager. While the discussions with these individuals obviously stayed at a high level, the experiences helped us crystallize our view of the firm's industry and profit opportunity. The stock made it into our portfolios and we are excited about the long-term potential for the company.

The focus of these conversations usually centers on potential risks to the business. It's typically easier for an investor to think through what could go right, but it's much harder to envision all the different ways things could go wrong. How could the company lose market share? Are there new products that could threaten the company's sales? Will management do the right things with shareholder money? Are there any regulatory or litigation risks that could create sizable financial liabilities? When exploring these risks, scuttlebutt can be a huge advantage.

Stock Speed Dating

We've told you before about our trips to stock conferences, which we've described as "stock speed dating." Conference sessions consist of 20-30 minute presentations, typically by the CEO or CFO of a publicly-traded company, followed by a breakout session if the analyst wishes to ask more questions. In late September, Jacob and Josh headed down to Indianapolis for the InvestIN conference, which exclusively featured Indiana-based companies. We visited with several publicly-traded banks, a transmission manufacturer and specialty metals producer. More recently, Jacob traveled to Chicago for the Baird Industrial Conference, which hosted over 100 industrial companies, both large and small.

Perhaps like real speed dating, these conferences don't translate into immediate marriages. We rarely, if ever, have returned from one with a new stock in hand. But it does offer us the opportunity to engage with companies that we might already own, to get to know companies that we may purchase in the future if and when they encounter some short-term bump in the road that creates a cheap stock price, and to create a broader context on industries we follow and the overall investment environment. Having the chance to ask CEOs detailed industry questions and get a feel for their appetite for investment and acquisitions is a useful input, and could also be classified as "scuttlebutt." We didn't find any "brides" at either conference this fall, but we did add several companies to our watch list.

Manager Visits

As with our stocks, we like to visit with the management teams of any outside funds that we own. We visited one such manager, headquartered in the Midwest, this past fall and spent four hours at his office. During these visits, we are focused on several key issues:

1. Does the manager have some kind of competitive advantage? In other words, does he bring something to the investment process that is hard for other investors to replicate? Such advantages are rare, but powerful.
2. Does the manager have aligned interests? Has he fully put himself in the shoes of his investors? Is he a worthwhile partner?
3. Finally, we try to have in-depth conversations with the manager about their current and past portfolio positions, and ascertain if they fully and reasonably considered all of the potential risks.

We also took the opportunity to interact with a couple of investment management firms from other cities whose businesses resemble our own. This was a great opportunity to share best practices and look for ways that we can provide even better service to our clients. We came away with several new ideas that we are excited to implement in 2015.

We look forward to updating you again soon on our research efforts. In the meantime, stay warm!

Sincerely,

Michael D. Axel, CFA
Jacob D. Benedict, CFA
Ryan A. Kay