Value Investor INSIGHT
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Living Up to the Name

"Law of capitalism #1 is that excess returns get competed away," says Keith Ashworth-Lord, who does his best to invest only in companies breaking that law.

INVESTOR INSIGHT

Keith Ashworth-Lord
Sanford DeLand Asset Management

Investment Focus: Seeks companies with sustainable competitive moats in businesses "that should be in much their present form in 10 to 20 years' time."

It's pretty gutsy to take on the management of a "Buffettology" branded investment fund, as Keith Ashworth-Lord did in launching the CFP SDL UK Buffettology Fund nearly nine years ago. It's a rather tough name to live up to and there would certainly be no shortage of observers ready to take note if things didn't go well.

Naysayers, as it turns out, have had to hold their tongues. Since March 2011 Ashworth-Lord's £1.5 billion (assets) fund has trounced the market, earning a net annualized 16.0%, vs. 7.9% for the IA UK All Companies sector. Targeting mostly small to mid-sized companies that he "would prefer to hold forever," he's seeing upside opportunity today in such diverse areas as language translation, educational support, credit scores, fantasy games and pest control.

It's safe to say our readership has its fair share of learned and accomplished "Buffettologists" in their own right. Describe how you've translated your learning from Mr. Buffett into an investment strategy.

Keith Ashworth-Lord: The core idea that when you buy a stock you're buying an economic interest in a real company rather than chips at the gaming casino struck me as eminently sensible and smart. What it says is switch off the extraneous factors like predicting where the markets or economy or interest rates are going and spend all your time on the company's business, the industry it serves and the competitive market in which it operates. If you get those things and how they translate into cash generation right over time, you'll do perfectly well as an investor.

We have a pretty regimented way of going about it all. Right at the top we're looking for companies with economic moats that have consistently earned an excess return on capital without that excess return being competed away down to the cost of capital. Law of capitalism #1 is that excess returns get competed away over time. Companies that avoid that – and of course, critically, that you believe will continue to avoid that – have something very special. Much of our research is around the strength of the walls, barriers and drawbridges businesses have that keep the competition away.

We generally think profitability of capital is even more important than profitability of sales. We believe across the board that the cost of equity capital is around 10%, so we want returns on average equity to be in the late-teens or higher. We also want those to be cash returns because it's free cash flow that can actually be reinvested in the business, used for bolt-on acquisitions or handed back to shareholders through dividends and share buybacks. We look at moving five-year periods and are typically not interested unless the business is converting at least 80% of its book earnings into free cash flow. That often leads us to asset-light businesses, where generating returns depends less on physical assets.

We pay a lot of attention to operating-margin development. From garnering economies of scale and increasing bargaining power, businesses should at the very least see their margins steadily improving over time as they grow. Operating margins that are flat-lining or declining suggest to us that the economic power of the franchise is waning, which we most definitely want to avoid.

The last thing I'd highlight is our emphasis on businesses that are predictable with a higher than normal degree of certainty. By that I don't mean you can predict earnings to decimal-place precision, but more that the characteristics of the business are going to be substantially the same in ten or even 20 years' time. One classic example from the portfolio would be Diageo [London: DGE], which has a premier global roster of hard-liquor brands. In general, teetotalism isn't likely to break out globally. There's also a direct correlation between GDP per capita and hard-liquor consumption, so you can imagine developing and emerging markets firing additional demand over time. This is not a business we'd expect to be fundamentally disrupted for the foreseeable future.

How important are growth prospects?

KAL: Ideally we're looking for companies and industries that have solid growth prospects, so we can benefit both from overall market growth as well as market-share gains. But we're not overly fussed about explosive growth – in fact we worry about it because it's very hard to manage. Businesses that can steadily compound revenues at, say, 5%, 6% or 7% make wonderful investments over a long time horizon.

I should mention here that when it comes to capital allocation I always ask myself if the people running the business are acting like owners of the business or like expensively paid management consultants. I want owners, and our first choice on capital allocation is reinvestment into new projects generating high-marginal-return organic growth, which is the simplest form of growth to manage. Our next best use of capital would be bolt-on acquisitions that maybe add new expertise, new products or new technologies. We find that's often a perfectly rational use of shareholders' capital.

We're quite leery of "transformational" acquisitions. There's a horrible temptation for a professional manager with excess cash to go out and splash it, buying something big to make his or her name. I'd prefer they hand it back whenever it's truly cash they can't put to better use. We'll talk later about Games Workshop [London: GAW], but it's a beautiful example of a company that is reinvesting considerably in new growth but also is generating far more cash than it needs. They declare dividends as and when they think they have surplus capital, which last year resulted in five dividends being paid out. That to me is so rational – we love to see that.

Are you usually counting on a market break of some kind to create share prices at which you're willing to buy?

KAL: We will at times invest in companies going through some sort of transition or turnaround where the market is still pricing in defeat when we believe the odds favor victory. But yes, very often we'll pick up ideas that are on our watchlist during the depths of some sort of market funk. That happened noticeably in 2016 after Brexit first passed. It happened again in the last quarter of 2018, when shares we'd passed on just a short time earlier were suddenly selling for 20-25% less.

As an example, during that period we added Experian [London: EXPN] to the portfolio for the first time. It's one of the top three global credit-checking agencies, with strong market positions in the U.K. and the U.S. and an intelligent and successful strategy for further geographic expansion. It's a business with secular tailwinds, pricing power and high barriers to entry that we think translates into high and sustainable returns on capital. The stock didn't fall as much as some did when the market went into its funk, but it did enough for us to establish a position at what we considered a fair price. I should add that it didn't stay down for long. [*Note*: Experian's stock in October 2018 fell 11% in three weeks from its 52-week high. Since bottoming at that point, the shares at a recent £27 have increased more than 50%.]

A company that's been in the portfolio much longer is Rotork [London: ROR], which makes the actuators that basically open and close valves in such things as oil and gas refineries, power-generation facilities and water and wastewater plants. The key thing about it is that it's the best in the world at what it does, consistently at the forefront of innovation in its market. By the time the patent on an old product runs out they've got a new product out with a new moat around it. Its kits have been on virtually every refinery that's been built over the last 30-odd years, so the installed base is quite large and there's a substantial aftermarket business.

In this case there is an element of cyclicality, when new-build capex can turn

ON BREXIT:

Mediocre businesses like to blame Brexit for their ills, while the great businesses are just getting on with it.

Keith Ashworth-Lord

Begging to Differ

While he'd already had a long career as an investment analyst, Keith Ashworth-Lord hadn't yet managed a portfolio for anyone else when he got a call in December 2009 from his friends David Clark and Mary Buffett, who co-authored the book *Buffettology*. They were looking to launch a Buffettology-branded investment fund in Europe and thought Ashworth-Lord was the perfect person to run it. Once they'd agreed on the geographic scope – Ashworth-Lord preferred to focus only on his home U.K. – "it took me about a nanosecond to say yes," he says.

He set up Sanford DeLand Asset Management in Manchester to manage the fund and he highly values the independence owning his own firm provides. "There's a real risk in working for a large investment house that if you get things wrong for three to six months you show up on Monday with a black sack on your desk and you're asked to clear out and leave the premises. That makes people prone to hug the indexes – like Warren says, no single lemming ever got bad press – and portfolios end up looking like the market. I'm accountable to my clients, of course, but I have freedom to own a portfolio that's very different than the market. That's obviously the only way you can ever beat it."

down for a year or two before it comes back, but if you look carefully at the business over time the market tends to think it's more correlated to things like oil prices than it really is. Generally when the market gets really down on it we get the chance to buy more. A relatively stable company economically that has a volatile share price is a great opportunity for an investor.

When you were first approached to launch your current fund it was envisioned as one investing across Europe. Why did you want to focus more narrowly on the U.K.?

KAL: There's really nothing more to it than that the U.K. and Ireland were my home turf, where I knew the companies I wanted to invest in and those I didn't want to invest in. I wanted to start out with businesses and managements I knew well and was quite confident they wouldn't let me down.

Which is not to say our portfolio isn't international. With only two holdings that are not domiciled in the U.K. or Ireland – Berkshire Hathaway [BRK.A] and the pest-control company Rollins [ROL] – if you look collectively at where the companies earned their revenue as of December 31, it's 37% U.K., 25% North America, 14% rest of Europe, 6% Asia/Pacific and 4% other. The remainder was in cash. You would expect that type of breakdown given the companies we favor. If a company has a product or service that is fundamentally better than what else is in the market, you'd typically expect that good or service to be in demand the world over, not just in the domestic market. We're trying to find companies with something special like that.

How has Brexit impacted what you do?

KAL: It hasn't really. There have been times, as I mentioned, when the overall market went down out of concern for Brexit and we've tried to take advantage of that. But for most of our companies, they have international footprints and are basically prepared to respond to whatever hand they are dealt as a result of Brexit. I find in this country it's the mediocre businesses that like to blame Brexit for their ills, while the great businesses are just getting on with it.

Are you pro or con Brexit?

KAL: Personally, I'm very pro-Brexit. The economy in continental Europe is sclerotic and hindered broadly by regulatory overkill. Our mindset is much more like yours in the U.S., as global traders operating in a global economy. Our trade with Europe has actually been falling while that with the rest of the world has been increasing. Freed from all of the bureaucratic regulation and directives of Europe, I think will be a wonderful opportunity for this country.

ON HOLDING "FOREVER":

There are so few great business out there that when you have one, why would you want to get rid of it?

Speaking of regulation, the U.K. has adopted the EU's MiFID II framework that says third-party equity research can no longer be bundled with other services and has to be paid for separately. Have you seen any impact from that?

KAL: You could see what was going to happen. Equity analysts were going to be shown the door and research was going to be cut back, predominantly in smaller companies that fewer people were interested in and where the trading commissions would be lower. The analyst coverage for many small companies has materially diminished, which is a positive for us. Fewer people paying attention makes valuation anomalies more likely. There is a negative to it, though. It feels like liquidity in smaller companies has been compromised by MiFID II.

Describe generally how you think about valuation.

KAL: We don't pay much attention to P/E ratios, all we're interested in is the long-term free-cash-flow generation. Trying to use conservative assumptions – which I know everyone says they do – we do full discounted-cash-flow models using a 10% discount rate for every company. The beauty of 10% is that if an equity investor does that per annum on average, he's going to be quite well off at the end of it. It also stops us from overvaluing things in low-interest-rate environments and undervaluing things when interest rates spike. I've been doing it this way for 25 years and it's always kept me on the straight and narrow.

Typically when I look at my portfolio I've got roughly one-third in stocks trading below our estimate of fair value, one-third trading around fair value, and one-third that's looking more fully valued. But it's quite rare that you'll see me trade. I put in 22 holdings when we started the fund in 2011 and 14 are still in the portfolio. Of the remaining eight, three have been taken over and five I've decided to sell. I do really believe the ideal holding period is forever. There are so few great businesses that when you have one, why would you want to get rid of it?

Peter Lynch used to talk about "stalking the elusive ten-bagger." We actually have four of those in the portfolio today – Dart Group [London: DTG], which has been a 22-bagger, Games Workshop is an 18-bagger, and Liontrust Asset Management [London: LIO] and AB Dynamics [London: ABDP] are both 10-baggers. You don't get those if you're constantly chopping and changing your portfolio. We have yet to sell anything because it appeared to get too expensive.

That's particularly important because it's extremely difficult to know in advance what's going to hit big, and anyone who tells you otherwise is likely kidding themselves. We saw a lot of potential in Games Workshop, for example, but several things have happened that we didn't necessarily expect. We didn't expect that the COO who became CEO would be as talented on a variety of fronts as he's proven to be. We didn't expect the business to benefit from the devaluation of the pound – all the company's manufacturing is in the U.K. but 75% of revenues are abroad – to the extent it has. We didn't expect one of their new games, *Warhammer Age of Sigmar*, to be the blowout success it has been. I loved the company and its prospects, but I didn't see all this coming. Had I not truly signed up for the long term, there's a very good chance I would have missed a lot of the upside.

If we're reading it right, you appear to have sold and then bought back shares in sub-prime credit provider Provident Financial PLC [London: PFG]. What happened there?

KAL: This business has been around since 1880, engaged in door-to-door lending and collection to subprime customers. Agents were predominantly female, working part-time, and living in the same neighborhoods as their customers. The model worked very well, but then the company decided to change it. Go much more "professional." They started calling people customer relations managers instead of just agents. They wanted them to work full-time. They outfitted them with new technology which was supposed to replace the agents' good sense. I was already on my guard with all the management-school gobbledygook, but what killed it for me was seeing the early indications on what the new operating model cost, which came in at three times previously estimated levels. In this case I concluded something was out of control and sold my entire position in the high-teens in July and August 2017. Later that year the stock fell heavily and was below £7 when we bought back in the following Spring.

What made me go back in at the end of May 2018 was they brought back the guy who ran the main business for many years to sort it all out and he's been working to reverse the mistakes. I can't say it's worked yet the second time around. It's taking longer than I would have expected, but we do think they'll eventually get it right. [*Note*: Provident shares closed recently at around £4.70.]

Describe a sale after concluding you'd made a mistake.

KAL: In the middle of 2017 I took a position in Dignity [London: DTY], which is a funeral-services business I'd owned successfully before. I thought I knew a lot about funeral services and liked the steady demand, industry consolidation, general lack of pricing competition and low capex spending requirements. The stock had gotten cheap after a rocky quarter, which I just attributed to the natural pipeline cyclicality you see from time to time in the death business.

What I missed completely was the increasing prevalence of funeral price-comparison websites in the U.K. You were seeing a business where nobody talked about price now with a lot of information out there about comparison pricing. Within six months of our buying the shares, the company warned that in order to protect market share it was cutting the price of its no-frills funeral service option by around 25% and freezing the price of its full-service offering. That drove a stake through the heart of the business model and the stock responded accordingly. I will absolutely sell if I'm convinced a business has gotten materially worse and is not about to improve any time soon. That was the case here, giving us the worst result the fund has ever had.

Describe your broader investment case for language-translation company RWS Holdings [London: RWS].

KAL: The company started life as a patent and commercial translator and has built from that base a global franchise serving multinational clients such as Siemens, AstraZeneca and Mercedes-Benz. Say you're Siemens and you have a patent written in German but you want to file for that same technology around the world in whatever language necessary. Or you're Microsoft and you have highly technical documentation that needs to be translated broadly in the proper form and filed with the proper authorities globally. RWS handles all that for you.

What caught my attention early on was that they almost never seemed to lose a client. Then every year they'd add new clients and that's the way they'd organically grow. Much of it has to do with human capital. Their professional staff is typically dual-trained, both as linguists and in the scientific or technical specialization in which they work. No one else was doing that – they generally compete against patent attorneys, smaller mom-and-pop firms or freelancers. Big clients need to be sure this highly specialized work is done to the highest level and RWS has proven, at some scale, to do that consistently.

The company has a strong and unbroken sales, earnings and dividend record going back to its IPO in 2004. Early on that was mostly from organic growth, but they've also been quite successful in making bolt-on acquisitions that expand their geographic reach or extend their expertise. One took them into the life-sciences patent and translation business in a big way. Others built out their presence in the U.S. and brought in more computer and software clients. This all fosters cross-fertilization that makes sense. Global American companies they now serve hire them for business outside the U.S., for example. Or having hardware and software expertise in Europe helps them build out that type of business in the U.S.

Like many stocks in your portfolio, this one has been on a very good run over the past few years. How are you looking at upside today with the shares trading at around £5.85?

KAL: The underlying demand for what RWS does goes up every year and I believe through organic growth and continued select acquisitions the company can still grow quite nicely over the next five to ten years. Returns on equity are in the high-teens. Net debt to EBITDA is less than 1. It's true that the shares have done well, but we peg the current fair value – again, using

INVESTMENT SNAPSHOT

RWS Holdings
(London: RWS)

Business: Global provider – primarily to corporate clients – of a broad range of language-translation, search and filing services related to the protection of intellectual property.

Share Information
(@1/30/20, Exchange Rate: $1 = £0.76):

Price	**£5.85**
52-Week Range	£4.46 – £6.74
Dividend Yield	1.4%
Market Cap	£1.61 billion

Financials (TTM):

Revenue	£355.7 million
Operating Profit Margin	17.4%
Net Profit Margin	12.7%

Valuation Metrics
(@1/30/20):

	RWS	S&P 500
P/E (TTM)	35.7	25.9
Forward P/E (Est.)	26.3	19.2

Largest Institutional Owners
(@9/30/19 or latest filing):

Company	% Owned
Liontrust Inv Partners	11.7%
Standard Life Inv	7.7%
Octopus Inv	5.0%
Hargreave Hale	5.0%
Investec Asset Mgmt	3.1%

Short Interest (as of 1/15/20):

Shares Short/Float	n/a

RWS PRICE HISTORY

THE BOTTOM LINE

The company has a "strong and unbroken" sales and earnings record going back to its 2004 IPO, says Keith Ashworth-Lord, who believes an expanding market and select acquisitions can drive attractive growth for years to come. Based on his DCF analysis, he believes shareholder returns from today's price can compound at least 10% per year.

Sources: Company reports, other publicly available information

a 10% discount rate – at close to today's price. So if all goes according to what we consider a conservative plan, we'd earn roughly 10% per year on the shares. This is one we wouldn't consider selling at fair value – it's too good a business not to just let it compound value for you.

Is this a business that technology like machine translation could disrupt?

KAL: That's always an accusation that's been leveled. The reality in our view is that machine translation has a very long way to go before it's able to do anything close to the job necessary for the types of applications clients need RWS to do. Even with the length of my time horizon, I don't see that as an issue here.

What made you venture from your side of the Atlantic to buy Rollins.

KAL: We were actually looking at a business here called Rentokil [London: RTO], which after a long period of di-worsifying was in the process of getting back to basics, which in its case meant pest control and washroom-hygiene services. As we looked at it, I said we should look more deeply at pest control in the U.S. market, because I can tell you as a homeowner in Florida that such a service is not a discretionary spend. We're not talking about the odd rat in the kitchen or a wasp's nest here or there, we're talking about the need for regular treatment for a variety of infesting or destructive insects, including termites in wood-frame houses. For commercial operators it's equally or even more important.

That brought us to Rollins, which is one of the top two pest-control businesses in North America, operating mainly under the trade name Orkin. It has been a steady compounder over decades, including right through the financial crisis in 2008 and 2009. Organic growth is 5% or so a year and they consistently make bolt-on acquisitions, allowing them to increase operating profit and earnings per share at around 11% per year over the past ten years. Great cash generation, great returns on equity, an owner-operator family that owns more than 50% of the shares, great capital allocation, low capital-spending and working-capital needs, and little risk of disintermediation – it fits all the boxes.

Is this still an industry consolidation play?

KAL: Very much so, in a business where scale works to the benefit of the biggest players. As selling, general and administrative costs get spread over a larger base, Rollins over the past ten years has increased its operating margin from 11.5% to better than 16%. It can also spend more on innovation. One initiative they currently have is to work with the big homebuilders to embed Orkin termite-control systems directly into the wood frames of houses. There's a little nipple they've designed – and patented – used to refill the pesticide as needed. That's a clever means of locking in customers in a way the mom-and-pop competitor just couldn't do.

Their long tenure in the business helps in other ways. Last year Rollins made a good-sized acquisition, buying Clark Pest Control, which was the eighth-largest pest-control company in the U.S. and the largest independent one in California. The senior Rollins, Randall, who is still the

INVESTMENT SNAPSHOT

Rollins
(NYSE: ROL)

Business: Provider of pest and termite control services to both residential and commercial customers in North America, Australia and Europe, primarily under the Orkin brand name.

Share Information (@1/30/20):

Price	**38.22**
52-Week Range	31.36 – 43.91
Dividend Yield	1.2%
Market Cap	$12.51 billion

Financials (TTM):

Revenue	$1.95 billion
Operating Profit Margin	16.1%
Net Profit Margin	10.4%

Valuation Metrics
(@1/30/20):

	ROL	S&P 500
P/E (TTM)	61.4	25.9
Forward P/E (Est.)	42.9	19.2

Largest Institutional Owners
(@9/30/19 or latest filing):

Company	% Owned
Vanguard Group	5.6%
T. Rowe Price	4.1%
Morgan Stanley Inv Mgmt	3.8%
BlackRock	2.4%
State Street	2.2%

Short Interest (as of 1/15/20):

Shares Short/Float	10.6%

ROL PRICE HISTORY

THE BOTTOM LINE

The company "fits all the boxes," says Keith Ashworth-Lord: great cash generation and returns on equity, owner-operator family, smart capital allocation, low capex and low risk of disintermediation. With pricing power and benefits from further industry consolidation, he believes earnings – and shareholder returns – can compound at least 10-11% per year.

Sources: Company reports, other publicly available information

company's Chairman, said his family had been talking to Clark on and off about doing a deal starting 20 or 25 years ago. Rollins knows what it's getting and that type of history I think makes it more likely the acquisition goes well.

How are you valuing the shares, which don't look optically cheap, at today's price of around $38?

KAL: As I mentioned, we look at long-term free-cash-flow generation over current P/E multiples. We can't see this business being fundamentally different in 20 years, so it's not unreasonable to expect the company to compound earnings over a long period at 10-11% per year, plus the dividend. Using our 10% discount rate, we on a DCF basis think the shares today are right around fair value.

We bought into this last year and so far haven't had any performance out of it. With our time horizon, we've got plenty of time for that to change.

Describe the "in-transition" potential you see in RM Plc [London: RM].

KAL: This is a position we added to the portfolio in the latter half of last year. The company is a leading supplier of technology and resources to the education sector, operating through three divisions. The Resources business provides educational materials to "bring the curriculum to life" for teachers and students. The Education division supplies software, hardware, consulting and services to enable clients to better utilize technology to improve teaching and learning outcomes. The smallest unit, called RM Results, provides digital assessment and testing services and systems on a global basis.

I have known and followed RM on and off since the late 1990s. It was a major player in the U.K's "Building Schools for the Future" program, but operated more as a technology reseller than anything else. That tended to be low-margin, low-value-add business, and the company now for several years has been transforming its business to the current incarnation. Total annual revenues are down probably 40% from their peak, but operating margins have increased from a low of 2.5% in 2011 to better than 12% today. Earnings per share over the past five years have grown more than 15% annually. Returns on equity are above 30%.

Our view is that the business has turned and the new model is working. Intelligently applying technology to improve student learning outcomes is not going to go out of favor any time soon, nor are applications for digital assessment of both students and employees. The company is taking early steps in expanding its international business – nearly 90% of revenues now come from the U.K. – and there's still some room to go in making the operations more efficient. Combining modest top-line growth and some margin expansion, we believe earnings per share can compound at a low-double-digit rate.

How are you looking at valuation with the shares currently trading at around £2.80?

KAL: Our DCF value today is around £3.30, so this is one where we still see an attractive discount to fair value even using

INVESTMENT SNAPSHOT

RM Plc
(London: RM)

Business: Designs, develops and provides curriculum, software and technology products and services for customer educational institutions primarily in the United Kingdom.

Share Information
(@1/30/20, Exchange Rate: $1 = £0.76):

Price	**£2.79**
52-Week Range	£2.20 – £3.10
Dividend Yield	2.7%
Market Cap	£234.1 million

Financials (TTM):

Revenue	£221.6 million
Operating Profit Margin	12.2%
Net Profit Margin	8.2%

Valuation Metrics
(@1/30/20):

	RM	S&P 500
P/E (TTM)	12.6	25.9
Forward P/E (Est.)	10.9	19.2

Largest Institutional Owners
(@9/30/19 or latest filing):

Company	% Owned
Schroder Inv Mgmt	17.2%
Aberforth Partners	15.0%
Sanford DeLand Asset Mgmt	12.2%
Hargreave Hale	5.6%
BlackRock	5.1%

Short Interest (as of 1/15/20):

Shares Short/Float	n/a

RM PRICE HISTORY

THE BOTTOM LINE

The market isn't fully recognizing the company's successful transition from low-margin technology reseller to a more value-added provider of educational products, software and services, says Keith Ashworth-Lord. His DCF value for the stock is nearly 20% above today's price, for a company he believes can grow EPS at a low-double-digit annual rate.

Sources: Company reports, other publicly available information

our 10% discount rate. The dividend yield is also material, at 2.7%, and the dividend rate has been growing at a fairly nice clip. If earnings compound as we expect and the market takes notice, while it may not be a ten-bagger any time soon, we think it offers a very attractive potential return.

You mentioned it as one of your (at least) ten-baggers, but explain why you're still fully committed to Games Workshop.

KAL: This is really quite a fascinating business. The company makes fantasy miniatures that are used in war gaming. There are two basic game genres, one of which is more futuristic and exemplified by the game *Warhammer 40,000*, and the other more Tolkienesque, as in *Warhammer Age of Sigmar*. The miniatures are metallic and unpainted when you get them, so you also need to buy from GW the paint, scenery, vehicles, game manuals and most everything else needed to play.

Warren Buffett says the ideal product is something that costs a penny to make, sells for a dollar, and is preferably habit-forming. While the economics aren't quite that good here – gross margins are more like 67% and operating margins are over 30% – the customer base is absolutely rabid. Players, who are almost all male, come to this usually in their late teens and often play regularly well into their 30s. The products are sold through more than 500 company-owned stores, directly online, and through some 4,700 independent game shops. As I mentioned earlier, 75% of sales are outside of the U.K.

People have long said electronic games are going to be the death of this, but I'm sorry, they're not. In fact it's gone the other way. The people who play want to touch the miniatures, do the painting, set up the battlefield and interact with real people when playing. Over the past 15 years the company's compound annual growth rate of sales is 3.6%. Over the last ten years it's 7.4%. Over the last five years it's 15.7%. The current store base has been growing and is by no means saturated. Social media around the game community has taken off. Customer satisfaction scores are rising.

They're very careful with their intellectual property, but they do see licensing and other opportunities around entertainment and electronic media. Licensing revenues five years ago were £1.5 million per year. In just the first six months of the current fiscal year, that number was £10.5 million.

The company seems to be shooting the lights out. What makes things even better?

KAL: To take advantage of what they still see as considerable untapped demand, the company has been investing heavily in manufacturing and distribution. Capital spending has doubled over the past two years to increase production capacity, expand the owned store base and invest in a new enterprise resource management [ERM] system. If demand growth stays as strong as it's been, the revenue growth potential is still quite high. As they look to increasingly shift revenues to their own stores and their own online channels, that should also have a materially positive impact on margins.

One unknown, of course, is whether they can keep coming up with blockbuster titles that people want to play. What's a

INVESTMENT SNAPSHOT

Games Workshop
(London: GAW)

Business: Design, manufacture and sale of model soldiers that are collected, painted and used to play in-person fantasy games, many of which fall under the Warhammer brand.

Share Information
(@1/30/20, Exchange Rate: $1 = £0.76):

Price	**£66.55**
52-Week Range	£27.85 – £71.35
Dividend Yield	2.1%
Market Cap	£2.17 billion

Financials (TTM):

Revenue	£279.7 million
Operating Profit Margin	35.6%
Net Profit Margin	28.8%

Valuation Metrics
(@1/30/20):

	GAW	S&P 500
P/E (TTM)	27.2	25.9
Forward P/E (Est.)	n/a	19.2

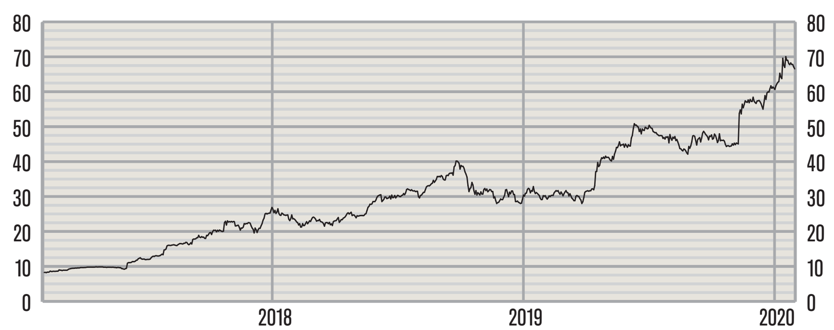
Largest Institutional Owners
(@9/30/19 or latest filing):

Company	% Owned
Investec Asset Mgmt	9.4%
JPMorgan Asset Mgmt	8.6%
Schroder Inv Mgmt	5.6%
Standard Life Inv	5.4%
MFS International	4.9%

Short Interest (as of 1/15/20):

Shares Short/Float	n/a

GAW PRICE HISTORY



THE BOTTOM LINE

Keith Ashworth-Lord believes the company's upside is still high as it expands production and distribution to meet high demand. While he might not buy at today's price, he says he has no intention of selling the stock in a company "growing revenues at a mid-teens rate, with 30%-plus operating margins and returns on average equity close to 70%."

Sources: Company reports, other publicly available information

bit different here is that the games tend to have a very long life. It's generally the same basic game, they just evolve it and add to it from time to time. That makes us a bit less concerned about a game actually going out of fashion.

The first GW shares you bought for your fund were at £3.75. Now trading closer to £68, would you buy the stock at this level?

KAL: To be honest, I'd want to see it come off a bit before buying any more. I would say though that as dramatic as the share-price rise has been, the vast majority of it has been driven by increasing earnings rather than the P/E expanding.

We have no intention of selling. With companies doing this well, it doesn't take long for the current price to look less expensive. For the fiscal year ending in May 2021 we think cash earnings could be 300 pence per share. So on that you're paying 22-23x earnings today for a company growing revenues at a mid-teens rate, with 30%-plus operating margins and returns on average equity close to 70%. Maybe that's not bargain-basement, but it's not bad either.

You mentioned earlier owning Berkshire Hathaway. How does it trade today relative to your estimate of fair value?

KAL: Before we started buying we sounded out our large investors because I thought I'd be accused of not only using the Buffettology name, but also just coat-tailing on the back of his company. I thought some people might not like that, but the opposite was the case. Most people were surprised we hadn't owned the shares earlier.

This I value by looking at the extent of the premium to book value. I first bought the stock in July 2018 when the shares were trading at what I considered an attractive 1.1-1.2x book. I felt good about the fact that Warren himself disclosed not long after that buying back some Berkshire shares at around the same level. My average price is something around $312,000 on the A shares. At today's price of around $340,000, I would say it's up with events near-term at that level.

One thing is exercising my mind about Berkshire. What if all the cash that's built up is partly there to do a massive share buyback if the stock tanks when Warren passes away. The share price might be resilient as the investment banks are all over it trying to break it up, but there's also a case to be made that the stock falls pretty sharply when Buffett and Munger are gone. What a wonderful deployment it would be to buy back equity if that happened. It could be his next great trade, from beyond the grave. VII