

Skill Farm Paper Portfolio Summary Example

Investment Career – Six years of investment experience

I believe our early investment experiences matter a lot and this is the key reason I started a paper portfolio. During the last two years, I have used this exercise as an opportunity to **create a journal of my investment philosophy, process and investment decisions**. I now have an iterative process which can screen and identify companies at scale. More importantly, this exercise has helped me separate process from outcome and I expect to learn from my mistakes going forward.

Whilst the journaling began two years ago, my investment career started six years ago and includes experience across the following sectors: (1) European Consumer, Discretionary and Staples (2) European Small-Mid Cap Generalist (3) Emerging Markets – LATAM (4) European Defence, Transport and Aerospace (5) UK Generalist. Working across these different sectors, during a noteworthy macro period has led to many lessons learned and of course influenced my investment philosophy. This is reflected in my concentrated portfolio; an outcome of identifying the most resilient companies in the sectors I have experience in.

My most recent addition to the portfolio is Frontdoor (FTDR), a company outside of my work coverage. I selected this company as an output of my process (see below) and believe there is material upside based on my analysis – A detailed summary of my review is attached separately.

Investment Philosophy – Identifying opportunities during inflections

Investors tend to be backward looking and pay a lot of attention to historical patterns, which can lead one to miss material changes. Within my investment career, I have always prioritised industry reviews, **with the aim of identifying the intersection of change and neglect within a given industry**. This inflection point offers active investors a unique opportunity to act. Change can come in the form of many events such as: new management, M&A, restructuring, capital allocation, regulatory change and new products/services. Neglect on the other hand, occurs once companies are not appreciated by the market (new entities or business models), negative sentiment (underearning, bad news and failing to meet expectations) or negative reaction due to macro events. **I view change as a key driver of the denominator in a multiple (e.g., the “E” in P/E), whilst neglect can impact the numerator of a multiple (e.g., the “P” in P/E).**

As a result, my investment approach is very much bottom up. I like to build strong convictions behind each investment and therefore have a very concentrated portfolio with low turnover. Whilst I am a bottom-up investor, **during the last 18 months I have paid a lot more attention to the overall statements my portfolio is making**. Do my holdings in totality, reflect my outlook on the world is a key question I ask myself daily. This has led to more of a focus on risk-reward for each of my holdings with sizing and conviction being the main output of these thoughts.

Investment Process – Iterative process which I am constantly modifying

To begin with, I screened for my initial investment ideas from the universe of companies which I had covered over the years. However, over time I built a **quantitative screen which reflected my philosophy and lessons learnt**. This screen includes: Low PEG ratio, high FCF generation, high ROIC and margin analysis.

I am a big fan of checklists and use this once I have a shortlist of names, which have passed the quantitative screen. The checklist is more qualitative based with a weighted scoring for the following categories: **business quality, growth duration, industry structure, management, financial cleanliness, stock, related, valuation and financials**. **An example checklist can be seen on page 16 of the Frontdoor (FTDR) analysis attached separately.**

My overall end goal is to find investment ideas which align with the following:

Thesis	Characteristics
Consistency	<p>Quality of the business model is vital and I pay a lot of attention to how a company grows. I have a strong bias for consistent business models which deserve a premium – especially as less consistent businesses require more attention to timing.</p> <p><u>Evaluation</u>: Recurring revenues, pricing power, stable end markets, secular tailwinds, steadying earnings, cashflow trends and capital allocation record.</p>
Strong Cashflow	<p>Cashflow helps me understand the quality of the business and is much harder to manipulate than earnings. Companies with strong cashflow and capital deployment track records can create good value.</p> <p><u>Evaluation</u>: Analysis of managements definition of free cashflow, review historical capital allocation record, philosophy and objectives.</p>
Unique growth	<p>Understanding a company’s prospects through analysis of the industry architecture is key. I appreciate companies which are capable of discovering and expanding TAMs, as this form of growth tends to be more resilient.</p> <p><u>Evaluation</u>: ROIC, Understanding a company’s layers of customers, suppliers, and competition. Analysis of TAM and how opportunities have been created historically – innovation and capital deployment.</p>
Great Management and Culture	<p>Great management is arguably one of the most important factors for me, as great teams are capable of creating their own success. I believe identifying exceptional management and cultures is one of the most differentiated things an active investor can do. Investing in talented management is also a key way to control risk.</p> <p><u>Evaluation</u>: Hearing it from ‘the source’ deepens my understanding and conviction of the respective team & culture. However, I also find alternative mediums such as interviews and podcasts about management and company cultures very useful.</p>
Valuation	<p>Multiples across the market have come down as a result of the economic and political environment changing and I am now accounting for more valuation metrics like FCF. I also try to reduce my risk of permanent capital loss by ensuring that there is a suitable margin of safety in the investment I am making.</p> <p><u>Evaluation</u>: Valuation metrics, pay attention to sentiment, review previous cycles and the macro, exercise more patience and scepticism.</p>

Prospective Portfolio – Balance of growth types

Whilst remaining focused on the analytical aspects of my portfolio, I am making progress with the portfolio construction and balance is the focus for me. Upon reflection of my initial portfolio, I did not have a balance of growth types and this left me highly exposed and vulnerable to the macro situation. Going forward I want to ensure I have a balance of the following growth types:

- A) Strong franchises growing by repeating the same thing that is self-reinforcing – *Returns tend to come from getting the growth magnitude and duration right over time*
 - 1. **Frontdoor (FTDR)** – Industry leader in the US home warranty business generating >20% ROIC in an industry with high barriers to entry and strong revenue visibility.
 - 2. **Next (NXT)** – British multinational retailer, with a differentiated business model gaining market share and a disproportionate share of industry profits.

- B) Companies where something has changed for the better – *Returns tend to come from getting the growth magnitude and duration right over time*
 - 3. **Adidas (ADS)** – Athletic and sporting lifestyle brand. Currently experiencing a strong product cycle (heavily influenced by new mgmt.) at the expense of industry leader Nike.

- C) Early-stage growth – *Returns is often driven by being right about higher for longer growth and business quality to offset eventual multiple contraction*
 - 4. **BBB Foods (TBBB)** – Mexican hard discount grocery retailer. Strong unit economics with 35% ROIC and cash-on-cash payback of 2.5 years.

I am currently working through several new and old ideas to further grow my portfolio, with those three buckets in mind. From a top-down perspective, reviewing my top holdings and reasons for inclusion, I have observed the following:

- 1) Overtime my views on the importance of macro have evolved. Initially I focused more on fundamentals at the expense of having a macro view. Whilst I still intend to not get caught in trying to predict GDP growth, recessions, etc (leave this to the experts), I have come to appreciate the importance of rates and liquidity. They are now central to how I shape my portfolio and go about sizing my holdings. For example, when liquidity tightens, I raise the bar on my longer duration holdings; and when it eases, I lower the bar.

- 2) I am leaning towards companies with lower leverage at this point of time. This is a derivative of point 1. I am becoming more aware of the multiplication of risks and feel more comfortable with less leverage on the balance sheet at this moment of time.

- 3) Inflation, lower growth, and/or stagflation are here to stay for now. I have selected companies that have either shown resilience within the margin (FTDR and NXT) or companies which have a unique opportunity to gain market share in their respective industry (ADS and TBBB).