Ashworth-Lord is a long time Warren Buffett-style investor

KEITH ASHWORTH-LORD

A British Buffett

Warren Buffett and his investing partner Charlie Munger extol a tried and tested investment philosophy that has inspired a number of the UK's most successful long-term investors, one of whom is Keith Ashworth-Lord, founder of Sanford DeLand Asset Management and manager of the CFP SDL UK Buffettology fund

What is Warren Buffett's investment philosophy and why is it still relevant today?

When you buy shares in a company, you are buying an economic interest in the business. Therefore, you have to ask yourself whether you would buy the business in its entirety. If not, you shouldn't be buying the shares. So, what really matters is the quality of the business, most certainly not the level of the stock market. Everything should be focused around that judgement.

Once you have decided to buy the business, you have to estimate what its intrinsic worth is. To do that you need to have a feel for how much free cash it will generate for you, the owner, from now to eternity. Then you discount those cash flows back to a present value and compare that to what the stock market is asking you to pay in price. If you are being offered more in value than you are being asked for in price, you invest there and then. Otherwise you wait until a better opportunity (i.e. price) is presented to you. Once invested, you should aim to hold the shares forever.

This is business perspective investing. It will always be relevant because it encapsulates the essence of investing. You are looking to buy great companies with enduring franchises at below what you think they are worth. You are not playing with gaming chips on a casino table.

Buffett was inspired by Benjamin Graham and his book The Intelligent Investor – what does the book say and given it's nearly 100 years old why does it remain relevant?

The Intelligent Investor is the bible for most value investors. Its whole point is to show you how to buy securities that appear mispriced when set against fundamental analysis. The discount of the market price to the intrinsic value is what Benjamin Graham called the 'Margin of Safety'. This central concept has been described by Buffett as three of the most important words in the investment lexicon.

In an effort to stop the investor falling under the spell of the stock market, Graham introduces a character called Mr Market. He describes him as an obliging fellow who turns up every day offering to buy or sell his shares at a different price. Often, the price quoted by Mr. Market seems sensible, but sometimes it is crazy. The investor is free to either agree with his quoted price and trade with him, or ignore him completely. Mr. Market isn't offended by this and will be back the following day to quote another price. The point of this anecdote is that you should not regard the whims of Mr. Market as a determining factor in the value of your shares. Rather, you should attempt to profit from market folly rather than participate in it. You should concentrate on the performance of your companies, not Mr. Market's often irrational behaviour.

It is as relevant today as ever because all value investors are trying to do is buy little pieces of businesses at the right price.

Buffett and Graham are both US investors and their success is largely around the US equity market – do their theories 'carry' across this side of the Atlantic and if they do why are they relevant?

Business perspective investing is as relevant to the UK as the US since all we are doing is trying to assess the quality of a business and then decide whether the price is right. Such an investment philosophy does not respect geographical boundaries.

What has inspired you about Buffett over the years and which of his many famous investment expressions do you think are most relevant for the average UK investor?

I think more than anything, his consistent out-performance over six decades and being able to call out his detractors.

The most relevant expressions from Buffett and/or Graham are probably:

"Investment is most intelligent when it is most business-like."

"Price is what you pay, value is what you get."

"In the short run, the market is a voting machine but in the long run it is a weighing machine."

"I put a heavy weight on certainty… if you do that, the whole idea of a risk factor doesn't make any sense to me. Risk comes from not knowing what you're doing."

"Stocks are simple. All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever."

You have been a shareholder in Buffett's company and been to the annual shareholder meetings – what are they like and what do you learn as an investor?

There is a great book that has just been published called "The Warren Buffett Shareholder – Stories from inside the Berkshire Hathaway Meeting". It is a collection of forty-three essays edited by Larry Cunningham and Stephanie Cuba, his wife. Forty-two of the contributors are North Americans; I am the only European.

The essays serve up some of the gems of wisdom that have been imparted by Messrs Buffett and Munger over the years in the formal meeting. I like to recall how listening to the pair kept me away from the dotcom boom-and-bust with its wholesale monetisation of ignorance and destruction of capital. But more importantly, these essays address the fact that Berkshire shareholders are a society bound together by common values of learning, integrity, innovation and community. Indeed, as a seasoned veteran, I now probably enjoy the interaction with like-minded Buffettologists at fringe events, as much as the AGM itself; receptions, discount shopping at BH companies like Borsheims Jewelry Store or Nebraska Furniture Mart and much more. And there is the annual Columbia Business School gala dinner the night before with its networking opportunity and panel discussion.

What is Buffettology and what is the link to Buffett?

Buffettology was the title of a book published in 1997 by Mary Buffett and David Clark. It was the first serious attempt to codify how The Master sets about finding great businesses to invest in. For me, that book was the Damascene moment when the wool was lifted from my eyes. Using the tenets of Buffettology enabled me to develop a robust investment methodology based on business perspective investing and turned me from an investment or securities analyst into a business analyst.

The connection with Buffett is that Mary was married for twelve years to Peter, Warren's second son, and Dave is a native of Omaha who was a family friend of the Buffetts. Mary and Dave trade marked the name Buffettology the world over and subsequently licensed it to Sanford DeLand to use on the fund that I manage.

What encouraged you to start a fund linked to Buffett and what are you aiming to do with the Fund?

I had been running my own money for over ten years from 1999 using this methodology. During that time, I had put my investments up by 113.7% compared to a fall of 1.5% in the FTSE All-Share Index (the lost decade for equities).

At the time I had been working with a variety of clients as a self-employed consultant and decided I wanted to paint on a larger canvas. The offer of the exclusive Buffettology trade mark licence to use on the fund provided a differentiating factor to get the fund the oxygen of publicity.

> "Mr Market is the obliging fellow who turns up everyday to buy or sell shares"

In terms of the aim of the fund, it can be summed up in the three words that Peter Hargreaves says are the most important in investment – performance, performance, performance. I am not interested in asset gathering if the size of the fund starts to impinge on its performance. I have got the entire equity portion of my SIPP and all my family's stock market investments in this fund. My stakes in the fund and its management company, Sanford DeLand, are my pension.

Your Fund has a small, focused portfolio, does fewer stocks mean more risk?

Modern portfolio theory postulates that the more holdings there are in a fund, the more risk is reduced. That is because it claims risk is associated with share price volatility, not the underlying economics of the business.

I view conventional portfolio diversification as little more than a hedge against having the courage of one's convictions. Therefore, I favour a focused approach to investing and typically have ownership of around 25-35 holdings in appropriate companies.

> "The Intelligent Investor book is the bible for most value investors"

I regard real risk as being that of investing in the wrong businesses, i.e. it is economics-based not market-price-based.

The opportunity for investors of focused investing was neatly summarised by Warren Buffett speaking to the New York Society of Security Analysts:

"A lot of great fortunes in this world have been made by owning a single wonderful

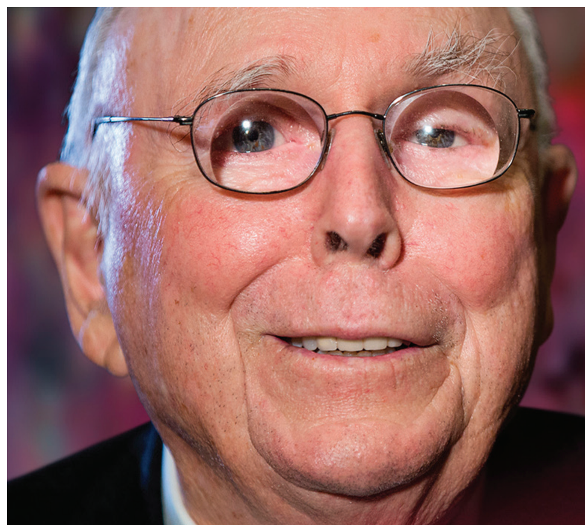
business. If you understand the business, you don't need to own very many of them."

The problem with conventional portfolio diversification is that it increases the chances of making investments in too many companies that too little is known about. So, I believe in restricting myself to those businesses that firstly I understand and that secondly I know most about. This is what I mean by limiting myself to my 'circle of competence'. Too many investors' circles of competence seem to be a mile wide and an inch deep. I think mine is quite the opposite. I aim to invest in a spread of superior businesses that I know well, which I believe reduces economic risk.

How do you get your ideas for stocks and when you look at a company what metrics are you looking at and why are they important?

My ideas come from a variety of sources. Several of the businesses and management teams I have known for donkey's years (and a lot of them are located in and around Lancashire or Yorkshire). Others have been more recent discoveries, either through screening or perhaps just bumping into companies at exhibitions or conferences. My broker contacts would complain that I never take any of their ideas and that is in large part true. I like to do my own research.

On the subject of screening and what I look for, let's take it in order. I am looking for enduring franchises that possess pricing power and what Buffett would call an 'economic moat'. That means they are able to earn excess returns on sales and capital without the latter being competed away to the cost of capital (the First Law of Capitalism). I look for these returns to be stable or increasing over time and highly relative to the average business.



Warren Buffett (top)and his investing partner Charlie Munger

Of course, I am interested in growth – either in the market or a company's market share, or preferably both – but I am not obsessed with it. Good 'steady Eddie' businesses will always have a place in my portfolio. High conversion of earnings into free cash is another pre-requisite and I favour strong balance sheets. Whenever I analyse a business and its markets, I have Michael Porter's Five Forces analysis in my head, viz. industry rivalry, threat of new entrants, threat of substitute products, bargaining power of customers and bargaining power of suppliers. Finally, I look for management that acts with the owner's eye. Rational allocation of capital to projects that will generate future organic growth and/or to manageable bolt-on acquisitions. If that is not possible, then I favour managements that hand back surplus capital to the owners of the business so they can deploy it.

> **"I'm looking for enduring franchises that possess what Buffet calls an economic moat"**

How long do you run a 'winner' for in a portfolio and how do you decide which is a winner?

I am wired differently from most investors. I prefer to run my profits forever, so long as the operational performance of the business remains up to scratch. I don't worry about temporary over-valuation and certainly not about stock market levels. When deploying new money, my default position is always to own more of what I already hold rather than casting around for new companies. There are so few great businesses around that once I own one, I want to keep owning it. Of the 30 companies that I currently own in the fund, eighteen have been there for over five years and three of the early investments have been taken over.

What encourages you to sell a stock and how do you know when you have got a stock idea wrong?

There are really only two sell disciplines that I employ. Firstly, something has gone wrong, which might be company specific, market / industry specific, deterioration in the financial ratios (shape of the business), management change or some kind of disruptive technology. If it's got worse and it isn't fixable any time soon, I will probably look to sell. Secondly, I have got it wrong and invested in something that wasn't what I thought it was. There have been about half a dozen of those instances over the lifetime of the fund. When selling, I don't obsess about taking losses. It doesn't matter as much as being able to sleep at night.

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