ValueInvestor INSIGHT
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Investor Insight: Andrew Brenton

Andrew Brenton of Turtle Creek Asset Management describes what he thinks makes his portfolio companies unique, why he gravitates toward "true platform companies," what's required to be good at trading around positions, and why he sees unrecognized value in Berry Global, Middleby, Badger Daylighting, Home Capital Group and Premium Brands.

INVESTOR INSIGHT

Andrew Brenton
Turtle Creek Asset Management

Investment Focus: Seeks unique companies run by uniquely skilled managers when their shares appear to be trading at relatively run-of-the-mill valuations.

There were many reasons Andrew Brenton and his partners Jeff Cole and Jeff Hebel left their jobs running Bank of Nova Scotia's private-equity subsidiary in the late 1990s to invest in public equities, but one stood out: "By consistently taking advantage of the fact that company stock prices fluctuate far more broadly than their business values, we thought we could earn better risk-adjusted returns than we could make in private equity," he says.

Their firm, Toronto-based Turtle Creek Asset Management, now manages over C$3 billion and its flagship Equity Fund has over the past 20 years earned a net annualized 14.7%, vs. 4.7% for a blend of the S&P MidCap 400 and S&P/TSX indices. Among areas of high interest today: plastics, food services, mortgage lending and excavation.

Your portfolio companies don't tend to be household names. What would you say are some of the characteristics they share?

Andrew Brenton: We're drawn to things everyone looks for: well-run companies with honest management that allocates capital well and are shareholder focused for the long-term. What we tend not to want are companies that are, let's say, typical and easy to understand. We don't want them to be impossible to understand either, but in most cases their products or services, strategy, business mix or business model are somewhat unique.

Berry Global [BERY], for example, is a plastic-product manufacturer that I don't think has a comparable peer. Premium Brands [Toronto: PBH] is a specialty-food company unlike any other I've seen. Badger Daylighting [Toronto: BAD] manufactures and operates excavation equipment that uses hydrovac technology – basically using highly pressurized water to dig – that a lot of people haven't heard about yet and that no one else can deliver at scale. These tend to be businesses where sell-side analysts have a hard time figuring out what they're worth because you can't just run a bunch of comps. We think that makes them more likely to be inefficiently priced.

Probably half our portfolio is in what I would call true platform companies. Not roll ups in the Valeant Pharmaceuticals do-no-due-diligence and have-no-strategy-except-jacking-up-prices mold, but high-quality, value-added platform companies. For these types of businesses with long track records of value-accretive acquisitions, if you don't assume they'll make any more acquisitions, then they won't look nearly as cheap as we think they are.

Premium Brands has a successful 20-year track record of expanding through acquisition, and management is saying as they continue to grow in the U.S. and beyond that they've never had such a large opportunity set. Berry Global has proven to be an excellent acquirer, and they say they have decades of consolidation ahead in their industry. TFI International [TFII] 25 years ago was a near-bankrupt trucking business based in Quebec with maybe C$100 million in annual revenues. Behind CEO Alain Bédard, who is one of the best managers of capital for shareholder benefit we've ever seen, they've made well over 100 acquisitions and are now a major trucking and logistics business with more than C$5 billion in annual sales and a market cap of C$5.6 billion.

If you're good at it, acquisitions can create a lot of value. To not in some way build that into a long-term forecast – which gives us a higher view of the present value of future cash flows – makes no sense to us. But the public markets in general don't recognize that potential value creation until it happens or it becomes so constant and frequent that it gets reflected in analysts' calculations. The fact that it's usually not recognized – which, by the way, we understand because a lot of acquisitions don't turn out very well – is to us an inefficiency that can create opportunity.

The last point I'd make here is on management. Our time in private equity I think brought us a higher appreciation of the complexity of businesses and how uncertain the world is. The people running our companies will know their business

better than we ever can, which reinforces to us every day the importance of having really smart, flexible and shareholder-oriented management teams in place. One reason we invest mostly in mid-caps with less than $25 billion in market cap is that we want to interact reasonably frequently and in reasonable depth with top management. At the end of the day that's such a critical element of what we're buying.

I'm not saying we care about management quality and no one else does, but I would say our record has benefitted considerably from our aligning ourselves with the right people. And if we believe we have, we'll listen to them. Other value investors often stress how conservative their assumptions and forecasts are. We're not like that. If Badger Daylighting believes it can double its U.S. business in three to five years – and they consistently deliver over a long period on what they say they're going to do – we're probably going to reflect that in our long-term outlook and valuation to a greater degree than a more traditional money manager might.

Speaking to the profile of the businesses you own, why does something like Discover Financial [DFS] make the cut?

AB: Everybody knows about the other three companies that own global payment-processing networks – Visa, Mastercard and American Express – but Discover is less appreciated, despite the fact that it's capably run and in a quiet way continues to build a global merchant-acceptance network out of the Diners Club platform it bought around the financial crisis. They're also lending-centric in their approach with customers and manage that very well. It's a unique company that we don't think is as well understood as it should be. Analysts want them to run off and spend a bunch of money on fintech startups – we think the company will be much better off doing what they're doing.

Describe how you prospect for ideas.

AB: The process is very bottom-up – we never think about sectors that are "good to be in" and then look for a company. For us it's all about finding what we consider highly intelligent companies and then learning about the industries they're in.

We've identified good ideas in many different ways over the years, but the most common is by speaking with research analysts at mid-cap investment dealers like Baird, William Blair, Raymond James, Stifel and Stephens. They're often too focused on predicting short-term stock prices based on quarterly earnings, but they have experienced research analysts who have followed companies in their coverage universes for years and have real insight into how those companies have dealt with challenges and opportunities over time. As we get to know them they understand what we're looking for and can from time to time point us in the right direction. These dealers also put on excellent institutional conferences every year where hundreds of management teams present and meet with investors like us.

ON THE PANDEMIC CRASH:

Share prices generally fell much further than business values, so we got our cash position invested quickly.

A few years ago one of my partners was at such a conference and he decided to go to a presentation by Bill Stone, the founder and CEO of SS&C Technologies [SSNC]. It wasn't a company we knew very well, but it became clear to my partner after listening to Bill – who we've come to look on as a force of nature – that we should do more work on the company.

What we found was a firm that started out more than 30 years ago as a fund administrator for the hedge-fund industry, which through organic growth and a large number of acquisitions had built itself into a vertical software-focused services provider with domain expertise mostly in financial services and healthcare. One of Bill's favorite phrases is "We simply apply common sense, which is uncommon." The way he talks about the business, the company and its culture is remarkably clear-headed and intelligent, and the track record over time bears that out. Most of his wealth is still tied up in the company and he's never paid a dividend and only once bought back any shares. But he's flexible and says at some point he won't have enough uses for all of the capital – to buy things and fix them – and at that point there is going to be a tsunami of cash coming back to shareholders. That's the type of company we want to own.

With SS&C I anticipated that we'd do our work and because it wasn't a secret this was an excellent company, the stock would be fully priced. But four years ago there was concern in the market about the viability of hedge funds due to bad performance and excessive fees, and that was weighing pretty heavily on SS&C's stock, even though the exposure to hedge funds at that point was less than 20% of the business. It also wasn't obvious that that part of the business was really going to decline. In any event, the negativity at the time gave us an opportunity to buy in.

Explain how you approach valuation.

AB: We calculate for every business we want to own its "cash-flow value," which is our way of saying the present value of estimated future cash earnings. By cash earnings we mean profits available to shareholders after all cash costs to run the business. In many cases for the companies we own there are non-cash accounting expenses like the amortization of acquisition-related intangibles that we don't expense because they're not reflective of the true economics of the business.

If the traded price of a company is attractive relative to our view of its cash-flow value, then we'll buy it. If it gets cheaper – assuming our forecast hasn't changed – we'll buy more. We don't try to guess when and to what degree the market will recognize the value of the company. And we don't concern ourselves with catalysts. We focus exclusively on making sure our calculation of cash-flow value is as com-

plete and balanced as it can be. A once-attractive investment only truly becomes a trap when we fail to recognize risks to our cash-flow forecast and don't take down our cash-flow value.

Describe how you navigated the market selloff earlier this year.

AB: We were able to speak directly to all of our companies, and step one was focused on the balance sheet and liquidity. If Gildan Activewear [GIL] has to close most of its key plants, how does that play out for them over time and how likely are they to make it to the other side? Step two was to go company by company and work through in detail the changes necessary to our cash-flow forecasts. That resulted in some intrinsic-value estimates coming down, but in no case did we feel that any of our companies were permanently impaired as a result of the pandemic. Given that share prices generally fell much further than business values, we got all of the roughly 10% cash position we held in mid-February invested fairly quickly.

You actively trade around your positions, which you consider an important contributor to your outperformance over time. Explain how you approach that and what you think it takes to be good at it.

AB: We look at it this way: Say you have a two-stock portfolio. Both trade at $10 and you think they're worth $20, the risk profiles and management quality are similar, and you know them equally well. In this case, you'd probably have 50% of the portfolio in one and 50% in the other. But if the share price of one goes from $10 to $8 and the other goes from $10 to $12, and nothing else has really changed, you have a portfolio that's turned upside down. You own more of the company that has less of a margin of safety. You should try to fix that. How exactly you do that can vary, but we incrementally take money from holdings that are more in the market's favor and add to those that are not.

If we own a portfolio trading at intrinsic value and in 10 years it also trades at intrinsic value, if our forecasts are right on average and we use a 9.5% discount rate, we're going to make 9.5% compounded annually. But we own a portfolio trading at a significant discount to intrinsic value, so if we lock that portfolio away and again our forecasts are right, we'll earn better than 9.5%, say into the teens. By actively buying and trimming based on how expected returns rise and fall, we're trying to improve on that return even further.

ON CONVICTION:

If we have conviction in our forecasts, we're not worried about why other people are buying or selling.

To give you a sense of what we try to do, we looked at the four stocks we discussed when we spoke five years ago that we still own in size, Badger Daylighting, Home Capital Group [Toronto: HCG], Premium Brands and TFI International. For each we compared the buy-and-hold return since the issue appeared with the return we earned, which includes trimming and adding. In every case, our return was better. The best was Premium Brands, where buying and holding would have earned 31% compounded, but our IRR was 73%. With Home Capital, a 5% compounded buy-and-hold loss was for us a 5% compounded gain. Even in the least-beneficial case, in TFI, we earned a 27% annual return versus a buy and hold of 23%. There are many reasons the market can be inefficient in the short-term – we try to take advantage of that.

To make this work your estimates of intrinsic value have to be fairly accurate, but a lot of it is also temperament. We're confident we've done enough work to have conviction in our forecasts. If that's the case, we're not worried about why other people are buying or selling on any given day, and we don't think the share price is telling us anything. I think that's tough for a lot of money managers to do.

Walk through your broader investment thesis for Berry Global.

AB: Berry is the world's biggest plastics company, producing a broad range of consumer packaging, engineered materials, and health and hygiene products. Of note in today's environment, for example, it manufactures material used in disinfecting wipes, medical garments and surgical masks. It generally doesn't participate in some of the more criticized areas of the plastics industry, including single-use plastic bags and water bottles. The geographic footprint is broad, with over 300 plants globally.

When I first heard about the company, it didn't jump out at all. Plastics packaging is highly competitive and fairly commoditized. Unlike with glass and cans, it's not as capital intensive so has lower barriers to entry – if you have an idea and a potential customer, you buy an injection-molding machine and you're in business.

One result of that is that the business is still fragmented, and Berry has proved to be both an excellent acquirer and that as the biggest player it can take advantage of scale. It has buying power in purchasing resin, which makes up 50% of its costs of goods sold. With 300 plants it has the flexibility to shift capacity around the world more efficiently. It spends more on R&D than anyone else. Management says that the post-synergy purchase prices for Berry's prior six or seven acquisitions – after cost savings and other benefits of integration – have been made at what turns out to be roughly 5.5x EBITDA. We and they think they have decades of consolidation ahead of them.

How do plastics size up against other packaging materials, including with respect to the environmental impact?

AB: Plastics are very cost competitive against other substrates and the environmental footprint arising from the production process is superior as well. Making plastics uses less energy and less water and generates less greenhouse-gas emissions and solid waste. But because plastics are

so inexpensive, you have a post-consumer waste problem because recycling isn't as economically viable. So plastic waste can end up in places other than landfills, which is where the problem is.

While I mentioned that Berry avoids the most-controversial single-use plastics, roughly 65% of the business is what you'd call consumer-facing – such as food and cosmetic packaging – so it is incumbent upon them to innovate and make their products more environmentally friendly and recyclable. They recognize this and were founding members of the Alliance to End Plastic Waste. We think they're ready when there's true consumer demand willing to pay the price differential for more environmentally friendly packaging, and that their ability to invest in innovation will continue to give them an incremental advantage when that happens.

How has the pandemic impacted Berry?

AB: The surge in demand for health and hygiene products as well as for basic consumer staples has basically offset softness in markets like industrial and cosmetics. They were actually one of only a few companies that did not withdraw their 2020 guidance at the onset of the pandemic. Of course the stock was not immune from the overall market decline, so we were able to buy additional shares at very attractive prices. [*Note*: Berry's shares from mid-February to mid-March fell more than 40%, hitting a low of $25 on March 18.] The share price has since more than recovered from its decline and we've sold the incremental shares we purchased during the crash, but this is still our largest holding.

There have been ups and downs, but the stock has been relatively flat for the past three years. Why is that?

AB: I don't like to speculate about why the market does what it does, but the company thinks one key issue stems from an industrial-side acquisition they made where the purchased company had, prior to the deal, bungled a large product delivery that resulted in the loss of a big customer. In this market if organic growth goes from +1% to -1% the market can be pretty unforgiving. In this case that's a fixable problem.

I also wouldn't be surprised that other investors are somewhat worried about the balance sheet after the $6.5 billion acquisition last year of RPC Group. We think it's a highly intelligent, strategic deal, which dramatically expands Berry's footprint in Europe. But it caused their debt-to-EBITDA ratio to go above 5x and that seems to set off warning lights for some people regardless of how resilient the business is. This is a case where we're actually arguing against the company deleveraging too much. It can manage that level of debt and shouldn't pass on otherwise important deals to stay within some artificial leverage ratio that doesn't necessarily apply.

Another issue may be that because the company for years was owned by a succession of private-equity owners, its asset base is bigger than those of what might be considered comps. The equipment lasts a long time and typically gets depreciated fully, but when the company is sold the assets get revalued up again from the depreciated level. In this case, that means Berry's return on assets doesn't look that

INVESTMENT SNAPSHOT

Berry Global
(NYSE: BERY)

Business: Manufacture and sale of plastic-based products through three operating segments: Consumer Packaging, Engineered Materials, and Health, Hygiene & Specialties.

Share Information (@8/28/20):

Price	**52.48**
52-Week Range	25.00 – 54.98
Dividend Yield	0.0%
Market Cap	$6.96 billion

Financials (TTM):

Revenue	$11.72 billion
Operating Profit Margin	9.6%
Net Profit Margin	5.1%

Valuation Metrics
(@8/28/20):

	BERY	S&P 500
P/E (TTM)	11.7	36.2
Forward P/E (Est.)	10.2	26.7

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
EdgePoint Inv Group	11.3%
Vanguard Group	8.9%
Eminence Capital	7.0%
Canyon Capital Adv	6.7%
Turtle Creek Asset Mgmt	4.2%

Short Interest (as of 8/15/20):

Shares Short/Float	2.5%

BERY PRICE HISTORY

THE BOTTOM LINE

The company has proved to be both an excellent acquirer and that as the biggest player in a still-fragmented industry that it can take advantage of scale – both of which bode well for its future prospects, says Andrew Brenton. Even without giving credit for potential future acquisitions, his discounted-cash-flow value for the shares today is close to $100.

Sources: Company reports, other publicly available information

impressive. Unless you dig through the accounting noise, you might think the company is less profitable than it really is.

How are you valuing the shares at today's price of around $52.50?

AB: The stock today trades at a consensus forward P/E of around 10x at a time when that same number for the S&P 500 is in the mid-20s. On a stand-alone basis, assuming modest revenue growth, modest operating leverage and a 9% discount rate, we believe the discounted present value of the future cash flows is worth closer to $100 per share.

With acquisitions – which will continue and which we expect to be accretive – we think the value is meaningfully higher than that. Management is disciplined and patient, so if they aren't making acquisitions, they'll have considerable surplus capital that they'll use to buy back shares. They'll also continue to swap out higher-cost debt for lower-cost debt as they can.

The last thing I'd mention is that the company doesn't yet have a wide following on Wall Street, and it doesn't show up in many of the more prominent mid-cap indices. If it's as successful as we expect, both of those things will likely change.

Turning to another not particularly high-profile mid-cap, explain why you're high on the prospects for Middleby [MIDD].

AB: This is a manufacturer of commercial cooking equipment, industrial food-processing equipment and residential kitchen appliances. The commercial business is the largest, accounting for close to 60% of sales, where they sell food-preparation equipment to restaurants, including almost all of the top quick-service restaurants in the world. The residential business is the second-largest and growing the fastest, with an expanding product portfolio that now includes such mostly high-end brands as Viking, La Cornue, U-Line and Lynx.

We always focus more on the company than the industry as the first point of attack in assessing ideas, but in this case the industry backdrop given the pandemic is important. There has clearly been a near-term hit to restaurant sales – which is the big reason the stock fell as low as $42 [from around $110] in March – but Middleby tends to be more indexed to restaurants with higher take-out and delivery, which has mitigated some of the impact. Most of their chain customers are financially strong and many have said they believe pandemic-related disruptions will help them accelerate their own growth over the medium term at the expense of independents.

Longer term, you typically have to worry about something coming out of the valley that changes the game. But we don't see that here. Where and how food is prepared and delivered will certainly shift, but we believe it will always be the case that families and friends will get together to talk and eat. That's just how we are made. So then you have to get comfortable that you own a company that is nimble and on top of all that, and we think Middleby is quite innovative and right there with its customers to provide solutions. For example, they're working with several large players in the food-delivery space to develop highly automated, "ghost kitchens" – preparing food for delivery only – that

INVESTMENT SNAPSHOT

Middleby
(Nasdaq: MIDD)

Business: Designs, manufactures, markets and services a wide range of commercial and residential kitchen, food-preparation and foodservice equipment and appliances.

Share Information (@8/28/20):

Price	**99.82**
52-Week Range	41.73 – 128.48
Dividend Yield	0.0%
Market Cap	$5.55 billion

Financials (TTM):

Revenue	$2.66 billion
Operating Profit Margin	16.8%
Net Profit Margin	10.7%

Valuation Metrics
(@8/28/20):

	MIDD	S&P 500
P/E (TTM)	18.8	36.2
Forward P/E (Est.)	22.0	26.7

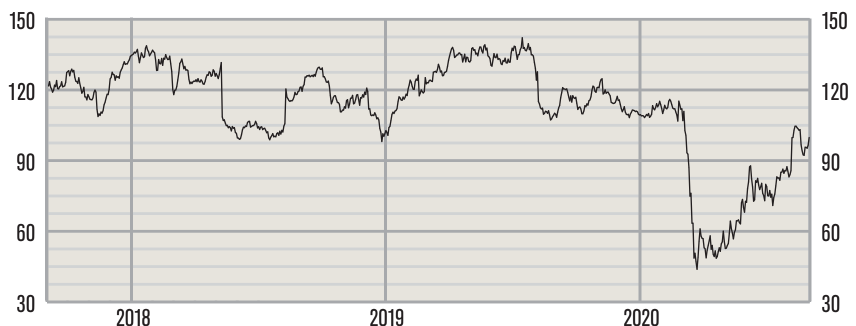
Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
EdgePoint Inv Group	9.0%
Vanguard Group	8.9%
BlackRock	7.9%
Goldman Sachs	7.7%
JPMorgan Inv Mgmt	5.1%

Short Interest (as of 8/15/20):

Shares Short/Float	18.7%

MIDD PRICE HISTORY



THE BOTTOM LINE

The company is nimble, well managed and well positioned in areas of the food-preparation and foodservices industries that – despite near-term challenges – have bright prospective outlooks, says Andrew Brenton. Without assuming upside for acquisitions that he expects to happen, his per-share estimate of the stock's fair value is around $200.

Sources: Company reports, other publicly available information

combine equipment from their commercial and food-processing segments. Another example: they've developed a "ventless" kitchen, which significantly broadens where food vendors can set up shop and reduces the cost and hassle of doing so.

Are regular acquisitions a big part of the story here?

AB: Maybe not to the extent it is with Berry, but acquisitions are a core competency of Middleby as well. One big thing acquisitions bring them is technological innovation. A current example is a company they acquired late last year called Brava Home, which uses xenon light to cook in a unique way that really works. Brava didn't have the scale or footprint to go to a much higher level and it now does. Middleby has also been successful in buying well-known residential brands that maybe had lost a step and then restoring them to their prior strength. They did that with the Viking appliance brand, for example. They're doing the same with AGA, a premium brand of ranges and ovens in the U.K. that they believe has great potential in North America.

How inexpensive do you consider the shares at a recent price of just under $100?

AB: This is another case where we significantly increased our position when the shares fell so sharply due to the pandemic. While we've sold some of that as the price has come back, it's now a much larger position for us than it was before.

Taking into consideration short-term impacts from the crisis but assuming the long-term story is intact, our stand-alone fair-value estimate for the company is around $200 per share. Then there's the incremental value they should create, as they have historically, from future acquisitions. In hindsight we think the fact that the stock traded as low as $42 a few months ago is going to make people say, wow, that was crazy cheap.

Does the fairly high short interest in the stock worry you?

AB: As I've said, we don't spend a lot of time worrying about what other investors think. We imagine the short interest has reflected concern that the next quarterly earnings would be unexpectedly bad, which so far hasn't been the case.

You've mentioned Badger Daylighting a few times. What do you think the market is missing about it?

AB: We've observed that the average institutional investor doesn't seem to be able to get their head around the company's economic moat and the sustainability of its double-digit operating margins. How hard is it to buy a hydrovac truck and put it to use? Maybe it's not obvious at first blush, but we think the company's competitive advantage comes from a number of things and will endure for a long time. Scale matters. You can move vehicles from Alberta to Chicago when energy-related demand goes off a cliff. You can invest in better information and logistics systems to serve customers and run your business more efficiently. You can build your own trucks, as Badger does, which are of better quality and lower all-in cost. When Duke Energy calls and says it wants 100 vehicles

INVESTMENT SNAPSHOT

Badger Daylighting
(Toronto: BAD)

Business: North American provider to contractors, engineering firms and facility owners of excavation equipment and services using its proprietary "hydrovac" technology.

Share Information
(@8/28/20, Exchange Rate: $1 = C$1.31):

Price	**C$37.81**
52-Week Range	C$18.00 – C$43.14
Dividend Yield	1.6%
Market Cap	C$1.32 billion

Financials (TTM):

Revenue	C$617.6 million
Operating Profit Margin	12.6%
Net Profit Margin	7.9%

Valuation Metrics
(@8/28/20):

	BAD	S&P 500
P/E (TTM)	27.5	36.2
Forward P/E (Est.)	33.3	26.7

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Turtle Creek Asset Mgmt	12.4%
Caisse de depot et placement (Quebec)	8.0%
Fiera Capital	3.7%
RBC Global Asset Mgmt	3.3%
Canoe Financial	2.0%

Short Interest (as of 8/15/20):

Shares Short/Float	n/a

BAD PRICE HISTORY

THE BOTTOM LINE

Andrew Brenton believes the market either doesn't know enough about the company's unique technology and growth potential or just doesn't understand it. He expects management to hit ambitious growth targets, particularly through U.S. expansion, which helps drive his current intrinsic-value estimate for the stock "north of" C$50 per share.

Sources: Company reports, other publicly available information

standing ready as a hurricane bears down on the Carolinas, you can do that. There are only a couple of competitors that even have 100 trucks in all of North America, so no one else could have come even close to fulfilling that request.

This gets back to what can happen if you own a unique business. There is really only one company like this and you need to put in the work to understand whether it can consistently out-execute its competition. A special-situations analyst who covers dozens of companies in totally different industries is going to have a harder time getting what Badger Daylighting is all about. There's a better chance its stock can get mispriced as a result.

You noted earlier the company's ambitious growth aspirations. What's driving that?

AB: Part of it is the efficacy of the technology, which isn't as well known – particularly in the U.S. – as we believe it is going to be. This is a non-destructive way to excavate, using high-pressure water and a powerful vacuum. That makes it an attractive alternative to picks, shovels or backhoes for digging and clearing without damaging buried cables, wires or other infrastructure. In addition, while hydrovac technology was initially used primarily in energy applications in the Western Canadian oil patch – a legacy that probably weighs on the stock given the difficulties in that sector in recent years – Badger and its customers are continually finding new applications. It could be digging more precise holes for telephone poles. It could be for cleaning out obstructed culverts. We think all this provides a multi-year tailwind for the company.

Long-time CEO Tor Wilson decided to step down in mid-2016. Given the emphasis you put on leadership in general and his stewardship of Badger in particular, did that cause you to reassess your thesis?

AB: When a long-time CEO steps down, we in essence de-rate the company until we've had a chance to get to know his or her replacement. We were surprised Tor was stepping down, which was for personal health reasons, but we've become entirely comfortable with his successor, Paul Vanderberg, and his executive team. When you have a lot of growth, sometimes the company outgrows its founding leadership – we think Paul is absolutely the right person to continue to take Badger to the next level.

Now at C$37.80, how are you looking at upside for the stock?

AB: We assume a decline in overall revenue and profit in the short term due to the pandemic, but offsetting that a bit further out is that we believe Badger in this environment will take market share from smaller and less-capable local competitors. Of note, in management's latest business update they reiterated their goal of doubling their U.S. business over the next three to five years.

ON SERIAL ACQUIRERS:

If you don't assume they'll make any more acquisitions, they won't look nearly as cheap as we think they are.

While it's a bit less compellingly cheap than Berry or Middleby, our intrinsic-value estimate here for the stock is north of C$50. This is a pure organic-growth story, which as you can appreciate tends to get a pretty high valuation. In this case we think the market either doesn't understand the company or doesn't know enough about it yet for that to be the case.

Canadian mortgage lender Home Capital Group has had its share of drama over the past few years. Explain why you think everything is back on track.

AB: This is a company we spoke about five years ago when there was concern that Canada's residential housing market was overheating and was going to run into some of the same problems you had seen in the U.S. several years earlier. Because Home Capital was the leading provider of so-called "Alt-A" mortgage loans – made primarily to people who because they are self-employed or new to Canada don't have the standard credit profile – it was considered at risk if the housing "bubble" popped.

As it turns out, the bust never happened and, I think for good reason, you don't hear much anymore about the perceived excesses in Canadian residential real estate. That said, Home Capital in mid-2017 faced a funding crisis when it let itself become overly reliant on demand deposits that disappeared in volume when there were rumors – which turned out to be patently false – that the company faced significant credit-quality issues. But the short-term damage was done.

The company needed to sell assets and raise capital to shore up its balance sheet, and the stock fell from the mid-C$20s to a low of around C$6. Of note, one thing Home did was sell a 20% stake in the company to Berkshire Hathaway at C$10 per share, which it ended up buying back 18 months later at around C$16. Berkshire's involvement had exactly the desired effect, and by the time they stepped out the crisis had fully passed and the business was operating as well as ever under a reconstituted and upgraded board and management.

The company has regained its position as the #1 Alt-A mortgage lender, a market with ongoing strong demand and where Home's long experience and deep relationships give it a competitive edge. Banks are becoming tougher to deal with in terms of documentation on mortgage loans, which benefits Home because it's willing and able to do the work to prove up income. The client base also tends to be quite resilient in a recession, as they often work for themselves or family firms and aren't as likely to get laid off. Home's loan losses over time have been extremely low, even lower than on prime mortgages at the big Canadian banks.

As for the Canadian housing market today, I'd characterize it as strong. Hous-

INVESTMENT SNAPSHOT

Home Capital Group
(Toronto: HCG)

Business: Through operating subsidiary Home Trust Co., underwrites and securitizes mortgage loans and offers consumer-lending and credit-card services throughout Canada.

Share Information
(@8/28/20, Exchange Rate: $1 = C$1.31):

Price	**C$22.57**
52-Week Range	C$13.67 – C$35.49
Dividend Yield	0.0%
Market Cap	C$1.17 billion

Financials (TTM):

Revenue	C$443.4 million
Operating Profit Margin	46.5%
Net Profit Margin	31.1%

Valuation Metrics
(@8/28/20):

	HCG	S&P 500
P/E (TTM)	9.1	36.2
Forward P/E (Est.)	8.0	26.7

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Turtle Creek Asset Mgmt	15.3%
Fidelity Canada Asset Mgmt	7.9%
Dimensional Fund Adv	5.3%
Vanguard Group	3.1%
CI Investments	2.0%

Short Interest (as of 8/15/20):

Shares Short/Float	n/a

HCG PRICE HISTORY

THE BOTTOM LINE

The company is the leading player in a high-quality and growing segment of the Canadian residential mortgage market where its expertise and relationships provide it with a sustainable competitive advantage, says Andrew Brenton. He believes the stock should be valued closer to 1.5x book value, which would result in the price doubling from today.

Sources: Company reports, other publicly available information

ing prices are at an all-time high and loan-to-value ratios on Home's mortgages are better than ever at 60-65%. They're good underwriters and have proven to have a very good handle on what houses can be sold for – in rare cases where they have to foreclose and sell off the home, they're typically able to recoup all of their money. The market just doesn't appear frothy.

What do you think the shares, now around C$22.50, are more reasonably worth?

AB: In terms of intrinsic value here, we think about a multiple of book value. There's growth in the loan book as their target markets in the Toronto and Vancouver metropolitan areas expand. Returns on equity are in the mid-to-high teens. Given the company's profile, you could justify a multiple of book value on the stock of 1.5x to 2x. Today on a book value slightly above C$30, the multiple is less than 0.8x.

They have surplus capital we expect them to use to continue to buy back stock once the restrictions on doing so in Canada because of the pandemic are lifted. Given where the stock trades today, that's an intelligent use of the money.

You've been a long-time investor in Premium Brands. What makes it special in your estimation?

AB: It's a combination of strategy, execution and capital allocation. This was a commodity pork producer in Canada when George Paleologou and his long-time CFO, Will Kalutycz, took charge nearly 20 years ago. George's central idea was that consumers were increasingly going to care about the provenance of their food – where it came from, how it was prepared. From that insight he's built a remarkable business focused on specialty foods where the purchase decision is often based on factors other than price – namely quality, health-consciousness, sourcing and brand recognition. Acquisitions have been key, as food-company entrepreneurs have come to see Premium as the best partner to help take their businesses to the next level.

We like to find companies with large, rational ambition. When we first met George more than 15 years ago he said he wanted Premium to be one of the leading specialty-food companies in Canada. Then he said he wanted it to be the leading specialty-food company in Canada. Then it changed to being one of the leading specialty-food companies in North America. Then he wanted to be the leading specialty-food company in North America. Last year for the first time they stepped up the ambition again, making an acquisition of a deli-meat company in Milan and stating that they want to be a leading global specialty-food company.

George believes the opportunity set it still has for accretive acquisitions is enormous. In addition to geographic expansion, they continue to deepen and broaden their vertical markets, which today consist of things like specialty sandwiches, premium meats, fresh seafood and specialty baking. They've proven to be very skilled in integrating the businesses they buy and making them better. To give just one example, two years ago Premium bought a sausage business based in Seattle called Oberto. It was a classic case of a 100-year-old brand, family ownership, picture of the founder on the packaging,

but the brand had slipped somewhat over the years. They didn't smoke the meat anymore and used liquid smoke instead. They expanded more into mass-market channels where quality wasn't as important. The strategy post-acquisition has been to go back to the brand's roots, with higher-quality products and distribution, taking advantage of Premium's expertise, relationships and capital to help make that happen. Last year Oberto had its best sales year ever.

It appears the company is building its war chest to do a lot more deals.

AB: They are. Last year they raised capital by selling a 7% equity stake to the Canada Pension Plan, which is a very active direct investor. After the share price recovered from the recent crash, they raised another nearly $300 million by issuing equity and convertible bonds. The company didn't ostensibly need the capital, but when you ask George Paleologou about it, he says, "The potential here is bigger than you think." We could argue that the pandemic, while maybe delaying some potential deals, will actually cause more family owners who were on the fence about selling to see the virtue in the ongoing environment of partnering with a bigger, better-capitalized competitor.

The shares, now around C$98, don't appear cheap. What potential upside do you see from here?

AB: If you just take the current business and put a multiple on it, you're right that the stock's not that cheap. But this is another case where not taking future acquisition potential into account doesn't make any sense. If we assume they never buy another company, the stock trades at right around our estimate of discounted fair value. So if we use a 9.5% discount rate and our numbers turn out to be right, we'd expect to earn 9.5% compounded on our money. Given the growth runway ahead from acquisitions, we expect to do a lot better than that. To give some historical perspective, our return in owning Premium over the past 15 years has compounded annually in the high-20% range. Even if we had just bought and held, that would have still been above 20%.

Would you say there are any recurring themes to your mistakes?

AB: One change in our approach that was a result of some investments not working out as we would have liked has been to put greater emphasis on companies' and managements' shareholder focus. That can mean a lot of things, but to us it typically gets down to capital efficiency. We don't want companies to be afraid of debt if interest rates are low and the business can comfortably support it. We also want to be sure that if they can't intelligently deploy all their cash flow and have surplus capital that they return it to shareholders.

If you own that type of company, you don't worry too much about whether or when the market is going to come around to your thinking. Even if it doesn't and the stock stays cheap, the company buying back shares can be a significant driver to the share price. When we first got to know Discover, for example, it had over the previous seven-year period repurchased 40% of its shares. We generally think that's an

INVESTMENT SNAPSHOT

Premium Brands
(Toronto: PBH)

Business: Prepares, sells and distributes specialty foods through separate units serving specific product niches and geographic markets mostly in the United States and Canada.

Share Information
(@8/28/20, Exchange Rate: $1 = C$1.31):

Price	**C$97.62**
52-Week Range	C$62.79 – C$102.68
Dividend Yield	2.4%
Market Cap	C$3.87 billion

Financials (TTM):

Revenue	C$3.84 billion
Operating Profit Margin	4.2%
Net Profit Margin	1.8%

Valuation Metrics
(@8/28/20):

	PBH	S&P 500
P/E (TTM)	53.8	36.2
Forward P/E (Est.)	36.0	26.7

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Mackenzie Financial	14.0%
Janus Capital Mgmt	2.8%
Vanguard Group	2.5%
CI Investments	2.1%
Dimensional Fund Adv	1.3%

Short Interest (as of 8/15/20):

Shares Short/Float	n/a

PBH PRICE HISTORY

THE BOTTOM LINE

Despite remarkable long-term success in delivering on its expanding ambitions, the company believes its growth prospects remain better than ever, says Andrew Brenton. From today's price, assuming no M&A to come, he expects to earn a compound return of nearly 10% on the stock. With M&A, he says, "We expect to do a lot better than that."

Sources: Company reports, other publicly available information

efficient way to return capital – you're basically giving it back to the shareholder who at the time has the lowest view of the company's value.

Another thing we're increasingly aware of is to avoid situations where we can't see as clearly as we should that things are off track. That's particularly an issue in companies subject to big cycles. As an investor looking in from the outside, it can be harder to tell if bureaucracy is creeping in, if capital isn't being well allocated, or if costs aren't as well in control. With Premium Brands, we'll know pretty quickly if the acquisitions they're making are destroying or creating value. In an energy business, say, at the high or low end of a pronounced cycle it has at times been harder for us to see that type of thing.

We have a small position today in a company called Flowserve [FLS] that makes pumps, seals, valves and related control devices. It's a fairly new holding and there's a new CEO who we think highly of, but it's eye-opening when he describes the mess he's having to deal with in getting the company back on track. I really don't want to be a shareholder in a company that some years from now has a new CEO saying those types of things.

Is there anything in particular keeping you up at night about today's markets?

AB: People ask that from time to time and I really can't say anything keeps me up at night related to investing and our portfolio. I joke sometimes that I worry that maybe I should be more worried.

Our portfolio companies overall are trading at significantly lower multiples than the broad market, and at the same time are expected to have higher growth rates. We're invested in what we believe are leaders in their respective industries. What that means for returns in the near term, I don't know. But if we own leading companies that are growing and trade in aggregate at a single-digit multiple of normalized earnings – now around 9x – we think regardless of what happens next, that is a good place to be. VII