Meggen, 18 July 2018

Business Owner TGV vs. the DAX

Year	Annual % Change in Business Owner (1)	Annual % Change in the DAX (2)	Relative Results (1-2)
2008 (3 months)	-13.4%	-17.5%	4.1%
2009	31.1%	23.8%	7.3%
2010	27.0%	16.1%	10.9%
2011	6.5%	-14.7%	21.2%
2012	18.4%	29.1%	-10.7%
2013	31.9%	25.5%	6.4%
2014	24.9%	2.7%	22.2%
2015	46.7%	9.6%	37.1%
2016	-1.1%	6.9%	-8.0%
2017	28.5%	12.5%	16.0%
2018 H1	13.9%	-4.7%	18.6%
Compounded Annual Gain 2008 – H1 2018	21.0%	8.0%	13.0%
Overall Gain Sep 2008 – H1 2018	540.4%	111.0%	429.4%

Dear Co-Investor,

The NAV of Business Owner was €635.39 as of 29 June 2018. The NAV increased 13.9% since the start of the year and 540.4% since inception on 30 September 2008. The DAX was down 4.7% and up 111.0% respectively. Please note that these percentage changes differ from the changes in NAV due to disbursements from the fund related to taxes.

Update on Business Owner

In my half-year letter, I like to report on the operating development of our investee companies in the previous financial year. It is unconventional to discuss the previous year in July, but as most companies do not report until late February/early March, it is the earliest opportunity to do so. Furthermore, I like to allow some time to pass before commenting on the results. It allows a more objective assessment of whether the short-term development is consistent with the long-term journey, as opposed to whether the results are above or below somebody else’s expectations.

I am happy to report that our companies continued their positive trend in 2017. When I invest in a company, I generally hope it can expand its earnings power by 15% annually. I would settle for less growth if the earnings multiple were lower, but it would have to be substantially lower given my predilection for long holding periods. Given the high multiples that prevail today, I am rarely confronted with such a dilemma. Of course, not all our companies will ultimately deliver 15% annual growth but given that nominal GDP growth is less than 5% in developed markets, there is a wide margin of safety provided we do not pay too much more than a market-like multiple for our businesses.

Amongst the companies that have been in the portfolio for over a year, Credit Acceptance, Ryman Healthcare, Grenke, Facebook, Alphabet and BETT met or beat the 15% hurdle rate, in some cases by a huge margin.

Berkshire Hathaway grew its book value by 23%. Excluding the downward valuation of deferred tax liabilities resulting from the US tax reform, it would have been 8%.

Trupanion is a trickier company to track. As it acquires subscriptions, its marketing costs are front-loaded whereas the revenues come in over time. Counterintuitive as it might

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seem, the lower the earnings, the higher the value creation, if it is due to higher marketing spend and new pets are acquired at attractive IRRs (which is the case). Revenue growth is a better, if imperfect, proxy for earnings power growth. At close to 30%, it continues to be strong.

TFF Group was the sole laggard with "only" 8% net income growth excluding the impact of foreign exchange. Given a historically low grape harvest in 2017 and a continued cyclical downturn in whiskey, I expect a strong rebound in the new financial year.

Our US businesses benefited from tax reform in the US at the turn of the year. This led to positive one-time gains due to the revaluation of tax assets and liabilities in 2017 and will lead to higher after-tax earnings from 2018 onwards. I look forward to reporting on this in my half-year letter next year.

The standout performer of 2017 was Facebook. It grew its earnings power by – wait for it – 63%. Of course, negative headlines about election interference, privacy violations and fake news dominated the news cycle. Without question, Facebook made mistakes and, rightly, is working on correcting them. However, I found the frequency and intensity of the criticism levelled against it absurd. There are billions of interactions on Facebook every day. Those that go wrong need to be seen in the context of those that go right, for example when families and friends connect and businesses are matched with customers. Telephones are occasionally used to arrange bank robberies, but Alexander Bell is generally not pilloried as Dagobert Duck made flesh. That newspapers compete with Facebook for advertisers no doubt coloured their reporting of Facebook's missteps. The theme of unbalanced criticism of companies and the opportunity for outperformance it creates is one I return to later in this letter.

First new investment: AddLife

In late 2017, I built up a stake in the Swedish AddLife. In finding this investment, I am indebted to my friend Ryan Krafft, manager of Scott Partners, who drew my attention to the wonderful companies that emerged from the Bergman & Beving ecosystem.

AddLife is a holding company with 29 independent subsidiaries that distribute laboratory and medical technology to healthcare and life sciences companies predominantly in the Nordic region. It has two divisions: Labtech, which sells diagnostic equipment and reagents to healthcare and research laboratories, and Medtech, which sells medical devices to hospitals and the home care market. The Group's revenues are largely recurring in nature. Labtech is a classic razor-blade model with reagents making up the bulk of revenues. Medtech's products are mainly needs-based.

Although AddLife was only recently listed on the Stockholm Stock Exchange, its roots go back much further. AddLife was spun out of Addtech in 2016, which in turn was spun out of Bergman & Beving in 2001. Bergman & Beving was founded in 1906 as a trading company for technological products in the industrial sector in Sweden. It first entered the Life Sciences market in the 1940s when it signed an agreement with Radiometer. AddLife is still the distributor for Radiometer in the Nordics. The long history of AddLife's predecessor companies and their shared DNA give me confidence in the durability of AddLife's business despite its short operating history.

As a niche trading company, the core of AddLife's business model is adding value to customers and suppliers – hence the "Add" in "AddLife". AddLife's customers are the laboratory engineers and researchers who use the equipment and the public procurement bodies who pay for it. It adds value to the former by scouring the world for the most innovative equipment, training them on it, and providing support and maintenance. It adds value to the latter by preparing the tenders, which can be complex and drawn-out.

Suppliers tend to be diagnostic and medical equipment OEMs. For all but the very largest players, the Nordic market has too many languages and regulatory regimes relative to its size to allow them to profitably build their own sales organisations. AddLife adds value to them by providing access to the Nordic markets and feedback from customers on how to improve their products and adapt them to local market conditions.

AddLife is a platform for acquiring niche trading companies in the Life Sciences space. Target companies are small and focused, typically employing 15 people and generating SEK 50 m in revenue. It made three acquisitions last year and aims to add about 10% in sales each year through inorganic growth. The market is highly fragmented, so there is plenty of runway. At any one time, AddLife has 60-70 prospects.

AddLife is an advantaged buyer in at least two respects. First, it has deep experience as an operator. It improves acquired companies by benchmarking them against each other and creating a network for the exchange of ideas within the Group. Second, AddLife is a preferred buyer given the long relationships it builds with potential sellers and its track record as an owner. Acquired businesses maintain their independence and generally flourish under AddLife's ownership. Its separate listing in 2016 helped sharpen its profile as the first port of call for owners looking to sell a healthcare trading company.

Why are we invested in AddLife?

The first thing I look for in an investment is the people. In Kristina Willgård, we are investing for the first time in a company run by a female CEO and I could not be happier.

Kristina has only been CEO of the company since around the time of the listing in 2016, but her association with the company predates this. She became CFO of Addtech in 2010. As CFO, she knew AddLife's businesses well and, most importantly, was infused with the Addtech culture. Core to this culture is the idea of "freedom with responsibility" meaning that managers have the freedom to develop their businesses but are accountable for the results. This is reflected in Kristina's management style. She views her primary role as supporting employees and leading by example. She accords with my idea of the modern CEO – a coach as opposed to an order giver.

Regarding people, I would be remiss not to mention Johan Sjö. Johan will shortly step down as CEO of Addtech. He continues to be the Non-executive Chairman of AddLife and a mentor to Kristina. As CEO of Addtech, Johan put together an outstanding track record of capital allocation completing 90 acquisitions over 10 years, of which just 2.5 were abject failures, according to Johan. Johan spent hours explaining Addtech's playbook to me, for which I feel privileged and grateful. A big part of AddLife's appeal to me is getting Kristina and Johan in a single package at a company that is still early in its life.

The next thing I look for in an investment is a growing competitive advantage. The emphasis is on "growing" as any moat that is not growing is, by definition, shrinking given the increased pace of technological change.

AddLife's main competitive advantage is its deep relationships with customers and suppliers. Many supplier relationships have persisted over decades. The main way to grow this moat is to have highly qualified staff who are attentive to customers' and suppliers' needs. AddLife achieves by devolving responsibility to those closest to both groups whilst continually helping them to improve. This happens formally through the AddLife Academy and informally through the exchange of ideas between subsidiaries. AddLife also deepens these relationships through acquisitions, which add new products for customers or territories for suppliers.

AddLife's culture of freedom with responsibility is also a moat. It works, as demonstrated by the success of Bergman & Beving for over a century. As culture is automatically

reinforced over the time, the biggest risk is destroying it. In this respect, it impresses me how aligned everything in the organisation is with culture. A good example is financial reporting. The central metric at AddLife is "P/WC" (EBITA divided by working capital). The target is 45%. When companies are underperforming, senior management drills down with business heads into the component parts (for example, gross profit over inventory) and can draw on the experience of other group companies to see how they can improve. When a company is outperforming, growth projects for the excess cash flow are jointly developed. AddLife's financial reporting creates a framework for autonomous action by surfacing problems fast and helping business leaders improve.

The final thing that I look for in an investment is an attractive price. We paid around 20x forward after-tax owner earnings for our stake. As AddLife's revenues are largely recurring in nature, this should be a reliable estimate of its earnings power. My definition of owner earnings differs from GAAP net income as I add back intangible amortization. It results mainly from acquisitions and relates to capitalised assets such as customer lists. I do not consider it to be an economic expense.

For this price, we own a stake in a company that aims to grow earnings at 15% per annum, made up of 5% organic growth and 10% from acquisitions, whilst at the same time returning 30-50% of net income as a dividend. This implies an owner return above 15% per annum. Even if the owner return is below this, the investment should work well. If organic growth or the pace of acquisitions picks up, it should work better than well.

Second new investment: PSG (not the football club)

In early 2018, I built up a stake in PSG Group, a South African investment holding company. Its five largest holdings are Capitec Bank (a retail bank), Curro (a provider of private school education), PSG Konsult (a wealth and insurance advisor network), Zeder (a holding company for food and related businesses), and PSG Alpha (an early stage investment company). Except for PSG Alpha, they are listed on the Johannesburg Stock Exchange, whereby some of Alpha's businesses are themselves listed.

I first heard about PSG when one of Capitec's founders enquired about becoming a co-investor in Business Owner in early 2016. I read up on Capitec and then PSG, initially out of politeness, but was quickly bowled over by what I learnt. When I started the fund, I hoped that a network of fellow business owners would develop and assist me in sourcing and analysing investment opportunities. It is great to see this materialising.

PSG began life in 1995 when Jannie Mouton bought a controlling stake in PAG (Professional Assignment Group), a recruitment agency for about ZAR 3.5m. Shortly after this, he started a stockbroking operation in PAG called PSG (Professional Securities Group). Jannie sold the recruitment business a year and a half later for ZAR 107 m, giving him his first home run. PAG was subsequently renamed PSG Group.

Prior to buying PAG, Jannie was fired from SMK, a stockbroking business he founded. PAG was both a lifeline out of the funk he descended into after being fired and a new canvass to work on. PSG is his life's work, something he movingly talked about in a recent letter when he announced he had early stage Dementia. If you are interested in the company's history, I recommend Jannie's autobiography: "and then they fired me".

Out of PAG grew today's PSG Group, a company with a market value of ZAR 50 bn (€4 bn). Since 1995, PSG has compounded capital at nearly 50% p.a., an astonishing rate. This was achieved through astute financial investments as well as early-stage investments in private businesses. Three of those (Capitec, Curro, and Konsult) account for 80% of the PSG's sum of the parts value. Today, the focus is on developing its existing businesses, and starting businesses or buying them at an early stage.

In 2010, Jannie passed on the day-to-day running of PSG to his son, Piet. Jannie remains active as Chairman and largest shareholder. Over the last years, I have got to know Piet as well as senior executives at PSG's subsidiaries well. They are talented, motivated and, most importantly, high-quality people. I could not be happier to co-invest with them.

I view our investment in PSG Group as having two buckets of value: the listed companies and future value creation from capital allocation.

The largest holding, accounting for 55% of PSG's NAV, is a 31% stake in Capitec Bank. Capitec is a branch-based retail bank with four core products: Save, Transact, Insure and Credit, covering South Africans' basic financial needs. It was started in PSG's offices in the early 2000s. Today, Capitec is South Africa's second-largest bank with 10 m customers and a 28% share of the employed population. What makes Capitec special is a rigorous focus on four values: Simplicity, Affordability, Accessibility and Personalised Service. If you are wondering what "Accessibility" means, it literally means *access* – prior to Capitec, lower-income customers had to wait an hour or more at peak hours to use an ATM or be served in a branch, if they were taken as customers at all.

The second largest investment is a 55% stake in Curro, accounting for 14% of NAV. Curro builds and operates private schools. It was started in 1998 by Chris van der Merwe with 28 school children in a church vestry. PSG became the largest shareholder in 2009 when Curro had just three schools. Today, it has 138 schools on 59 campuses with over 52'000 school children. Curro brings affordable education to middle and higher income families who are underserved by the existing school system. Its school fees start in Curro Academies at ZAR 1'700 per month (just over €100). For this, the pupil gets a first-class education in a school with modern academic and sporting facilities.

The third largest investment, roughly equal in size to Curro, is a 62% interest in PSG Konsult. It has its roots in the broker set up in PAG. Konsult provides wealth management services to affluent South Africans. It has 784 advisors working out of 211 offices. It also has an asset management business and a commercial insurer. A key element of Konsult's success is decentralisation. The branches keep 70% of their revenue and have complete autonomy over how they run their business. For its 30%, Konsult takes over back-office tasks, allowing the advisors to focus on their customers.

Other important holdings of PSG Group accounting for roughly 20% of NAV are Zeder, PSG Alpha, Dipeo, a BEE (Black Economic Empowerment) investment fund owned 49% by PSG, and PSG Capital, a corporate finance and advisory boutique.

The second bucket of value is PSG's ability to allocate capital. Characteristics of all its investments are easy-to-understand businesses; large markets, which are underserved by incumbents; independent and talented operating managers; differentiated business models; and a South Africa focus. I expect this playbook, that has served PSG so well in the past, to continue to do so in the future. PSG has a promising pipeline of earlier stage investments in PSG Alpha, including Evergreen (retirement villages), Energy Partners (solar and other energy assets), and FutureLearn (distance learning), and no shortage of new investment proposals given its wide network and first-class reputation.

<u>Why we are invested in PSG</u>

The Moutons: I see in the Mouton family a committed owner with a deep love for PSG. This reduces the risk of bureaucracy, waste, politics, wrong incentives and all the other things that blight the average business. It is a pleasure to invest alongside them.

Widening Moats: PSG's businesses enjoy widening moats. For example, Capitec is growing faster than its rivals, building both scale and customer loyalty. Curro can continually improve its curricula based on a feedback loop from its 138 schools. Most

importantly, the PSG's ability to allocate capital opportunistically constitutes a widening moat. In contrast to a one-product or service company, it can allocate capital to what the most promising business opportunities, constantly upgrading its business mix.

Growth: PSG can grow within its listed businesses. For example, Capitec has just 2.7% of the consumer credit market in South Africa. Curro provides schooling to just 0.4% of school-aged South African children. Within its unlisted businesses, I am hopeful that at least one will become a substantial business over time. Evergreen and Energy Partners are the most promising prospects, in my opinion.

Culture: PSG has a strong culture, the foundation of which is decentralisation or what Jannie terms "Ultimate Empowerment". It is incredibly difficult to create a culture where people have authority and responsibility whilst at the same time maintaining strong controls. When it works, it unleashes human potential.

Capital Allocation: The company allocates capital well. Most importantly, this is based on its culture, organisational abilities, and reputation as opposed to the brilliance of any one individual. As such, it should persist over time.

Purpose: All of PSG's businesses are infused with a strong sense of purpose, such as providing ordinary South Africans access to financial services or a decent education. They serve to make the country better and more prosperous. This creates a win-win-win between PSG, customers, and society.

South Africa: You may have been disconcerted to see a South African company in the portfolio. There is a drumbeat of negative news in South Africa. The advice of the locals is to get your capital out, not in. However, I like PSG *because* it is in South Africa, not *despite* it. To an investor, a scarcity of capital is a plus, not a minus. PSG is uniquely adapted to the environment there given its experience, network and reputation. Most importantly, the underdeveloped nature of the economy creates the opportunity to build companies where the State or big business has failed ordinary South Africans, such as banking and schooling. Such opportunities are scarcer, by definition, in developed markets. PSG is what Nicholas Taleb would term an *anti-fragile* business. The tougher things get in South Africa, the more opportunity for PSG.

Why Buy now?

I first visited Piet in Stellenbosch in 2016. I did not buy then as I had not known the company long and the price was not right. The passage of time took care of the first objection and a double whammy of bad news early in 2018 took care of the second.

Through no fault of its own, PSG got caught up in the Steinhoff debacle. Steinhoff had a large stake in PSG that was placed in the market in January. The expectation of the placement depressed PSG's share price. Shortly after the placement, a short seller published a critical report on Capitec. This depressed the share price further.

The report questioned the integrity of Capitec's accounts and hence the people running the bank. I have had the fortune to spend time with Capitec's CEO Gerrie Fourie (pronounced "HGerrie", not "Jerrie" as I learnt to my embarrassment in front of several hundred people at PSG's shareholder meeting). Gerrie is mission and process driven in equal measure. The opportunity to bet on his integrity is my definition of a fat pitch.

For our stake in PSG, we paid around 20x forward after-tax recurring earnings. For that, we got the rapidly growing businesses in the existing portfolio, one of which (Curro) only modestly contributes to earnings due to losses at newly opened schools, and the future value creation from the early stage businesses, some of which are in PSG Alpha's portfolio and some of which are yet to be bought.

On Capital Allocation

Both new investments are in companies where acquisitions are central to their business models. At AddLife, target companies are in healthcare. At PSG Group, they can be in almost any sector. Prior to these investments, I had never deliberately invested in a company that regularly makes acquisitions apart from Berkshire Hathaway.

The archetypal Business Owner investment has been a founder-led company with a narrow focus on a single product or service and the opportunity to grow organically by expanding in new and existing markets. Think Grenke and leasing, or Credit Acceptance and subprime auto lending, or Ryman Healthcare and retirement villages.

Not only did I not invest in acquisitive companies, I actively avoided them. I have changed my mind about this (obviously given the investments in AddLife and PSG Group), but before I explain why, it is worth laying out why it was not, in my view, completely idiotic how I did things in the past.

Firstly, especially when you are at an earlier stage investing career, it is essential to develop shortcuts to figure out which companies to dive deeper on and which to skip. Avoiding acquisitive companies was one shortcut I took and, as shortcuts go, I think it is one of the best. A rapid pace of acquisitions generally correlates with all kinds of undesirable attributes in an investment. A megalomaniac CEO, financial leverage, accounting trickery, lack of focus, and a troubled core business spring to mind as just a few. A list of acquisitive companies that turned out to be frauds would be long indeed.

Second, a focused company run by a passionate founder is, in my view, nearly always the best-case scenario. Invariably, when a company spreads its energies over different businesses or replaces the founder with a professional manager something is lost. To be blunt, if a conglomerate puts an MBA into bat against a founder whose business constitutes his or her life's work, I expect a no-contest. If you ask successful people what the secret to their success is, invariably the response is "focus".

Third, a company with the capacity to reinvest is nearly always the highest return opportunity. When Grenke retains 1 EUR of earnings, it is automatically converted into 3 EUR of market value at today's market price. In practice, it is virtually impossible for a company to consistently buy other companies at a third of their fair value.

Fourth, I frequently found in southwestern Germany, where I cut my teeth in investing, that the best engineers and managers were somewhat financially illiterate. Return on capital and working capital cycles were a foreign language to them. As counterintuitive as it might seem, this was a good sign. Their energy went into improving products and keeping customers satisfied. A lack of financial sophistication was the trade-off. MBAs in the Anglo-Saxon tradition, by contrast, tended to know everything about IRRs and nothing about business. I infinitely preferred the former. Still do.

So why did I change my mind?

First, I got lucky. In 2011, I made an investment in TFF Group, our French barrel maker. At the time, I thought of TFF as a solid business with high barriers to entry, but only modest growth opportunity. Aside from partnering with Jerome, the central attraction of the investment was the crazy valuation - the business was trading at a discount to the value of its wood stock. You got the business for free. Had that been all there was to the investment case, I am sure the investment would have worked well, but the prudent thing to have done would have been to sell it once the discount unwound. In fact, the share price has appreciated by over 5 times since our initial purchase. The rocket fuel has been Jerome's shrewd capital allocation. It led to an increase in earnings power that far outstrips what would have been feasible organically. He benefits from a network in

the wine industry and a reputation as a responsible owner. When someone is ready to sell their cooperage, he is the one who gets the call.

Second, I read Will Thorndike's excellent book on investing – "The Outsiders". Actually, I had to read it twice as my bias against acquisitive companies was so strong, I missed the point on the first reading. Will argues that a small minority of CEOs create enormous wealth through capital allocation - the purchase of other businesses or their own stock at a discount to intrinsic value. They tend to be outsiders with a non-typical background for the industry. One example is Katharine Graham. She took over the Washington Post after the death of her husband without any prior experience in the newspaper business. I have often found value in the less popular corners of the financial markets (think subprime auto loans). Reframed this way, it made sense to me that if most acquisitions are ill-conceived and badly executed, there must be the exceptions that confirm the rule - the baby thrown out with the bathwater.

Third, the pace of technological change has increased is accelerating. The company with a holding company structure, such as PSG or Berkshire Hathaway, has a big advantage over the single product company. It has a licence to invest its capital wherever it makes the most sense at any point in time. To a certain extent, it makes PSG future-proof as its more mature businesses will generate plenty of capital over the coming years which Piet can invest in the most promising opportunities. In theory, this should be possible at other companies, but in practice they face the choice of reinvesting in the existing business or returning capital to shareholders. Anything else would trigger a shareholder revolt.

Fourth, I have learnt a lot from following Amazon. One thing Amazon does exceptionally well is take one of its internal competencies (think IT) and turn it into an external service for 3rd parties (think AWS). It is one of the most important organisational innovations of the last decades, in my opinion. Once you understand this concept, you start to see it everywhere (logistics, marketplace, grocery). It brings enormous benefit: by exposing internal cost centres to the harsh winds of competition, it forces them to raise their game rather than wallow in mediocrity thanks to a single captive customer. It stimulates growth by spawning new businesses. AWS, logistics, etc. have the potential to sustain Amazon's growth long after its retail business matures. It also gives employees the opportunity to grow by creating new businesses and hence new leadership positions.

The upshot of these points is that I am open to investing in acquisitive companies. However, I still love businesses that grow by reinvesting earnings in their core business.

Some further thoughts for our companies

All businesses should be open to "productising" their internal competencies, in my view. In addition to the benefits mentioned above, it allows them to square the circle of diversifying and focussing. A business can enter a new field at the same time as sharpening its core competencies. It is an incredibly powerful idea.

As I look through our portfolio, it strikes me that Ryman could license its care app to other care home operators and Credit Acceptance could build a marketplace for used cars (as it already has dealers' inventory on CAPS), to name just two examples. Trupanion already makes its insurance product available on a white label basis.

Positive Activism

In my last letter, I wrote about how well capitalism works, at least compared to all alternatives. In fact, I suggested replacing the term *Capitalism* with *Innovationism* as it is innovation, not capital, which best captures the essence of our economic system. So far,

my dabbling in politics does not seem to be triggering a movement. Hey-ho, back to the day job of allocating capital…

In this letter, I would like to extend the argument from the macro to the micro level, i.e. how well companies work. I hope these are not empty musings and will attempt to link my conviction with a description of how this creates the opportunity for outperformance.

Long-time observers of how I allocate capital will perhaps acknowledge that I pick companies not just based on the highest immediate financial return but on the value they create for their customers and society at large. I have tried to avoid companies that actively harm or exploit their customers. Incidentally, this is not due to an excess of morality on my part, but because I happen to believe that for the long-term owner of a business this is the most profitable path to go down.

Assuming I have been at least modestly successful in my endeavours, you would think that our companies have been relatively free from attacks from mass media in the case of the larger, well-known companies, and short sellers in the case of smaller, under-the-radar companies. In fact, virtually every company I have ever invested in has been subject to a sustained attack by the media, by short sellers, or by both. Facebook is currently in the firing line. Last year, it was Google. Credit Acceptance, Trupanion, and Capitec have all seen their share prices hit by critical reports by short sellers in the past. To be fair, BETT has never been subject to a short attack, though it was subject to a planned terrorist attack.

It strikes me that a lot of the criticism is based on two misunderstandings. First, it is inevitable that, if a company has thousands or even millions of interactions with its customers over years or even decades, things sometimes go wrong. A balanced analysis would weigh the cost versus the benefit. This is almost never the case. The instances where things go wrong tend to be magnified to the point where they become representative of the entire company to the exclusion of all else. In response to a critical question on Coca-Cola at the 2016 Berkshire Hathaway AGM, Charlie Munger drew the analogy of banning air travel because 100 people die in air crashes a year. He went on:

We ought to have almost a law…where these people shouldn't be allowed to cite the defects without sighting the offsetting advantage. It's immature and stupid.

He is right.

Second, people tend to ignore the benefit that accrues to the consumer from a commercial exchange and, instead, focus solely on the benefit to the company. Seen through such a lens, every company is exploitative, and its customers are its victims. The "When Something Online Is Free, You're Not The Customer, You're The Product" charge levelled at Google and Facebook is part of this sorry tradition. It is absurd. The foundation of a liberal economy is free exchange to the benefit of both parties. Adam Smith nailed it more than two centuries ago:

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.

In fact, he clearly thought that the benefit to the company was most in need of emphasising – the benefit to the consumer being self-evident.

All this seems so painfully obvious, it begs the question why it is worth stating at all. It strikes me that when something goes wrong, and a company finds itself in the firing line, there is no natural constituent who is willing or able to stand up for it. For the press, politicians and commentators, the no-brainer play is to ride the wave of outrage and opprobrium. It generates free airtime whilst at the same time aligning them with "the

little guy". Companies cannot defend themselves without setting off a new cycle of outrage. The only acceptable response is acknowledging shortcomings, asking for forgiveness and promising to do things differently next time around.

Owners also appear to have little incentive to speak up. To the extent, they believe the criticism is overblown, it is an ideal opportunity to quietly purchase shares, confident that the market will at some point return to its senses. To the extent, they believe they have misjudged a company, it is better to sell up and quietly slink off into the shadows.

Or do they?

I have written in the past that engaging with companies should not be left solely to the activists when the companies are being poorly run (valid though this activity is). It is equally or even more important that long-term owners are as vociferous in their support when businesses are doing things right, especially when the right thing is unpopular.

A period when a company is subject to unfounded or excessive criticism presents a unique opportunity to put this idea into practice. It is easy to praise management after a long run of success, but the impact is likely marginal at best. By contrast, standing up for a company when it is under fire almost certainly provides a much-needed fillip to its managers, especially given how incentives are skewed towards silencing the supporters. At such a time, the active long-term owner increases the probability of management staying the course with a value creating strategy. By tipping the scales in his or her favour, it can be a fertile source of outperformance.

I hope that by supporting our companies when they are under fire, I can exploit it.

2019 Investor Meeting in Engelberg

I look forward to welcoming you to my Investor and Emerging Manager Meeting in Engelberg on 19-20 January 2019. If you who cannot make it, do not despair! There will be a live stream on my YouTube channel.

One final date for your diaries: 30 September 2018 will be Business Owner's 10th anniversary. When I started the fund, I dreamt of having a 10-year track record…now I dream of being 10 years younger.

Yours sincerely

Robert Vinall