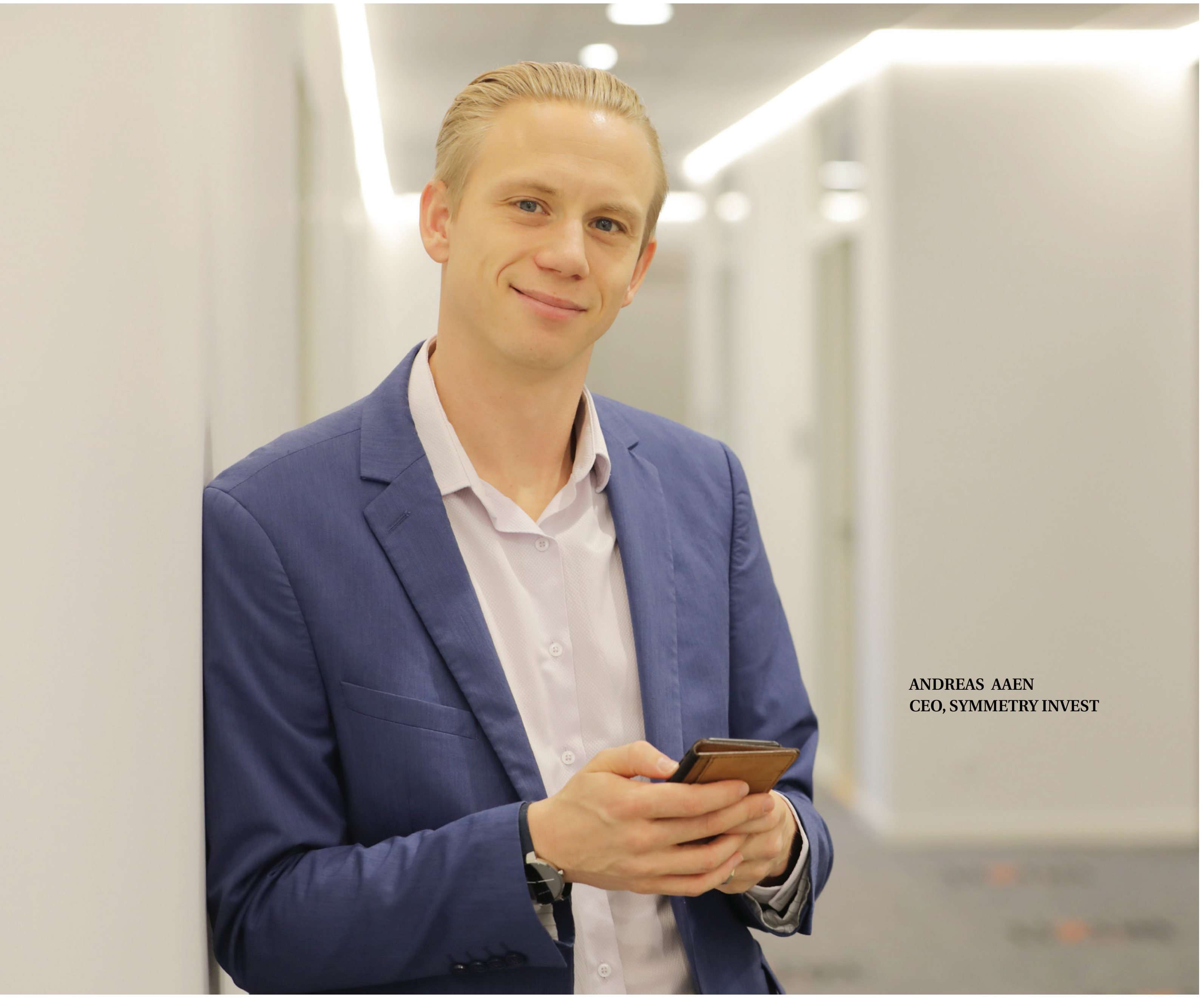
INVESTING IN FOUNDER-LED COMPANIES

By Eugeniu Guzun – HedgeNordic



ANDREAS AAEN
CEO, SYMMETRY INVEST

Andreas Aaen operates under the motto of "putting your money where your mouth is," which has proven successful thus far. After all, Symmetry Invest generated an annualized return of 17.3 percent since launching in March of 2013 despite suffering a bad year in 2018. Mistakes had been made and learned from, says Aaen, and the fund has recouped last year's losses after gaining nearly 28 percent year-to-date.

After successfully managing his own money and capital from friends and family for a few years, Andreas Aaen decided to open up his long/short value equity fund to outside investors. "We have this mindset of putting our investors' capital where our own money is," explains Aaen. With Symmetry Invest currently managing just shy of €10 million, "around 40 percent of the money comes from me, the board members, my family and close friends."

Search for Founder-Led Companies

Symmetry Invest's investment approach is inspired by that of Charlie Munger and Warren Buffett. The approach involves looking for strong businesses that generate high returns on capital for a long time and face a large set of high-return reinvestment opportunities. Aaen predominantly looks for such businesses among European small- and mid-cap companies. More importantly, his way of investing resembles Buffett's approach of acquiring entire businesses led by their founders. "The main characteristic of our holdings is that they are founder-led companies," emphasizes Aaen, usually companies with a founder that acts as president, chief executive, member of the board of directors, or holds some other position of significant influence.

Aaen mentions Italian company Piteco S.p.A., one of their top holdings. "Piteco is a treasury management software (TMS) provider with 99 percent customer retention and high-single-digit organic growth trading at around 13 times free cash flow," says Aaen. On top of that, the Podini Family controls 65 percent of the company and Marco Podini is the chairman of Piteco's board of directors. "The Podini family has created a lot of value in their family business DedaGroup and have done the same so far in Piteco," elaborates Aaen.

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Besides Podini chairing the board, the company's three founders still hold leading management roles and have high ownership stakes.

The majority of Symmetry Invest's holdings are founder-led, points out Aaen, but "those companies that are not founder-led have a really big shareholder sitting on the board instead." As the portfolio manager explains, "it is very important for smaller and mid-cap companies to have the founding entrepreneur or a big investor who can take control and lead these companies." With a fragmented ownership structure, argues Aaen, the management team can take the business in the wrong direction without shareholders being able to reverse the course at short notice. "A business does not necessarily have to be led by the founder, but I learned that founders normally tend to care about their businesses really well and they do well for themselves and other shareholders," says Aaen.

Good Allocators in Need

Allocating capital is one of the most essential responsibilities of chief executive officers, as long-term wealth creation for shareholders involves reinvesting internally-generated cash and borrowed capital at attractive rates of return. Aaen relies on the measure of return on capital and return on incremental invested capital to judge a company's capital allocation. "Return on capital is the most important bit of information," argues Aaen, who adds that if "companies do not make incremental investments, the returns investors get in the end will never be compelling."

The Aalborg-based manager reckons that the return on incremental invested capital is more important than the return on previously invested capital because reinvestments contribute to the growth of a business. "If companies can get returns of 15 percent or more on reinvested capital, I definitely want them to keep reinvesting rather than pay out dividends, for instance," argues Aaen. "But if they do not find reinvestment opportunities, they should buy back shares to take advantage of cheap valuations or pay dividends." That represents good capital allocation in Aaen's view.

Nonetheless, "companies that pay out almost all their earnings as dividends are not in our interest," points out the portfolio manager. Symmetry Invest aims to achieve an annual return of 20 percent before fees, which implies that "if companies do not find opportunities to reinvest, we need a dividend yield of 20 percent to achieve our target return," explains Aaen. "We really want companies to grow and if businesses keep compounding, we do not care very much if the price-to-earnings goes from 12 to 15." He prefers to never sell if investments go well, arguing that investing in a company is "like going into a marriage." Yet, Aaen is eager to part from holdings if mistakes in the original investment case are found or valuations increase too much relative to intrinsic value.

"If there are flaws in our analysis, we exit," says the Dane, who emphasizes that "if things turn out really well, we are not focused on exiting." But of course, exclaims the portfolio manager, "we will trim a position or sell it out completely if the valuation gets too high and the margin of safety declines." Aaen defines margin of safety as the difference between the present value of future cash flows and the current market capitalization of the business. "We look for a big discrepancy between what a company is worth and what we pay for it," explains Aaen. This value-oriented approach does not restrict Symmetry Invest from investing in companies with high valuation multiples. "We own stocks that trade at high multiples because we anticipate high returns on incremental capital."

Portfolio Concentration and Approach to Shorting

Aaen prefers Symmetry Invest to own between 15 and 20 positions, preferably in founder-led businesses, that can grow by deploying incremental capital at attractive rates of return. The portfolio manager also piles up a less concentrated portfolio of short positions, usually between 30 to 40 names. Whereas "the aim of short selling is to generate returns rather than reduce net exposure," Aaen does not afford to spend a lot of time to analyse short positions and limits each short's position sizing to 1-2 percent of the portfolio. "We cannot spend too much time on a short position. Even if a short position returns over 50 percent, it only adds one or two percent to our overall return."

For efficiency reasons, Aaen put in place a number of systematic processes for the search of short candidates. "We use screens that pop out companies that post really good earnings but bad cash flows, or companies with negative returns on incremental capital, or companies with an unsustainable expansion of debt," says Aaen. "Then we follow what the really good short sellers are shorting." In Europe, investors have to disclose short positions that constitute more than 0.5 percent of a company's shares, whereas in the United States there are lot of activist investors who make their shorts public. Symmetry Invest uses a variety of ways to find short candidates, but the ultimate goal is to make money on shorts. "If we just wanted to reduce exposure, we could simply short index futures."

Learning Curve

As a former accountant, Aaen can put his accounting experience to good use when searching for investment opportunities. Yet, he acknowledges that investing is not all about numbers. "When I read a financial statement, I can see in a really short time if the company is a good long, a short or a pass. But I do not think accounting knowledge alone can make you a good investor." The biggest learning curve for Aaen in recent years involved the human side of investing. "What I really tried to learn over the past couple of years was the human nature of investing," says Aaen. Even the best strategy is made worse in the hands of a frantic manager, which emphasizes the importance of controlling emotion and ego in investing.

That is the reason why Aaen spends a lot of his time reading books on different topics (biographies, psychology, among others). "As I only recently turned 30, I will be in this business for the next 50 years. The best investment I can make is in myself by strengthening my knowledge and capabilities," says the portfolio manager. Aaen also somewhat disagrees with the notion that value investing has underperformed in recent years. "It depends on how you see and define value investing," he argues. "Buying a struggling retailer or a capital intensive industrial with negative cash flows trading at 6-7 times earnings is not value investing to us. That's just bad investing."