

R/ Capital

Identifying Managers with Talent and Integrity

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Omaha, 5 May 2017

About RV Capital

- RV Capital was founded in 2006.
- A one captain ship: Robert Vinall is the sole owner and employee.
- Rob advises the Business Owner Fund, a long only equity fund that invests worldwide in most sectors.
- Concentration is high. The fund has 10 holdings.
- Holding periods are long, biasing the fund towards companies with widening moats and excellent long-term prospects.
- High concentration + low turnover permits a wide investment universe and deep relationships with investee companies.

Capital Allocation Framework

Topic: May 2017



Topic: May 2014

Topic: May 2020?

Management Matters

- It is most obvious in the negative
 - Frauds, theft
 - Disastrous acquisitions
 - Toxic culture
 - Misalignment
- Non-trivial point as great investing is principally about avoiding errors.
- But also in the positive: Business owners know: “it always comes down to the people”.
- Great managers:
 - Live and breath the company’s culture
 - Allocate capital productively
 - Decentralize
 - Create alignment
 - Give permission to make mistakes
- Investments generally work out far differently than expected.
- Sometimes the bad guys win, but the goal is to gain an edge over an investing lifetime, not on every single investment.

Judging Character Is Possible

- There is considerable scepticism amongst investors about their ability to judge character.
- Many investors avoid management contact altogether to avoid “biasing their judgement of the business”.
- Buffett has a near 100% track record in picking his managers.
- We tend to overestimate our ability to forecast financials and underestimate the role of people and our ability to spot them.
 - When a new CEO took the reins at Berkshire Hathaway in the 1960s, it was not the economics of the textile industry that determined the outcome.
- People generally prefer to meet their future spouse before marrying them. Why is investing so different?
- It is a wonderful situation for a stock picker when a factor is important, knowable, and overlooked.

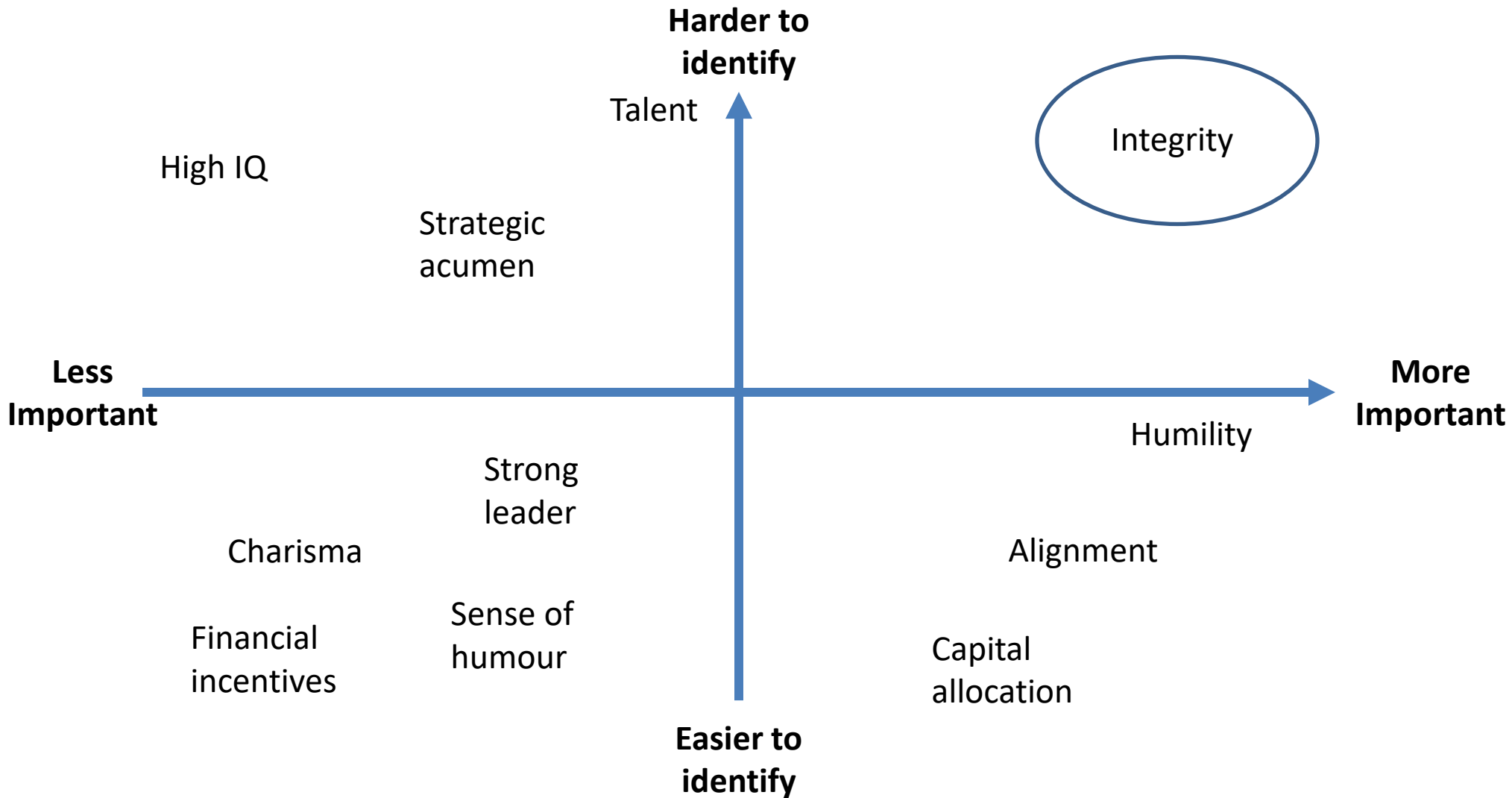
What Makes It Difficult

- Investors generally do not focus on evaluating managers.
- Managers self-select for good salesmanship (fortunately!).
- It is difficult to separate management excellence from the general tailwinds of a successful business (see: “The Halo Effect” and “Fooled by Randomness”).
- Management meetings tend to be in a fixed domain with a fixed script.
- No CEO ever volunteers negative information.
- There is a societal taboo against talking about people in the negative.
- Everyone has at least some positive attributes.

Strategies To Evaluate Managers

- Decide to focus on it:
 - Structure meetings and analysis accordingly
 - Reject investments where management falls short
- Look for very small details - “tells”.
- Stay within circle of competence.
 - Choose a universe of long-tenured managers, ideally founders and owner operators.
- Formulate short, precise questions (see: “Spy the Lie”).
- Break the task down into identifying a handful of desirable attributes rather than forming a holistic view of character.

Which Attributes To Look For?



It's All About Integrity

- Attributes such as strategic acumen, high IQ, and perhaps even talent speak to an old organizational model of a lone genius at the top filtering wisdom to the underlings below.
- In a modern corporation, responsibility and accountability are devolved to those closest to the customer. (see: "Reinventing Organizations" .
- The main job of the CEO is to protect the culture. This comes down to integrity or more broadly speaking "setting the right example".
- An excess of energy or intelligence can be an actual burden.

Sources of Data on Managers

- Management meetings
- Annual Reports (in time series)
- Former employees
- Competitors/Suppliers
- Company biographies (see “The Buffett CEO”)
- Situations where there is “an opportunity for a reveal”
 - There is a huge payoff to being perceived as honest. It will only be revealed when there is a strong incentive to sacrifice values for a short-term gain.

The Most Important Source Is Yourself

- Live by the values that you seek in your managers.
- We like people who are similar to ourselves (see “Influence”).
- Liking is a very powerful emotional bias that can be harnessed to your advantage.
- Buffett on Ajit Jain in “The Snowball”:
“Buffett **saw himself** in Ajit, who quickly rose in his esteem to share Mrs B’s pinnacle. “He had no background in insurance. **I just liked the guy.**”
- According to the Wall Street Journal, Buffett decided to invest in Precision Castparts after a 30 minute meeting with Mark Donegan.
- Life is more fun (and more profitable) when you partner people you like and admire.

Books referenced in this presentation

- “The Snowball: Warren Buffett and the Business of Life” by Alice Schroeder
- “Influence: The Psychology of Persuasion” by Robert Cialdini
- “The Halo Effect” by Phil Rosenzweig
- “Reinventing Organizations” by Frederic Laloux
- “Spy the Lie” by Philip Houston
- “Fooled by Randomness” by Nicholas Taleb
- “If Disney Ran Your Hospital: 9 ½ Things You Would Do Differently” by Fred Lee
- “The Warren Buffett CEO” by Robert P. Miles

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