PENDER
Forward thinking. Finding value.

Blog Post: Taking advantage of business, sector and market cycles

"It's déjà vu all over again." – Yogi Berra

We often own stakes in companies which can be characterized as boring, operating in "meat and potatoes" industries that have faced cyclical headwinds. Some major current Pender holdings in this category include Liberty Global and Liberty Latin America (large international TV and broadband companies), Platform Specialty Products (specialty chemicals), and Colfax (diversified industrials). None of these holdings were purchased at anywhere near the peaks of their respective cycles, but the subsequent downturns in some cases turned out to be much deeper and longer lasting than we anticipated. Although these stocks are US-listed, their operations are not US-centric and most have significant operations in emerging markets which are currently out of favour. Nevertheless, a bad cycle did not change our thesis that these are robust businesses that enjoy strong competitive positions, generate attractive returns on tangible capital, while providing essential services and products to customers. Important to our thesis, they are run by proven operators and vested capital allocators.

We view these companies somewhat akin to publicly traded private equity proxies because the management teams have a history of creating shareholder wealth using similar value-enhancing strategies. Part of the private equity model of using financial leverage to enhance the returns to equity, when combined with a greater-than-expected cyclical downturn, delivered a double blow to the underlying equity values. Nevertheless, the worst of the recent cycle appears to be behind them, and we believe they have the capacity to de-lever naturally over time as operating cashflows are used to lower debt levels. Moreover, significant operational improvements made during the downturn have laid the groundwork for considerable upside optionality when conditions improve. Not so long ago these firms were lauded for their outstanding performance and long-term potential – we don't believe they suddenly lost their attractive attributes just because they faced a tough patch. We believe all these holdings are trading at sizable discounts to our intrinsic business value ranges and we remain optimistic that today's "dogs" have the potential to be tomorrow's "stars".

As we have seen in the past, the future is far less predictable than most people assume, so there is real potential for repricing in stocks as the narrative shifts from pessimism to optimism. It makes sense to keep in mind that just about everything is cyclical.

Read more on this topic in my March 2018 Commentary.

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