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When to Buy: A Journey Inside Our Investment Process

Roz McLean: Good afternoon, my name is Roz McLean, and I work in Burgundy's Institutional group. When my institutional clients are doing research on Burgundy's strategies, they tend to focus on people, process, and performance. Today, we're just going to focus on process.

We're going to explore the fundamental tenets of the research our investment professionals conduct, where ideas come from, and what contributes to a "buy" decision. We're going to go through the five main areas of investment: research, travel, management meetings, talking to industry experts, financial analysis, and governance.

But let's start with people. I am joined by Mike Elkins, Deputy Portfolio Manager for European Equities and Director of Research, by Matt O'Meara, Investment Analyst on Burgundy's Asian equity strategy, which focuses on developed Asia, primarily Japan, and I'm joined by Andrew Iu, Portfolio Manager for Burgundy's Canadian Small-Cap strategy.

So, when we had our first prep meeting for this panel, I asked the team: What is a commonality of your process that's shared across geographies but is also crucial to the work you do? And the overwhelming response was travel and insights gained on the road.

So, Mike, let's start with you. Why is travel the right place to start this conversation?

Mike Elkins: Thanks, Roz. Travel is a tremendously important part of our investment process. It's our primary source of new ideas, it provides us with fantastic access to management, and it gives us important insights into the culture and the operations of the companies that we invest in. To give you some perspective on the extent to which we travel at Burgundy, there are 28 investment professionals at the firm. Last year, amongst that group, we travelled 893,000 kilometres. For context, that is equivalent to 22 times around the globe. We visited 16 countries. We spent 526 nights on the road away from home, and we had meetings with 1,100 companies. So, travel is just an absolutely critical component of our investment process, and we spend a lot of time doing it.

Roz McLean: Great. So, Matt, you must contribute significantly to some of those miles around the globe flown by travelling to Japan two, three, four times a year. Can you talk about why travel is important to your investment process?

Matt O'Meara: I think it starts with the fact that we run concentrated portfolios. 20 to 30 names in Asia. We might change a position one or two times a year, so there's a lot of inactivity in terms of the buy and sell decisions. So, when you make those decisions, you have to have a lot of conviction, a lot of confidence that you're making the right decisions. We talked earlier about not putting all your eggs in one basket. There's still a lot of eggs in one basket in the Asia portfolio, for example. And to get that conviction, meeting with management, meeting with middle management, if we can, walking factory floors, it's important to build that. And it's no different than in your personal life, there are some decisions you're only going to make a few times in your life—buying a house, buying a car. But when you're making those decisions, you're going to go to the house, you're going to look at the rooms, you're going to knock on the walls, you're going to take the car for a test drive, and you're going to look under the hood to get you that confidence, that conviction you need that you're making a good decision.

> "...to get that conviction, meeting with management, meeting with middle management, if we can, walking factory floors, it's important to build that."

Roz McLean: I just want to push back on that a little bit because we have so much access to teleconferencing technology that's new and improved, and even the factory floor tours can be done with virtual reality. So, what is tangible? What's important about being there and touching and feeling?

Matt O'Meara: I'll give you an example from a recent trip when the team travelled to Japan in March. This is around a company called **Kobe Bussan** (a Dream Team company). It's a discount grocery store. A simple way to think about it—it's not a perfect analogy—would be Costco with Japanese characteristics. So, the same bulk buying, no-frills, warehouse-style operations to keep costs low and deliver great value to customers, but catering to an island nation with very, very high population density and, as a result, smaller cars, smaller homes, smaller storage spaces. So, Costco but smaller. I spent six hours over the course of the day with their Investor Relations team. We visited one of the grocery stores

> **Businesses are people, and that's an important part of building conviction, I think.**

to see the low-cost operations firsthand. We visited a competing grocery store to compare prices. We went on a factory tour at one of the factories where they produce some of the private-label products that are sold in the grocery store. I learned a lot over those six hours, much more than I would have learned had I been sitting at my desk reading about the company or even on the phone on a Zoom call with an expert about the company. But the story that sticks out the most for me from that trip was when we were visiting the competitor's grocery store. We were comparing prices and one of the Kobe Bussan employees I was travelling with was running from the tofu aisle to the noodle aisle to the produce aisle yelling, "So cheap! So cheap!" And that told me something about the mission, the culture, and what gets people up to go to work every day at this company. And that's important. Businesses are people, and that's an important part of building conviction, I think.

Roz McLean: I want to turn to you, Andrew. You travel a little bit closer to home for Canadian small cap, but are there some insights from your trips to Mississauga that you would like to share with us?

Andrew Iu: Yes, I'm not contributing much to the hundreds of thousands of kilometres that Mike mentioned earlier. But I think whether you're going to Mississauga or you're going to Japan, you're trying to get at the same thing, which is you are trying to see the management team in their home environment. You're trying to see them in their factory interacting with their employees. You get very different information when you do that versus doing a Zoom call. I'll give you an example to bring this to life, which is from Brampton, by the way, not Mississauga. A few years ago, we were weighing investing in this company called **Savaria**. The company makes home elevators. Its biggest factory is in Brampton, where its headquarters are. They had just gotten a new CEO, a guy named Sébastien Bourassa. He worked at the company for many years. He finally got the big promotion. I decided I'd drive out to see him, so I drove out to Brampton to the factory. Normally, when you do a management team visit, the corporate offices are in the front of the factory. So, you go in, shake their hands, and then you go upstairs to their office to do the meeting. Sébastien shows me in and says, "Come to my office," and we start walking, and we're still walking. We're walking through the factory floor and I'm like, Where are we going? And, eventually, we get to the middle of the factory, and there's this control tower in the middle of the factory. And he says, "This is my office. Come upstairs." And I thought, this is interesting. We had a chat up there, and then he took me for a tour of the operations, and he knew the details of every assembly line with remarkable precision. He could answer all my questions, and he was super excited. "Here's where we make the curved stairlift," and "We're going to get a robotic arm in and it's going to change the weekly throughput rate from X to Y." He was super excited. And I left that meeting impressed. You meet a lot of what I call ivory tower CEOs. They hang out in corporate offices, and they delegate the nuts and bolts to somebody else.

When he took over, Sebastien put out these very aggressive margin targets, and said, "We're going to significantly improve the profit margins of this business." The reaction from Bay Street was crickets. Everybody said, "Yeah, right," and the stock price didn't do anything, and there was a lot of skepticism.

But I thought he was worth betting on, so we made an investment. And you look back now from when he took over, there has been a huge change in profitability. And it's not from one or two things. It's from a thousand tiny things that he was able to improve. And every quarter, you just get a little more margin. I told you that story for two reasons. One, you cannot get this on a Zoom call, even a virtual reality Zoom call, which I've never done and didn't know existed. But you can't get that. And then the second thing, which Matt alluded to, is that so much of investing is about investing in people. And you can't build relationships with people and really evaluate people unless you meet them in person.

Roz McLean: It sounds like when you're travelling with boots on the ground, you're looking for who the passionate, driven operators are. Mike, can I come to you? Tell me about how travel plays into your process in Europe.

Mike Elkins: Well, travel is, as you could probably tell from some of the photos in Ken's presentation, an incredibly important part of our investment process. I would say that it influences almost all of our investment decisions to some degree. It was actually particularly important to the investment that we made in Diploma, which Ken referenced in his speech. I'll share a story from that, that I think provides some perspective into the types of insights that we get from travel.

Diploma is a distributor of value-added industrial products. It's a very good business that generates very good economics. But importantly, for this example, it's also a sizable company. It has a $10 billion market cap, global operations, but you would have no idea of the size and the success of this company from the looks of its head office. We visited Diploma's head office during a trip that we were on to the U.K. to meet with the company's CFO. When we got there, genuinely, we thought that we were lost and kind of in the wrong spot. The head office of this $10 billion company with global operations is literally just a house in a residential neighborhood in London. And, to be honest, it's not even that nice of house. It's kind of old, a little bit run down. It's a semi-detached—not even a fully detached—house. So, it was kind of an amusing example for us. But there were two important insights that we took away from it.

The first is that the humble nature of the head office was an indication to us that this is probably a very shareholder-oriented management team that prioritizes value creation over things like executive perks, and I think that type of cultural disposition is almost a prerequisite for a company to be truly successful. The second insight that we took away from the meeting is that Diploma is clearly decentralized. There's no way that you could centrally manage a $10 billion company with global operations from a house with a few people in London. And in our experience, we have generally found that truly decentralized companies, where decision-making is made closest to the customer, tend to be very conducive to creating shareholder value. These are the types of insights that I just don't think we could have gotten from sitting at our desk, or on a Zoom call, or staring at Bloomberg. And they were important to our decision to invest in Diploma—twice actually. So, travel was absolutely critical to that. And my colleague, Kyle Stolys, did some fantastic work on the company.

Roz McLean: It's interesting to hear how observing these quality businesses and the characteristics that make them quality. In one case, it's total decentralization and in another, it's total control from a central tower in the office. But those are both appropriate for the markets these companies operate in.

Matt, beyond culture and a passion for the business, I want to move on to management and talk about what makes a good management team. So, in your opinion, how would you answer that?

Matt O'Meara: I think about it in two words: ability and integrity. I'm just going to pick on integrity for a second because I think that's a harder one to flesh out. At the end of the day, we are trusting these management teams with your capital—to preserve and grow your capital. That requires that we trust them. They're honest, they're transparent. How do we test for these things?

This is an example that comes from Mainfreight, a company we own in the Asia portfolio. It's a third-party logistics company based in New Zealand, operating globally. **Mainfreight** makes money basically shipping its customers' goods from point A to point Z along the supply chain, making sure everything shows up on time, in good order. During the early days of COVID in 2020, sales of Mainfreight fell off a cliff—as they did for many companies as the economy shut down and ground to a standstill. The New Zealand government, as many governments did, provided a wage subsidy to the businesses that needed it, so the businesses could keep their employees employed and unemployment didn't go too high.

Well, Mainfreight accessed the subsidy to the tune of about $10 million. But very quickly, performance rebounded. Management realized they didn't need the subsidy—it's $10 million sitting in our bank account. This isn't our money. We didn't earn it. This is taxpayers' money. Let's give it back. But the officials responsible for handing it out didn't know how to take it back. That was never the intention. So, Mainfreight worked with the officials and finally paid it back. To me, that story—if you're going to treat taxpayers like that, then I have a high degree of confidence that you're going to treat your shareholders pretty fairly. And the CEO of this company, Don Braid, we've met them a dozen times over the past six, seven years. One message he constantly hammers home is: Our reputation is gold. We have to keep a pristine reputation if we want to win more business from existing clients, if we want to win business through word of mouth from new clients, if we want to hire fantastic quality people, who are necessary in this people-intensive business to continue growing this business and make it—they like to say, a 100-year company. They want to be around and be better over the next 100 years.

Roz McLean: Yes, that's incredible. You don't often hear about companies voluntarily returning money to the government unless they're compelled to do so.

Andrew, anything you would add to what you look for in a quality management team?

Andrew Iu: I'll add to one of the things Matt said, which is ability and adding to that track record. If you find a management team who has a particular skill creating shareholder value with a particular playbook, and they've got a long track record doing it, it can be useful to keep an eye on that management team. Occasionally, management teams will move from one company to another, and you can follow them. I'll give an example.

When I started here as an Analyst, I was covering a company called Medworxx, which makes patient flow software—software that debottlenecks hospitals. Think of all of the friction points in hospitals: you're filling out a paper form, you're being routed to this bed or this department—much of that can be digitized with software. That's what the company did. And it was run by this exceptional CEO, Dan Matlow. He had figured out that there are thousands of these little point solution software companies out there solving all these little bottlenecks, and that he could buy them at a low price and help them commercialize and roll out across hospital networks across Canada. He did a phenomenal job, created a lot of shareholder value, and ultimately, the company was sold. And it was a great outcome for our clients, but it was sort of disappointing to see somebody so talented gone from the capital markets.

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Anyway, fast-forward six years to the pandemic, he comes back with another company. And he's doing the exact same thing. He's putting together a portfolio of these solutions, but it's a bit tougher this time because hospitals are all in lockdown. It's much harder to sell software to hospitals when they're dealing with the pandemic and they don't want to change workflows and what have you. So, for a number of years, the stock goes nowhere. The performance is good, but it's not as good as what I knew he was capable of and what I'd seen him do before. So, we just bought as much stock as we could, and the pandemic came to an end and the business performance just exploded. And he proved again that this playbook works and that he could do it really well. And it was a great outcome. I'm telling you this story because I think looking at a management team's track record and following a management team with a great track record is a good thing to do.

Roz McLean: I appreciate that each of you has met some great management teams. But I have to ask, wouldn't those management teams be incentivized to tell you what you want to hear or to talk about the company in the most positive light that they can? Mike, how do you differentiate what is true and what is spin?

Mike Elkins: As Matt and Andrew alluded to, meeting with and evaluating management, it's an absolutely critical component of our investment process. But the thing about management is these people aren't always totally objective, particularly when it comes to the companies that they manage. They tend to be eternal optimists and aren't always realistic. To get a complete view of a company, it's important to speak with people that are close to the company, that know the company well, but that have a perspective on it that is different from and independent of management. This could include speaking with people like customers, suppliers, competitors, and former employees. At Burgundy, we call this type of research scuttlebutt, and it's a very important part of our investment process. To give you some perspective on this, last year, across the firm, those 28 investment professionals that I mentioned earlier, we had over 400 of those types of interactions.

Roz McLean: Mike, could you share an example that helps highlight the role that talking to these industry experts plays in your investment process, and how that could contribute to a decision?

Mike Elkins: Scuttlebutt was tremendously important to an investment that we made in **Universal Music**—and I'll just provide a very brief background on Universal. It's such an interesting and unique business, in my opinion. Universal Music is a music label. So, what the company does is it invests in and develops musical artists and then earns a royalty anytime and anywhere their music is played. One aspect of the company that I think is particularly important to emphasize is that it is by far the largest owner of music rights in the world. It owns the rights to about one-third of all the commercial music that's been recorded over the past 100 years. This would include the rights to classic artists like the Beatles, the Rolling Stones, Guns N' Roses.

It also includes the rights to contemporary artists like Taylor Swift, Sabrina Carpenter, Drake, and Justin Bieber—so, Universal Music is such an interesting business, in my opinion. But as I alluded to earlier, when we were developing our perspective on Universal, I leaned heavily on scuttlebutt because it's a unique and difficult-to-understand business. So, I probably spent 10 to 15 hours on the phone speaking with people who were deeply involved in the music business and had a perspective on Universal. And this included conversations with a pretty diverse group of people—everyone from talent scouts that spend their time in bars and clubs trying to discover new artists all the way up to very senior executives at Spotify and Warner Music.

Roz McLean: So, if we need concert ticket hookups, we can call you to call the music executives to connect us with a guy? Seriously, though, can you talk about how the insights that you gained from speaking with these executives and club promoters contributed to your investment thesis?

Mike Elkins: When I had those conversations, I heard the same overwhelming message from almost everyone I spoke to: The music business is fundamentally changing, and these changes are likely to significantly benefit Universal. I think it was the consistency of that message from a wide variety of different people that really shaped our perspective on the company and motivated our decision to invest in it.

Maybe I'll just share one quick story from those conversations that I found particularly impactful. One thing I heard over and over again in these conversations was that the distribution of music is fundamentally changing from the physical distribution, of course, where music is distributed via CD to digital distribution. And importantly, this is significantly expanding the size of the global music market. So, in the past, when music was predominantly distributed via CD, the relatively high cost of distribution limited the size of the global music market—I was really surprised about this—to just five countries around the world that accounted for 75% of global music sales.

Now, with digital distribution, it costs literally nothing to distribute music to anyone, anywhere around the world who has a smartphone. As a result, the global music market is expanding from being confined to just 5 countries, say, 10 years ago to being truly global now. And this, of course, significantly benefits Universal. As the largest owner of music rights in the world, it now has a much larger audience to sell those rights to. So, I think this insight, along with other insights I got from speaking to people in the music industry, really shaped our perspective on the company. It motivated our decision to invest in it two years ago now. And it's been a successful investment for us so far.

Roz McLean: Before we turn to financial analysis and governance, Andrew, when it comes to the three areas we've discussed so far—travel, management meetings, talking to industry experts—is our approach different from what any other market participant would be doing, or can you speak to how it's different?

Andrew Iu: Maybe I'll ask Tony to cover his ears. There are a few other good investment firms that do these things, but there are not very many. I think there are fewer and fewer these days. And I think there are two reasons for that. I think one of them stems from the pandemic—how it changed things and how it might have encouraged some investors to be a bit lazy. When I started as an Analyst, I'd go on these field trips and there would be tons of investors. I think during the pandemic, people resorted to Zoom, and a lot of investors never went back to travelling. They found it was easier to stay at home and make calls and decided not to go back into the field.

> **"People are just getting more and more short-term oriented. Investment horizons are shrinking."**

I'll share an anecdote on that. Last year, I went to Montreal on a research trip and when I met the management teams, I asked them how many investors had flown out to see them in the last 12 months. And the answer I got back from all of them was two, three, or four. So, you can literally count on one hand the number of investors who are willing to go to Montreal to see Montreal-headquartered small-cap companies. It's a tiny number of people. I think that's one aspect. But I think the more pervasive reason that you don't see more investment firms doing this is the increasing myopia in our industry. People are just getting more and more short-term oriented. Investment horizons are shrinking. I looked this up this morning, the average holding period of a stock on the New York Stock Exchange is five months. So, the average holding period for an investor who trades in that market is five months. So, if you think about it, if your horizon is five months, you don't get value from going all the way to Japan to understand the cost-conscious cul-ture of Kobe Bussan or talking to club promoters. The insights these things give you don't pay off over five months.

> **Financial analysis is a critical component of our investment process. It really underpins all of our investment decisions.**

They pay off over five years. So, you don't see that many people doing these things as a result.

Roz McLean: Matt, is there anything you would add to that?

Matt O'Meara: Anecdotally—for example, when we travel to Japan, sometimes these trips will be built around investor conferences. And you can think of these conferences like speed dating between management and investors. It's in a hotel, you'll go from one room to another, spend an hour in a room talking to management. Most of these are one-on-ones, but the odd one—we might do 30-plus meetings in a trip over a week and a handful of those would be group meetings because there might be a lot of demand for a particular management team. So, they'll pile several investors into a room with this management team, and it's kind of a free for all in terms of asking questions. And you attended enough of these with enough different investors, and you see the bias towards short-term oriented questions, trying to figure out…

Andrew Iu: The next 90 days—what's next quarter going to look like?

Matt O'Meara: Yes, earnings next year, next quarter. And more power to them. This isn't to disparage. If you do this and do this well, then more power to you. But it just seems like that's where the majority of the focus is.

Roz McLean: All right. Well, now we're going to move on to financials. But not to worry, I won't ask our panelists to walk us through a discounted cash flow model. But I will ask—Financial information is so widely available, I suppose, to anyone who has a Bloomberg terminal. Mike, can you talk about how you process this widely available information into insights that are unique? Maybe you can use an example to illustrate that.

Mike Elkins: Yes. So, of course, financial analysis is a critical component of our investment process. It really underpins all of our investment decisions. Rather than walk through some of the steps in our methodology here, I'll provide an example of an investment where financial analysis was particularly consequential.

I think an investment that we made in a company called **Richemont**, which Ken mentioned earlier, is a very good example of this. Richemont, in my opinion, is such an exceptionally high-quality business. It's among the very best companies that we own in Europe, I think. But when we invested in the company initially in 2019, it honestly didn't look that way at all. The company's earnings hadn't grown in seven years, and its consolidated profitability and return metrics were, I would say, maybe average at best. But when we did a deep dive into the company's financials, we noticed two important things. The first was that the company owned an exceptionally high-quality jewelry business—Cartier and Van Cleef & Arpels are the primary brands here—but the performance and the profitability and the returns of that business were being offset and kind of overwhelmed by a collection of lower-quality businesses that the company owned.

The second thing we noticed was that the diverging performances between these businesses was quietly transforming Richemont from, I would say, an average-quality conglomerate into an exceptionally high-quality jewelry business. I'll just give you a little bit more perspective on this. When we invested in Richemont in 2019, the size of its jewelry business had doubled over the past five years. Over the same period, the earnings that it generated from its collection of other businesses had been cut in half. Such that when we invested in Richemont in 2019, it was generating over 85% of its earnings solely from Cartier and Van Cleef & Arpels. Despite this, the market was still valuing the company as though it were the lower-quality conglomerate that it had been in the past, that hadn't grown its earnings in seven years.

In the six years since we invested in Richemont, the company's earnings have tripled despite not growing at all in the seven years prior to that, driven by just the continued strong performance of the company's jewelry business. I believe the deep dive that we did into the company's financials was critical to us recognizing that the company had fundamentally changed and that its earnings were about to inflect because of that change. And that really motivated our decision to invest in the company six years ago now, and it's been a tremendously successful investment for quite some time.

Roz McLean: Yeah, seven years is a long time to have underperforming earnings and have market participants still interested in learning about the company. Thanks for sharing that.

Andrew, I want to talk about one key financial characteristic. We talk a lot about key metrics and financial characteristics here at Burgundy but maybe pick one and share why it's important.

Andrew Iu: Yeah, I'll pick return on invested capital. If you've been to our Client Day before, you probably heard us talk about this metric before, and Mike was alluding to it there with Richemont. So, what is return on invested capital? It's the return that a company makes when it makes an internal investment. So, to extend Mike's example, if Richemont opens up a new Cartier store, the return on that Cartier store is Richemont's return on invested capital. Why do we care so much about this metric? The reason is, mathematically, if you own a company for a long enough time period and that company reinvests enough of its earnings at its return on invested capital, the shareholder return equals the return on invested capital. In other words, your return is the company's return if you're a long-term investor. That's why we obsess over this metric. The next question you're going to ask is: Well, then why doesn't everyone just calculate it if it's going to tell you what the future returns on your stocks are going to be? And, again, I'll borrow from what Mike said, it's not that easy. It's very complicated. The world is much noisier than it might appear. If you take Richemont as an example, they've got this crummy watch business and it's commoditized and it obscures the quality of the luxury jewelry business. And in the middle, the accountants come and say, Well, now you have to capitalize operating leases. There's all this noise. So, figuring it out is really difficult, and that's part of the reason we spend so much time on financial analysis.

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Roz McLean: Right, and I know part of the role of Director of Research is to ensure that the investment team has those tools to parse through that complexity and get at the core of the financials.

I'd like to move on to governance. Matt, I'm going to come to you first on this because of the special nature of governance in Japan and some of the improvements that we're seeing. Can you talk about what I mean by "the special nature of governance in Japan," and touch on portfolio examples or other examples of what you're seeing that's getting better?

Matt O'Meara: So, I'm going to walk through a scenario, and we're going to do some role-playing to explain this in the time we have left. So, Roz, Andrew, and I—we're CEOs of public companies in Japan. We all own big stakes in each other, so collectively, there's kind of a majority between all of us. We're very influenced by each other. Now, Mike comes along. Mike's an outside investor, and he takes a small stake in my business. And he approaches me and says, "Matt, I've got some recommendations for you to improve your performance. That hotel you own in California, you're an automotive company. You don't need to own a hotel in California. Sell that and use the cash for something else. All the cash you have on your balance sheet that's sitting idle, not doing anything, invest that in your core business at a good return on invested capital or give it to me and I will find more productive things to do with it." Well, Mike is a smart guy. He makes some good points, but I don't like his recommendations. They represent a change to the status quo. Roz and Andrew don't like them either. They support me. So, the majority rules. I can tell Mike, "Thank you, but no thanks."

That's how governance, more or less, worked in Japan. Decades ago, post-World War II, the objective was building back the economy—reconstruction. And the thinking was that to do that required stability. And this system of what was known as cross-shareholdings, where we all kind of collectively own big pieces of each other, contributed to that stability. And it worked pretty well. It led to Japanese economic miracle. Japan became one of the largest economies in the world by the '80s. But it also came with some bad things. There was a lack of transparency, a lack of accountability, some bad decisions, and some ethical lapses—there's a record of corporate scandals happening in Japan, going back decades—and poor capital allocation decisions.

So, fast-forward to today, the demands of the economy have changed. The cross-shareholdings—this collective club that Roz, Andrew, and I were in—doesn't exist, at least not to the extent that it did. And this has opened up the door for Mike and many other people like Mike, who think like Mike to come back to me, to my company, and say, "Matt, remember those things we talked about—all that cash sitting on your balance sheet? I want you to do something with that. I want you to take a risk, invest in the business, or give it back to me in some form." And that, essentially, is what's happening.

And how that ties back to the portfolio is companies that we would own across the board who would have sat idle on this cash that's not doing anything, that has accumulated over decades, they're starting to pay that out. They're paying out larger dividends. They're buying back more shares. A month ago, **Shin-Etsu Chemical**, a company that makes silicon wafers used to make computer chips, announced its decision to buy back 10% of the business over the next year. And so, if there's 100 shares of Shin-Etsu Chemical outstanding and we own 10 of them, and they're going to buy back 10, and now there's 90—well, we went from owning 10 out of 100 to 10 out of 90. We own more of a wonderful business just by sitting on our hands, and there's more examples of that across the portfolio.

Roz McLean: Thank you, so it sounds like you look for transparency and accountability and focus.

Andrew, what do you look for from a governance perspective in Canadian small cap? Or perhaps more interestingly, what do you do when you see lower-quality governance in Canadian small cap?

Andrew Iu: Run. If you see bad governance, just run. There is no valuation low enough to protect you from bad corporate governance. So, put it in the "too hard" pile and walk away. But unfortunately, if you find bad governance at the outset, you pass. We don't always get the corporate governance assessment right. Sometimes we think something is well governed. But when things go wrong in a business, that's when you find out whether you have

> “When an investment isn’t tracking to our thesis, we don’t always necessarily default to selling. Sometimes we’ll engage with the management and the Board of the company to see if we can come up with a solution to the situation.”

good governance or not. And occasionally, we find out we got it wrong. I’ll just tell a quick story about what to do when you’re in one of those scenarios.

We invested in this company called **McCoy**. They made rig tools. We knew it was cyclical. We didn’t think it was going to cycle as hard as it did when the pandemic hit. Drilling activity went into a nuclear winter, and the stock price was under a lot of pressure. The only thing we got right was the balance sheet. They had a lot of cash. And, at the bottom, it was trading at about one-third of book value, which is cash receivables, inventory, and a little bit of real estate for them. And as Matt was alluding to, when you’re in that scenario, you’ve got a great balance sheet, you’ve got a low valuation, the thing to do is to shrink the share count. And every time we met the management team during the pandemic, we’d say, “You’ve got all this cash, you’re trading at a ridiculously low valuation, the energy business is going to have a cyclical recovery at some point, buy back your shares.” They just wouldn’t do it. And what we found they were doing instead was investing in science projects and doing acquisitions that didn’t make any sense. And it became clear that there was an agency issue, right? The CEO was more interested in preserving his kingdom than maximizing per-share value. And we realized at that point that there was bad governance. We got angry enough that we decided we were going to do something about it. We teamed up with another big shareholder and got Board representation, and I called an old friend of mine who loves a good fight, and he went onto the Board for us. And lo and behold, they started buying back their shares and we made a partial recovery. It was still a bad investment, but that’s something you can do if you are in that situation and you’ve got the governance wrong.

Roz McLean: That’s a good example of engagement and how our teams can use engagement as a tool.

Mike, how does your team use engagement as a tool if an investment thesis is going sideways?

Mike Elkins: When an investment isn’t tracking to our thesis, we don’t always necessarily default to selling. Sometimes we’ll engage with the management and the Board of the company to see if we can come up with a solution to the situation. An investment that we had in a company called Hargreaves Lansdown is a good example of this.

Hargreaves Lansdown is a very good business. It is an online investment platform based in the UK. It has a dominant position in that country, close to 50% market share. We initially invested in the company in 2021. And after that, revenue actually evolved quite a bit better than our expectations, but profitability significantly and consistently lagged what we thought the company was capable of. So, we decided to engage with the CEO of the company on this. We met with him several times and advocated pretty strongly for him to take steps to just address the profitability of the company. And during these conversations, I think he was always very sympathetic to our perspective. But over time, it just became clear to us that he just didn’t have the same sense of urgency on the issue that we did. And we ultimately came to the conclusion that for the company to really reach its potential, a change in management was necessary. We decided to see what we could do to potentially bring about that change. We reached out to and met with several members of the Board of Directors, including the Chair of the Board and advocated, again, pretty strongly for them to change the management. We also met with other large shareholders and shared our perspective on the issue with them. And ultimately, this effort—I think in conjunction with similar efforts from other large shareholders—worked. The Board replaced the CEO with someone who we thought had a more constructive approach to profitability and definitely more urgency on the issue. So, I think as long-term, involved shareholders at Burgundy, from time to time, there are opportunities to use engagement as a tool to create value for shareholders, create value for our clients, and I think our experience with Hargreaves is an example of that.

Roz McLean: Before we close this conversation, Andrew, I'm going to ask you to tie together all of these pieces of research. How do they contribute to the buy decision at the end of the day?

Andrew Iu: We've talked about a lot of different work streams. Ultimately, the returns in equity markets come from a tiny cohort of the highest-quality companies. And whether you're covering Canadian small cap, 400 stocks, or Japan, 4,000 stocks, we're using all of these work streams and tools we've talked about to get that big list of companies down to the quality cohort, that list of companies that generates real shareholder wealth. And the final step in the process, which we don't have time to talk about, is taking that list and dividing it in half. The half of the companies that are cheap enough, that's where you build your portfolios from.

Roz McLean: Great. Well, thank you. Thank you to our panellists. Thank you to our audience for your time and attention.

FINANCIAL CONCEPTS

Active Investing/Passive Investing

Investors employing an active approach look to generate returns above and beyond an index – their goal is to create a portfolio that beats the markets. A passive approach involves creating a portfolio that mirrors an index (in terms of both stock selection and weight within the portfolio) in order to earn an index-like return.

Bottom-up Investing

Bottom-up investing is an investment approach that focuses on analyzing individual stocks and de-emphasizes the significance of macroeconomic and market cycles. Bottom-up investors like Burgundy focus on specific companies and their fundamentals.

Bull Market/Bear Market

A "bull" market signifies an upward-trending market and positive sentiment from market participants, whereas a "bear" market signifies a downward-trending market and negative sentiment or fear. They are named for each animal's motion of attack (the upward motion of a bull's horns versus the downward motion of a bear's claw).

Capital Allocation

How a company allocates its cash within the business. Examples would be to reinvest in the business, or to pay out cash to shareholders in the form of dividends.

Dream Team

A list of companies that embody the business, financial and management characteristics that Burgundy deems high quality, but their current market price does not offer enough of a margin of safety to warrant investing at this time.

Intrinsic Value (Valuation)

An estimate of a company's actual worth, based on in-depth research and both quantitative and qualitative factors. A company's intrinsic value may differ from its market price.

Margin of Safety

The difference between a company's market price and its intrinsic value. The lower the price compared to intrinsic value, the higher the margin of safety; conversely, the higher the price compared to intrinsic value, the lower the margin of safety.

Market Capitalization

Determines the financial "size" of a company. It is calculated by multiplying a company's stock price by the number of shares outstanding. Companies are often then categorized into small market capitalization (small cap), small/mid-market capitalization (small/mid cap) and large market capitalization (large cap).

Moat (Economic Moat)

Likened to a physical moat around a castle, an economic moat is used to describe the advantages a company possesses over its competitors. The more competitive advantages, the wider the moat.

Quality/Value Investing

Value investing encompasses a spectrum of styles. At one end, "deep value" (associated with Ben Graham) focuses on the companies that are significantly undervalued with less focus on the quality of these companies.

Watch List

A list of companies that do not yet meet the criteria to be deemed high quality but are worth monitoring for any changes that strengthen the business. If any companies are deemed at some point to be of high quality, we will invest (if the price is right) or move them to the Dream Team.

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The Burgundy forum

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