Future Generation and 2Fold: Take Stock
Caroline Gurney and Nick Markiewicz

Future Generation acknowledges the Traditional Owners of Country throughout Australia, and recognises their continuing connection to lands, waters and communities. We pay our respects to Elders past and present.

CAROLINE GURNEY: Hello and welcome to Take Stock. A new podcast by Future Generation. In this series, we get a backstage pass into the minds of our leading fund managers and how they work. And why they make those stock choices. I'm Caroline Gurney, the CEO of Future Generation. Australia's first listed investment companies deliver both social and investment returns and that's all thanks to the Managers who we are going to be talking to. So far, Future Generation has donated more than $65 million to Australian not-for-profits, improving the lives of young Australians. And we're able to do this because of people like Nicholas Markiewicz and David Prescott of Lanyon Asset Management. They charge us zero management or performance fees for managing Future Generation's money. Nick is in the studio today. Welcome Nick.

NICK MARKIEWICZ: Thanks for having me Caroline.

CAROLINE GURNEY: It's a pleasure to talk to you. So I just want to ask you what is your day job?

NICK MARKIEWICZ: So my day job, very simply, is I work for a boutique equity investor. And my day job is simply to find and invest in companies that we think are undervalued and companies that we think can deliver fantastic results for our investors long term.

CAROLINE GURNEY: As CEO of Future Generation, I deal with more than 30 Fund Managers. All unique. Best in the business both globally and in Australia. And what I always wonder is how do you go about selecting a stock? How do you do it Nick?

NICK MARKIEWICZ: Yeah that's a great question. And so obviously finding companies to invest in is the core of what we do and Fund Managers ultimately live and die by the quality and efficacy of their ideas. And so for Lanyon specifically just taking a step back and at a high level, our goal for our investors is to preserve their capital and deliver strong risk adjusted returns. And we think the best way to do this is by identifying and then buying what we would call a mispriced company. That is where there's a clear gap between the market value of a company which is the stock price and the underlying value or the underlying fundamental value of the business. When you study Finance at University, you get taught that markets are efficient and I think that's probably true for most stocks and most indices and aggregate, but experience tells us that there's often times when severe dislocations in value, that is the difference between the stock price and the underlying value of that company, can happen. And they happen for lots of different reasons, but at Lanyon we think it is our job to find those mispricings of companies and then exploit them for our Shareholders. So you know taking this a step further, we try and find these mispriced businesses, but you know the additional caveat would be that we try and do this in an incredibly low risk way. That is we try and find businesses where there is a risk asymmetry which is the downside is low if we are wrong, but the upside is potentially very high if we are right. And yeah the best analogy I can give it's the heads and tails analogy where heads I win and tails I don't lose too much. So...

CAROLINE GURNEY: So like...

NICK MARKIEWICZ: We are trying to do that consistently, but you know we're not going to be right every single time. We make mistakes like everyone else. But ultimately we think if we can find these stocks, these mispriced stock consistently, we think if we can build a portfolio of them of the highest conviction ideas we have, we think we can do a good job for our investors long term.

CAROLINE GURNEY: I mean that's really interesting Nick. So maybe can you talk me through your process using a stock you like as an example?

NICK MARKIEWICZ: Yeah sure. So you know it might be useful for me to use Universal Music Group which is the fund's largest holding at the moment. We are in the business of finding mispriced companies. That is companies that trade, the stock price is well below what we think the inherent value of the company is and for Universal Music, it is an interesting story how it came into the portfolio. But we first started looking at Universal Music when it spun out of Vivendi in late 2021. And the reason it came onto our radar was that spinouts have a low and rich history of creating value and being fertile places to look for investments and yeah there are a lot of reasons for that. Companies tend to be unknown, they have a limited trading history, there is often for-selling and sometimes they can be listed in obscure markets. And for Universal Music it actually ticked all those boxes. So yeah for us immediately when we find a business in that bucket so to speak, we are interested. But beyond the company being a spinout, once we started looking at it there were a number of qualities in the business that lead us to think that this could be a potentially wonderful investment. So just to maybe run through a few of the things that we loved about the business model, but just starting with the assets. This companies has three million songs in its catalogue. These are nonreplicable assets. So they own everything from the Beatles, Bob Dylan, Taylor Swift, Ed Sheeran. These are assets or songs that are going to be listened to for a number of decades to come. So we have what is called a lot of duration in this business. But more than just the asset base itself, what we started to notice or what we liked was that the asset base could potentially be monetised at five greater levels in the future than what it was being monetised at today. And by that I mean, Universal Music is distributed through streaming platforms like Spotify. Spotify is growing subscribers at a healthy rate every single month. The streaming platforms are increasing their pricing of their subscriptions which I'm sure everyone is noticing. But also there is new revenue streams from a lot of the social media apps like Tik Tok and Spotify who are now licensing music for shortform videos. So you put those factors together and it became clear to us at least that you've got a phenomenal asset base. An asset base that can't be replicated by anyone else, but the value of that asset base should actually grow in the future. And one of the amazing things or the surprising things that came out of our research into Universal Music was that listeners or Spotify subscribers tend to listen to – all of us tend to listen to music from the 15 to 25 year old period of our lives. And why that's interesting, it means that as Spotify grows its subscribers and older subscribers join, the value of that catalogue actually grows which is phenomenal. Most old assets tend to decay over their lifetime, whereas we have an asset base here that should actually grow in value in the future. So that is what initially attract us to the assets. But one of the other things to come out of our research was just what we would consider to be the attractive unit economics of the company. And by that I mean and I'll give you an example here. All of us, I am guessing all of us on this podcast pay $12 dollars or $13 dollars a month to Spotify. It is how that money gets transferred to Universal Music and trickles down it's a profit that really gave us a lot of pause for thought about the business. And so just to give you an example. Of the $12 dollars or $13 dollars that Spotify charges you every single month, $9 dollars of that gets paid straightaway to the record labels. And it gets proportionally divided amongst the labels based on how much music you listen to and what music you listen to and Universal Music has almost 50% market share for Western music and Western markets. So of the $13 dollars you pay to Spotify, $9 dollars goes to the labels and of that $9 dollars almost $4.50 goes to Universal Music on average and of that $4.50 the vast majority falls down to their pre-tax profit from which they can do things like buy new catalogues, invest in new Artists or return that capital to Shareholders. So a business model that is capable of producing very high margins, but importantly for us at very high incremental margin. So really a fantastic asset and to top it off it had a great Balance Sheet and a very prescriptive Capital Return Policy. So we were interested in Universal Music from the start, but it actually took us around 12 months to buy the asset or make the first investment and that's because when we first started looking at the business it was too expensive. But as events would transpire through 2022, being a European listed company after the Ukraine invasion it sold off dramatically. I think down 50% from peak to trough in US dollar terms and then to top it off, there was some scepticism from the market around given the high interest rates around highly priced businesses or formally highly priced businesses. So between those two factors and I guess having confidence in the underlying business we were able to start an investment in Universal Music in September/October last year.

CAROLINE GURNEY: Thank you Nick. I mean that is such a relatable example using Universal Music to illustrate your process so thank you. So, at any given time how many stocks are you looking at?

NICK MARKIEWICZ: So we are typically looking at, you know I would on my shortlist today there is around 30 to 40 companies. And the reason it is such a small amount is at Lanyon we run small concentrated portfolios. We typically have 15 to 25 businesses that we own and there is a very simple reason for that. It is because we think that first 10 ideas are generally better than our last 10 ideas and the idea of running a 100 stock portfolio makes less sense to us than a 15 to 25 stock portfolio. And because of that smaller portfolio size it means we can be really selective about the businesses that we have on our watchlist. So typically it is 30 to 40. Sometimes it could be more if there is a lot of opportunities out there. And maybe sometimes it could be only a small number of stocks that we are actively considering if markets are expensive or nothing appeals to us.

CAROLINE GURNEY: So I mean I think that probably answers the question that I wanted to ask you was how long it actually takes to get one of your picks into your portfolio, so I presume it varies with each company you are looking at?

NICK MARKIEWICZ: Yeah that is exactly right. I mean we love buying different kinds of businesses. So we like buying, I think there is a lot of breadth in the ideas in our portfolio which is at one bookend we have listed cash boxes, that is companies that trade on relatively low multiples, the companies have a very high proportion of their market cap in cash and a very strong capital return policy and so the time taken to analyse and own a company like that is potentially different to say a Universal Music where a lot of the value creation for that business is in the future. And higher quality companies like that tend to trade on, naturally trade on higher multiples and so for us to own a company like Universal Music we have to have a deeper understanding of the industry which it sits in and the drivers of value in that business. And so you know if I think about how long it takes to buy a company, it really depends on where we can identify value and I guess the valuation that we are paying and what we need to have confidence in to make the investment.

CAROLINE GURNEY: So I might just follow on. Like how do you know when you are wrong on a stock? And how do you decide to exit or to double down? I find that really interesting. Like is it a split second decision that you just know or is it something you look at over a period of time?

NICK MARKIEWICZ: The short answer to your question is you are wrong on the stock if the stock price is falling. You know I used to twist myself into knots justifying why a stock price might be falling when we own the underlying stock. But you know the reality is for our investors we are trying to preserve their capital and if their capital is being impaired, then ultimately you are wrong. You know whether you know to double the position or increase the position, that is a function of why the stock price is falling. The stock price could simply be falling for any number of reasons, but it could be falling because the stock sits in a geography that is falling in unison. So for example, again going back to Universal Music, Universal Music listed in Amsterdam. 90% of its revenue is derived from the world in general, but when Ukraine was invaded by Russia, Universal Music fell 50% in US dollar terms alongside the rest of Europe. So we had a thesis on

Universal Music and it fell in sympathy with Europe. But the underlying thesis didn't really change too much just given 90% of its revenues were US dollar based and derived from around the world. But you know so in that sense the decision to add or increase that position is just a function of the stock price is deviated for identifiable reasons and we can have the confidence to add to our position. But sometimes stock prices will fall because there has been a change in the investment case. Maybe there has been a downgrade to company earnings or maybe there has been a change in management or the capital management policy and then it is up to us to work out what that means for our investment case. Whether our investment case still stands, whether it has been diminished somewhat, whether it has improved and so then it is up to us to make that call as to what we do with the underlying position.

CAROLINE GURNEY: And if you are short a stock, do you go through the same process?

NICK MARKIEWICZ: The short answer is you do. So I don't short in my current role thankfully. We are a long only fund. But I did short in a previous life and when you are shorting you have got all the normal things you would consider about an investment, but I think particularly given how markets have moved over the last and behaved over the last 3 to 5 years in particular, when you are shorting a business you need to be very aware of quarterly earnings. So you need to have a very strong view on how earnings expectations are progressing in the market. But you also need to have a view on the narrative of the stock and how that is shifting as well. So, shorting requires the same skillset as owning the stock, but there is a few more boxes on the checklist that you need to tick off before you are short of stock.

CAROLINE GURNEY: And now I want to sort of go to talk more about your process. So what was the first stock pick you ever made? Do you want to remember it and why?

NICK MARKIEWICZ: Are you talking the first stock I ever picked in my entire life or my buy side career?

CAROLINE GURNEY: Oh your buy side career yeah.

NICK MARKIEWICZ: Well I think the first stock I owned in my entire life was something probably lame like BHP or ANZ. No disrespect to BHP and ANZ owners, but it was a reasonably unimaginative investment. But my first buy as a professional investor I think was actually Kering and Louis Vuitton. This was around 7 years ago I think. Kering which is the owner of Gucci, obviously everyone knows Gucci, the luxury fashion label. Gucci had been in the doldrums for a long period of time and they just hired a new creative director. The stock had spiked on that because there was some enthusiasm around what he was doing with the brand and it was up to me to work out whether that momentum in the stock or the business could continue and whether that was reflected in the stock price or not. So thankfully I got off to a good start with my first investment. So that was in European luxury goods, but after that I moved onto the automotive industry was my next project after that and that consumed a lot of my time.

CAROLINE GURNEY: And how has your process evolved in sort of the 13 years?

NICK MARKIEWICZ: When you first start as a professional investor, a lot of your underpinning and your background is from books you read and for me personally value investing resonated with me a lot and as a result of that I went down the path of reading about Warren Buffett and all the great value investors and I think as a result of that value itself which historically has been defined as buying companies that are trading on a low price to earnings or a low price to book. That used to occupy a disproportionate amount of my time, whereas in recent years my focus has more shifted to the underlying quality of the business itself. So, I would say that my investment philosophy is all about finding the highest quality business possible at the lowest price I can buy it as opposed to maybe when I first started out being more focused on that valuation component. But outside of that I think generally speaking as I have got a bit more experienced and a bit older I generally prefer more simple investment cases. I like to have a really simple idea where there is only a few things that I need to be right in my thesis for us to make a lot of money for our investors. You know I guess the final thing would be and this is as I've become a Portfolio Manager, but position sizing is an incredibly important thing and I think I've learnt over the years that you should let your winners run and cut your losers early. So, I think those three things are something that I have learnt over a period of time and what has changed for me in recent years.

CAROLINE GURNEY: So which investor do you most admire?

NICK MARKIEWICZ: I think internally at Lanyon Seth Klaiman is viewed as our pin up investor and that's specifically because he has that investment philosophy of preserving capital and making smart and sensible bets when there is a very high margin of safety which is that concept I mentioned at the start, a wide gap between the stock price and the underlying value. So, certainly at Lanyon Seth Klaiman. But I think personally and this is going to be a strange answer because he is not my favourite investor, but there is an investor called Joel Greenblatt who wrote a book, he wrote two books about investing and the crux of it was that the best way to beat the market consistently over long periods of time was by buying stocks that are very high quality and have very low valuations. And you know that really stuck with me that that is really the essence of this game is finding the highest quality business you can at the lowest possible price. So, yeah I think between those two investors, they've certainly been quite influential on me.

CAROLINE GURNEY: So finally, are good investors born or made?

NICK MARKIEWICZ: That is a... geez that is a great question. You know I think there are, certainly there are, I think there is two aspects to investing. One is the technical side. You know identifying a high quality business, being able to model a company forecast numbers, talk to management, talk to industry experts, clearly define a thesis, express that thesis. I think those things can be taught, but at the same time there is a huge art to this game and if I think about the best investors in the world, a lot of them have a lot of personality traits that I don't think can be taught. So, they are typically very passionate. They are very curious. They are tenacious. They are relentless. Probably the most important thing about them all is they have this independent thinking and a contrarian streak to them, so they make very, very interesting bets or investments that a lot of people seem to miss or don't want to invest in and our view at Lanyon is that sometimes being a contrarian or investing where companies maybe less popular, that's a potentially incredibly lucrative place to invest. So, you know I think adding all those factors together, I am not sure some of them can be taught, I think you are born with a lot of those traits.

CAROLINE GURNEY: Oh excellent. Thank you. Have I missed anything? What else do you think is critical that we have not mentioned?

NICK MARKIEWICZ: Continuing on from what traits make a good investor. But you know I think personally a lot of the investors I think who do quite well tend to be ones that just love the game. Because this can be an incredibly stressful job. It can be you know there's nothing worse than putting investor capital into a stock that maybe doesn't do so well or they have an earnings downgrade and the stock falls. I think being able to do this job with a smile on your face and do it consistently day in day out for a number of years, I am always very, very impressed and take my hat off to those investors that can make a 30, 40 year career out of it.

CAROLINE GURNEY: Excellent. Thank you so much Nick, I've really enjoyed talking to you and getting an insight into your investment process. Thanks for your time today and all of the work that you and Lanyon do to ensure that Future Generation can keep on giving. Thanks Nick.

NICK Markiewicz: Thank you.
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