Madison INVESTMENTS

Investing with a Business Owner Mentality

How to approach stock investing with a long-term, business owner mindset

Benjamin Graham once wrote, “Investment is most intelligent when it is most businesslike.” It is hard to imagine the 20th-century economist, author, and investor appreciating what has become commonplace in investing today, where near-term results have investors acting impulsively on daily stock price movements rather than taking a longer-term, businesslike approach to assessing a business’s value.

Buying an ownership stake vs. trading pieces of paper

Most conventional investors are taught to follow a set of heuristics for investing, believing that for a company to be a good investment, its stock must fit a predefined mold based on certain characteristics. However, these characteristics tend to focus on near-term fluctuations in the stock’s price, as opposed to determining long-term value, as would be the focus of an owner of a business. At Madison Investments, we believe our role as investors takes on a bigger purpose. We believe that when you invest in a company, you’re not just trading a piece of paper but rather buying a genuine ownership stake in that business. Here’s how we think like a buyer:

	Conventional investing	Ownership mentality
Earnings	When the earnings forecast is expected to be lower, investors should step aside and try to purchase later.	We want the company to spend money (potentially hurting near-term earnings) if it leads to positive return on investment.
Valuation	Believe valuation is all relative.	We believe value depends on all the cash the company could generate from now until eternity.
Peer comparison	Take shortcuts: For example, industrial companies should be worth 15x earnings, insurance companies should be worth 1.2x book value, etc.	Each company is its unique entity; we think value should be based on company-specific characteristics and not defined by market indices.
Price movements	Focus on “what ifs”… What might another investor pay for my stock? What sectors might catch fire? Where will investors want to hide if there’s a downturn? Where will investors want to be aggressive if rates go down?	Our research focuses on business attributes, competitive threats, customer satisfaction, acquisitive acumen, management depth, etc. Not just stock price movement.
Growth	Focus on short-term: next month, next quarter, next year, current growth trends.	As long-term investors, we consider cyclical forces and 5, 10, and 15+ year trends.
Financials	Care only about one or two valuation or corporate metrics they think other investors will care about. Take management presentations “as is.”	Our analysis focuses on the company’s actual economic and financial profile, not the presentation or a rule of thumb.
Competitive advantages	Growth metrics are more important than competitive advantages (“moats”). Believe they can “get out” and sell the stock before the moat is breached, no matter how narrow or shallow the moat is.	We want a durable, “wide moat” with a long-term outlook. If we don’t want to own the company for the long term, we don’t want to own it for a day.
Timing	Believe they can get out before things get tough and that they can consistently make the right economic calls.	We want the company to be able to weather storms. If we focus on strong balance sheets, strong financial conditions, durable competitive advantages, and astute management, we believe we will have an “all-weather” portfolio.

Madison Mid Cap Equity Strategy

The Madison Mid Cap Equity strategy brings this philosophy to fruition. By investing with the mindset that we are buying a business, our research tends to focus on qualitative factors like competitive moats, customer preferences, management, and capital allocation decisions. These factors give us an indication of whether the business will survive and thrive over the long term and return value to shareholders.

EXAMPLE: THE ECONOMIC PRESSURES OF A DISCOUNT RETAILER IN 2020-2021

Dollar Tree's namesake store was known for selling everything for $1. However, this unique business model faced a significant test in the inflationary economic environment of 2020-2021. Conventional investors concerned with near-term financial results, daily stock price movements, and broad-stroke macroeconomic assumptions (i.e., factors influential to someone trading a stock like a piece of paper) saw this stock as an explicit sell candidate. And many did. Madison's Mid Cap Equity team, which prescribes to the business owner mentality, had a different perspective.

Concerns and assumptions of "paper" investors:

— Freight and logistics costs spike, negatively impacting near-term earnings.

— Sell-side reports indicate investors should step aside until freight costs subside.

— Believe that the retailer's fixed price point is a structural flaw in its business model.

— Given these dynamics, stock price won't do well in the short term.

Madison Investments' thinking:

— Cost pressures from freight and logistics were transient; investors gave too much weight to this factor.

— Rather than focus on near-term pressures, consider the company's long-term earnings power – and thereby value – which was largely unscathed.

— Get to know the management team and its options. While they may be reluctant to abandon its price point, they could easily increase it if cost pressures persisted, creating great value for the business.

The company decided to raise prices, and, over time, cost pressures subsided. Subsequently, margins and earnings improved, and the stock rebounded nicely.

About Madison Mid Cap Equity

The Madison Mid Cap Equity Strategy is an actively managed, high-conviction portfolio of 25-40 mid cap stocks that are categorized as "growth at a reasonable price". Each holding is viewed as a long-term investment in a durable business, and the portfolio has adhered to the same investment process for more than 20 years. To learn more about Madison Investments and our U.S. equity capabilities, visit madisoninvestments.com.

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