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.

EXAMPLE: COMMERCIAL ROOFING LEADER OVERLOOKED WITHIN DIVERSIFIED INDUSTRIAL COMPANY

When we made our initial investment in Carlisle Companies in 2020, it was a diversified industrial firm with operations spanning commercial roofing, interconnect products, fluid handling equipment, and brake and friction components. The onset of COVID-19 and the resulting economic disruption posed significant challenges to Carlisle's various business segments. Many conventional investors, fixated on short-term financial results, daily stock price fluctuations, and broad-stroke macroeconomic assumptions (i.e., factors influential to someone trading a stock like a piece of paper), viewed the company as a clear sell candidate amid the bleak economic outlook. In contrast, Madison's Mid Cap Equity team, which prescribes to the business owner mentality, took a more thoughtful and long-term perspective.

Concerns and assumptions of "paper" investors:

- COVID-19 policies had grounded economic activity to a halt, which would hurt Carlisle's profits in 2020.
- Sell-side reports lumped Carlisle with slower growth and cyclical commercial construction-exposed building material businesses and used this comparative set to justify a lower valuation multiple.
- Investors viewed Carlisle's non-roofing businesses (and their current weakness) as permanent anchors on the company's stock.
- Given these dynamics, stock price won't do well in the short term.

Madison Investments' thinking:

- We agreed that 2020 would be a tough year, but that didn't matter because we were looking through the cycle at the company's normalized earnings power.
- The commercial roofing business had a more consistent demand profile, a strong competitive advantage, and an increasingly favorable industry structure, resulting in an attractive return on invested capital (ROIC) and latent pricing power. This wasn't your run-of-the-mill building materials company.
- We got to know the management team and its options. The newer management team recognized the opportunity to concentrate reinvestment on its highest returning business, commercial roofing.

Since our initial investment in 2020, Carlisle has transformed into a pure-play building products company by divesting its non-commercial roofing businesses. Further, on the back of strong price increases, the company's margins expanded from below 20% to above 25%, and the stock advanced nicely.

Madison Mid Cap Equity Strategy

The Madison Mid Cap Equity Strategy is an actively managed, high-conviction portfolio of 25-40 mid cap stocks, categorized as "growth at a reasonable price," with a focus on long-term investments in durable businesses. The strategy adheres to the same investment process that has been in place for over 20 years, emphasizing qualitative factors such as competitive moats, customer preferences, management, and capital allocation decisions. By investing with the mindset of buying a business, the research aims to assess whether a company will survive, thrive, and deliver long-term value to shareholders. To learn more about Madison Investments and our U.S. equity capabilities, visit madisoninvestments.com.

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Madison-651229-2024-12-03

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