HollAnd Advisors

Holland Macro Views – Part 2 of 2

Owner Managers, Road Trips & Modern Moats

Part One of this piece gave some reflections on the market cycle we find ourselves in. This continuation will look at our learnings from much time recently spent with a number of company founders/owner managers. It also looks at some instructive experiences we had with numerous leisure brands and what we think it tells us about the modern moats of these and other businesses.

On recent trips abroad we have spent considerable time with Michael O'Leary, and the owner managers of **Biglari Holdings, RCI Hospitality and Green Brick.** We would be happy to discuss our detailed views on any of these companies with readers that request it. This note however looks at a few generic lessons we have observed from time in front of these and other owner managers. It then looks at a few other learnings and reflections.

Market Cycle

Before doing so we point out something we omitted in our market cycle observations in Part One. It is what we heard Joel Greenblatt say at the London Value Investor Conference last month. Amid heavy market falls both speakers and the audience could be said to be enjoying such a correction, hoping it boded well for the future returns of their value approach. Joel Greenblatt's comments were not what many wanted to hear, but we thought insightful and agree with every word:

> He pointed out that 30 years ago the S+P index constituents had a RONTA of 20%. Today that return is c.70%: "*these are some of the best companies we have ever seen and they are getting to be reasonably priced*." He also observed: "*asset prices move the most when people change their mind about them"*

Owner Managers: Past money makers vs lasting culture creators

In a piece on Facebook last year, we observed some common traits that sets owner managers apart from ordinary large organisation CEOs. This contrasting list is included again in the Appendix. We would ask readers to look again at it maybe before reading on. What follows are perhaps more nuanced reflections post meeting a number of individuals that all could be described as 'owner managers'.

'People' Matter

When looking for our owner manager investment candidates it is easy to assess your tangible mental checklist whilst still at your desk. This might look for proof that they are skilled in the functions of Operate, Generate and Allocate that we seek. Add 'alignment' to these traits and quickly we can convince ourselves we have found a manager we wish to invest alongside. Each of these four drivers however is just a financial score card ruled off at today's date. It tells you nothing of the future, or about the person that achieved them. Past results could be achieved by someone who was mean and unkind to staff or, one that was generous with time and money. Whilst the financial outcomes of the past will not be changed by different types of individuals, the prospects for a company's future might be altered a great deal.

Is the company poised to grow for many more decades due to a lasting culture that has been created and bought into by all that work there? Or is the business about to fail because disgruntled staff or regulators may soon call out its short comings?

Here are a few Owner-Manager (OM) questions we found ourselves returning to

- What is the breath of the OM's outlook towards competitors and the wider industry? Does he see the company's role in the industry accurately? Does he understand the true scale of problems and opportunities in the wider sector? Has he or, or is he trying to seek win-win scenarios for all those that the company affects.
- Is the OM thinking realistically about possible threats to the business? Have they considered them and reasoned through the implications, or just dismissed them?
- How is the OM perceived by those that work for her and how does she perceive her employees? Is there an admiration and compassion that runs both ways or more fear as employees look up? Is any culture that the company claims to possess truly spread throughout the organisation?

Twin track thinking

The above list is just a start. We also have to be mindful of what mistakes are we making in our assessment of such people. First impressions often last, but they can be misleading. We must remember the context in which we meet such people, and that they are…just human beings who have good days and bad. Also, when we consider the list of traits outlined in the Appendix, we need to remember that such people are brave, unafraid to speak out and used to being contrarian. As such, depending on the context of our meeting, or our line of questioning we might see one version of the owner manager one day and a different one on the next. As such:

- Visiting companies on their home turf matters
- The consistency of message over time matters
- We need to be prepared to change our minds about someone who might have a strong personality that either attracted or repelled us initially
- If in doubt we should trust our instincts about the person and the integrity we believe them to have
- The we need to listen. Not for what we hoped they might tell us, but to what they are actually telling us

Bringing some of these points together we observe that:

a) Because owner managers are often genuine, they might be harder to assess. They have tempers and frustrations and might show them. We need to be prepared to change what might have been our initial assessment

b) Seeing a company at its own office is usually far more revealing than on a roadshow. Founders are more relaxed on home soil than out presenting to investors. Also, the culture that surrounds a founder is often clear to see (or not) from those that work for them

c) The good thing about these genuine people is that they are unlikely to construct a corporate message to please you. Thus over a few meetings they will always be visible for what they really are. Their values and what interests and drives them will become easily apparent if met more than once.

Whilst we need to be careful about 'liking' or 'loving' managers, for such a trait could outweigh all others. Instead, we should find ourselves at a point of admiration, but not towards the financial outcomes they have achieved. But about the values they have spread around the organisation.

The quality of the people they have employed, or the positive affect they might be having on others further afield. If those lower in the organisation share the founder's passion for it, then the culture is genuine.

Whilst clearly, we can admire those that have built businesses with notable financial success, this as a measure is not enough. We want to be partnering with people who know what they have achieved, but who want to do more. Not just financially, but in other ways too. This wider aspiration comes in all shapes and sizes, but it is not self-centred. It is informed and intelligent, seeking to keep improving and creating win-win scenarios for employees, suppliers and shareholders.

Brands don't care about Customers, only people do

During the last few weeks your author on his travels used British Airways, Eurostar and Avis. He stayed in Virgin, Hilton and independent hotels and used Uber and local taxis. He even hired a bicycle! He ate in all manner of branded and local restaurants. Having done much of this in the US with its service culture he makes a number of observations. Additionally, maybe your author's view is unusual. Clearly, he is an analyst who happens to be using the services of companies he seeks to understand. However, he is also a corporate traveller doing something that not all experience, spending his own money.

Older brands with declining moats

Having used companies like those listed above for c.30 years now, whilst at the same time analysing them, a few things are notable.

The first would be that whilst the branding stays the same and in theory the customer offer does too (planes that fly on time and cars that don't break down) customer service has changed dramatically, mostly for the worse. This is in part because the staff that the customer might interact with don't really have any relationship for the brand as they are now likely an outsourced provider of a service rather than long term salaried employees.ie they are not paid to care, or aligned.

At a personal level some of those that work in customer facing roles do care/would like to try and solve customer problems. The bigger issue comes when they are not trusted to do so by their corporate employer, i.e., such power to help/solve customer problems has been taken away from front line staff. This we think is now a very common occurrence.

We observe that CEO's of such leisure brands may proudly present to investors the benefits of their 'yield management system' or talk of 'staff-efficiency'. Such language should maybe be a red flag in customer facing businesses. These tools are likely helping shorter term profitability, however maybe they are also narrowing the company's moat, or at least reducing brand equity, in invisible ways. A few examples:

- Stopping at a Taco Bell just outside Dallas we noted how much cleaner it was and how much better the $10 food was than the British Airways business lounge at Heathrow T5! The staff at the former were engaged, likely working for a local franchisee owner. The staff at the later were cleaners/service providers that BA had clearly outsourced the lounge to.
- Post an incident we had to change our hire car. The emergency number to call works, but those that answer it are two times zones away and powerless to solve real world problems, e.g., like how to contact someone with an overseas mobile number as Avis's systems, we have since learnt, prohibit its staff from calling such numbers. The solution, reached 10 hours later was to contact us via WhatsApp, but this was not worked out by Avis, but by the local tow truck driver!

Hopefully these are not just the moaning's of a middle-aged traveller suggesting it used to be so much better. Instead, we are trying to more and more look at the businesses we analyse "*through the customers eyes"*. We find it interesting that businesses like Amazon and Schwab which we have recently analysed use such expressions as they seek to delight the customer.

By contrast those with a great deal of customer interaction day to day do not. In practice most have stopped trying, seeing the customer now as a commodity or number. Instead, they have found new processes/systems to try and improve the businesses outputs they as a company experience. We accept that they may be driven to make these changes due to cyclicality or poor economics and therefore were we in the same management role we might have little choice but to do the same. That said we are not in that role; we are outsiders tasked with assessing which businesses and brands to consider investment worthy in the long term and which are not. Having reflected on this whilst travelling we will make a few general observations:

- For the types of companies we list, customer outcomes are either OK or awful. The reason for this is that yield management means that you likely paid a full price for your seat/room or car, so your ability to be occasionally delighted from a value-for-money perspective is rare
- However, if something goes wrong (cancelled flight, broken down car) you are then at the mercy of call centres and outsourced functions that are designed to sell to the majority of callers not provide service to the minority who are in need of local problem solving
- Customer facing businesses lose their brand power when they start outsourcing customer facing functions. Also, corporate drives to efficiency have consequences that likely do not show up in the C-suite reports or in customer satisfaction surveys. (Those not using you/leaving you tend not to fill these in!)
- Maybe a red flag is when customer facing companies stop being obsessed with delighting them and instead talk of yield, operational efficiency and margin
- Whilst these observations are true of the leisure companies we list above, arguably they are also true of many other companies such as utilities like telecoms and cable providers

Eroding Moats

All of this leads to eroding moats as customers are always on the look out for a better price/value trade off as they know there is little benefit to their loyalty. In doing so an industry becomes commoditised, gradually, then suddenly. Companies like IAG/Hilton have for a long while now been reliant on their only real competitive advantage being the point-to-point route/hotel location they have that you wish to use. What were once network economies of scale have now become diseconomies. Clearly online booking/search etc. created a level playing field for those that might provide customers with a better value/product trade-off. As the big brands have responded to such threats the spiral of cost cutting starts and then escalates into a vortex. Whilst brands like easyJet and Virgin tried in the past to stand apart from those they once challenged, they have now also been sucked into the same spiral of commoditisation.

Clearly there are capital cycle winners in these sectors who will benefit as others go bankrupt, but these survivors are not consumer champions. Instead, just mostly cynical late in life corporates trying to capitalise on whatever monopoly they can keep for a while until challenged again. Whilst this might make a company like IAG good profits for a while we must not mistake this for a long-term sustainable moat.

Know what you are

Uber – Interestingly one company on our trip that stood out was Uber. When requesting taxis from hotel receptions those that work there no longer recommend local taxi services. Instead encouraging you to: "just *use Uber, as it is cheaper and will arrive faster."* Its powerful network effects that offer better pricing and faster service make in stand out.

Ryanair – Also on our travels we spent time with Michael O'Leary (MOL). Many wealthy investors reading this will think it odd for Ryan to get a mention in any brand/customer service write up. However, our exchanges with MOL were instructive. Seeing, as we do, the EU short haul industry endgame of ultimately higher yields we spoke with him about the need to improve the company's reputation amongst those who could afford higher fares. His response we think was instructive. We paraphrase:

- *I don't want to advertise how great our customer experience is only for people to turn up and say, its nothing like as good as you claim. I would rather they just tried it and realised its not as bad as everyone tells them*
- *The way we get into more business type traffic is not by advertising etc, it is by having >30% market share in a market. Then the frequency is such that these customers naturally come to you. When they then enjoy the value for money and flight frequency they will stay*

Amongst others observations he made we thought these interesting. This is an owner manager that is able to see who he/Ryanair really are. He is not fooled by the illusion (suggested by your author) that a few adverts and smiling cabin crew are going to change Ryan's customer perception. However, as an offeror of enormous value to the customer the price/service trade off can still be a good one. Ryan will be flying 15% more capacity than 2019 this summer. It also worked hard during Covid to keep its staff and keep their flying licences up to date.

The sentiments that MOL offered in the two bullet points above are also often given to us by Tim Martin. Shorter term investors (like your author on an off day) will ask why don't you advertise how cheap you are? To which Tim's response is, it is better to let customers find the value for themselves.

PR disasters and earnt trust

We note the recent news of flight and holiday cancellations by the likes of TUI, British Airways and easyJet. We also note the absence of both Ryanair and Jet2 from that list, despite Jet2 operating much capacity from Manchester. Jet2 was a company at the end of last year that talked to us about the need to invest heavily then if they were going to deliver on customer promises this summer. TUI, was too busy trying not to go bankrupt! We sense that every penny of TUI's UK advertising budget this year was undone by two news stories of young families having their holidays cancelled by TUI the day before departure. In November 2020 when writing about what the airline industry would look like post-Covid we wrote about the importance of customer, regulator and supplier (hotels) trust. The implications of this are now playing out.

As brands become commodities, can commodities become brands?

It is interesting making these consumer and analytical observations so soon after having studied Amazon and Schwab. Schwab has a "*no trade off's*" slogan it has used widely throughout the company for years. It is designed to spread the message that there is no trade-off between the service they offer customers and the better value customers are getting.

Amazon's appetite for wanting to solve customer problems and its drive to create new hard to deliver services in an age when other brands are dying, stands out.

While our friends moan about the price of a pint in a Young's London pub, or have their holidays cancelled, in the next breath they will marvel at what Amazon offers them. This contrast is the customer trust we wrote about in our recent Amazon piece. Only by pulling apart so many other customer facing businesses can you start to understand just how difficult what Amazon has achieved is. It has arguably made powerful brands ('Amazon' and 'Prime') out of just delivering commodity services time and time again, reliably and at great value.

How does it make you feel + business trust?

Our car hire experience in the US was less than ideal, having to wait 10 hours for a replacement car with no contact during that time from Avis. When we tried to complain to an Avis rep. when returning our second car, we were just blanked and told we would need to liaise with customer services from the UK. Your author's heart sank at the tortuous thought of such a process. By contrast how would we feel were we complaining to Amazon for past poor service? Likely very relaxed and confident in how they would respond. **That is what trust in a brand feels like**. A knowing that they will do the right thing and make your life easy. As we said in our Amazon piece, if that trust matters to consumers it really matters to businesses. That Amazon is so deeply trusted by both groups globally suggested it may yet have a significant runway still left for more growth ahead.

The leisure brands we experienced on our trip are mostly now commoditised businesses dressed up as brands. Such businesses are no longer seeking to delight customers to build their long-term loyalty. Instead, they are pricing what assets they have left, like routes, locations or customer databases. For periods this might look lucrative but customer champions they are not. The phrase below comes to mind:

"Never rely of a trust fund or a wealth spouse – you never know when either will run out"

Buz Lurman. Sunscreen 1999

For the companies we seek longer ownership of we want more win-win outcomes:

- Lower costs that mean lower customer prices – **Ryan, JDW, Costco, TSMC**
- A better network resulting in a better service offer to all users – **Uber**
- Greater customer trust giving an ability to sell other services – **Amazon, Schwab**

Attached to this email is also our one-page summary of Built to Last by Jim Collins. We hope the combinations of it, our appendix list of owner manager traits and the observations above will provide a useful reminder of what the best owner manager look (and sound) like.

Texas – Reflections on a US road trip

What follows is just a few general observations from an 8-day 800 miles drive round Texas, from someone who has not been to the US in 4 years:

- The scale of some US states is hard to grasp until you are there. It helps you understand why places like Texas and say Australia have a fairly local centric view of the world. The reason is simple, everything else to too far away to matter much
- Since I last visited the US, its payment system has gone from being based on cash and credit with signature to being contactless/chip and pin

- Yes, the cost of filling your gas tank has risen 50% in the last year and 100% up from 2015-2018 prices, but it still only costs $50 to fill a Sedan that could drive for 400 miles. Cleary wages have also risen during that time.
- Almost everywhere we went we saw "We're Hiring" signs
- In c.800 miles we likely saw three Tesla's, all in Austin city centre. Texas is not California
- Texas has mass immigration going on. Not from Mexico, but from the West coast and even New York. As a result, cities like Austin and San Antonio are growing fast
    - All over Texas we saw significant investment in new highways. It needs it due to population increases across the state.
    - Demand for single family homes in Texas are booming for the same reason
    - Rush hour is a big thing in the main cites. Covid may have changed office life attendance/traffic in the UK. There is little sign of that in Texas
- Dyson hand dryers have not just made it into French motorway services stations but Texan ones too. Impressive we thought!

We hope you found these observations of use, on whatever level.

Kind regards

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Appendix

Owner Manager Traits

- Is likely someone who will have constantly challenged consensus thinking
- Will have turned left when all others turned right for long parts of their life
- They will have constantly been told to comply with certain rules. Not done so and likely proved the rule makers wrong
- They probably want to break existing industry norms by **revolution**
- They will have fought bureaucracy every step of the way
- They are **outsiders,** not insiders. They hate the status quo
- They may have been outsiders at a young age, not fitting in and not looking to fit in
- Their success will have emboldened them that such non-consensus actions whilst not always successful, do yield real world results in time
    - As a result, when confronted with future requirements to 'comply' they are brave enough to almost always say no
    - They are likely to remain non-consensus in their thinking for life
- Owner Managers tend to be either quietly influential or charismatic. If their product is working well, then are those around them know it and there is buy in. The 'need' for having to 'sell' themselves stopped many decades ago

Large Org CEO Traits

- In order to have been recognised and promoted in mainstream org. to a high level they need to have excelled academically in a conventional sense
- They had to be able to build consensus views that were popular with those above and below them
- They have to be able to lead in conventional sense
- They have to be able to cope with bureaucracy and compliance and grow despite its burdens
- They probably want to grow and change existing norms but by **evolution**
- They are very much **insiders** of the existing systems, not outsiders
- Crucially large org CEO's have to be good at selling themselves or they would never have got promoted in the first place above the c.45,000 other people whom they now lead
- Also, without self-promotion skill they are unlikely to get their next role

Source: Holland Views: Facebook/Meta – Owner Manager Inc., Nov 2021

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