July 12, 2019

June Performance Update for LRT Global Opportunities, LP and Ltd.:

If you are an accredited investor, please contact us for performance information.

I think it is important to periodically step back and remind everyone about the LRT mandate. It is to earn a return of 20% per year over an entire market cycle, with a risk level similar or lower to the overall market. To achieve this objective, we follow a 3-pronged strategy:

1) Only invest in companies with durable competitive advantages growing per-share value significantly faster than then market;
2) Don't overpay;
3) PATIENCE.

The order in which I list these points is important. LRT is first and foremost interested in the quality and durability of the businesses we evaluate. What matters most are the competitive advantage of the company ("the moat"), the length of its growth runway and the quality of its management team. The share price is of least importance. As a long-term investor, LRT focuses on companies that consistently compound their value – it is therefore critical for not to make a mistake about the durability of the company's competitive advantage.

LRT never wants to "overpay" for a company but purchasing a business on the cheap is not crucial to the success of our strategy, as most of our excess return is expected to come from the growth in value of the companies we own. Over time, the returns of a stock will follow the returns of the underlying businesses. This differentiates LRT from most "value" investors who are primarily looking to buy things which they perceive as "cheap" and expect to make their excess return from the closing of the gap between value and price.

The last part of our investment strategy – "PATIENCE" – is paradoxically the hardest one to execute. Investors are bombarded daily with reasons to "act" – trade wars, macro forecasts, fears about high valuations, and the desire to "lock in a profit". However, LRT believes as long as the competitive advantages of the companies are secure, the best course of action is usually to exercise patience. Of course, if everyone followed this strategy most brokers would starve. At LRT we are one of the worst clients the sell-side ("Wall Street Brokers") has ever seen!

In this month's comment and each future month, I will highlight 2 or 3 portfolio companies to provide greater transparency and a bit more depth as to the names in the LRT portfolio to illuminate the LRT strategy in action. This month I will highlight: Comcast and Brown-Forman.

While they operate in two completely different industries: media and hard liquor, respectively, they share a common characteristic: they are both controlled by members of their founding families.

Comcast

Comcast is a recent addition to the LRT portfolio. The company combines two attractive businesses under one roof: the largest cable system in the United States, and one of the leading global media companies with properties such as: NBC, Dreamworks and Universal Studios. Comcast's cable assets are the key to its long growth opportunities as cable companies are uniquely positioned to deliver high speed internet services via their existing infrastructure. The company's management is conservative financially and operates with significantly less leverage than its peers. This conservative and long-term focused approach is the hallmark of family-controlled companies.

Currently, Comcast is in the middle of a bidding war for both Sky, a UK based media, and Fox, the media conglomerate controlled by Rupert Murdoch. Disney also wants to buy Fox and is currently winning the bidding process. Bidding wars are dangerous as the winner often overpays – it is this fear that has recently driven down the price of Comcast shares. I believe Disney is likely to win this process because:

a) there are more cost synergies between Disney and Fox;

b) Disney is further along in the regulatory approval process than Comcast which makes the closing of the transaction more likely; and

c) Rupert Murdoch has expressed his preference for the Disney bid as it has a large stock component – making it more tax efficient for the Murdoch family. I believe Comcast will soon walk away from the Fox transaction.

Secondly, the entire cable TV ecosystem has been under pressure because of fears of "cord cutting". Cord cutting is an overused and misused term. In actuality, no one is really "cutting" their cord – they are simply switching from watching linear programming to on-demand internet based programing such as Netflix, Hulu or Amazon Prime. These so called "over-the-top" or "direct-to-consumer" offerings require a fast internet connection. With more and more programming going to 4K resolution and more people watching content in a household the need for bandwidth and high-speed internet goes up. Comcast is in the business of selling both traditional cable TV programing and high-speed internet. Even as the company loses pay-TV subscribers it is gaining new internet subscribers. In the future, Comcast will be primarily a provider of high-speed internet services and not pay-TV.

There are two prospective competitors to cable when it comes to delivering high speed internet (1GB and faster): 1) fiber to the home (FTTH), and 2) 5G cellular broadband. Installing new fiber is incredibly expensive and therefore uncompetitive with cable in neighborhoods where cable is already in the ground. This is the lesson that Verizon and more recently Google learned through their adventures in FTTH. 5G on the other hand suffers from serious technical challenges and has yet to be proven economical to deploy as it requires a much denser network with more towers and antennas.

Comcast's share price currently reflects an undue degree of pessimism for what is otherwise a business with strong competitive advantages and a long growth runway ahead of it. Finally, I view the family controlled nature of the company as an asset – not a liability – as they have been careful stewards of capital over the long-term.

Brown-Forman

Brown-Forman is the maker of Jack Daniels – an iconic American brand. The company also owns several other brands within its spirits portfolio, but they pale in comparison to the importance of Jack Daniels. Brown-Forman's competitive advantage is the brand, scale and wide distribution of its whiskey. Its growth opportunity is based on expanding sales overseas, following in the footsteps of Johnnie Walker (pun intended). More recently however, the company's share price has become collateral damage in President Trump's trade war, as American whiskey has been targeted with retaliatory tariffs by the European Union.

Longer term, the company's competitive advantages remain intact: it owns strong brands, broad distribution and benefits from high barriers to entry. It takes years to build a whiskey brand, and because whiskey is an aged product, significant capital must be invested in inventory. Simply put the chances for a "craft whiskey" revolution disrupting the industry – as craft beer as done to big brand beers – are slim. What's more, drinking is an age-old invention and is immune to being disrupted through technology. As the global middle-class continues to grow, Jack-Daniels sales will grow with it and the opportunity ahead of Brown-Forman is immense in our opinion.

Brown-Forman is a controlled by the Brown family, which allows the company to take a long-term view – something that is crucial when it comes to brand building. This means that the company can continue to spend on building the value of its brands, expanding its distribution networks and investing in inventory – all of which requires patience and a long-term focus. In summary, Brown-Forman has formidable competitive advantages, a meaningful set of growth opportunities ahead of it, and a management team capable of executing on those opportunities. While the market focuses on the short-term, which looks ugly due to the President's trade wars, this gem of business continues to build value for the long-term and we are happy to have it a component of the LRT portfolio.

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