September/October 2015

Caldwell North American Equity Strategy - Monthly Update

Portfolio Additions

Accenture (ACN-us)

About the Company: Accenture provides management consulting, technology and outsourcing services worldwide. It competes in the same space as Cognizant Technology Solutions, another portfolio holding.

Investment Thesis: Accenture has built capabilities around helping companies across a diverse set of industries use technology to generate revenue and run more efficiently. We think this is a compelling value proposition, particularly in the current low growth environment where companies will continually need to find ways to get better in order to compete. Accenture does a great job investing in growth opportunities as evidenced by its high return on equity, and generates a mid-single digit free cash flow yield (after growth investments are made), which we expect will grow over time. The strong U.S. dollar is masking growth - while reported revenue growth was below 2% this past quarter, constant currency growth accelerated to a very strong 12% (10% last quarter). As the company laps currency impacts, we think the market will begin to better appreciate the strength of the business and re-rate shares higher.

Portfolio Deletions

Verizon Communications (VZ-us)

Reason We Sold the Stock: Simply put, we did not like how the stock was performing. Our expectation at the time of purchase was that the company's cash flow yield would limit any downside, even as the company worked through a period of higher competition. Additionally, low-beta stocks, such as Verizon, typically add stability to a portfolio in market sell-offs given that earnings are less economically-sensitive and therefore more stable. However, the stock under-performed the broader market as markets sold off in August and September. Since our investors are not getting the benefit of portfolio stability, we prefer to shift to a name that has greater clarity around growth prospects.

Company Updates: A Few Highlights

Suncor: Growing Value in Times of Distress

Our investment process looks at risk across four categories: valuation, balance sheet, management and environment. The thought is that if we do a good job protecting investors against each of these risks, each one of them has the ability to drive growth in the portfolio. In terms of the balance sheet, we avoid companies with high debt because negative developments can force undesirable actions, such as fire-sales of assets, expensive capital raises or dividend cuts. On the flip side, companies with strong balance sheets are able to grow the value of their businesses in difficult environments given the ability to take advantage of fire-sales and buy assets at attractive prices. This is precisely the story behind Suncor, a company that is using its diversified asset base and strong balance sheet to grow the value of its business in the midst of an extremely difficult oil price environment.

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Suncor is one of a few energy producers that has not had to sell assets, raise equity or cut its dividend. The market has rewarded this with strong relative share price performance: year-to-date through October 30, Suncor shares have gained 5.4% versus a loss of 19.1% for the iShares Capped Energy Index ETF (even though Suncor accounts for over 20% of that index). The relative strength of Suncor's shares has been outstanding and the company is using this to its advantage. Specifically, Suncor announced a bid to acquire Canadian Oil Sands, a company that derives its value from a 36.7% ownership interest in the Syncrude oil sands project in Alberta. Suncor also has ownership in Syncrude and is looking to acquire a larger stake at an attractive price. Suncor has also said it is looking at additional acquisition opportunities, which can be funded through its strong balance sheet. In sum, a great example of how capital protection leads to capital growth.

KKR: Changing the Distribution Policy to Unlock Value

KKR announced it is changing its distribution policy. The distribution had been based on a formula that includes carried interest (performance bonus), which is realized when an investment is sold/monetized. Given monetizations can be lumpy from quarter to quarter, there was a high degree of variability in the distribution. Going forward, KKR has set a fixed quarterly distribution at 16 cents/share. At the time of the earnings release, this worked out to a 3.6% dividend yield. This amount is entirely covered by fee income, which is recurring in nature, and as such, does not put KKR into a position where it is forced to monetize an investment. The company also announced a share buyback, which was non-existent previously. The shares initially sold off on this news but we view the change in policy as a positive development. We actually prefer management teams that generate strong returns, which KKR does, to keep and re-invest the cash they generate. The company is enthusiastic about the growth opportunities available to them. As they execute, we expect the value of the shares to move materially higher.

Robert Half: Returning Cash to Shareholders

Robert Half announced a significant buy-back amounting to 10% of its shares outstanding. The company is in a great position to do so given almost 20% of its balance sheet is in cash with no offsetting debt. The business performed well this past quarter, with 7% revenue growth and continued margin expansion. We expect the shares to react positively.

Best Regards,

Investment Management Team

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