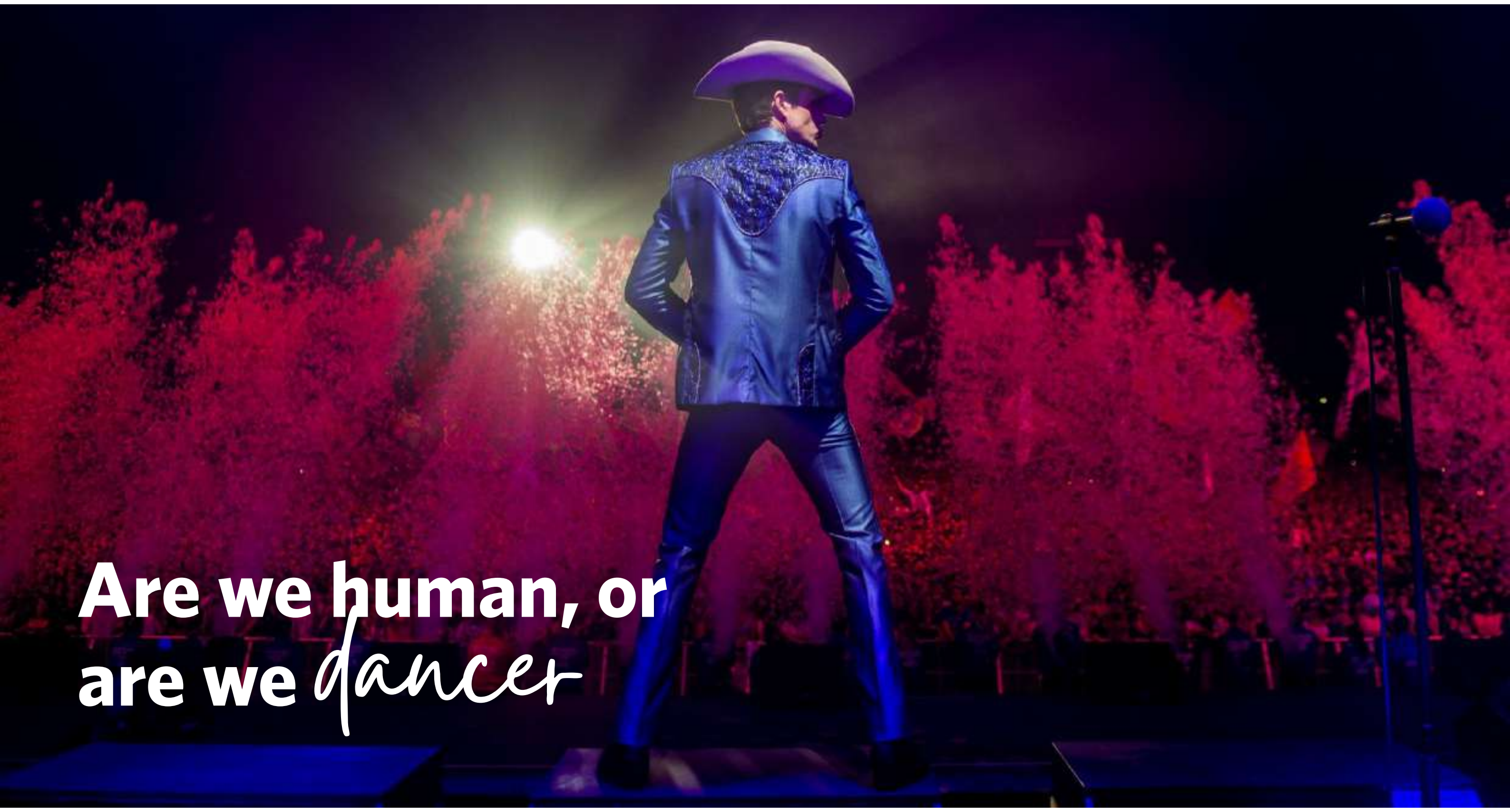

Are we human, or are we *dancer*

Back in 2008, The Killers released an album called Day and Age, which featured a song called Human. Although some of the lyrics caused some debate, the song caught the world's attention by leading listeners to question what it is to find one's own way in life. In the first line of the chorus the lead vocalist, Brandon Flowers, sings the iconic line, *"Are we human, or are we dancer?"*, prompting listeners to question whether we're dancing puppets moving to external influences or if we are, in fact, just being ourselves.

by Ryno Oosthuizen

We are often asked if we are value, growth or quality investors. Which genre does Granate dance to?

The investing playlist

The investment industry has had a long, and in many cases fruitful, affinity for value investing. Multiple generations of investors would almost certainly have soaked up the wisdom of the founders of value investing, Benjamin Graham and Graham Dodd. Warren Buffett, who at the time was a student of Graham and Dodd, later picked up the baton and added further fame to the investment style (though he has over time refined his investment approach). Value investors try to find companies with share prices trading below what is thought to be their intrinsic values (what the business and its assets are inherently worth). You will regularly hear investment managers speak about price-to-earnings or P/E ratios. The lower the number, the 'cheaper' the share and the better the value.

At around the same time that value investing was beginning to gain recognition, a Stanford Business School student, Philip Fisher, dropped out and started working as a securities analyst in San Francisco. He later went on to found Fisher & Co and is recognised as one of the first proponents of growth investing. The growth investing style focuses on finding businesses that can compound their

growth over many years – and in some instances, even decades. Companies that are thought of as growth businesses manage to grow their revenue and earnings faster than others. Value is less of a consideration, as investors are willing to pay a premium for this growth.

Then along came quality. This was an aspect of investing the late Charlie Munger introduced to the more value-orientated Buffett. Quality investing, as the name says, is focused on finding businesses you believe to have outstanding quality characteristics. These can be 'softer' or qualitative factors (for example, the credibility of the management team and the application of corporate governance) as well as more concrete or quantitative measurements, such as balance sheet strength; the stability and sustainability of free cash flow; evidence of astute capital allocation and returns generated on invested capital. Like growth companies, quality businesses may trade at premiums to their fair or intrinsic values because they are thought to be more robust.

Granate's playlist

We have spent our collective investment experience learning and evolving. We have applied different elements of all these investment disciplines, and have had success and failures along the way.

Our learnings can be distilled into three truths:

- Many companies fail to deliver the returns clients need. This usually comes down to weaknesses or flaws in governance structures, the management team, the balance sheet or the company's ability to generate sustainable free cash flow (a weak competitive advantage).
- Very few companies can compound their growth over long periods of time.
- Emotions exist in markets, at times over-hyping or underappreciating what a company may be worth.

What you may appreciate from these three truths is that each speaks to a quality, growth or value approach. We think the most reliable way to generate the returns our clients need is to dance to a wide variety of different music, and not one specific genre.

Deliberate choreography

To do this we first eliminate companies that may not be good businesses. In our minds, these would be businesses with poor governance structures, badly structured balance sheets, unsustainable cash flow generation or where management's track record is questionable. By eliminating companies that fail on one or more of these four qualitative hurdles and focusing our efforts on finding high-quality businesses from the outset, we aim to increase the odds of identifying great businesses that will be around for a very long time.

Only once we are satisfied that a company passes these qualitative hurdles, will we consider valuation. The valuation discussion is a separate discussion on a different day.

There are two reasons for this. If you start doing qualitative work on a company you have already determined to be cheap, some strange stuff can start to

happen. You might hear the words "It's in the price", which often means a concession is being made on the qualitative attributes that are needed for a successful investment. This is much like a dealership trying to sell you a car with no engine and explaining that's why it's so cheap. That car isn't going anywhere.

The other reason is that assets that appear expensive on traditional valuation metrics may be overlooked. Quality businesses that are growing their free cashflow year on year will rarely appear cheap, and waiting for them to become cheap may be a very expensive decision. Take Capitec, for example. An investor could have spent the last 15 years waiting for the share to be cheap enough to buy, missing out on some extraordinary returns along the way.

So, are we human, or are we dancer?

We are very clear on what we think constitutes a good investment. Our approach is to remain rational by trying to avoid businesses that may fail the test of time and seeking out exceptional companies that increase the odds of compounding our clients' savings, all while not overpaying. This does not mean that we only buy companies that can compound their profits at high rates over long periods. We do also harvest emotions in markets (i.e., 'cheapness'), but only by buying robust companies that have passed our hurdles. At a point of time in the lifecycle of our funds, an observer may conclude we are dancing to the rhythm of a certain genre. But that will just depend on the opportunity set at the time. Our genre is best described as rational; not value, growth or quality. After all, if you only dance to one genre, you by definition will have fewer opportunities to dance.

Granate is a people business.

We are committed to creating a rich and rewarding culture through our shared values. Granate is configured thoughtfully and intentionally so that our team can thrive for the benefit of our clients. We care about the same things you do and are *relentlessly* **committed to protect and grow your savings**.