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## **Purpose and Process**

Devon Equity Management has one core strategy; we run the money as if it was our own; indeed, the partners are heavily invested in the strategy. Our purpose is to make money for our investors. We think and act as owners and investors, not speculators. We invest in companies, not stocks. We are not in a hurry or desperate for short term performance. Consequently, we take decisions for long term success and are patient. Our process is consistently applied and coherent; there are no surprises in what we do. We recognise our mistakes, cutting them and learning from them.

We seek to identify ‘special’ companies. These are companies which, amongst other things, fulfil two criteria. The first is that they can withstand competitors (and regulators) to grow longer and stronger. Where industry structure is favourable and a company has unique advantages, would-be competitors find it hard to erode growth rates and high margins through competition. We are mindful also of regulators and see special companies as being ones where regulators do not want or need to step in to impair profitable growth. A second criterion of special companies is that they grow through the cycle and flourish in a variety of economic circumstances. We want structural winners not cyclical stocks.

In assessing companies, our starting point is their ownership and motivation. As far as possible, we want alignment of interests where company management is focussed on delivering good returns for shareholders over many years. We put great emphasis a good company culture: honest and accountable management, building for multi-year success; delivering high quality products and services and attracting commensurately high-quality staff. Our long experience of engaging with management teams helps us understand the rhythm of business. A ‘real world’ understanding underpins realistic investment expectations. This patient style is well rewarded by special companies.

We look for the same patterns of success in all our companies in a wide range of business areas: favourable industry structure; free, or at least strong pricing power; high intellectual property (IP); low capital intensity; and multiple growth opportunities. We like business models with multiple barriers to entry, where, in some cases at least, the diversity of the customer base and the geographic reach constitute barriers to entry in and of themselves. We are particularly attentive to threats of disruption: we analyse the downside first. The upside comes from an understanding of the opportunities catalysed by change: technological, consumer preferences and regulatory.

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Our style is more qualitative than quantitative in the first instance. We dedicate most time to understanding the company and the domain in which it operates, meeting competitors, suppliers, adjacencies and customers. Typically, we have very long holding periods. Our best investments are companies which keep developing and exploiting their core value added with ‘growth options’, constantly evolving and building on the core proposition. These are companies that create new markets, or capture opportunities as disruptors.

Our core skill derives from the long experience of engaging with management teams and understanding what makes successful investments. Although we invest in ‘special’ companies we have ‘total market coverage’ (TMC) which improves our understanding of the opportunity set. We are investment specialists not sector specialists.

### **Risk Management**

The overarching rationale for our approach is good risk management, increasing the odds of success. Our investments are ‘good quality risk’, where we can understand and companies can control, the main elements that determine their success. We highlight elements of ‘good quality’ risk.

- Focussing on company specific fundamentals, avoiding companies where macro factors are unduly important to the company’s prospects increases the chances of success. The vast number of variable factors make macro forecasting extremely difficult. Our focus on a smaller number of factors which we understand and which the company controls increases the chances of success.
- Our preference for secular growth (over cyclical) companies lowers the relative importance of timing the cycle and macro forecasting. Our companies typically have multiple drivers of success, avoiding binary outcomes.
- We look for world class companies who happen to be listed in Europe. Such companies typically have globally diversified revenues; thus, our portfolio is exposed to global (rather than just European) economies and end markets. Accordingly, there is less regional economic risk. Moreover, global sales are also a validation of a company’s offer.
- We favour Intellectual Property (IP) over capital intensity. IP focussed businesses tend to have greater flexibility both in costs and revenues. This flexibility is a significant operating advantage. Moreover, less capital-intensive businesses are likely to have both higher returns and less debt, both are intrinsic advantages.

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- We like companies that have, as far as reasonably possible, all the ingredients for success and are therefore not unduly dependent on third parties for critical elements (such as licenses, or the supply of raw materials). Dependence on third parties which have the pricing power, constitute a significant risk.

### **Valuation**

The market's focus on short-term accounting-based earnings can create a 'time arbitrage' for those with a truly long-term investment outlook. We are attracted to companies which can deliver consistent free cash flow growth at incrementally high returns (well in excess of their cost of capital). Our forecasts include our expectations for the success of the 'growth options'. Our approach to valuation seeks to capture and reward these characteristics. We therefore focus on cash flow metrics on a 3 year + horizon, assessing the growth potential and implied yield. Typically, this is cross checked with DCF and other valuation metrics appropriate to the business model in question.

### **Outcome**

The portfolio is a collection of 25-40 'special' companies in a wide range of activities—single company, uncorrelated risk – with global reach all fitting a pattern of favourable competitive landscape, pricing power and strong independence. Our companies typically have high return, cash generative business models. We expect this to be reflected in less volatile share prices. The fund is always fully invested.