ValueWalk Interview With Glenn Surowiec, Founder Of GDS Investments

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Rupert Hargreaves: First off, could you tell our readers a little about your investment strategy?

Glenn Surowiec: Like all value investors, buying assets at a discount to fair value is the centerpiece of my strategy. I leverage my time and knowledge by focusing on U.S. listed companies with fairly long and stable operating histories. I'd rather own a best-of-breed company which operates in a slow-moving industry than otherwise. Layered on top of the valuation component is a comfort around management, capital structure, etc.

RH: How do you go about looking for an investment (both long and short)? What's your investing process?

GS: Owing to my aversion to asymmetric risk-reward structures, I don't short stocks. My view is that shorting is a business with terrible economics. My long ideas typically come from getting comfortable with lots of different publicly-traded companies (mainly through Value Line and The Manual of Ideas) which exhibit desirable investment characteristics. I then take a position only when value exceeds price by a significant enough level (at least 1.5x). For many businesses, getting $1.50 in value for every $1 spent is generally enough margin of safety to initiate a position.

RH: How do you approach valuation?

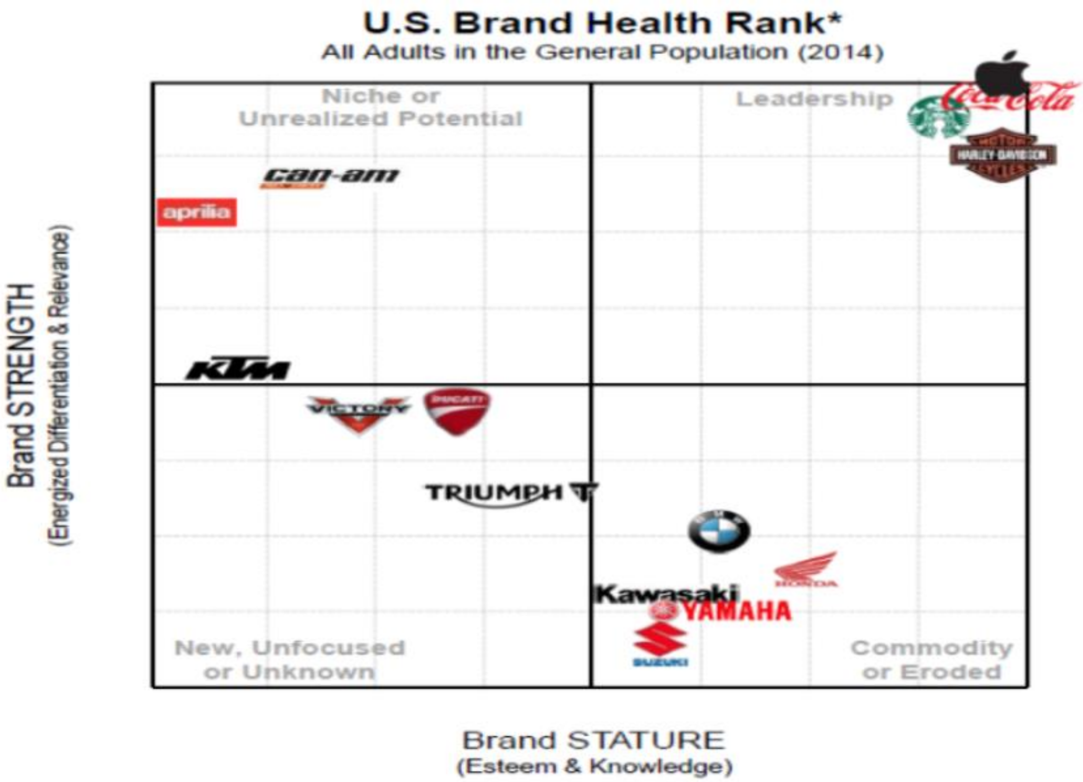
GS: I approach valuation in a classical way using discounted cash flow analysis while adjusting for cyclical considerations. A business with cyclical characteristics shouldn't be valued on peak or trough earnings, so I attempt to normalize the income statement.

RH: How much concentration are you prepared to take in a portfolio?

GS: Certainly more than the average investment fund. My clients typically own 15 different positions, with each position's cost basis averaging roughly 5%-6% of the portfolio. At the end of the day, I want to be in a position (financially and psychologically) where I can own more of a company as its stock price comes down so that I can add to the portfolio's holdings at those lower price points. Having some cash, of course, helps is this regard. Owning quality companies where you possess deep-rooted knowledge helps too. I can't maximize the value of someone else's idea where my insight is low. Frequently, stocks go down from the point of original purchase, and it's important to have a solid foundation of familiarity to apply at that time.

RH: One of the companies you liked at the end of 2015 was Harley-Davidson. Can you walk us through your investment thesis here?

GS: First and foremost, I was attracted to Harley-Davidson's (NYSE: HOG) long-standing and extremely powerful brand which dominates the market it serves. At times, even great brands get materially discounted by the market and, at sub-$50/share, HOG was one recent example. In addition, management initiated an aggressive recapitalization plan which optimized the company's balance sheet to reflect current conditions in the capital markets. Issuing long-term debt, and buying back a material amount of stocks, indicates an awareness from management that credit markets are expensive for the lender and cheap for the borrower, and that HOG's common equity is cheap. Transactions like this tend to accelerate shareholder value creation.



RH: Do you think the bid rumors have any weight behind them?

GS: I don't know if the KKR rumors are true or not. In full disclosure, I used those rumors and subsequent spike in HOG's share price to liquidate the position and re-allocate to other companies that sold off following the Brexit vote.

RH: You're also finding value in the oil sector I believe. Can you reveal what you're looking at in this industry?

GS: I'm a huge fan of the two capital cycle books by Marathon Asset Management –Capital Account and Capital Returns. One of my favorite quotes from those books is "[y]ou don't want to think linearly in a cyclical world". Capital flows into and out of various industries, and this impacts future returns. Because of this, there are limits to how strong and weak profitability can be in a particular industry throughout a full economic cycle. Oil prices at sub-$30/barrel (when I initiated most of my energy positions) are no more sustainable than oil at $140/barrel because of the economic laws I mentioned above. Today's massive reduction in capital spending will eventually restore pricing and profitability in the energy markets.

RH: Is there a particular oil sector play you can discuss?

GS: Without discussing a single position in detail, my advice is to find the highest quality companies in terms of cost structure, commodity price breakeven level, management, and balance sheet. I have positions in British Petroleum (NYSE: BP) and National-Oilwell Varco (NYSE: NOV), as well as a few other companies which are leveraged to higher energy prices (e.g. Loews Corp (NYSE: L)).

RH: And lastly, what advice would you give to value investors who are just starting out (or even experienced value investors) to help them navigate today's market?

GS: Here is a list of items to consider:

- You must accept that there is a lag (often in years) between when great ideas are initiated and when the rewards come. I've seen too many intelligent investors short-circuit strong ideas simply because the payback didn't come quickly enough.
- Understand the interplay between short-term underperformance and long-term outperformance. These two flow through each other.
- Avoid Internet "addiction," and stop watching daily price changes.
- Be intellectually honest with your strengths and weaknesses and invest in situations which maximize strengths and minimize weaknesses. This increases the probability of success during adverse times (e.g. an investment has 20%+ in unrealized losses).
- Be obsessive when it comes to learning and study the top 2-3 companies in each industry.
- Become a better stock owner. Thinking clearly is easier to do before initiating a position than after.
- When it comes to investment analysis, look through the windshield and not the rear view mirror. In this vein, practice what Howard Marks calls "Second Level Thinking."

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