Wiedower Capital Owner's Manual

Wiedower Capital's investors play an important role in how successful this investment firm is. I run a concentrated, long-term portfolio. My hope is that this document serves as a way to self-select for the right potential partners who are aligned with my investing philosophy. If you read this Owner's Manual and find yourself nodding in agreement to how I run Wiedower Capital, I would love to talk.

Investing Principles

I look at investments through a long-term lens. When I invest in a new company, I go in with the mindset that I will own it forever. That mentality forces me to focus on what matters most to the long-term health of a business.

A company is worth its future free cash flow discounted back to today. A discounted cash flow analysis shows that the majority of a company's intrinsic value comes from the distant future, not near-term results. If how a company will perform over many years is the majority of its worth today, then the durability of their competitive advantage is of paramount importance.

Because of this, my research is focused on how an industry may evolve over the next 5-10+ years and if a company's competitive advantage can expand within that evolution. This is most likely if the leaders of the company are focused on, and incentivized by, the long-term success of the company.

More often than not, the CEO traits I look for are found in passionate founders who are internally driven to see their own business succeed. I like investing in the person who was there on day one to start the company with their own money and hard work in return for zero pay. Founders often have the vast majority of their net worth, reputation, and personal identity tied to their company.

A CEO's ability to lead their company and allocate capital is extremely important, but I also have to be confident that they are good human beings who lead with integrity. I only want to invest alongside CEOs who overwhelmingly impress me. There are tens of thousands of public companies in the world, and Wiedower Capital is generally invested in around ten of them at any one time. I do not want to invest even $1 of Wiedower Capital's money into a CEO who I do not trust.

In my experience, founders are more likely to make tough decisions that may hurt the short-term financials of their company but help their long-term competitive position. They are able to do this because of their job security. Hired CEOs generally own far less stock—that was gifted to them via options—and know they could be fired at any time. Because of this, it is human nature for hired CEOs to be more incentivized by their annual bonus than how the company will maintain its competitive advantage ten years from now.

With that being said, company culture is just as important as the founder. Over a long enough timeframe, all employees will eventually turnover, including the founder. But a strong culture that emphasizes customer care, product innovation, and capital allocation can continue to thrive. Luckily, the types of founders who create great businesses often do so by creating great cultures. They frequently go hand-in-hand.

In addition to culture, my mindset of owning companies forever results in me focusing on certain types of businesses. The businesses that Wiedower Capital invests in generally have a significant element of recurring revenue to them. Selling small subscriptions on a regular basis is more attractive to me than selling cars or houses to customers once a decade. Recurring revenue businesses can create habits in their customers that are easier to maintain during downturns.

When a product becomes an ingrained part of someone's life or workflow, customers can become captive to the provider. This results in businesses that have pricing power over their customers. However, as much as I like companies that have the ability to increase their prices over time, a company culture that does not take advantage of that is also important. My preference is companies that can at least keep their pricing in line with inflation over time, but they only focus on increasing price as they add value to their customers.

As much as I like when Wiedower Capital's holdings have customers that are captive to them, I equally dislike when a company is captive to their suppliers. A powerful supplier means less control over input costs, and thus pricing. Likewise, a powerful customer can have similar control. The best businesses have a diversified customer base and are not beholden to any single supplier.

Because I plan to own companies for many years, it is inevitable that I will own them during downturns. Thus, I invest in companies that I think can survive and thrive during bad periods. First and foremost, this means profitable companies with safe balance sheets. It may not be the most theoretically efficient capital structure, but I like when companies keep lots of cash and little debt on the balance sheet. When I do invest in a company that has not yet reached profitability or one that has meaningful amounts of debt, it is because I am especially confident in their underlying unit economics and their ability to perform well during a downturn.

When making a long-term investment, I want to bet on companies that benefit from major trends that are nearly inevitable (for example, increased internet use). It is easier for me to maintain my long-term mindset when I am confident that a company has large tailwinds pushing them forward and a long runway for growth to reinvest their earnings back into.

Portfolio Management

My investment criteria boil down to an investment universe of less than one hundred public companies that I am even potentially interested in owning. Out of those, Wiedower Capital's portfolio typically has around ten holdings. And it is not uncommon for three or four positions to make up 50% or more of the portfolio.

Wiedower Capital normally holds little cash. The reason for this is simple: I believe cash has a worse expected value compared to whatever I would own instead of cash. Over long periods of time, the stock market has historically always performed well, and I have no reason to believe this trend will not continue in the future.

Even when the stock market is "high" (ignoring whether that is knowable in the moment without hindsight bias), future expected returns are still positive—just lower than historical averages. And if the stock market goes up over the long-term, then the odds are in my favor. Whether the market falls or not in the short-term does not matter. If the long-term expected value of a bet is positive, then making that bet many times over a long career will be profitable. Because investing in the stock market is a bet that wins more often than not, I prefer being invested as opposed to holding cash.

Position sizing and deciding what new companies to invest in are determined by a portfolio management model that I custom built. My goal with building a model to make portfolio management decisions was to remove emotions, bias, and subjectiveness from my investment process.

After my initial research on a company is complete, I score the quality of the business. Every company is scored on the same criteria that I have deemed to reflect my own investing philosophy. The quality score is made up of three parts: moat, management, and understanding.

The moat score is my rating of how strong a company's competitive advantage is. The management score is my rating of how good a company's management and board of directors are, including incentives and corporate governance. Finally, the understanding score is there to reflect how understandable a company is given my own knowledge and life experiences. This model-based approach helps me quantify things that are qualitative in nature—such as how shareholder friendly a CEO is or how strong an industry's barriers to entry are.

When a newly researched company is scored, there is a minimum quality score it must achieve to even be considered for purchase. If that quality threshold is met, I go through my valuation process. If the quality threshold is not met, the company goes on my watch list without me even attempting to value it.

Valuing companies at the end of my research process—and only if they reach my quality threshold—is an important part of my investing. I want to dedicate my time to finding great companies and then follow them until they get undervalued enough to purchase. I do not want to dedicate my time to finding undervalued companies initially.

My goal when valuing a company is not to be precise. Companies have uncertain futures and I come up with a wide range of possible fair values to attempt to reflect that. It is not uncommon for the high end of my fair value range to be 100% or 200% higher than the low end. That fair value range is then compared to the current stock price to give the company a valuation score.

Just like the quality score, the valuation score has a minimum threshold that must be met to even be considered for purchase. This minimum undervaluation threshold is there as a barrier to help protect myself from overpaying for companies I get excited about. Together, the quality score and valuation score are how buy and sell decisions are made.

Buying a new position only happens when a company on my want-to-own list has a quality score above the threshold, a valuation score above the threshold, and—very importantly—inclusion into Wiedower Capital's portfolio would increase the expected value of the overall portfolio. If all three of those boxes are checked and thus a new position needs to be purchased, the model tells me what holdings to sell down and by how much, and that is what I do.

In summary, my research provides the inputs for each company via their quality and valuation scores, and then the model makes all portfolio management suggestions. Large positions (20%+) are only taken when a company that I have rated as very high-quality also gets extremely undervalued. That is rare.

Owning companies for long periods of time is not easy because business is not smooth. No company's path is linear. There will be economic downturns and every company Wiedower Capital owns will go through struggles. Every stock will have periods where it is down a substantial amount. Following my mindset of owning companies forever, my mindset is to always hold. If a company's competitive positioning has not changed and the CEO who I trust is still there, my default is to hold.

Notice I did not mention valuation. I have no desire to sell the high-quality businesses that Wiedower Capital invests in, regardless of their share price. There have been occasions when the stock prices of holdings have exceeded my estimate of fair value. Even then, I continue to hold. I may sell down the position to a smaller size, but I do not sell completely. There are three reasons I have little interest in selling high-quality companies that have reached, or even exceeded, my estimate of their fair value.

First, my estimates for fair value are always wrong—sometimes on the low side and sometimes on the high side. Valuing companies is a guessing game played with imperfect information based on an unknowable future. My goal is only to be in the ballpark of whatever the theoretically correct number is—if there even is such a thing. And the higher quality the company is, the more likely I am to understate its fair value, which leads to the second reason.

I believe the best companies have more unknown upside optionality to them as opposed to low-quality companies that have more unknown downside optionality. Basically, unpredictable good things happen more frequently to good companies. It is hard to put a number on unknown upside optionality—because it is unknown—but it is one reason that I believe qualitative factors are more important than quantitative factors when evaluating companies.

Finally, a fairly valued company still has a positive expected value in terms of stock appreciation in the future. Fairly valued just means that a stock's return will be in line with the market's return. Because of the first two reasons, I still expect a fairly valued company that we own to match or slightly beat the market going forward—maybe 6-10% expected returns per year. So, if I sell a fairly valued stock just to sit in cash, I am costing Wiedower Capital an expected 6-10% per year on that position size.

With that being said, there are of course situations where holdings are sold completely, but they generally do not relate to valuation. I said above: If a company's competitive positioning has not changed and the CEO who I trust is still there, my default is to hold. Inverting that, if a company's competitive positioning worsens or I no longer trust the CEO, I will consider selling. See my 2018 annual letter for a detailed example of when I sold a company because I lost trust in management. I have zero tolerance for management who I do not trust with Wiedower Capital's money.

About Me

I got into investing as a side hobby while playing poker full-time in my late teens and early twenties. Over time, that side hobby grew into a passion and an obsession. I have always felt like an outsider to Wall Street. I did not go to an Ivy League school or get my CFA, and I have never worked at a big bank or hedge fund. My investing education has been self-taught. When I started Wiedower Capital, assets under management were $130,000 and I knew virtually nobody in this industry.

I am an introvert by nature. My favorite workdays consist of me sitting in my office by myself reading and researching companies. Despite my job title, I consider myself more of an entrepreneur than an investor. I have never had a traditional job—I played poker, started two companies in the foodservice industry, and then launched Wiedower Capital.

Wiedower Capital is a one-man shop and I expect it to remain that way. I also expect to remain the sole equity owner of the firm. I am a bit of a loner and I like having sole responsibility for the company I named after myself.

Wiedower Capital's portfolio is kind of like my own personal art collection. I invest in companies to enjoy owning them for long periods of time—not to sell them to someone else. Public markets allow me to partner with some of the best CEOs who are trying to make the world a better place. I think that is pretty damn cool and it is something that gives me pleasure. I do not sell that enjoyment because my estimate of a stock's annual return goes from 15% to 7%.

The above paragraph explains a lot about my approach to investing. It is why I do not get tempted by lower-quality companies that appear "cheap." Some investors can buy commodities at the bottom of a cycle and make a killing. There is nothing wrong with that, but it is not conducive to my goals. On a similar note, I do not invest in tobacco or other businesses I do not believe are making the world a better place. I have zero desire to invest in most companies—no matter the price. I want to be a small part of great companies for long periods of time.

Likewise, Wiedower Capital does not do any shorting. I consider myself an optimist. On a day-to-day basis, I am a pretty happy person and I feel lucky to have a life that I enjoy. Researching fraudulent companies run by CEOs who are scamming their shareholders sounds a lot less fun than what I do.

I optimize for simplicity. Even if I thought shorting could add value to Wiedower Capital, I would not be interested. I want to do something that I love for work—and I want to make more money than I spend—but maximizing my net worth is not my top priority. This also explains why Wiedower Capital does not use leverage. It could theoretically increase returns on occasion, but it would also increase risk and add stress to my life.

In 2017, I wrote down a list of personal core values that I still look at on a regular basis. While my adherence is not perfect, these are the rules I try to live my life by:

1. Have fun.
2. Lead with empathy. Everyone is different and every human has their own struggles.
3. Pay forward the kindness that others have shown you.
4. Be honest, open, and vulnerable.
5. Being wrong is only a mistake if you do not learn from it. Changing your view on something means you grew and that is a good thing—not something to be embarrassed about.
6. Never forget that you were born on third base. Keep your ego in check.
7. There are three sides to every story—my side, their side, and the truth.
8. You are the common denominator in everything that happens to you.
9. Rarely speak in absolutes (like "always" and "never"). The world is grey.
10. Live your life by an inner scorecard. This list is a reflection of that scorecard.

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