



THE LONG VIEW

The Price of Integrity

At Skerryvore, we look beyond short-term financial results to check whether they're underpinned by sound behaviours. Here, we explain how assessing intangible value builds our confidence in a business.

NB. Skerryvore Asset Management ("Skerryvore") is the trading name of BennBridge Ltd

Any information provided in this document relating to specific companies/securities should not be considered a recommendation to buy or sell any particular company/security.

IDENTIFYING A MISALIGNMENT

In our view, it has become clear that increased recognition of the long-term challenges facing society – including growing inequality and the degradation of the environment – led to a financial marketer’s dream as far as ESG is concerned. But in the end the misalignment between our industry’s desire to create relevant products, and its customers’ hoped-for outcomes, has led to accusations of greenwashing and a regulatory and political backlash that has not helped make progress on these serious issues. Trust has suffered. An investment manager in the US, for example, justifying an about-face on some of its ESG commitments, has quoted laws that now require money managers to act solely in clients’ long-term economic interests, with the implication that investing in companies that are pushing sustainable agendas is bad for business. As an independent fund manager, Skerryvore is immune to pressure from a marketing department or a CEO worrying about quarterly earnings and, indeed, we have long held the opposite view. Why is this?

Simply, because the actions businesses take to address governance, environmental and social challenges also lead to the building of a reputation. The average company in the MSCI Emerging Markets Index trades, at the time of writing, on a 1.7 times multiple of its net asset or book value. Net asset value is what is left when you take what a company owes away from what it owns – buildings, factories, machinery, trucks, fridges, inventory etc. By contrast, at the time of writing our funds are nearly double that average, with a multiple of over 3 times. What could justify this difference in price?

QUANTIFYING THE ABSTRACT

This gets us into the territory of ‘intangible’ value, that part of a company’s value that doesn’t have a physical presence. Some of these elements can be valued, such as customer relationships or patents, which typically have a defined lifetime and decline over these useful lives.

However, in many cases there is still a lot of unaccounted-for value that is covered by the catch-all term ‘goodwill’. This manifests on balance sheets as the price one company pays for another minus all the things that can have a value ascribed to them and was first defined in law in the UK in 1810¹. We opt for a simple understanding: that this intangible value represents a company’s reputation – often embodied by the company’s brand, which Jeff Bezos once described as ‘what people say about you when you’re not in the room’.

BEHAVIOUR: THE FOUNDATION OF TRUST

So if reputation is valuable, how do you go about building it? Henry Ford once said that ‘a business that just makes money is a poor business’², implying that for a business to endure it has to do more than simply make money in the short term. What then are the other things that matter? Oddly, it turns out these seem to line up with the kind of things that people talk about when they discuss ESG.

Take, for example, governance – a company that is well governed by people with integrity can build trust. **Voltronic**, a Taiwanese maker of uninterruptible power supplies (UPS) among other electrical equipment, has built a very successful business by deciding only to act as a manufacturer for brand owners, which is possible because the company is run by a founder with high integrity, Alex Hsieh.

Another example is **Cipla**, a manufacturer of generic medicines. The willingness of international companies to partner with it and employees to work for it, we believe, is tied to the company’s environmental record of not dumping effluent into waterways, which many of its competitors do³. Despite the fact it makes generic medicines, one of the most cutthroat and commodity industries that exists, Cipla, like Voltronic, is priced at a significant multiple of its book value. Cipla has built a trusted brand in India and other emerging markets by maintaining higher standards which has created significant long-term value for shareholders.

Any information provided in this document relating to specific companies/securities should not be considered a recommendation to buy or sell any particular company/security.

Reputation only really matters over the long term, and this gives us an advantage as patient investors. We can see, often at a relatively early stage, whether a company cares about building this intangible value and understands that, despite all the time it takes to build it, it can be destroyed by one bad decision that adversely affects any of its stakeholders. For those who are patient enough to commit to the behaviour required over time, the rewards are persistent and difficult to copy.

Tata Consultancy Services makes a point of treating its employees well, for example, training them in new technologies instead of acquiring existing companies. This results in lower staff turnover and higher returns than any of its competitors. Indeed, the Tata family in India has long understood the importance of integrity and the long-term benefits it can bring. One of its most famous products, even today, is salt, a basic commodity with which Tata has been able to engender trust and, as a result, price it at a premium.

FEMSA, a Mexican holding company, was able to sell its beer brands to **Heineken**, the Dutch brewer, to focus on retail and Coke bottling, but the family's reputation for integrity was such that the deal included shares in the Heineken holding company, owned for many generations by the Heineken family.

GOODWILL AS A BEACON IN STORMY WATERS

It is perhaps when things go wrong that the real value of reputation reveals itself. Recently an Indian business magnate who had previously been targeted by a short-selling report found himself charged with fraud by the SEC. When this happens, as an investor in that business, what confidence can you have that you own what you thought you owned, or that the value of the business will ever recover? This makes it difficult to buy when the company stumbles. Contrast this with the companies that we own which, if they fall in price, don't leave us wondering about the integrity of the owners but rather how much of the company to add to our portfolio while it's available at a more attractive price, as we have been doing recently with FEMSA.

Conflating morals, values or business agendas with the act of investment is dangerous territory when thinking about returns. We favour management teams who recognise that their intangible value represents the ultimately fragile reputation of the business for integrity and treating all stakeholders in a fair manner. For those companies that take the time and care to build it, a good reputation can serve as an enduring competitive advantage as long as the owners and culture support it. As investors and owners of a business, we love to invest in these kinds of companies because we believe that they are capable of generating great returns over the long run.

SOURCES

- 1 Accounting Information (no date). *Goodwill in Accounting: A History of the Issues and Problems*. <https://www.accountingin.com/accounting-historians-journal/volume-10-number-1/goodwill-in-accounting-a-history-of-the-issues-and-problems/>
- 2 Henry Ford (1922) *My life and Work*.
- 3 Changing Markets (2015). *Bad medicine - How the pharmaceutical industry is contributing to the global rise of antibiotic-resistant superbugs*. <https://changingmarkets.org/report/bad-medicine-how-the-pharmaceutical-industry-is-contributing-to-the-global-rise-of-antibiotic-resistant-superbugs>.

Any information provided in this document relating to specific companies/securities should not be considered a recommendation to buy or sell any particular company/security.

Disclaimer

For professional investors only

This document is issued and approved by BennBridge Ltd ("BennBridge").

Effective August 1, 2024, following regulatory approval, from the UK's Financial Conduct Authority, BennBridge became a wholly owned subsidiary of Skerryvore AM LLP ("Skerryvore"). Collectively, BennBridge and Skerryvore are referred herein as the Investment Manager or Firm. The Firm is based at 45 Charlotte Square, Edinburgh EH2 4HQ in the United Kingdom. The registered office of the Firm is Windsor House, Station Court, Station Road, Great Shelford, Cambridge CB22 5NE.

Skerryvore Asset Management, the new trading name of BennBridge, is an investment manager authorised and regulated by the Financial Conduct Authority in the UK and is registered as an investment adviser with the US Securities and Exchange Commission ("SEC").

This material is provided as a general overview of the Firm, our processes and our investment capabilities. It has been provided for informational purposes only. It does not constitute or form part of any offer to issue or sell, or any solicitation of any offer to subscribe or to purchase, shares, units or other interests in investments that may be referred to herein and must not be construed as investment or financial product advice. BennBridge has not considered any reader's financial situation, objective or needs in providing the relevant information.

Any projections, market outlooks or estimates contained in this document constitute forward looking statements and are based on certain assumptions and subject to certain known and unknown risks. Accordingly, such forward looking statements should not be relied upon as being indicative of future performance or events. The information provided in this document relating to specific companies/securities should not be considered a recommendation to buy or sell any particular company/security.

Past performance does not predict future returns. Potential investors in Emerging markets should be aware that investments in these markets can involve a higher degree of risk. Any investment should be viewed as medium to long term and should only be made by those persons who could sustain a loss on their investment. It should not constitute a substantial portion of an investment portfolio and may not be appropriate for all investors. The value of investments and the income from them may go down as well as up and may be subject to sudden and large falls in value. An investor may lose their entire investment.

The views and opinions contained herein are those of the Skerryvore investment team. BennBridge will not assume any liability for any loss or damage of any kind arising directly or indirectly by using the information provided.

This document may not be reproduced or distributed by the recipient, in whole or part, except that this document may be provided to the recipient's advisers in connection with an evaluation of a potential investment.

The distribution of this document and the offering or purchase of interests in strategies or funds managed by BennBridge may be restricted in certain jurisdictions. No person receiving a copy of this document in any such jurisdiction may treat this document as constituting marketing or an invitation to them to subscribe for interests in a BennBridge fund or otherwise make an investment.

It is the responsibility of any persons in possession of this document, including individuals who may be employed by or a consultant to the recipient, to inform themselves of, and to observe, all applicable laws and regulations of any relevant jurisdiction. If any recipient, including individuals, is or becomes aware that the receipt of this document by them contravenes any law or regulation, they must destroy it or return it to BennBridge immediately. Prospective investors should inform themselves as to the legal requirements of so applying and any applicable exchange control regulations and taxes in the countries of their respective citizenship, residence, or domicile.

Telephone calls may be recorded for training and monitoring purposes.

RISK FACTORS

- Capital is at risk and there is no guarantee any investment will achieve its objective. Investors should make sure their attitude towards risk is aligned with the risk profile of their investment, however made.
- Past performance does not predict future returns. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.
- Currency exposure is not hedged.
- Equity prices fluctuate daily, based on many factors including general, economic, industry or company news. In difficult market conditions, BennBridge may not be able to sell a security for full value or at all. This could affect performance of an investment and with regards to an investment made via a fund, could cause the fund to defer or suspend redemptions of its shares.
- Investments in Emerging markets can involve a higher degree of risk.

Disclaimer

FOR INVESTORS RESIDING IN THE UNITED KINGDOM OR THE EUROPEAN ECONOMIC AREA

In the United Kingdom this document is only available to professional investors meeting the criteria for Professional Clients set out in COBS 3.5 of the Conduct of Business Sourcebook in the Financial Conduct Authority's Handbook of rules and guidance.

Although the information in this document is believed to be materially correct as at the date of issue, no representation or warranty, express or implied, is given as to the accuracy, reliability, or completeness of any of the information provided as at the date of issue or at any future date. Certain information included in this document is based on information obtained from third-party sources considered to be reliable. Any projections or analysis provided to assist the recipient of this document in evaluating the matters described herein may be based on subjective assessments and assumptions and may use one among many alternative methodologies that produce different results. Accordingly, any projections or analysis should not be viewed as factual and should not be relied upon as an accurate prediction of future results. Furthermore, to the extent permitted by law, BennBridge, any BennBridge fund, their affiliates, agents, service providers and professional advisers assume no liability or responsibility and owe no duty of care for any consequences of any person acting or refraining to act in reliance on the information contained in this document or for any decision based on it.

FOR INVESTORS RESIDING IN AUSTRALIA OR NEW ZEALAND

This information is issued and approved by Bennelong Funds Management Ltd (ABN 39 111 214 085, AFSL 296806) ("BFML"). BFML has appointed BennBridge Ltd ("BennBridge") as the investment manager, which is authorised and regulated by the UK's Financial Conduct Authority (with Firm Reference Number 769109). BennBridge is a Corporate Authorised Representative of BFML (AFSL Representative No. 1281639). All regulated activity relating to portfolio management, including the execution of trades, takes place within BennBridge as the regulated entity.

This is general information only, and does not constitute financial, tax or legal advice or an offer or solicitation to enter into any investment management agreement with BFML or subscribe for units in any fund of which BFML is the Trustee or Responsible Entity (Bennelong Fund). This information has been prepared without taking account of your objectives, financial situation or needs. Before acting on the information or deciding whether to enter into an agreement, acquire or hold a product, you should consider the appropriateness of the information based on your own objectives, financial situation or needs or consult a professional adviser. For any Bennelong Fund, you should also consider the relevant Information Memorandum (IM) and or Product Disclosure Statement (PDS) which is available on the BFML website, bennelongfunds.com, or by phoning 1800 895 388 (AU) or 0800 442 304 (NZ). Information about the Target Market Determinations (TMDs) for the BFML funds is available on the BFML website. BFML may receive management and or performance fees from the BFML Funds, details of which are also set out in the current IM and or PDS. BFML and the BFML Funds, their affiliates and associates accept no liability for any inaccurate, incomplete, or omitted information of any kind or any losses or damage caused by using this information. All investments carry risks. There can be no assurance that any investment or BFML fund will achieve its targeted rate of return and no guarantee against loss resulting from such investment. Past performance does not predict future returns. Information is current as at the date of this document.

Contacts

SKERRYVORE

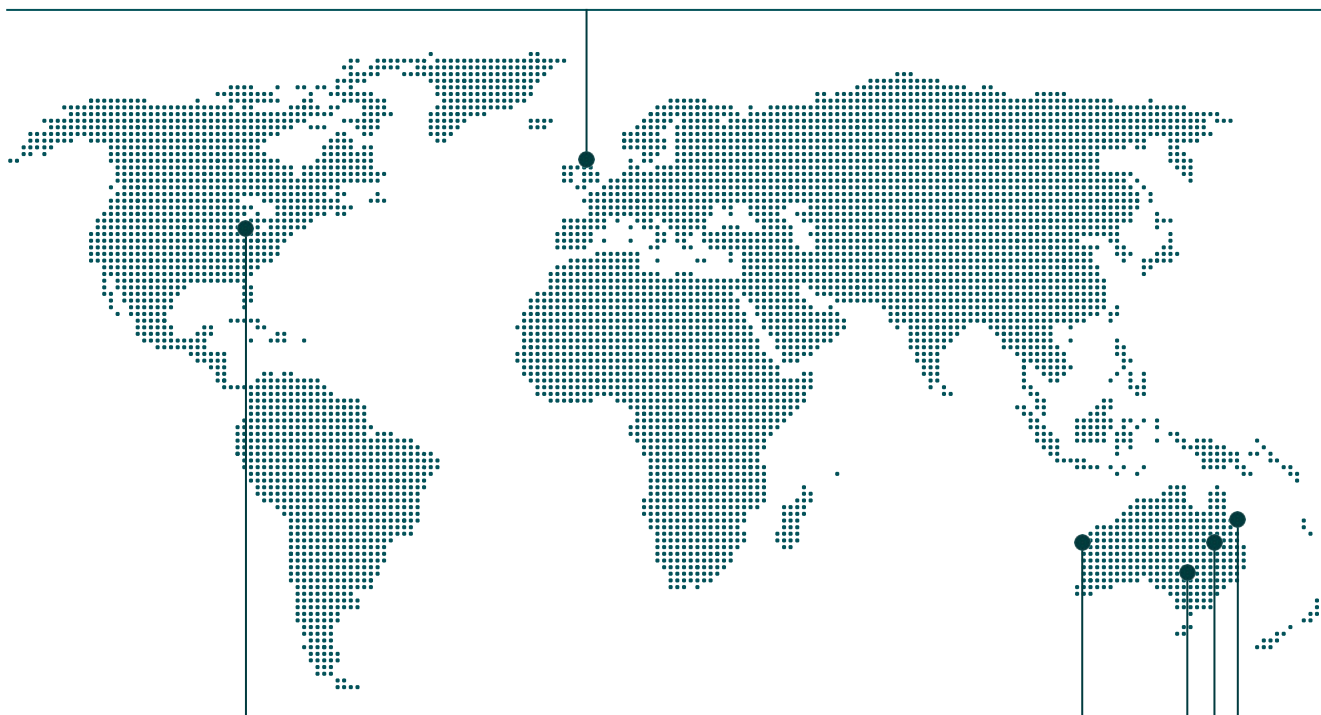
45 Charlotte Square, Edinburgh EH2 4HQ
clients@skerryvoream.com

Charles Oldmeadow
Head of Distribution

Charles.Oldmeadow@skerryvoream.com
+44 (0) 7866 222 172

Fiona Stout
Product Marketing Co-ordinator

Fiona.Stout@skerryvoream.com
+44 (0) 131 202 3089



OUR DISTRIBUTION PARTNERS

FRONTIER ONE LLC

1033 Skokie Boulevard, Suite 260
Northbrook, IL 60062

Jason Ciaglo

jciaglo@frontieronellc.com

Bill Forsyth

bforsyth@frontieronellc.com

BENNELONG – AUSTRALIA

Level 21, 20 Bond Street, Sydney NSW 2000

Bennelong House, 9 Queen Street
Melbourne VIC 3000

Level 38, Riparian Plaza
71 Eagle Street, Brisbane QLD 4000

Level 1, 81 Stirling Highway
Nedlands, Perth WA 6009
client.experience@bennelongfunds.com

SKERRYVORE

Tel: +44(0) 131 202 3070

Email: clients@skerryvoream.com

www.skerryvoream.com



Skerryvore
ASSET MANAGEMENT

For professional investors only