

Focus on Good Decades, Not Good Days

We had the pleasure of speaking with Peter Mantas, general partner of Toronto-based [Logos LP](#), last week. Peter discussed his background and investment approach at Logos LP, an investment fund he started with Matthew Castel in order to implement the timeless investment principles they had always followed on behalf of their own families.

Peter and Matthew invoke Charlie Munger in describing their approach:

“The investment game always involves considering both quality and price, and the trick is to get more quality than you pay for in price. It’s just that simple.”

The following transcript has been edited for space and clarity.

John Mihaljevic, MOI Global: It’s a great pleasure to welcome Peter Mantas, general partner of Logos LP based in Toronto, Canada. Peter, it’s great to have you here, and I look forward to learning about your investment approach. Perhaps we could start with a little background on yourself and the genesis of your firm.

Peter Mantas, Logos LP: I’m originally from Ottawa, Canada, and I attended business school at the University of Ottawa. I met my partner, who’s also a general partner, Matthew, at McGill where we did our post-secondary education. I went to McGill for law school, and he went to McGill as well. I had done a lot of research – academic and general research – on how portfolio construction can optimize performance and on the multiple ways to value companies bottom-up. Matthew had experience internationally and expertise in global macro and behavioral economics. We combined that expertise and developed a unique approach to portfolio construction, which we tested as a beta prior to fund inception. Given the success, we launched Logos in March 2014.

Matt came up with the word “Logos.” At the time, he was reading Greek philosophy. The word logos is Greek for “word” or “reason.” The idea of logos in Greek harks back to the 6th century when Heraclitus discerned the cosmic process was a logos, analogous to reasoning power in men. We thought it was a great name because we take an interdisciplinary outlook to value investing which allows us to find and value businesses using equal part logic and creativity.

MOI: You’ve been doing this for some years now, and I’d love to get a sense for how those years have gone, whether the initial impetus for launching it has played out as you expected. Where do you hope to take the firm over time?

Mantas: We’re long-term investors. The first five years have been good. We were fortunate to see a major drawdown in the fourth quarter of 2018, which would provide for excess returns for at least the short- to medium-term. Our compounded annual return is around 15%, and every year we try to push out a double-digit return for our limited partners. Our minimum goal is high double-digit returns over the long term.

MOI: Let’s talk a little about your investment approach. You alluded to the impetus for starting the firm. Is that still part of the approach?

Mantas: Yes. Our ideal investment universe is usually mid-cap to small-cap stocks with long secular growth stories and high returns on capital. However, we evaluate large-caps and mega-caps if we suspect a significant mismatch between value and price in the short- to medium-term. I typically start the process by generating ideas via value-based screeners that give us a list of investment ideas. Sometimes, as in August 2018, nothing comes up. Ultimately, we create a list of names to evaluate further in proxy statements and annual reports.

MOI: You are based in Canada. Does Canada figure prominently in your investment universe? Or do you tend to look elsewhere?

Mantas: The portfolio is about 65% U.S. and 35% Canadian. We typically invest in North America. We evaluate European and Asian potential opportunities as well. We do not have a bias toward Canadian equity. Rather, we seek the best value and best companies that fit the profile of investments we seek.

MOI: Let's talk a little more about the profile you seek. There's a lot of different flavors of value investing, a wide spectrum. Where would you put yourselves on that spectrum?

Mantas: More individual funds consider value investing by seeking companies with discounted cash flow, some apply a multiple-based approach, and others select investments based on earnings. We consider those factors, but for us the most important thing is a secular growth tailwind. If we find that, we favor stocks whose price is well below what we believe the company would be worth based on projected or current cash flows.

For example, we like Huntington Ingalls Industries (NYSE, HII), a 2011 Northrop Grumman spinoff. Huntington is the largest shipbuilder in the United States. This company enjoys a huge backlog of \$23 billion and a high return on capital. It sits on a lot of cash. The secular growth story was apparent in October 2018 when the U.S. Navy published a report proposing one of the largest investments in U.S. Navy ships and submarines since Reagan. There is a massive push for the buildup of these ships and submarines, which are needed given how much these ships have deteriorated or depreciated over time. The company is a consistent earner and generates tons of free cash. HII also has an IT arm, which hasn't been priced effectively. The IT arm provides IT cybersecurity, IT networking, IT consulting, and software. Also, the IT arm has served an acquisitive role. This is a company with long tailwinds, high return on capital, and excellent secular growth. In December of this past quarter, the stock sold off largely because of the prospect of trade wars. It was trading at 10x earnings, 10x cash flow, and less than 1x sales, which was well below multiples a normal defense stock would command with such a large backlog and a software business. Its size is perfect, has the perfect secular growth story, and presents excellent valuation. We can buy and hold, waiting for the market to appreciate its value.

MOI: How do you come across an idea like this? Is that screening? Or have you had it on a watchlist for some time? Give us a sense of your idea generation process, please.

Mantas: Our universe is small to mid-cap stocks. We use value-based proprietary screens to create a list of candidates. Sometimes we find many prospective investments. Sometimes we find none. Next, we develop a short list of companies requiring further valuation; these are the names we dive deep into. We study proxy reports, annual reports, and presentations. We call up management teams and eventually develop our watchlist. Then we mark exact pricing thresholds and figure the percentage they represent in our portfolio construction thresholds. Once a stock hits our threshold, our price target, we take a position.

MOI: There's a lot of talk of moats and competitive advantage. Let's take Huntington Ingalls as an example. How would you judge the moat of a company like that?

Mantas: It's about the stickiness of the services and products. If anyone is going to be touching U.S. ships, it will be Huntington. It is the preferred vendor for the U.S. government. It has a long history of delivering projects. It provides other services to the U.S. government, too. Huntington has expertise in its field and expertise in stickiness. With stickiness comes pricing power. Pricing power is not merely the power to increase prices. Pricing power includes understanding the business well, including controlling business costs. Huntington is an example of a business with a large moat because no one else will be able to touch U.S. ships. They're a preferred vendor with the U.S. government. There's a lot of stickiness there. This creates a significant competitive advantage. Even though Huntington is only a \$7 billion business, it has a wide moat.

MOI: How does the pricing dynamic work in a case like this? It seems on the one hand, as the dominant player, Huntington could raise prices. On the other hand, it has only one customer, the U.S. government; that single customer could push back. Help us to understand more about the pricing power and how the procurement process works.

Mantas: Pricing can go two ways, price increases and price decreases. Huntington can go to the U.S. government and say, "Look, the typical cost for this particular ship is \$2 billion. We can do it for \$1 billion or \$900 million." And because of its expertise, it has had a long track record of building ships for the U.S. government. Because of its expertise, Huntington can reduce prices creating significant cash flow and profit. This, in turn, creates large shareholder returns. In this example, it would be difficult for a competitor to build ships at budgets that Huntington can use because it wouldn't be economical. Given its expertise, Huntington can save the U.S. government a lot of money by building a lot of ships. At the same time, Huntington also enjoys pricing power going upwards because of its innovation in technology, software, simulation, and professional services. Huntington can add more value to a lot of the ships it builds and, therefore, add more pricing power to the deliverables it provides to the U.S. government.

MOI: Do they also build ships for U.S. allies? Is that a significant part of the business?

Mantas: The vast majority is U.S. government. Huntington also provides IT servicing and IT security to other multinationals like Boeing, ExxonMobil, or other companies that may have offshore oil sites like BP, but the vast majority is U.S. government contracting.

MOI: And are they the leader across all the various categories - let's say aircraft carriers or destroyers?

Mantas: Yes, they are leaders in all categories, aircraft carriers, nuclear submarines, and destroyers.

Because of Huntington's expertise creating the George H.W. Bush ship, the Gerald Ford, and several other high profile, large ship projects for the U.S. Navy, Huntington has a chance to solidify market share. Huntington is the company responsible for those large projects going forward.

MOI: Is this the kind of investment in which you buy at the right price and then hold for a long time? To what extent do you track things like the U.S. government budget and those kinds of developments to see whether your position makes sense?

Mantas: Yes, we look for a good entry point on price. We also monitor the secular story, in this case, government spending on outdated ships, to see if that thesis has changed. However, if we believe the story has not drastically changed and the market remains strong, we would buy a significant portion and hold. Because of the business profile, its return on capital, its size, and its story, few other businesses offer such a compelling story. If the position develops as a core position, we would intend to hold for a decade or more.

MOI: You mentioned it was a spinoff. Was that part of the attraction? Do you screen spinoffs or look at them as they come to the market?

Mantas: Spinoffs are interesting. We're always interested in spinoffs mainly because spinoffs often offer value because current shareholders in the mothership are sometimes not interested in the spinoff. Often, these spinoffs are truly uncovered because they're not part of the greater business. We do evaluate spinoffs with some clarity and certainty. We have a dedicated eye on spinoffs, but it's not the sole area we focus on. Huntington had many other characteristics making it an attractive investment.

MOI: Maybe using Huntington as an example, help us understand how you think about position sizing and concentration in the portfolio.

Mantas: We structure our portfolio with several core positions. Peripheral positions surround the core. We hold core positions for a long time, decades or many decades. Huntington is an example in which we took a position because of its long secular tailwinds, the rarity of finding a company of that size, which is a mid-cap, its return on invested capital, and a fantastic management team. Huntington is one name that would qualify as a core, and it would represent a larger portion of the portfolio. Another core holding is Church & Dwight. Many people are familiar with its businesses, including Arm & Hammer baking soda and Trojan condoms. These names start as mid-caps for us with \$6 to \$9 billion market caps and which we believe can become \$30 billion to \$40 billion market caps and beyond. We try to build cores on profiles like these. The peripherals around the core are significantly mispriced. It could be a large-cap stock that is unfairly punished due to an earnings report. It could be secular headwinds. Perhaps it's been beaten too much. It could be a macroeconomic story. Those positions will be more short-term to medium-term. Sixty-five percent of the portfolio is in our top ten names. Fifty-five percent of the portfolio is encompassed through the cores and 45% in the peripherals.

MOI: I'd love to hear a little more about how you view competitive advantage and what sources of competitive advantage you found to be the most durable. You talked about it with Huntington, but have you seen patterns that have worked particularly well in the past and that you tend to look for?

Mantas: We think price is powerful. Price is a consequence of a deeper competitive advantage in which we find a real necessity or inelasticity for that product or service. For example, we love Church & Dwight. It competes with Tide. This is a company with strong brand recognition, excellent margins, and a fantastic management team. Church & Dwight has positioned its products to a science. This is a company with significant pricing power because it dominates its categories. Church & Dwight is in the right spaces with long secular tailwinds, and it enjoys significant market share and brand recognition. Price will typically be the most durable competitive advantage because it impacts all levels of the business. It impacts top line growth, margins, and net profit. The companies that realize their price control can increase price without having significant capex investments. These companies start to see their return on capital increase. These are the outperforming companies with

strong moats.

MOI: How do you think through risks? For instance, with Church & Dwight there's a lot of talk about disruption in the consumer brand space because it's easier to launch new brands or market them on Amazon or in various other ways. How do you think about that kind of long-term threat? How do you assess it?

Mantas: We see risk and prospective low returns as two sides of the same coin. When we evaluate a business, we always look at potential downside threats to the company's moat. In the case of Church & Dwight, it's less exposed to a lot of the disruption competitors like Procter & Gamble face. Church & Dwight is in a unique position straddling personal care and healthcare. Because it dominates such niche brands or markets, there's little private label exposure. Church & Dwight has a tremendous track record of growth through its e-commerce channel and through acquisitions. We're less afraid of disruption from a brand perspective, but more concerned about the company getting ahead of itself with a bad acquisition. For any stock, we look at our impression of the business's future. Is the story still intact? Can it maintain the return on invested capital it's enjoyed for the last 20, 30 years? If the answer to that question is no, with or without some certainty, we see it as a risk investment and cannot make a purchase.

MOI: You talked about the management team at Church & Dwight as superb. Help us understand how you assess that.

Mantas: We look at management teams according to several characteristics, first of which is insider ownership. Second, does the management publish a fairly clean proxy statement? I don't like to see companies with a lot of related party transactions. Is management transparent in its communication? Is it focused on total shareholder returns? These are the kinds of characteristics I like to see in our companies. In the case of Church & Dwight, its management team grew organically. Managers have a healthy insider ownership mentality. They're transparent with their shareholders, focused on total shareholder returns, and patient when it comes to acquisitions. Their strategy is clear, and they understand their businesses well. With these kinds of management teams, I can sleep at night. We look for cultures like Church & Dwight's.

MOI: When it comes to management incentives, do you have things you look for there either in terms of how the compensation is structured, or how much equity the management team owns?

Mantas: We do look for compensation, because it links to performance. Church & Dwight links performance to gross margin, which is a leading indicator of outperformance for many companies. A recent academic paper revealed how gross margin can be the best indicator for total shareholder return. We favor fairly paid executive teams with an incentive structure linked to company performance.

MOI: Could you please talk about some CEOs whom you particularly admire, or are either invested alongside currently, or would like to be invested alongside at the right opportunity.

Mantas: I greatly admire Matt Farrell at Church & Dwight. Another is Stanley Ma at MTY Food Group. He's CEO of a franchise operator. Olivier Filliol at Mettler-Toledo is another great CEO. Of course, I admire Warren Buffett at Berkshire Hathaway. From past CEOs, I admire Henry Singleton at Teledyne. He was reclusive, had decentralized operations, and repurchased shares like nobody else. Those are the kinds of CEOs we admire from past and present.

MOI: Are there also a couple of approaches among value investors when it comes to talking to management teams? Some people like to avoid it completely to avoid bias, and others seek out the dialogue. What's your take on that? Is engaging with management part of your process?

Mantas: We typically don't talk to CEOs. We find CEOs are great salesmen, so they can certainly pitch their stock. We like to evaluate businesses with a detached perspective in an impersonal way to avoid bias. Having said that, sometimes we seek dialogue with management teams of smaller companies, companies with significant insider ownership, or family-owned businesses where there's not a lot of float. Sometimes we seek dialog if the company requires a little clarification on strategy. With respect to activist investing, it can be useful in creating greater shareholder value because there are many companies with terrible management teams. However, we do not typically ride shotgun on such adventures. There are enough high-quality businesses to choose from. We'd rather build significant stakes in businesses with solid management teams than deal with factors outside our control.

MOI: How do you think about the art of valuing a business? What considerations do you make? Are some metrics more important than others in your valuation approach?

Mantas: Many value investors seem to overemphasize traditional metrics that might provide what a value investment ought to look like. We take the view that multiples or industry comparables need to be taken with a grain of salt. Although investing is highly quantitative, a portion of the analysis is qualitative and should assist in quantitative valuation. For example, if you take a high growth, mission critical enterprise software company, it will have a price-to-book that might be high even compared to other software companies. If you look at a utility company, if you look at price-to-book for example, it might be quite low. A utility company might be cheaper than a software company, or one software company might be more expensive than another. For utilities, we know book value. We see the plants, property and equipment, inventory, assets, and liabilities.

For a mission critical software company, some important factors do not appear on the balance sheet like knowledge and processes created by investments in R&D and innovation. Although R&D, for example, might be an expensive income statement item, we know intuitively there's lasting value on the balance sheet through knowledge transfer, innovation, and repeatable processes. For a particular software company, we can speak to the value of that knowledge or that R&D. Thinking critically about the qualitative aspects of the business, we might say it's cheaper than other software companies with lower price-to-book values over the utility company. There's a little about understanding the secular growth story for the business that is in this art of value investing.

We also like to merge the art of value investing with the quantitative aspect so we can eventually translate our findings into earnings and cash flow. Free cash flow is a major input to our calculations. Also, we need to understand the meaning of earnings and how they will look in the future. We're interested in diving deep into those kinds of businesses. If businesses can grow free cash flow, we believe they can grow. If free cash flow becomes a greater percentage of sales while capex does not, then those are the kinds of businesses we are interested in.

MOI: Markets have cycles. Howard Marks's new book talks about that. Help us understand to what extent you are fully invested versus having cash in the portfolio at different times. Do you vary the cash position consciously? How does that work?

Mantas: We always remain fully invested, especially with our core positions. At times we hold more or less cash. For example, in August of 2018 we held a larger cash position than usual. We capitalized because we used that cash to make strategic purchases, particularly in December of 2018. We evaluate market cycles, compare our interpretations with the cash balance, and decide whether to change our cash balance. Give or take, we're always effectively fully invested, especially within our core positions.

MOI: You talked about concentration in the portfolio. Anything else you keep in mind on that front? What about industries? Do you prefer certain industries? To what extent do you keep the portfolio diversified across sectors?

Mantas: The industry and sector bear on an evaluation of how much of the portfolio we devote to these companies. Consider CGI, for example, a company with an addressable market in the trillions, worth \$23 billion, and with a huge backlog. CGI will be a \$100 billion company in the next decade. Sometimes we look at size like this and at the market and decide we could take a larger position in a company like this. If you take a company like Huntington, by our estimates, the company is north of \$20 billion to \$21 billion. We will have a somewhat larger position in the fund with a position like this. Church & Dwight has a massive market and markets that haven't been fully priced in yet. Not many people know that Church & Dwight has a large animal business. Humans consume resources faster than they replace them, so animal productivity will be a real story for the population over the next 30 or 40 years. That is an example of a business where not only do we have the consumer in the trillions of dollars, but we also have markets with large growth attached to it. We do look at the market and industry they operate in as well as their positioning and strategy. Those all come into play when looking at the kind of concentration we want for any stock.

MOI: If I can come back to CGI for a moment, you mentioned the recently \$23 billion market cap, but it could be up to \$100 billion over time. How do you think about that opportunity? Why do you believe CGI will continue to outperform?

Mantas: CGI enjoys the luxury of operating an effective oligopoly. Not only does it consult for large governments and multinationals, but it develops software. Its largest competitor is Accenture, which already is in the \$100 billion business plus. CGI has an ever-growing backlog of contracts for its services and technology, and its market is north of \$1 trillion. It has captured only a small percentage of the total addressable market. The growth rate for IT services is calculable and well known. One can see how the company, over the next ten to twenty years, can reach \$100 billion. Given its high return on capital and its shareholder-friendly policy, we can see how the value of the company can support that valuation. CGI exemplifies a company providing a strong secular growth story and excellent tailwinds. CGI presents an interesting industry. We can qualitatively analyze the business and see its path to \$100 billion or more in market cap.

MOI: What would you consider the biggest mistake that tends to keep investors from reaching their goals?

Mantas: Their biggest mistake is to fail to understand themselves intimately. They fail when they are unaware of their own human nature, how their emotions bear on their decisions, their individual ticks, their insecurities, and their destructive patterns. We spend a lot of time living on the surface, reacting emotionally. It's what people say and do, and we're drawn into action to stimulate our own human tendencies for greed, instant gratification, and the pursuit of pleasure. But refusing to come to terms with that basic human nature means investors can doom themselves to patterns beyond their control and to feelings of confusion and

helplessness. Negative investment outcomes tend to follow that. Avoiding investment mistakes means developing self-knowledge and self-awareness with discipline to make prudent decisions in the long run.

MOI: Are there books you find particularly illuminating and which you would recommend for insight into the art of investing?

Mantas: I like Thomas Phelps's 1972 original copy of "100 to 1 in the Stock Market: A Distinguished Security Analyst Tells How to Make More of Your Investment Opportunities." It's a bit of a lighter read. The book is about bagger stocks, companies in which a \$10,000 investment grows to \$1 million. The original 1972 book is a better read than a recent rewrite published maybe five years ago. The author dives deep into what it takes to have bagger-like returns. I've learned through the art of value investing how people underestimate patience to get those kinds of returns. I don't mean just one or two or five years. I mean waiting a long time. An example is Amazon. If you bought Amazon in 2000, you endured 10 years of terrible performance. It became a mega cap only recently. The book has many examples about extreme outperformance and how, for certain positions, some investors had to wait a decade or more to see the outperformance. The book opened my eyes to understanding how patience is truly one of the greatest assets an investor can have over the long run.

MOI: I'd love to understand more about your firm and your long-term outlook on your website. I found it interesting when you say you're focused on intergenerational wealth. Tell us about the kinds of partners or investors you look for and what role you hope to play in their financial lives.

Mantas: That's a great question. We don't focus on having good years for a couple of years. We focus on having good decades. We're truly long-term investors. Quite frankly, it's the only way we can ever see a true snowball effect for ourselves and for our limited partners. Typically, Logos LP investors seek high rate compounding for a long time. We're not interested in day-to-day trading. We're not interested in high turnover or in picking a particular theme for any given year and rotating in and out of the theme. Rather, we look for businesses in which we can buy meaningful stakes and then compound at high rates over decades. Many of our investors have an intergenerational wealth goal, a focus on long-term family wealth creation. It's for creating something greater than themselves. To do that effectively, one needs to have the snowball rolling and rolling for a long time.

MOI: To understand a little better how you and Matthew divvy up responsibilities, do you both research companies? How does the process of choosing investments work?

Mantas: I do a lot of the bottom-up fundamental analysis and portfolio management. Matthew uses his expertise and experience in international development, international economics, global macro, and behavioral economics. I get many research supports from him pertaining to market cycles, data from Europe, and what the recent inversion might mean for us. We divide the investing story two ways. I might screen for value or find a truly undervalued company. But the timing might be wrong, or it might be in the wrong sector given the macroeconomic environment or the particular cycle. Of course, we talk about every investment we make. We're sounding boards for each other with respect to our own research.

MOI: Peter, this has been great. I've enjoyed learning what you are up to and your investment approach. Thank you so much for sharing your philosophy and for discussing those case studies you mentioned. That was very instructive as well.

Peter Mantas has an assortment of business and financial experience at global institutions. Peter's prior experience includes senior managerial roles at large information service and enterprise technology companies in addition to legal experience within the capital markets, alternative investments and tax groups at McCarthy Tetrault LLP. Peter has also been involved in a variety of private equity transactions, ranging from retail to renewable energy, in addition to leading a proprietary trading team for a boutique desk. Prior to this, he held various economic research positions at the Export Development Bank of Canada, Statistics Canada and other various federal government departments.

Peter has both an LL.B. and B.C.L. from McGill University's Faculty of Law. Prior to studying law he obtained an Honours Baccalaureate in Commerce, Magna Cum Laude, from the University of Ottawa, Telfer School of Management, where he received several awards of excellence.