

*This article is excerpted from a letter by MOI Global instructor Phil Ordway, Managing Principal at Anabatic Investment Partners, based in Chicago, Illinois.*

## **Armstrong**

AWI remains our largest investment. AWI's returns were the star of the show in the first half of 2019 but the company has been performing well for a few years now. The flooring segment spin-off is in the rear-view mirror; the international segment sale proceeds have been received; the manufacturing operation has been streamlined; the balance sheet is in good shape and the free cash flow is piling up.

AWI has been the biggest investment in our partnership's history and it's been a very successful one. The core elements of the business - its dominant competitive position, high margins, and free-cash-flow generation - were in place and apparent in 2015 when we initiated our investment, yet investor patience was still required. There was fairly little risk in owning the business over a period of years but there was the usual uncertainty about the near-term specifics that drove market volatility. The biggest change has been in the market's perception of the company, as the share price has almost tripled.

A look back at our activity provides some insights. We acquired shares steadily through the second half of 2015 and first quarter of 2016 as the share price declined almost in a straight line. We then added to our investment by approximately 10% in the first half of 2017 at prices near those we paid in 2015 and 2016.

It's also worth noting that the path to good returns is almost never a straight line. The total return, compounded annually, from owning AWI has been 55% over the past year, 46% over the past two years, 36% over the past three years, and 21% over the past four years (essentially the entire life of our investment).<sup>[1]</sup> And yet the first two years of our investment provided...nothing. From the third quarter of 2015 through the third quarter of 2017 the stock declined and bounced around and provided no return despite plenty of business progress. By contrast, the first half of 2019 saw little news and only some slow, steady progress in the underlying business, but the stock returned 67.7%.

So now what? There is a school of thought that would have us sell some or all our shares because they've "had a good run" and are "fairly valued." There is no denying either sentiment, but the sarcastic quotation marks probably gave away the punchline. If we owned the entire business - which is the scenario I always envision when making investments - would I be tempted by an offer at this price? Only if we were short on cash and had opportunities that offered clearly superior returns. Neither condition holds at the moment.

## **Builders FirstSource**

BLDR remains a significant part of our portfolio. As discussed in prior letters, the market price has bounced up, then down, then partially back up again, but the business prospects

remain favorable.

Temporary constraints hampered business in 2018, and housing-related fears lead the share price to decline 50% for the year. The company never stumbled in any meaningful way, and as industry worries subsided to a degree the shares returned 54.5% in the first half of 2019. The more important facts lie with the business itself. Efficiency gains, an ever-increasing value proposition in the market, share gains over local competitors, a successful management transition, a more robust balance sheet, and growing amounts of free cash flow all point to a bright future.

<sup>[1]</sup> This is for illustrative purposes only; it does not exactly correspond to the timing of purchases made in the Fund and LP returns will vary. All market prices and total shareholder returns in this paragraph are through June 30, 2019. Source: FactSet.

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