

We are delighted to present the following conversation with Christian Billinger. Christian is an Investor at Billinger Förvaltning, a family-held investment company with no external capital. The simplicity of the setup as well as permanent and patient capital provides Christian with the proper environment to pursue his strategy of identifying long term compounders. In this interview, we explore elements of his investment process as well as some example companies that fit his criteria.

Billinger focuses first on the qualities of robustness and resilience which limit downside potential before determining the mix of returns on capital and scope for reinvestment opportunity that accounts for the upside. Often, these factors overlap with family-controlled management teams that more conservatively finance their operations.

Prior to Billinger Förvaltning, Christian worked as a European Equity Analyst for various investments funds. Before that, Christian was an associate at PwC. He holds an MS in Accounting and Finance from The London School of Economics as well as Karlstad University. He is also a CFA charterholder. He splits time between London and Sweden.

*The above interview was recorded in May 2019.*

*We are pleased to provide the following transcript as a courtesy. The transcript has been edited for space and clarity. It may contain errors.*

**Tyler Howell:** How would you characterize your investment operation. How is it structured, and what your mandate is?

**Christian Billinger:** The setup is essentially a closed-end structure, so there are no external investors. It's a family-held investment company. You have a permanent capital base, which is helpful in many ways in terms of being able to buy and hold securities and to be concentrated. There are none of the pressures that come with having external investors. I'd say that's a great benefit of the structure. There are also benefits in terms of how you spend your time. You don't spend time on marketing, internal politics, and operational stuff. I'd say it's a pure setup.

We have a portfolio of listed equities, mainly in Europe and also a couple in the US. It's about buying and holding good quality businesses. By good quality, I mean what most people mean - high returns, good reinvestment opportunities, usually strong balance sheets, and often family-controlled.

That's the setup and the philosophy. Simplicity is perhaps the keyword, and, importantly, the structure fits the philosophy well. If you're a buy-and-hold investor, you want the permanent capital base, and that's what we have.

**Howell:** Have you seen that strategy and structure borne out in terms of a relatively low number of names and low turnover?

**Billinger:** I'd say so. In terms of the number of names, we would typically hold no more than 20 to 25, and turnover is very low. In fact, the ambition is to have no turnover. When

we buy into companies, the idea is to hold on to them. Occasionally, you get it wrong. You have the odd voluntary sale where something goes wrong in terms of governance or strategy, and then you obviously have a few involuntary disposals or sales when a company is taken over. Typically, we'd hold on to things for many years. When we buy something, there's no intention of ever selling it, so we try to capture the underlying return of the business, the compounding of earnings and book value over time. That's the philosophy - long-term and relatively concentrated. We still want to have some diversification because you get things wrong from time to time, which is why we typically have 20 to 25 names.

**Howell:** How about geographical diversification? As you're based in Sweden and London, I assume you invest in equities in that area of the world and perhaps the US. Do you have any framework for geographical diversification?

**Billinger:** There's no explicit focus in terms of geography. I've ended up investing mainly in Europe because that's where my background and skills are. You find an awful lot of good businesses there in consumer brands and industrials. We have a bit of Nordics, a bit of UK, France, Germany, and Italy. Besides developed Europe, we have a couple of holdings in North America. That's often driven by the fact that there are some industries with exposures you can't get in Europe. I'd say, as a general rule, we end up in Europe because that's what we know, and we find a lot of good businesses with good governance there.

**Howell:** Finding long-term compounders is your mandate, your goal. How do you think about those? What are the most important metrics to you in identifying those 100-baggers or long-term holders?

**Billinger:** That is the big question. First of all, I start out by looking at how to lose money on an investment. I try to find issues in terms of the business model, the balance sheet, or governance, and only when I've failed to do that will I look at the potential upside. For me, quality has an element of robustness to it, and it has to do with the revenue side. We'd like to see recurring revenues in one form or another, good visibility on the revenue side, and limited cyclicality. Historically, we've found those businesses are easier to manage. On the cost side, we generally look for flexible cost structures, strong balance sheets, and a strong shareholder structure - all these things that limit the downside. On the upside, we like to see good organic growth opportunities and potential to consolidate the industry.

When it comes to metrics, like many value investors, we look at return on capital, and we look at sustainably high returns on capital in combination with good reinvestment opportunities. It's difficult to find both in one company, so we tend to find either very high return businesses with slightly narrower scope to reinvest or slightly lower returns with a slightly higher scope for reinvestment. Still, they all need some combination of the two: they need high returns, and they need growth opportunities. If we find that, it's a good start, and that's where work then begins on portfolio construction.

**Howell:** Could you describe an example that fits the bill in your area of the world?

**Billinger:** A group we like investing in are spirits companies. Typically, they're a good example of high returns. Diageo in the UK, Rémy Cointreau in France, and Brown-Forman in

the US are all holdings in our portfolio. They would tend to have great collections of brands and to be businesses with very high growth margins, high returns on capital, and fairly limited or low capital intensity. At the same time, there's typically a great opportunity to grow organically and through acquisitions, and they tend to have a very long runway of growth. That's a group of companies where you get the combination of high returns and a strong growth outlook.

Then there's industrials. We're invested in the likes of Kone, the Finnish lift maker, and Swedish company Assa Abloy, which is the world leader in locks. Similarly, they tend to be businesses with very high returns, recurring revenues, low fixed cost bases, good balance sheets, good organic growth outlook, and strong shareholder structures. To some extent, they are both family-controlled, or at least the majority shareholders are families, so they tend to have what some people in your community would call "capacity to suffer." They reinvest for the long term. You get high returns, the ability to grow, and the willingness to invest behind that growth.

There are many others, some of them in medical technology or healthcare. Coloplast is one. It's a Danish continence and ostomy care company with impressive returns and a great organic growth outlook. There's secular growth in that market. The company has a very strong position, a great balance sheet, and the opportunity to return cash to shareholders through dividends and buybacks. Typically, you tend to find a number of these different legs. Obviously, governance needs to be there for management to either return that cash to shareholders or reinvest sensibly in the business.

**Howell:** Do you have a process when you pick any of those verticals and think about recurring revenue, the runway, and the ability to reinvest for a long period? How do you think about dissecting the demand environment, or, more importantly, how do you think about it 10 years forward?

**Billinger:** There are a couple of elements to that. First of all, when I say recurring revenue, I define it broadly. I would argue that the spirits companies I referred to have an element of recurring revenues to them. They're not contractually recurring, but by the strength of their brands, they are recurring. I'm sure most of us will have strong preferences in terms of which brands we go to. I think that provides visibility. I also tend to look for companies with very long legacies. I want them to be time-tested because it gives you a better sense of how the business behaves in different demand and competitive environments. These are probably two of the key things I would look to - whether there's something to create stickiness in terms of revenues, whether it's contractual like in the case of Kone, where you need to have the units serviced every so often, or whether it's more in terms of the brand strength, like in the case of the spirits companies. Then, I like to see they've demonstrated over time that it has worked.

**Howell:** You mentioned management. You talk about going back and finding that track record. Do you have a process for how you go back and see what they've said and compare it to the results? Is there a particular way you do that?

**Billinger:** It depends on whether it's a company we hold and have held for a few years, in

which case you have probably built a track record over time or an understanding of how well they tend to deliver. In a way, it is easier if it's a company whose annual reports you have read and whose management you've met once or twice a year. If it's a company you haven't looked at before or haven't been invested in, you will be reading annual reports and listening to conference calls. I think you also tend to look at the nature of the business. There are businesses where it's much easier for management to deliver sustainably high returns on capital. I think it's difficult to look at the quality of management in isolation from the business. In addition, you like to see companies where management either has a big stake or is part of the founding or controlling family.

There are a number of such examples in our portfolio, one of them JCDecaux, the French out-of-home advertising company. Kone is family-controlled but not family run. Brown-Forman is another example. We tend to find that the family-controlled companies take the long-term view. They reinvest for growth. They're much more conservatively financed in terms of the balance sheet, and they think about risk in a different way. They worry more about the downside, or at least they start off by looking at the downside. They want to make sure the business is there for the next generations. Those are all aspects we would look at - the track record, how well the management team fits the nature of the business, the shareholder structure, and the incentives.

**Howell:** What do you think the threats are to JCDecaux? It does outdoor advertising, so I assume it is moving into a digital space. Its greatest competition over the long term is perhaps mobile. How do you think about that?

**Billinger:** That's already playing out. If you look at overall advertising spend, digital is the one segment growing very rapidly. Out-of-home is the only other segment which has managed to defend its share of overall spend in the last 10 or 20 years. A key reason for that is the conversion to digital. Starting off in big world cities like London, New York, Tokyo, and Beijing, the company is converting its inventory to digital, which requires a lot of upfront investment. On the other hand, it means you get multiples of the revenues per screen that you would get with analog screens and achieve much higher returns on capital. There's also an element of interactivity. Increasingly, these companies are creating campaigns or solutions whereby you can interact with these screens, either with your handset or other devices. The fact that they're defending their share of overall spend is encouraging. Also, some of the biggest out-of-home advertisers are companies like Facebook and Amazon, and it's very encouraging to see that the companies whose very business models could cause concern are some of the top spenders with the likes of JCDecaux. That gives me some comfort, but there are always risks, of course. It's why we have 20 or 25 holdings and why we tend to have one or two of the best businesses in each industry. However, we wouldn't want to hold too much of the portfolio in a certain industry or be exposed to a certain theme.

**Howell:** One last question on JCDecaux. How far are we in the process of converting to digital and measuring returns on that incremental capital? Has that borne out in the results?

**Billinger:** It's a good question and one I tend to ask the management when I see them. It

depends on which geographies you look at. In some cities, notably London, the share of digital inventory is very high. Actually, the share of inventory is often quite low, but the share of revenues is very high because revenue per screen is so much higher than for traditional inventory. For JC, I think the share of digital inventory groupwide is something like a couple percent, but the share of revenues would be as high as 20% or thereabouts. In some cities, like London and New York, it's much higher. Naturally, in second- and third-tier cities, it would be much lower. When you look at groupwide organic growth, it comes entirely from conversion to digital and organic growth in existing digital screens. There's a long runway for growth in terms of digital, which is encouraging.

**Howell:** I want to go back to another example you mentioned, Kone. Is there a barrier to entry quality there? How hard would it be for someone to replicate its assets?

**Billinger:** Very hard, in my opinion, mainly because of the service network. If you want to build an effective service network in elevators and escalators, you need a certain density of installed base. To make it cost-effective to have engineers going around servicing these units, you need to have a fairly large number of units installed, otherwise the cost per visit will be far too high. There are four big players in this industry, which has largely to do with that requirement for the service network to reach a certain density. The installed base needs to be of a certain level to justify building that service network. What also helps is that if you're a builder, the share of total spend going to elevators and escalators will be fairly marginal or at least very small as a percentage of total construction cost, but they're critical. They need to work and to be safe. I think there's limited price sensitivity. Similarly, with Assa Abloy, these are not things where you will worry about the price level, first of all.

**Howell:** Are the contracts in servicing and new building sensitive to a slowdown in construction or financing?

**Billinger:** They are. What helps is that aftermarket is such a big part of the business, but certainly, the slowdown in construction in China has had a major impact on Kone's business. It is, by far, the leading player in the Chinese market, which has represented something like 2/3 of global installations of new elevators in the last few years. The slowdown there has had a negative impact on the business, certainly on the new equipment business, and has also led to some price pressure. There's a relationship between demand levels and pricing power. Temporarily at least, Kone has lost that in China. It looks like it is now able to stabilize the situation. At the same time, it has the service business, which is profitable and generates recurring revenues. Overall, it's quite encouraging. The company also has a very strong balance sheet. Even if it experiences a temporary decline in earnings, it will be absolutely fine because the family behind the company is building for the long term. If anything, it might create opportunities for consolidation in the industry - there's a possibility that a player like Kone, with its balance sheet and shareholder structure, could be an active participant in that consolidation.

For the great companies out there, down cycles aren't necessarily a bad thing. Very often, they're a good thing. They clear out some of the excesses and the weaker competitors, and they create opportunities for consolidation, often at more attractive prices. Long term, that may even turn out to be a positive for them.

**Howell:** Regarding the healthcare names you mentioned and some of the issues, is the interest about an inflection point in their ability to generate returns over time or is that more to do with health trends and demographics and how long that flywheel can spin?

**Billinger:** You mean the attractiveness of them or the concerns I might have?

**Howell:** The attractiveness of those as an investment, is it a combination of the two? Or is it more weighted toward their ability to generate returns for some technology reason? Is it health trends and the sheer demographic trends that will be bouncing along?

**Billinger:** I think it's a bit of both. You have high returns - Coloplast, for instance, has operating margins in the mid-30s because it's very efficiently run. It's a business which generates very high returns, but it's also a business where you have strong organic growth. In a market growing 4% or 5%, it has been able to grow at 8% to 10% organically. It has been incredibly successful in taking share in this business. Understandably, one of my main concerns or questions around a business like that is how sustainable 8% or 10% growth is in a market growing at 4% or 5%. That is a valid concern. I tend to raise this with the management when I see them, and their response would be that there's still an awful lot to do, especially in the US market, where the company hasn't done as much historically. It's putting a lot of money into that market now in terms of R&D and direct-to-consumer. I still think there's a good runway for that business. With the balance sheet it has, consolidation is an opportunity, and it's something management have said on a number of occasions they want to do. Overall, I'm pretty comfortable owning this business.

**Howell:** Anything that was maybe a mistake?

**Billinger:** The mistakes have been mainly related to the quality of the businesses. Buying into less than great businesses for valuation reasons hasn't worked out so well for us. We're better off looking at the great businesses, and we tend to look less at valuation. One of the other lessons is run your winners. If you buy into a good business and it turns out well, we try to hold on to those businesses.

**Howell:** From a portfolio management standpoint, you're looking for something to hold forever if you can, 10 to 20 years. You're probably constantly reevaluating the market valuation versus your thesis. Do you have a framework or any way to structure your thinking on how you add and trim over a long period of time?

**Billinger:** We tend to do very little trimming. If we find a business we like and it turns out well, we want to hold on to it, so we tend not to trim positions. The only times I would sell would be if the business goes wrong for governance reasons or strategy. In terms of adding, historically, we've had some inflows from certain industrial holdings and real estate in the company. We've not held much cash, but we've been able to add to positions on sell-offs. Generally, we're pretty much fully invested. I certainly don't believe in market timing for myself. I expect these businesses to generate high returns over time and to grow underlying or intrinsic value, so there's no reason for me not to be practically fully invested or not to own them for long. We tend to build a position. The only times we'd add to a position is if we get more comfortable on the business over time. You see the company, read the quarterly

reports and the annual report, and look at the competition. You probably increase your comfort levels as time passes. That would be one situation where we might add to a position.

**Howell:** Is there anything else you'd like to add?

**Billinger:** We've covered the philosophy, the structure, and some examples. In terms of the process, I should add that the idea sharing of Manual of Ideas is great both in terms of investment ideas and investment process. Thank you for that wonderful forum.

**Howell:** Thanks for joining us, Christian.