

Good Companies Don't Always Make Good Investments

This article by MOI Global instructor Dominic Fisher has been excerpted from a letter of [Thistledown Investment Management](#).

One of our investments, Kulicke and Soffa Industries, supplies capital equipment to electronic chip manufacturers. It recently held an analyst's day. The company discussed its business objectives for the next three years. It then presented a range of profits for 2021. These suggest the share price should be around \$48 today, against \$27. (See reasoning below) The first investment in Kulicke and Soffa was in April 2015 at \$14 by October 2015 the price had fallen 40%, and the fund trebled its investment. In March 2016, I presented the company to investors in Madrid. The presentation bombed. Three attendees told me what a mistake it was to present it. I saw a company with a dominant market position in a growing but mature industry, stable gross margins through industry cycles and a balance sheet full of cash. They saw a cyclical company, where profits had fallen 75% in the last two years, which had no plans to return money to shareholders and was making low returns on invested capital.

Another investment in the fund is Svenska Handelsbanken. The bank has a unique business model, and as a customer, I know how good it is. The bank has been particularly good at avoiding crises; its competitors have been bailed out by shareholders or the Swedish government, it has not. It has high returns on capital, barely recorded losses in the financial crisis and is the most highly regarded bank by customers in all its markets. I presented this bank to a conference in the summer of 2015 as a high-quality investment, which it is. My presentation was well received. The price has since fallen around 30% to the same level as five years ago.

Most investors want to buy good quality businesses, but if the quality is evident the price reflects it, and future returns are likely to be unexciting. The opposite also applies. I think the quality of the leading technology companies is evident today; the prices reflect this and future returns will be low.

K&S Simple Model

The company forecast earnings in a range of \$4 to \$4.75 by September 2021 at its July 10th analyst day.

If this is achieved earnings will have risen by over 20% per annum since 2018 as new applications for vehicles, lighting add to a growing core business.

I believe investors will be prepared to pay a market multiple for those earnings. Today that would be 17 times. Using the low profit forecast investors should pay 17 times \$4 = \$68 in September 2021.

Discounting that value at 10% to today gives a price of \$48.

Clearly any number of things can turn out differently, but this is the basic logic.

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