

*This article is authored by MOI Global instructor by Phil Ordway, Portfolio Manager of Anabatic Investment Partners. The article previews Phil's presentation at Wide-Moat Investing Summit 2018.*

A competitive advantage can come in many different flavors, but my favorite might be a low-cost advantage. I don't think it's necessarily *better* than others, but for me it's easier to understand. A low-cost advantage can also be best exploited by one of my own areas of strength: patience.

An underlying premise here is that the world is competitive; I think the rumors of the death of capitalism are premature, and I see vicious competition in almost every business I come across. In these competitive fights there are few better allies to have than a low-cost advantage. Put differently, high costs - or even just an industry-average cost structure - can create serious impediments to success. Suffering less and avoiding failure can turn a prosaic business into a great success.

Some of the companies I most admire use a low-cost business model to create a virtuous feedback loop with volumes: low costs enable low prices; low prices generate high volumes; high volumes allow lower costs; lower costs are reinvested in lower prices; on and on we go. The best companies take this feedback loop and combine it with other hallmarks of "wide moat" companies - stellar customer service, notable brands/loyalty, strong network effects, effective capital allocation, etc. - to get exceptional and durable long-term results.

As noted in our 2017 letter to partners, history offers many examples of business success that was derived partially or mostly from a low-cost advantage:

*Ford* - The Model T changed the world with its efficient manufacturing approach, enabling a low-price product that was accessible to the masses.

*McDonald's* - Real estate played a big role, but without a standardized, low-cost approach and low-price menu there would be no McDonald's.

*Sears* - Before Amazon there was Sears and its low-cost catalog sales model that revolutionized the retail industry.

*GEICO* - Realizing that car insurance is both required and commodity-like, GEICO has been ruthless in exploiting its low-cost, direct-to-consumers approach.

*Walmart* - Sam Walton is perhaps the best-known example of a low-cost advantage being scaled up to massive effect.

*IKEA* - A simple warehouse with cheap, self-assembled furniture is now among the leading retailers (and brands) in the world.

*Costco* - Sol Price's low-cost warehouse model was perfected at Costco, a company famous for reinvesting every last nickel of cost savings back into a virtuous loop of low prices and

higher volumes. The annual membership fee (later copied by Amazon Prime) is also an important wrinkle that further enables low prices.

*Nucor* - Steel production is a brutal industry, but Nucor rode its low-cost “mini-mill” strategy to great success.

*Southwest* - Over more than 40 years Southwest has exploited its low-cost advantage to post an unbroken string of profits while many of its competitors withered and died. Ryanair took Southwest’s low-cost approach to the next level in Europe.

*The Home Depot* - After a successful stint running a leading home improvement chain, Blank and Marcus asked themselves a simple question: What kind of home improvement store could we not compete against? A big, no-frills, low-cost/low-price warehouse.

*Wells Fargo* - An efficient, low-cost deposit gathering machine is very tough to beat.

*Amazon* - The modern paragon of success, Amazon has low costs - and the reinvestment of those low costs - at the core of everything it does.

*Vanguard* - Aided by lean operations and its ownership structure, the low-cost index fund has made an enormous impact on the investment world.

Even if we accept the idea that history has proven low-cost business models to be successful, does that mean the future will offer similar rewards? Only time will tell, but I think the odds are favorable. I make an ongoing study of many of these companies and believe several of them are worthwhile investments.

Some current examples of companies/industries with a low-cost advantage that may be worth further consideration include:

- ultra-low-cost carriers (airlines);
- building products companies;
- industrial distributors;
- software companies;
- and financial intermediaries.