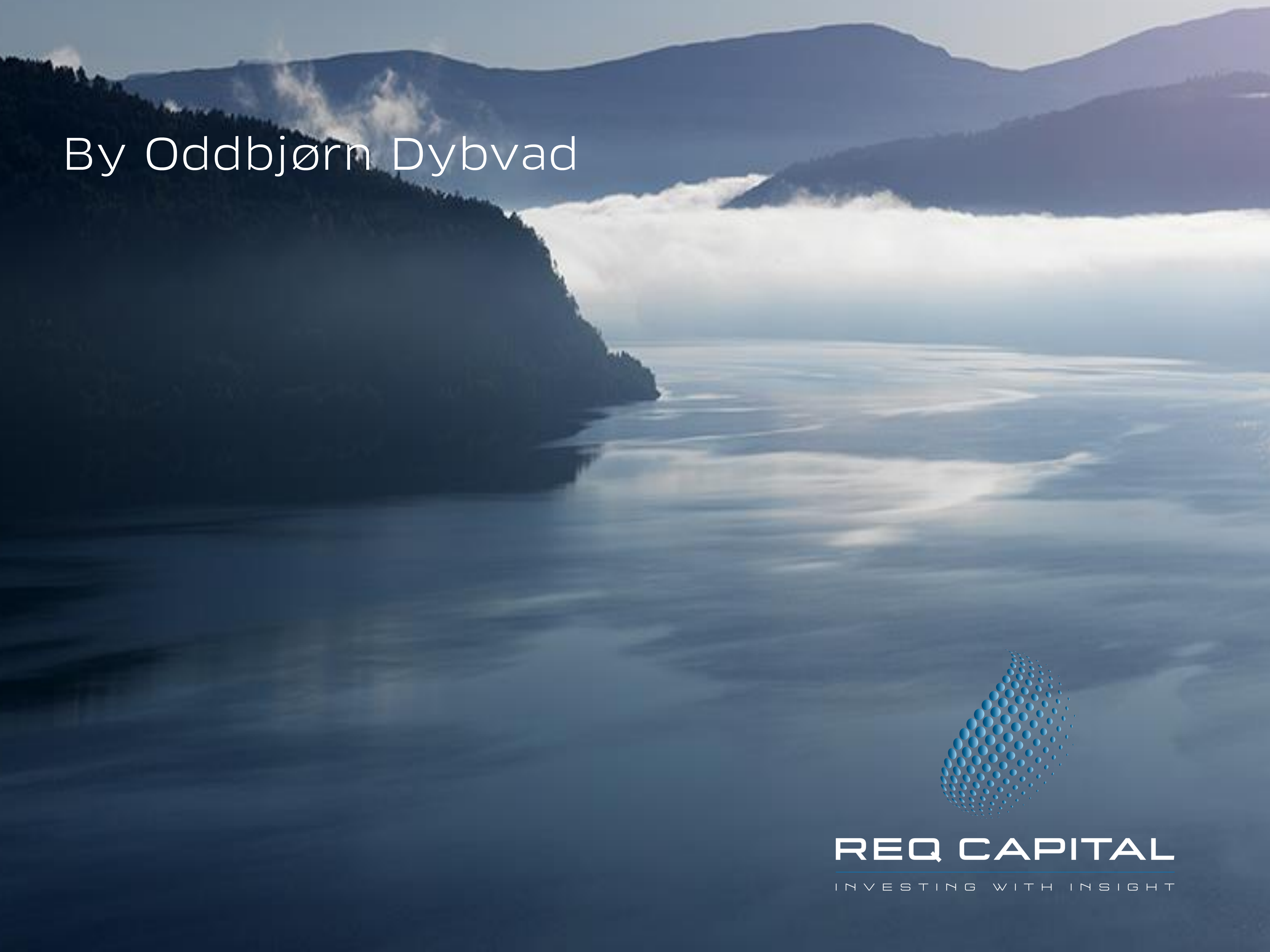
The three essential investment ingredients

By Oddbjørn Dybvad



REQ CAPITAL

INVESTING WITH INSIGHT

We invest in companies that create long term value for shareholders. Our investment philosophy is to identify companies that have superior capital allocation capabilities, decentralized business models, and management that develop high-performing corporate cultures. This often leads us to invest in business models that share three key ingredients that we believe drive long-term shareholder returns.

High return on capital

Shareholder value is created when capital is deployed at high returns over time. Our companies defy the financial laws of gravity, as their returns on capital employed do not experience a reversion to the mean.

Stocks are very often priced on the assumption that the return on capital will decline. Competitive forces should drive profitability down over time. Our strategy implies investing in companies where the return on capital does not decline. These companies grow stronger over time.

Durability

Growth is often overrated. Durability is often underrated. We want to invest in companies with characteristics that increase durability. We believe that the longevity of companies is closely related to their ability to both protect the core strengths of the business and be innovative and changeable.

We invest in many companies that are family owned, or where management has a significant ownership stake (3%-5%). Incentives matter. These management teams create corporate cultures that balance the original (often frugal) culture with encouraging entrepreneurship and growth. They focus on continuity and create a good balance between tradition and change.

Business model certainty

There are many companies that have a long track record of profitable reinvestments (both high return on capital and durability), that we will never invest in. The main reason is that there is too much uncertainty in the business model, ie the business success is basically based on one product, one customer or one end market.

We pass on investing in these companies even though they often have a strong financial track record in terms of profitability and cash flow generation. External factors outside of management's control makes the risk simply too high. Often, regulatory risk is a key risk factor, and it is nearly impossible to know whether success is based on a "megatrend" or company-specific factors.

We prefer companies that control their own destiny, and we are willing to pay for this certainty.

To sum up

High return on capital, durability and the security of the business model are the three essential ingredients for successful long-term investments. Our investment philosophy and strategy increase our chances of finding and investing in these extraordinary businesses.