CALL: 0117 929 0511
EMAIL: enquiries@wealthclub.co.uk

WealthClub

◆ Only for experienced investors ◆

Quality Shares Portfolio: Investment Checklist

"We've called this the Quality Shares Portfolio because that's exactly what you should get. A small number of quality shares chosen and managed by me, with my own money invested alongside yours.

I've admired these companies for years. They provide critical goods and services. They're the type of businesses where you can bury the share certificate, dig it out 10 years later, and, hopefully, find the profits and cash flows are materially higher.

Companies like this are few and far between. I've rejected hundreds of good ideas, to focus on the very best. And I've been totally uncompromising – fewer than 20 have made it into the portfolio.

I won't always get it right, and I can't guarantee results. But I'll always be open and honest with you. No fluff, jargon or empty promises. Just a high conviction portfolio of companies with extraordinary business models and cultures, held for the long-term."

Charlie Huggins,
Portfolio Manager

Every company I invest in is tested against this checklist (currently 60 points, I expect it to evolve over time). No business will pass every test, but the more ticks the better. Some are more crucial to me than others.

Business model

- Do I understand the business model? Is it well within my circle of competence?
- Is the business model durable?
- Is the business likely to produce higher profits and cash flows in 10 years?
- Are the earnings of the business relatively predictable?
- Does the business have reasonable pricing power?
- Can the business successfully evolve and adapt to exploit new opportunities and combat any structural threats that emerge? This will impact conviction in the eventual growth rate.
- Is the customer base healthy?
- Is the customer base sufficiently diverse?
- Is the pace of growth sustainable? Slow, steady growth is often easier to manage than fast growth.
- Is the business easy to scale? A data or subscription business with low marginal costs is usually better than an asset-heavy or people-based business (e.g. a consulting company).
- Is the business relatively simple to run? If highly complex, how confident am I there aren't skeletons in the cupboard?
- Does the business benefit from a high proportion of recurring revenue?
- Is the time lag between capital outlay and returns reasonable?
- Is the business model adequately diversified and not overly reliant on a single customer type, industry, country or product?

Accounting

- Do I understand the accounting?
- Is the business model capital light?
- Does the business generate significant free cash flow?
- Is the accounting of high quality, with minimal adjustments?
- Does the business have low working capital requirements, leading to high (preferably >80%) conversion of net income into free cash flow?

Competition/moat

- Does the business model and/or culture confer a moat, leading to a sustainable competitive advantage? If the industry/company is young, can I be confident?
- Is the moat stable or widening? Watch out for moat erosion, due to increased competition, new technology, lots of new capital entering the industry or societal changes, for example.

IMPORTANT NOTE – The information on this factsheet is for experienced investors. It is not a personal recommendation to invest. If you're unsure, please seek advice.

Investments are for the long term. They can fall as well as rise in value: you could lose all the money you invest. Please carefully read the Risks and Commitments to ensure you fully understand the risks before you invest.

The Quality Shares Portfolio is managed by Charlie Huggins through our subsidiary, Wealth Club Asset Management.

© Wealth Club 2023. This financial promotion is issued by Wealth Club Limited and is a marketing communication. Wealth Club Limited is authorised and regulated by the Financial Conduct Authority (FCA), Register Number 725176. Wealth Club Asset Management is authorised and regulated by the FCA, Register number 400139. Registered office for both firms: 20, Richmond Hill, Bristol, BS8 1BA, United Kingdom.

- Is the moat sustainable without the business having to increase investment to defend it?
- Does the company benefit from limited/inept competition?

Balance sheet

- Is the level of leverage appropriate to the cyclicality of the business, such that a major economic downturn or black swan event would not derail it?
- Is the balance sheet structured appropriately? Check debt maturities, covenants, etc.
- Can the business grow without having to rely on external financing?

Management and culture

- Do both the management and the culture of the business have integrity?
- Has this company generally been realistic with its communications with the market? Watch out for overly optimistic, glass half-full management.
- Does management admit to mistakes? Are they being open and honest?
- Do the executives think like owners?
- Does management have significant skin in the game?
- Is management compensation reasonable?
- Is compensation based on sensible metrics?
- Is the business run relatively conservatively?
- Is the business run with a long-term view?
- Is the business run in an entrepreneurial, decentralised fashion?
- Is the CEO/founder open to challenge?
- Does management think in a contrarian fashion and deploy capital in a countercyclical manner? This is particularly important for cyclical companies.
- Does the business employ a talented CFO with a good handle on the figures?
- Is the business a good operator? Good operators tend to be detail focused and concentrate on doing a few things well rather than many things badly.
- Does the business satisfy the interests of all stakeholders, while still being shareholder-focused? You want happy employees but don’t want the company to place employee interests above those of shareholders (often evidenced by hugely generous option packages).
- Does the business show care towards its customers?
- Does the business have a clear focus?
- Is management concentrated on what matters? An excessive focus on the share price and/or ‘guidance’ can be a red flag.
- Does management exhibit humility?
- Does the company have a clear and sensible pricing policy? Aggressive sales tactics/pricing can erode customer trust.
- Has management been forthcoming about competitive challenges?

Capital allocation

- Is the company a good acquirer? Things to consider:
  - » Regular acquirers with a strong track record often make brilliant investments.
  - » Companies that acquire infrequently often get it wrong.
  - » Bolt-on acquisitions are more likely to work and are generally less risky than large, transformational acquisitions.
  - » Direct negotiations with private, family-run businesses are more likely to succeed than auctions, acquiring publicly listed companies on a premium or acquiring from private equity.
  - » Does the acquisition raise or lower the overall quality of the business?
  - » Is there a clear, strategic rationale or is this a case of ‘diworsification’? Acquiring to gain scale (or worse still to avoid becoming a bid target) is a red flag.
  - » How well does the company understand the business it is acquiring, i.e. is it going off-piste or is it firmly within their circle of competence?
  - » If a business has become more reliant on acquisitions, always ask why. It may be because growth in the core business is slowing.

- Is the company acquiring for the right reasons? If the company operates in an industry where there is pressure to get bigger - for fear of being taken over or missing out on industry consolidation, this can be a red flag.
- Is capital deployment entirely discretionary and returns-focused? If the majority of capital is spent in an area with unproven returns prospects or the company's hand is being forced, it's a potential red flag.

Other risk factors

- Does the company benefit from innovation in its industry, as opposed to being threatened by it?
- Is the business model at low risk of disruption?
- Is the business largely protected from major regulatory risks?
- Does the business serve mostly non 'vulnerable' customers?
- Could the business survive and thrive without the CEO/founder?
- Has the company strategy been consistent? Recent changes in business model/strategy, management or a large acquisition could be warning signs.
- Is the business largely in charge of its own destiny, without being overly impacted by external events like weather or terrorism?
- Is the company largely immune from changing tastes and fashions? This is more common in B2B than B2C businesses.
- Is the company unlikely to become an easy target for short-sellers?
- Has the company been listed for many years, with a proven track record? If the company is a recent IPO, it is difficult to be confident in the quality of the business and the ability of management to run a plc.