Shareholder Letters – identifying CEOs that have shareholder interests at heart

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It has long been recognised that it is important to identify able and high-grade management when investing in companies. However, trying to do this successfully is often complicated – balancing the risk of visitee bias with the potential benefits of listening and meeting strong management teams who have been able to deliver shareholder value over the very long run. One way to make this assessment without the risk of visitee bias is through the shareholder letter.

L.J. Rittenhouse, the aptronymic author of the book, ‘*Investing Between the Lines*’ makes the case for succinct, candid and transparent communication in letters from CEOs to shareholders. One of these CEOs, Warren Buffett, said that he grades a company higher if the CEO wrote the letter. “I look for someone who talks to me frankly and honestly about the business, the way a partner would. That’s a significant plus. … If the CEO doesn’t write [the letter], it’s a black mark against them for one reason — they may not know their business very well. Plenty of CEOs don’t understand their business as well as a lot of people outside their business, or even the people who work for them. They do not want to be seen as they really are.”

Rittenhouse looks for several qualities when assessing these shareholder letters and has narrowed this down to the following clues: culture, sustainability, candour in communication, strategy, leadership and vision. This means that, as investors, we should not immediately fall for the motherhood and apple pie statements.

Rittenhouse suggests starting with a red pen and underlining all the clichés such as “employees are our greatest assets,” “our future is bright,” “advancing momentum,” and “we aim to create shareholder value.”

Around two years ago we sold the Global Equity Income strategy’s investment in IBM following the acquisition of Red Hat. However, there were warning signs prior to the acquisition; Ginny Rometty’s continued use of opaque English had caused us to have doubts with lines such as “journeys of transformation” and “we have prepared your company for this moment.”

One of the Global Equity Income strategy’s most recent purchases, the Swedish Bank, Handelsbanken, exemplifies some of the qualities when referring to culture. The Annual Report provides the evidence of a company with a long-term focus on employee relations, through the inclusion of the staff turnover rate at under 4% and listing the branch managers for the company’s 800 branches.

Joe Kaeser, CEO of Siemens, also an OP holding, addresses sustainability directly. Kaeser outlines how Siemens has been a follower for many years but he recognises that Siemens must lead in the coming years. One of these key trends is managing CO_2 emissions where Kaeser goes into the detail of how Siemens is going to be net neutral by 2030 but also helped customers reduce CO_2 emissions by 609million tons last year – 75% of Germany’s annual emissions.

Rittenhouse thinks that a reference to CEO pay is a good way to display candour in communication. Few firms do this – perhaps because the average CEO pay of FTSE 100 companies has reached 100x the average employee pay at the same firms.

Costco is one company that is effective at describing its strategy: "doing the right thing, operating efficiently, and providing great, quality goods and services at very low prices." But it is the evidence of the success of the strategy that makes Costco stand out from the pack – showing the like-for-like sales on a year-by-year basis with each cohort by year of opening for the last ten years. It is best in class disclosure bar none.

Leadership is a hard quality to identify from the outside. John Elkann, CEO of Exor, another OP investment, recently articulated his view of leadership when writing about Sergio Marchionne, the former CEO of FCA. "He combined his rationality with emotionality and was able to be both strategic and operational, tough but caring and serious with a smile." Both Rittenhouse and Elkann identify duality as a key component of Leadership. Elkann goes onto explain why Marchionne was such a successful leader referencing Francis Scott Fitzgerald: "the test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function."

Lord Wolfson, Next CEO and Chairman, articulated his succinct, candid and transparent vision in last year's annual letter with his Fifteen Year Stress Test, outlining how the offline retailer will transition to being an online retailer and the likely consequences for the offline business over the coming 15 years. We are yet to see any other retailer in the world address this issue with such vision.

It is not just the content that matters, style is an important part of resonating with the reader. Rittenhouse points to Mark Twain as he observed, "The difference between the right word and the almost right word is like the difference between lightning and the lightning bug."

We are on the lookout for well written shareholder letters. Our favourites, other than the ones we have mentioned so far, include J D Wetherspoon, Allegiant Travel, Fairfax Financial Holdings, Berkshire Hathaway and Constellation Software. Please let us know your favourites.

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The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance.