

Vulcan Value Partners Celebrates Five-Year Track Record

Vulcan Value Partners is looking to build out its client base with institutional investors that see the value in its unique approach to the markets as the firm reaches its five-year track record.

Vulcan is a value shop, however it does not look for "cheap" stocks, instead looking to identify a subset of businesses whose values are inherently more stable than their stock price, said Adam McClain, principal and head of business development and client services at the firm, which was founded in 2007 by CT Fitzpatrick, who previously was a partner and portfolio manager at Southeastern Asset Management.

"We approach the world, even though we manage public equity portfolios, much like how a private equity firm may approach a company," McClain said, explaining that the six-member investment team takes a five-year time horizon on investments when constructing the firm's large-cap and small-cap portfolios.

The main focus for the investment team is companies with a strong balance sheet and a lot of cash. "A lot of value investors like free cash flow. We don't like it, we demand it. Every business that we will be willing to invest in generates a consistent high level of free cash flow," he said, adding that it must be a long history of cash flow and not a short-term attribute.

"Recently, I think most value investors are so in love with finding cheap stocks, they are willing to forgo the value of holding something with a stable value," he said.

McClain said Vulcan spends about 80% of its work on qualitative assessment of companies and about 20% on valuation, which he said is the opposite of many value managers.

Much of that qualitative assessment centers around a company's management team.

"It is very important to us. We pay a lot of attention to management," he said, explaining that the investment team will go back and read past transcripts from significant events in the company's past and see what the management team said at the



CT Fitzpatrick

time and then go forward and see how those events played out.

"If there is a question, you don't have to play. We choose not to play a lot," he said. "Companies that generate cash and have a lot of cash on their balance sheet, a major determinant in the outcome is how management spends that cash. Management is the most difficult thing to gauge."

While many value investors are looking for a catalyst that can "unlock" a company's value, Vulcan has a different approach with its portfolios, whose holdings will typically range from 20 to 30 names.

"It is fine if there is a catalyst, but the types of businesses that we own, the value of the businesses tend to compound over time. The value of the business is growing simply from the compounding of cash on the balance sheet," McClain said, adding that over the long-term the market will not allow a company consistently growing and generating cash to remain undervalued.

A Focused Beginning

The firm spent its first three years largely serving as an extended family office for Fitzpatrick and his family.

"Those three years proved to be invaluable to us," said Adam McClain, principal and head of business development and client services at the firm, explaining that the firm spent those formative years establishing policies and procedures, investing in technical resources and building out an investment team and middle and back office staff.

"We have really focused on the institutional market. The first three years gave us time to build out the infrastructure and make it such that the institutional market was ready to talk to us right away," McClain said.

Ultimately, in February 2010 when the firm began targeting outside investors, Vulcan was "fully-baked" as opposed to a "three guys in a garage model," McClain said, noting that the firm had 12 employees when it started to take on clients and has since added an additional member to the research team.

"Growing a firm can be a distraction and we don't want any distractions. We are first and foremost a research staff as indicated by over half our staff focused on research," he added.

Andrew Taylor, managing director at marketing firm Cumberland Partners, which works with Vulcan, said the model

has allowed the firm to focus on investing rather than the training and assimilation that comes with the continual addition of staff as it increases its assets. "This was an institutional shop from the start and I think that is one of the significant differences from some of their peers," he said. "I think that is a nuance that the audience is really picking up on as a distinction from some other managers."

Since beginning to target external clients two years ago, the firm has grown to just under \$400 million in assets from \$20 million.

The majority of attention the firm has garnered has been in its large-cap portfolio as opposed to its small-cap strategy.

"If we all put a wager on it a year or two ago, we would have all lost the bet to the house. The natural assumption was that the small-cap strategy would get attention sooner just because of the capacity constraint, but it has been quite the opposite. The large cap over the last 6-12 months has gotten a lot more inter-

est and attraction," McClain said. "To have a smaller shop get traction in the large-cap space, we were a little surprised. Not surprised that it happened but surprised that it happened before the small-cap did."

Moving forward, the firm's focus is on finding the right clients that fully understand the investment philosophy and are not just focused on returns or checking off boxes.

Matt Morice, managing director at Cumberland, said that the strategy will not fit well with investors that attempt to put Vulcan in a narrow style box, explaining that the firm's concentrated portfolio can put it out-of-sync with short-term market changes.

That fact does lend itself to investors more attuned to a core-satellite approach in their portfolio that looks to build a diversified group of concentrated managers that have low correlation to each other and the index, McClain said. "We just don't fit neatly into a box," he said.

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