Compounding Quality: Pieter Sleger's Approach to Identifying Great Businesses

00:00:00 Dave

All right, folks. Welcome to Investing for Beginners podcast. Today we have a fun show we have somebody I'm super excited to talk to.

00:00:06 Dave

Today we have.

00:00:07 Dave

Pieter, who is the founder of the world famous and tremendously successful Compounding Quality newsletter. Pieter has a huge presence on Twitter, LinkedIn, Instagram.

00:00:17 Dave

As well as.

00:00:18 Dave

The wonderful aforementioned compounding.

00:00:20 Dave

Quality newsletter which is on sub stack. He's also written a book with his friend Luke. The Art of Quality Investing. We're going to talk about that a little bit today. Here's the book for those of you who cannot see us on the podcast. Fantastic book. So.

00:00:33 Dave

Pieter, thank you.

00:00:34 Dave

Very much for joining us today, we really appreciate.

00:00:36 PIeter

To be honored to be here. So I looked forward to this and yeah, just let's have fun over the next next hour and hopefully we can teach the list or something new. I think when that happens, we achieved our objective of today. You have the sun is also very important of course.

00:00:54 Dave

Yes, it is investing. Sometimes can get a stuffy or boring reputation, but it actually can be a lot of fun as we're going to prove today. So I guess my first question is you have we have so many choices to invest in today, why do you choose stocks like what about stocks? Gets you excited?

00:01:11 PIeter

Yeah, I think probably it's important to understand that there are multiple roads that lead to heaven and the stock markets quality investing can work, which I'm sure we will talk about over the next few minutes. Value investing, growth, investing and so on. But next to stocks, obviously, bonds might also be a possibility of.

00:01:33 PIeter

Have an equity or even buying physical real estate yourself? Well, I think that for me personally, I got an affection with stocks since I was 1314 years old.

00:01:45 PIeter

So I just love research those companies and so on. And when you compare it with most other asset classes like for example obviously cash, tea, bills, real estate, gold and other commodities and so on, it has been proven that stocks actually yield a very attractive return in the very long term.

00:02:06 PIeter

So if you invested $1.00 and 1800 you have something like $25 million today, which is just amazing. So if your investment horizon is long enough, meaning at least five years, preferably even 10.

00:02:22 PIeter

I think stocks are one of the best investments you can make and the beautiful thing is that probably everyone can do it and it's the best slash easiest way to become wealthy. So that's why I am in, in laugh at stocks basically.

00:02:37 Dave

Yeah. So, do you remember your first stock pick?

00:02:41 PIeter

Absolutely, absolutely. So I live in Belgium. From the story I was 30 years old, basically and.

00:02:49 PIeter

I heard a friend of my father talk about stock markets. Well, I very naively thought ohh, investing so not needing to do anything and being able to make money, that's something for me. I thought so. 40 years for 40 years old.

00:03:08 PIeter

Set up a brokerage account. Had no clue what I was doing, so I just followed a so-called expert of the broker child and the new stock was added to the list. So I basically made every mistake you could make there so.

00:03:24 PIeter

No different vacation. Not doing your own homework, not understanding what you're buying, and was actually a Belgian company in the oil and gas industry. And The funny thing also is that was this before the financial crisis started to happen. So you can already guess the the end result probably well.

00:03:44 PIeter

After one year, I sold that stock with a lot of 60%, but.

00:03:50 PIeter

I will say to people, well, that's actually the best thing that could have ever happened to me because yeah, it was very painful. I felt very stupid. And when that kind of thing happens to you, you can probably do two things. The first option you have is mentioning or stating investing is not something for me, it's gambling.

00:04:10 PIeter

Is dangerous and so on, and so all the other routes you can take and say, OK, I'm never going to make that kind of mistake again. I'm going to educate myself and what I've done basically. So I really start to read a lot of books about investing. I'm not sure.

00:04:28 PIeter

I should have kept track, but probably read about four or 500. Books would be my educated guess about investing, and that's really like compound interest to combining knowledge is also something that's very, very interesting and you can put that to use in the stock market, but also in other fields that that interest you in life.

00:04:48 Dave

That's great education. You know, like learning. That's one of the things that we've been trying to do. Both of us is trying to help educate.

00:04:54 Dave

People our friend Chris asked this great question on Twitter a few days ago. If you get stranded on an island for five years, what book? What investing book would you?

00:05:03 Dave

Want to take?

00:05:03 PIeter

With you very hard one. So for example I try. Usually I reach around two books a week, so when I.

00:05:14 PIeter

You can take one for five years. I would you book the ticket one I could find. Yeah. All the public holidays are for and that's an example. I think it's a 5000 page document. So those kind of pages are amazing. I think it teaches.

00:05:28 PIeter

You more than.

00:05:29 PIeter

In an NBA or whatever CA or whatever study you can basically do in science. So if that's alright, I think I would pick that one. So the compilation with all the writing the methods just because also with compound equality, that's exactly the philosophy you want to live by as well. So.

00:05:50 PIeter

I probably nobody is as good as as one Bassett and Charlie member, but living by that kind of integrity and honesty is also very important, and when you need the entire document, you have a very good, you know very well how perfect things and acts, why you make certain investment decisions.

00:06:11 PIeter

Why you chose to to partner up with Charlie Munger and so on and so on. So I've actually also been a a regular attendee of the the Berkshire AGM, the shareholder meeting and Emma. And every year is just for an eye opening.

00:06:25 PIeter

And it's not that much about what the sets in the meeting itself, but it's more about just the integrity check and what kind of investor do I want to be, what kind of person do I want to be and also the networking there, the the kind.

00:06:40 PIeter

Of people you.

00:06:41 PIeter

Meet and are are amazing and I can get along.

00:06:45 PIeter

My books. Well, maybe to just for those people who don't want to read 5000 pages and you will ask.

00:06:51 PIeter

Some people right?

00:06:52 PIeter

Well, on the one hand, that's summarized in.

00:06:54 PIeter

The 60 page book.

00:06:56 PIeter

But I think the best books, the best new books are flat over the past, let's say, three years. I think the joys of compounding from going to make this really good. You have. Yeah. Virtual wise, happier from really green and also another new one. What I learned about investing from Darwin is also an excellent one. So that might be an easier start.

00:07:17 PIeter

For some people want to.

00:07:18 PIeter

Start investing then, then reading everything out for one.

00:07:22 PIeter

Buffet.

00:07:23 Dave

Yeah, I would agree with that that I think they're going to read early on, but some of it may be a little over beginner's heads, but you know, that's OK. You got to stretch yourself to learn. So I guess my next question is, is why, why quality? What is quality and how is that different from growth investing, value investing, momentum, investing, whatever.

00:07:44 Dave

Hide or tag you want to put on it.

00:07:47 PIeter

Yeah, every investors you need and like you mentioned in the beginning, there are multiple roles that we do have. And I think that when you use quality investing and clear structure and clear frame in there and you can definitely outperform the market and history has proven that the same goes also for growth investing or value investing.

00:08:06 PIeter

For example, well to me, I live and breathe by by clothing.

00:08:12 PIeter

Testing. So it's just a strategy that's that fits my personality basically and that's probably really important. Why? Well, you can borrow someone's ID, but you can never build a conviction. Meaning that when you, for example, they tell me you should buy. I'm just selling saying something.

00:08:32 PIeter

Not investment advice or something that when when you say to me this well, you should buy Apple and today just saying something and I.

00:08:40 PIeter

By Apple, but I have no clue how the fundamentals of Apple look like, how the outlook looks like and so on. In that case, when things start to get tough when, for example, Apple declines 25% when that's the case, I will have a very hard time to keep going on and.

00:09:01 PIeter

Pursuing the strategy just because.

00:09:03 PIeter

Yes.

00:09:04 PIeter

I don't know what I'm doing and on the other hand, when you choose a strategy, when you pick a strategy that suits your personality, when you make your own homework and you pick Apple, for example, and you know why the company is down 2025% right now, but you still believe in the future prospects, well, that's a totally different thing.

00:09:25 PIeter

Now.

00:09:25 PIeter

You how would you define quality investing? To me personally I say well, quality investing is all about investing in the best companies in the world and I try to do that using three steps and that's based a bit on one benefit. Obviously one benefit and the other one.

00:09:45 PIeter

Quality investor Terry Smith. That's one you try to buy one for companies, so great businesses.

00:09:52 PIeter

So companies with a healthy balance sheet, high profitability, a bright outlook. So plenty of great opportunities and so on. And you want the second step, you want those wonderful companies to be led by excellent managers. That's for example welding company quality subscribers can see the portfolio.

00:10:12 PIeter

And in the portfolio, 70% of these companies?

00:10:17 PIeter

I'm allowed by the founder or still not by the founder. So why? Because when you do that well, the founder, usually those companies have grown already for quite some times for for quite some time. For a few decades. For most of them. And the founder has been doing it for 20 years. So we know that at least in the past.

00:10:37

Is it very?

00:10:37 PIeter

Well, in creating shareholder value and when management itself is still invested in the company, you also increase your chances that the incentives of management and.

00:10:49 PIeter

The ones of you.

00:10:50 PIeter

As a shareholder on the lines.

00:10:52 PIeter

And it has, for example, been proven.

00:10:54 PIeter

You have a.

00:10:56 PIeter

Research from the Harvard Business Review. It states OK companies that are still up by their farmers, they on average they outperform the market by 3.9% per year. And when you're able to outperform by 3.9% per year, well when you look for a few years or even.

00:11:12 PIeter

Two decades. Well, the.

00:11:13 PIeter

The difference will be huge. Just because every single year you make an extra return of 4% and then you make an extra turn of 4% hundred, 4% and so on and so on.

00:11:26 PIeter

So it's snowball. And then the third step for wonderful companies, Accent management and obviously the markets often recognizes that those companies are wonderful businesses, so.

00:11:39 PIeter

They trade higher.

00:11:40 PIeter

Valuation levels and then the yards. And that's also why the book for example is called the.

00:11:46 PIeter

Quality investing the artist to try and pick up those businesses at at the tractor acceleration levels. And when you folks on Apple also look at the historical performance, you see that on average well.

00:12:01 PIeter

Quality stocks have outperformed the market. Buy depends on language use and surrounded by 3.5 to 4.5% per year. So that's actually also what you try to to achieve and maybe one last thing to add. I think the key difference between the quality investing and then on the other end.

00:12:22 PIeter

Are you investing? Is that value investing is a rather active strategy. Understand that what you try to do is you try to find the number valid company.

00:12:34 PIeter

And after doing your homework, you buy that stock. You hope that you're you're thinking is correct and when that is the case, the valuation will go up and the stock price goes up. But when this happens, well then the valuation is gone. And this is a great business. So we should sell the business and try to find a new undervalued company.

00:12:54 PIeter

Uh.

00:12:55 PIeter

After you've done that, hopefully once again the valuation goes away and you need to sell the company, find a new one and you do it again and again and again. And the difference with quality lasting probably is that for quality investors, while the margin of safety is not in the in the low valuation level of the company.

00:13:14 PIeter

But the margin of.

00:13:15 PIeter

Safety is in the mode or the.

00:13:17 PIeter

Competitive advantage of the business so.

00:13:21 PIeter

Basically, when you found a quality stock and your homework is correct, when the best time to sell is almost never because that company can or should be able to keep growing, it's it's increasing value per share. It's very attractive rates and as long as this is the case, well, there's basically no reason to to sell the business.

00:13:43 PIeter

So when you for example 10 years.

00:13:46 PIeter

This will identified master card as a quality stock, for example. Well, I think your question for most today would be very happy because most the card has.

00:13:58 PIeter

Done really well.

00:13:59 PIeter

And it's still a great business and the future still is bad for them. There are still no other companies that are able to.

00:14:07 PIeter

Yeah. Break the oligopoly idea pretty of Visa MasterCard. So that's a beautiful strategy and then you can just, yeah.

00:14:17 PIeter

Sit down and do nothing and and let the magic of compounding.

00:14:20 PIeter

The tool basically.

00:14:22 Dave

That is music to my ears, right? And sit back and do nothing and let the companies do all the heavy lifting. So a couple of questions. I love that framework. I think that's a beautiful framework and I think that's very much how Andrew and I tried to invest. I think we've always kind of lumped ourselves.

00:14:37 Dave

Into the value investor camp.

00:14:39 Dave

If you will, but we don't really invest that. So we try to find great companies and hold on to them for a long time and try not to find the cigar butts. So I guess my question a couple of questions for you ever one is do you have like a watch list or companies that you look for that maybe don't quite?

00:14:55 Dave

Fit the criteria yet?

00:14:57 Dave

At this point, or a myriad of reasons.

00:14:59 Dave

So that's one part of it and.

00:15:01 Dave

The other part of it is.

00:15:02 Dave

Do you have a?

00:15:03 Dave

Like a size that you look for like market cap, do you try to find smaller company bigger companies like how does that kind of work into this framework?

00:15:13 PIeter

It's a very great question, I think regarding the watch list. Well, with compound quality aiming for a portfolio of 15 to maximum 20 stocks, why? Because your criteria are so strict that ruled Wilds. There are 60,000 stocks and when you use the criteria, the lawyers for example while.

00:15:33 PIeter

Only 150 companies remain so. Actually, I have a watch list.

00:15:39 PIeter

Of one of 50 stocks stocks that you identified as quality, but where you for example, think, yeah, those are all companies basically. I think when the valuation starts to become attractive, I would be considering to own them and and then there are multiple companies.

00:15:59 PIeter

Within the lists that are according to me too expensive and think about I would love to own the company like Constellation Software for example. I would love to own a business like like Copart. I would love to own a business like.

00:16:14 PIeter

Like MasterCard, actually, but I think the valuation is on the higher side and then it's really a.

00:16:20 PIeter

Case of of.

00:16:21 PIeter

Being patient and hopefully and one day they will arrive buying opportunity when the valuation comes down the stock market goes into a correction and so on. And I think that's really important.

00:16:34 PIeter

Also, for you as an investor that you have.

00:16:38 PIeter

Search the list ready for yourself to have a list of maybe 1020 companies or even more where you say, OK this these are really interesting. Companies would love to own them, but let's wait for better opportunities in the market. And just when things start to get tough and then you look at your list.

00:16:58 PIeter

Yeah, for example, written down the price at which you want to want to.

00:17:03 PIeter

Hold them back then.

00:17:05 PIeter

Well, this will really help help you.

00:17:08 PIeter

To to stay rational when when the market is losing its mind, I think it was Napoleon who said, well, an excellent investor is the one who can do the average while everyone around him is losing his mind. And I think that's that's exactly true. So having this list ready is is definitely something interesting.

00:17:28 PIeter

And for me personally, I have the watch list of one or fifty companies. There is also a list of subscribers have around 25 companies that are definitely on the radar. I would definitely would like to own that are on the verge of becoming.

00:17:47 PIeter

At least fairly valued and not overvalued in my view, and I have written down the price at which you want to own them. And then obviously you have the portfolio with some stocks you own. So I think that's important. Regarding your second question, I think it was about market cap, you prefer small caps, mid caps, large caps.

00:18:08 PIeter

Well.

00:18:10 PIeter

I worked as a professional investor for a few years and I'm was involved in in daily management of the other small equity fund, 2 million message fund management, and what listeners probably need to understand this in a global perspective.

00:18:29 PIeter

Doing with million might sound like a lot of money, but in a global perspective, it's actually periods exactly, and even we the small business management company, we never even looked at companies for the market cap below 10 billion.

00:18:45 PIeter

And this also means that larger asset management companies on Wall Street, they probably not don't even look at companies for the market cap lower than 50 billion and so on and one less at one set. Well if you want to outperform the market go your competition this week and last share. The meeting also said well when I.

00:19:06 PIeter

We would have 1,000,000 today. I would have no problem to make a return of 50% per year and and we would actually also do that in the in the in the small mid cap space. Why because.

00:19:20 PIeter

There's not much research available for those companies, and competition is very weaker there because all professional investors are not looking there and the market is is not as efficient through when you are able to make your own homework and do it an efficient way within that.

00:19:39 PIeter

Fields will the upside usually is larger.

00:19:43 PIeter

So it's also something.

00:19:45 PIeter

That I try.

00:19:46 PIeter

To do with company quality and when you put that into practice you when you try to find quality stocks in the small and mid cap space for example, you will also notice that you will find.

00:19:59 PIeter

Quality stocks that are active in the niche markets, so the niche markets that were the large big tech companies, for example, aren't looking at but and and that's why they can do it in a very, very profitable way and and they are very doing very well in that. So yeah, for example, a company like Kingsale Capital.

00:20:19 PIeter

In the US insurance space or special risks, well, we are targeting smaller projects, small.

00:20:28 PIeter

But those small insurances are way more profitable than than the larger insurances, because there there's larger projects while the other party as well more negotiation power and so on. So those companies are often, yeah, lovely as our companies are like to look for and hopefully it proves to be right in the future and the performance will be likewise.

00:20:49 Dave

Yeah, I'm sure it will be. It sounds like that's a great place to fish. So we were talking about kind of the criteria of quality investing. You talked about boats and that's one of my favorite subjects. So I'm curious, what do you think about boats and maybe what are a couple that you think are?

00:21:06 Dave

The best that if if you find them in companies, that's like some special sense.

00:21:10

Boss.

00:21:12 PIeter

Yeah, sure. So I think for quality investors, amount is the most important thing and other words you, you don't want to invest in the next big thing, but you want to invest in companies that already have the right mode and companies that run the market. These are 20 years.

00:21:28 PIeter

To go fill out the market either today and when you think that it will still be the case.

00:21:34 PIeter

In 20 years.

00:21:34 PIeter

From now, why one company hasn't made or sustainable competitive advantage while those companies are often able to grow at above attractive rates for very long periods of time.

00:21:50 PIeter

Think about a.

00:21:50 PIeter

S&P Global and movies they the credit rating agencies in the US while they work well the market leader in the 80s where the market leader in the 2000s.

00:22:00 PIeter

The other huge reputational damage during the financial crisis, but even that didn't harm there. They're no basically, so they are still leading the the pack today and this will still probably be the case in 20 years from now. And that's the case when you would do a DCF or discounted cash flow model and it's usually done.

00:22:20 PIeter

Injecting the free cash.

00:22:21 PIeter

Flow over the next 10 years.

00:22:23 PIeter

Well, what you will do for a company?

00:22:26 PIeter

Where we think they.

00:22:26 PIeter

Can be able to or they are able to.

00:22:29 PIeter

Go to the track freight.

00:22:30 PIeter

For 15 years or even 20 years, or even 30 years. But in that case basically one or succeed.

00:22:36 PIeter

Seeing that every company is undervalued and don't get me wrong here in the sense that making this yes with projections for for 20 years, it's a very dangerous thing. So I wouldn't recommend that. But I guess you get the point. And like I said, the most important thing now how are you going to quantify?

00:22:57 PIeter

For me personally, like the company is a gross margin larger than 40% investment capital larger than 15% and build metrics are very robust. So they don't fluctuate too much. But in that case you have a clear indication that the company has a sustainable competitive.

00:23:16 PIeter

And advantage and pricing power. So a high gross margin is also an indication of the company's pricing power. Now when you look for example morning stars, White Mountain next, that's the main next that only consists of companies with sustainable competitive advantage. Well, in that case, you'll notice that.

00:23:36 PIeter

Since 2000 and four 2005, something like that, nothing makes are performed by 3.5% per year.

00:23:44 PIeter

And that's rather funny to me. Why 90 to 95% of all professional investors don't perform market and by just using a very?

00:23:57 PIeter

Straight forward investment strategy and very simple one actually just by companies or only by companies with the white.

00:24:05 PIeter

You, you, you have the phone by 3.5% your marriage and you you would have that better than 99% of all investors. So that's a very funny thing and and and in general maybe it will be used to follow you well you have different kind of moods and I think the key take away here is that.

00:24:24 PIeter

Companies that have a sustainable competitive advantage based on the networks.

00:24:30 PIeter

Those are actually the strongest ones, so everyone has probably while you are listening to the already used the service of data platforms or Facebook or Instagram or WhatsApp and just the new users are on the platform. Well the better for for the business.

00:24:49 PIeter

Savings for MasterCard and MasterCard and Visa.

00:24:52 PIeter

Today it has actually.

00:24:55 PIeter

Become impossible for other companies to take away the market leading position of both companies. Why? What would cost hundreds of billions of dollars? And that's just not possible. You often hear about an infinite company that will take away your marketing position of them, but in.

00:25:15 PIeter

The end they.

00:25:15 PIeter

Always end up working together with Visa and master cards because they need those kind of companies. I think Kinsel capital is another excellent example. They have strong technological advantage compared to other insurance companies.

00:25:31 PIeter

And it reminds me a bit of progressive for people who know it so progressively, car insurance company that does it. But and that it's really low, why does remind me of that while they have a comparative advantage based on IT, in this case, the Ms. insurance market is doing it faster rate.

00:25:52 PIeter

Then the general insurance market and Miku, which is actually also the founder once again will operate the company. Miku thinks that.

00:26:01 PIeter

King sales should.

00:26:02 PIeter

Have no problem to double its market share over the next 10 to 15 years, so then you have multiple secular talents and that's obviously something that's.

00:26:12 PIeter

Really.

00:26:14 PIeter

Interesting because in the long term stock prices will always follow the evolution of.

00:26:18 PIeter

The intrinsic credit.

00:26:19 Dave

Yeah, exactly. I'd love to double down on pricing power. So that was something that I know you guys talked about in the book and I found it really fascinating. It's crucial for companies. Warren Buffett said it's probably one of the most powerful forces for stocks. So how do you identify a company that has pricing power and maybe how can you?

00:26:39 Dave

Analyze that. Whether a that will continue or B whether that's something that's just a fleeting thing.

00:26:45 PIeter

Yeah, sure. So maybe first to start with little process. That is just the lability of a company to raise its process without losing customers. And you're completely right. And it was, Charlie. We also said well where you can find the company.

00:27:00 PIeter

Which has ever kept pricing power. While that's one of the best kind of businesses you can do.

00:27:06 PIeter

And would impact pricing power. He meant that indeed the business is able to keep increasing its prices in the years ahead. And you can see the bit as a free growth source. Why a company doesn't need extra factories or extra employees or extra whatever to increase its prices.

00:27:13

It's.

00:27:26 PIeter

So you just increase your prices by 5%. For example, your revenue goes up by 5%. Hopefully you also have some operating leverage.

00:27:36 PIeter

Meaning that your.

00:27:37 PIeter

Your earnings on your EPS go up.

00:27:41 PIeter

By 678.

00:27:43 PIeter

And when you have such kind of business, well, that's a lovely business to be in I think.

00:27:48 PIeter

Great examples of.

00:27:51 PIeter

As a big label and movies, for example, increase their prices by three, 4% beyond average and you have companies in the in the luxury industry, there is a secular trends towards Premier Organization and another one I'm not sure where you're based in.

00:28:07 Dave

I'm in North Carolina.

00:28:08 PIeter

North Carolina. OK, I was in that. Another example I was about to mention this games workshop and Games Workshop is in the UK and probably it doesn't. During the battle for most people who are listening right now, but they are actually a market leader in many of your games for board games. So once again that's it's a small company and.

00:28:28 PIeter

Some niche.

00:28:29 PIeter

Company. But the clear marketing in there, they have a profit margins which are sky high. Return invested capital is 50% and so on and you can the loyalty of the customers, you can almost compare it with the customers about cigarettes. So they are so narrow, most people most.

00:28:49 PIeter

They're staying with them for doing their entire life, basically, and it's another example of the company that's year after year for 30 years in a row has increased its prices by around 5% per year. So those are the kind of characteristics you're I'm also looking for and.

00:29:10 PIeter

For example, for Games Workshop, when you increase your prices by 5% per year, the company has a dividend yield of 5%. That's already 10% and then?

00:29:19 PIeter

You will still have.

00:29:21 PIeter

A small organic revenue growth and a small organic EPS growth. But then you get to an expected return of 1213% per year and that's already very attractive, I guess. Yeah, that's.

00:29:32 Dave

Very attractive. Maybe you should use it that and please don't confuse that with GameStop.

00:29:37 PIeter

It's not the same. Thanks for.

00:29:38 PIeter

Exactly.

00:29:42 PIeter

GameStop.

00:29:43 Dave

No, no, no, nowhere near. So how do you think about?

00:29:47 Dave

ROI C That's one of my favorite metrics. How do you think about that in relation to motes, pricing, power margins, growth, any of those kinds?

00:29:56 Dave

Of things.

00:29:57 PIeter

Sure, some people ask you, well, if you could only look at one metric, which one would it be? And and the answer there is always you can answer that question because just looking at one metric will be way too naive. But I think when we were when someone put a gun to your head, it should give one metric.

00:30:15 PIeter

It will probably be the return on invested capital, so the return on invested capital is a very important metric and it actually shows you how much the company earns per year with the money that you invest as a shareholder. So when you when you return invested capital is 15%, this means that when you invest.

00:30:35 PIeter

$100 in the company, the company makes $15 per year for for you in net operating profit after.

00:30:43 PIeter

The tax, so obviously the higher this metric and the better for me personally, I will never consider the company when they return invested capital is smaller than 15%. So 15% is attractive there. But what is really important there as well and that's something that's that's.

00:31:04 PIeter

Yeah, a lot of investors forget, actually, is that a high return on invested capital is only only it's value to business when a company has plenty of reinvestment opportunities. So when the company has a return on invested capital of even 30% like master.

00:31:21 PIeter

But, but they don't have any reinvestment opportunities. And actually it's a bad example because most has plenty of reinvestment opportunities which when they don't have that well, the high return invested capital isn't worth anything because they are distributing everything to shareholders. So probably the golden goose.

00:31:42 PIeter

The quality investors is to find a company with a high return on invested capital that can be invest a lot, or ideally even everything and into organic growth.

00:31:54 PIeter

And when you find something like that, well, that's really where, where the magic can happen and how those compounding machines are created. Well, they're actually very few quality companies were able to do this. We were able to reinvest everything, organic code. I think 2 examples that pop into my mind and.

00:32:14 PIeter

Maybe a small?

00:32:15 PIeter

Disclaimer here or.

00:32:17 PIeter

None of the companies I mentioned are investment advice. Just to to make the framework clear and and please do your network. The two companies that are able to still be invest a lot of their free cash flow maybe recruit.

00:32:33 PIeter

It'll probably Copart on the one hand so the US company that can be seen as, yeah, the eBay for damaged cars, basically. So they sell damaged cars to of most insurance companies, umm, online. And the other one is a less less one manual probably it's dinner Posca it's a.

00:32:53 PIeter

Polish grocery store, while with a police car right now, they are struggling a bit because the the the the competition.

00:33:00 PIeter

In Poland or grocery stores is intensifying, but until last year they just used all their free cash flow to reinvest in organic growth. And that's something amazing. And that's really how you get a snowball and everything starts to get faster and faster and faster.

00:33:20 PIeter

Well, for being the best. Got tough times right now. But when you look at the consensus, when you look at what moment is saying.

00:33:26 PIeter

And so on well.

00:33:28 PIeter

It is very, very. It's quite likely that they will still double their stores, which also mean their revenue with double, double and swamp. So those are the companies you are trying to find and and that's probably at the the ideal world, the ideal company.

00:33:45 PIeter

For for quality investment.

00:33:46 Dave

And those are great examples of.

00:33:49 Dave

Companies that.

00:33:49 Dave

Are kind of hitting on all cylinders, but it's also interesting that Dina Polska is struggling, not struggling, but maybe going through some harder times. And it kind of leads me to like what you know, Jeff Bezos said, right, your margin is my opportunity. And so when you see companies with high ROI C that could also attract more competition. So it's.

00:34:09 Dave

Something you need to.

00:34:10 Dave

Be conscious.

00:34:11 PIeter

Absolutely, absolutely. I think that's why it's really important in the, in, in finance and the investment world, you have a phenomenon like more reversion to the mean. So meaning that companies are very cheap. We'll go back to their average generation level. It can be they're very profitable. We'll also go back to the average profitability.

00:34:31 PIeter

But the interesting thing for for quality investing is that this isn't true. When the company's mood is wide enough, so just meaning that other companies other people can.

00:34:44 PIeter

See, but the serving companies free profitable. They are doing really well, but that they are just not able to take away the marketing position of those kind of companies. And when you find that well those are the kind of companies that can be very profitable for multiple years or even decades. And that brings us.

00:35:04 PIeter

Maybe also to another important part for for quality men.

00:35:08 PIeter

And one of the key dangers for quality investing is disruption. So when a company has a note but other companies are easier way the mood, or in that case, that's a very dangerous thing for you as a quality western, right? It's a quality business. So when this happens.

00:35:28 PIeter

The goats will probably come.

00:35:29 PIeter

Done, because there's no competition and the market also see this and the quality stocks. So they trade high valuation multiples between the between the mood goes away. Well. In that case it's it, maybe it isn't justified anymore to pay a PE price earnings ratio of 30 times earnings for company and it drops to 12.

00:35:50 PIeter

And journals and the good goes down.

00:35:53 PIeter

So in that.

00:35:53 PIeter

Case you have a double edged sword in a negative sense, so that's a dangerous one. Just think about what happened with Nokia, for example. There used to be the market leader in phones and and right now.

00:36:06 PIeter

Apple took greater position seen for Quebec 20 years ago. A Quebec moment was was referred to as taking the perfect picture. Well, you should look at the stock price of Kodak and it definitely wasn't perfect. Stock over the past 20 years, but you can also have it the other way around. Think about Amazon.

00:36:25 PIeter

Briefly mentioned Jeff.

00:36:28 PIeter

They evolved from a loss, making online bookstore to the largest e-commerce brand, the world another AWS for a very, very important company in the cloud as well. For Netflix involved, from mailing DVD's to people to the largest streaming business in the world.

00:36:48 PIeter

So.

00:36:48 PIeter

The company should probably also always keep reinventing itself, investing in R&D, and when that's the case, it's probably interesting to invest in companies that have a successful track record and reinventing themselves.

00:37:05 Dave

Yeah, I and I think that's an important point. I think sometimes maybe you can correct me if I'm wrong.

00:37:10 Dave

But sometimes I feel like when people think about quality investing, they lump companies in like, you know, maybe newer businesses that like a crowd strike or an Airbnb where or companies like that.

00:37:21 Dave

That, albeit our great companies are still kind of newer in their journey and so the track record isn't set like a company like a visa or a Moodys for example, so I guess.

00:37:32 Dave

How do you think about?

00:37:33 Dave

That in kind of relation to when you're looking at companies and their potential notes.

00:37:37 PIeter

We have tend to agree with you. Everyone has his own style for me, I will never.

00:37:42 PIeter

That's the loss making companies. So you really want to see a strong track record of high profitability. And so for me personally, while it's code from Buffett once again.

00:37:55 PIeter

While only stay within your circle of competence, how do you define your circle of confidence? While two criteria should be met, first of all very obvious, you should understand how the company makes money. That's the essence. The second point also you should be able to make an educated guess about how the company, but also how the.

00:38:15 PIeter

This street will look like in 10 years from now, and you know that everyone in 10 years from now will still be brushing their teeth, drinking coffee, drinking coke and so on.

00:38:25 PIeter

That's.

00:38:26 PIeter

I have no clue how.

00:38:29 PIeter

Exactly. So for those only listening, I think they are showing me a bottle of coke. I also have a slight addiction. I also drink 1 bottle of coke every day. So it's a bad habit.

00:38:44 PIeter

So everyone will probably be drinking coke in 10 years from now, but for me, for example, the market for AI, it's.

00:38:54 PIeter

It's really hard to make an educated guess about that, and it's it's no secret that the the market for AI will grow a tremendous rate over the next few few decades. But when you're not an expert with in that field, well, I think it's it's important to be extra cautious there. And what you will also see with a lot of.

00:39:14 PIeter

Companies which are still not making is that the current projections are very high. The sky is the limiter, but a lot of these companies have a lot of problems to deliver on on their estimates, basically. And that's also for example, definitely in the small cap space when you.

00:39:34 PIeter

Do some research and you take for example you have the SP500, then the very long term and small cap stocks normally outperform the SP 500. But when you would take it one step further and you would take an index that tracks small caps.

00:39:53 PIeter

And you would only select the ones with the positive free cash flow within that index. Well then your outperforms even further increases, so it shows you that's that investing in companies that are profitable already. Well probably the right way to go and investing in the next big thing is probably very exciting.

00:40:13 PIeter

For most people, but to me it doesn't sound like like the best investment strategy just because the data and history has.

00:40:21 PIeter

Proven that a.

00:40:23 PIeter

Lot of those companies don't tend to deliver on what they promised.

00:40:27 Dave

And trying to.

00:40:29 Dave

Unless you buy all of them trying to pinpoint the one that's going to be the winner.

00:40:33 Dave

It can be a challenge.

00:40:34 Dave

Absolutely. All right, so I want to hear your thoughts on valuation. So we've, we've talked a lot about this, the framework and but one of the big frameworks of quality investing is valuation. So you mentioned MasterCard is.

00:40:46 Dave

Being overvalued earlier maybe.

00:40:49 Dave

Can you walk us through why you think that's overvalued and how you kind of?

00:40:52 Dave

Look at at kind of assessing that.

00:40:55 PIeter

Sure. So the entire philosophy from my side admit is that it's way better to be roughly right than approximately 1, right? So when I still.

00:41:06 PIeter

Work in the industry.

00:41:08 PIeter

Everyone was making those crazy complicated Excel files of of 1500 lines predicting 20 metrics at the same time, and so on. And the more assumptions you make, the more likely it is that you make a mistake in one of those assumptions. And when you are just, for example, the expected.

00:41:29 PIeter

While the other foot is very.

00:41:31 PIeter

Since. So that's why for me personally, I would like to use three very straight forwards, straightforward methods I believe, and try to be roughly right now to put them into practice. Well, first thing I do is is compare the forward be with the historical average B.

00:41:51 PIeter

That's a very simple one, right? And it's also a bit naive in the sense that.

00:41:57 PIeter

It can be the case that the company trades at the way level forward be than it used to be. Over the past 10 years, for example, but that the that the company is facing some serious problems or that the outlook doesn't like as good as it used to be. So in that case, well, it's justified that the four P/E is low. But that's exactly why you are going to look at the two.

00:42:18 PIeter

Next levels and those are I quite like them to be honest, and that's the name is great. Middle I'm.

00:42:24 PIeter

Very, very busy here.

00:42:26 PIeter

And I'll try to explain them briefly and it's a bit difficult for people who are just listen.

00:42:32 PIeter

But for the English growth medal, well.

00:42:38 PIeter

And Terry, it's really easy to calculate return. You will get as an investor and your your turn is always equal to the EPS gold.

00:42:51 PIeter

For the units per share growth plug with dividend yields plus or minus the changes.

00:42:56 PIeter

In the valuation.

00:42:57 PIeter

And now repeat it once more. So your turn is almost equal to the EPL goods.

00:43:03 PIeter

Plus the dividend.

00:43:05 PIeter

Plus or minus the changes in the valuation. So for example, let's say that let's take mastercards and I estimate that MasterCard can grow its earnings per share by 13% per year.

00:43:22 PIeter

Well, mastercards.

00:43:26 PIeter

There's a very small refinement of around .5%, and right now the poor P is roughly equal to 30 times earnings, and I expect that, well, I think that the PE of 25 times earnings is justified for mastercards. Then the EPS growth 13%.

00:43:46 PIeter

Possibility it's .5% minus the change in the valuation from 30 to 25.

00:43:54 PIeter

And and not some calculations that you expect the evaluation to normalize over five or or 10 years, they get 30% + + .5% and around and negative effects from the change in valuation of around 1% per year. So you're getting expected return of 12.5.

00:44:12 PIeter

Percent per year.

00:44:13 PIeter

And then the question for you as an investor.

00:44:15 PIeter

So.

00:44:16 PIeter

Well.

00:44:17 PIeter

Would you be happy when you return the 12.5% per year? And if that's the case, you can consider investing in MasterCard. If not, we'll look for another investment opportunity. Also, you notice that it's the outputs obviously depends on your assumptions of the growth rate as well as the the full of people you think is.

00:44:37 PIeter

Reasonable. That's not. You can use starch one as reverb. UCF. Well many people will know a classical VCF, but yeah, it was CC. Miller said will invert always invert turning the problem upside down when you want to find a solution to a complex problem. So that's also what you do with your.

00:44:57 PIeter

DCF, you're not going to make calculations or sumptuous yourself, but instead you are going to look at what expectations are implied in the current stock price. So you are basically just creating a classical BCF where the upside.

00:45:15 PIeter

Is 0%.

00:45:16

That's.

00:45:16 PIeter

When you will do another template that you can use on my website where you can execute your word this every two minutes. But when you would do something like that for MasterCard for example.

00:45:29 PIeter

You will get that MasterCard should be able to grow its free cash flow by around 14% per year.

00:45:39 PIeter

To return 10% per year to you as a shareholder. So I always use a required return of 10% and for MasterCard in this case they should be able to grow by 14% per year and then the the question to you as an investor as well. Do I think that MasterCard can grow?

00:45:59 PIeter

Cash flow by 14% per year, well in the past they have the answer. I think when you look at the consensus right now for for the future.

00:46:08 PIeter

It's more or less 14%, so then it's up to you to determine what you want to would like to own. MasterCard, I already mentioned that I think they are a bit too too expensive. So what I would like to see ideally is a a bit lower implied growth rate in the in the reverse DCF when the implied.

00:46:29 PIeter

Wait, wait for mascot, for example, the truck.

00:46:31 PIeter

Between 10 or.

00:46:32 PIeter

11% I would be quite comfortable owning the business because I'm.

00:46:38 PIeter

I think that that MasterCard can grow by more than 1011% per year just because there is also secular trends older men to towards more digital payments. So cash is actually the the worst or the the biggest driver for for MasterCard right now and not visa like many people think for example.

00:46:59 PIeter

So that's how I actually basically think about acceleration. Always look at two things. Just very naively compared the forward period historical average earnings growth model to calculate your expected return per year and then last but not least the reverse DCF to look at which.

00:47:17 PIeter

Estimates are implied in the current stock price, and that's you just trying to find the Windows model models and try to find companies where you think that the assumptions in the stock price in the current stock price are are reasonable.

00:47:30 Dave

With that framework, and I love the fact that you kind of check yourself to make sure your assumptions.

00:47:36 Dave

Aren't getting.

00:47:37 Dave

Crazy. We aren't expecting MasterCard to grow free cash flow at 75% for the next 10 years.

00:47:44 PIeter

Yeah, exactly. That's for example, the case with Copart Copart amazing business. But when you're in the reverse this year, there you get an expect.

00:47:52 PIeter

Or you you.

00:47:53 PIeter

The output says that core part should build free cash flow by 22%.

00:47:57 PIeter

Yeah. So maybe it's even 27%. So there the the great estimates, the expectations implied in the stock price are so high that for me personally, I wouldn't be comfortable to own the business, take a video for example, well.

00:48:15 PIeter

Or justify the current stock price of NVIDIA. NVIDIA needs to in 10 years from now needs to earn as much free cash flow as Microsoft, Apple, Amazon, MasterCard, Visa as the global and movies combined to justify the current stock price.

00:48:36 PIeter

So what basically are you?

00:48:39 PIeter

I'll think about federation using those kind of rule of thumb formulas and try to be approximately right instead of exactly 1 so it doesn't make sense to try and calculate the intrinsic value of a share to two decimal spaces because nobody is able to do.

00:48:56 PIeter

That in practice.

00:48:57 Dave

No, and it also doesn't in the long run, it doesn't matter. You know, if you if you buy the company for $40 versus $40.20, it's not that that's not to make a break of the investment, right.

00:49:02 PIeter

Exactly.

00:49:11 PIeter

Absolutely, it's exactly, exactly true.

00:49:14 Dave

So what to you is a quintessential Pieter investment, so it doesn't have to be something you own. Now. It could be something you owned in the past. I understand you have things behind the paywall and I don't want you to be forced to give those up. But if you had to, you know, say what would be the?

00:49:31 Dave

Perfect investment for you, like what would be the perfect company?

00:49:34 Dave

For you to.

00:49:35 PIeter

Buy well, both the companies that need to buy it would be one that ticks all the boxes in the sense that it's a quality stock and for quality stock I use 6 criteria, so that need to have a.

00:49:49 PIeter

It's low capital intensity and need to be skin in the game. The historical growth should be good. The outlook should look good and should have a healthy balance sheet.

00:50:01 PIeter

It should still be led by its farmer and preferably the farmer owns 2030 or 40 or even 50% of the business, and then one in .1 we already.

00:50:13 PIeter

Briefly touched upon.

00:50:15 PIeter

Should have quality characteristics.

00:50:18 PIeter

And it should still have plenty of reinvestment opportunities to reinvest a lot of free cash flow in itself to grow and and do that at a high return on invested capital. And obviously you want to buy the fair valuation level. I think last year we won the tick, all the boxes definitely ticked all the boxes for me was Kelly.

00:50:38 PIeter

Group.

00:50:39 PIeter

It's a serial acquiring.

00:50:40 PIeter

The country software and I've never met someone who.

00:50:44 PIeter

So it's so dedicated and so obsessed in the positive sense of the word to this company as Brad Kelly. So he found the company no six, he still owns a bit below 50% of the business and and the company doubled in size every two years since its IPO. So they're going by.

00:51:04 PIeter

Having about 130% yeah, the the pity there is that since it was back in October, just like doubled. So, so maybe not the the the the best timing right now but given what's happening in the stock market right now and I'm not sure.

00:51:20 PIeter

When? What's cost?

00:51:21 PIeter

Be will be published, but right now there is some uncertainty. There are some companies, some quality companies, that are down heavily. Think about all their majors down 25 to 30% from from its levels few months ago. And those kind of things definitely offer opportunities.

00:51:42 PIeter

If you if you ask me, you have.

00:51:45 PIeter

Companies so tenable stocks are coming. They are having buying, make their own shares that today trade 1010 times earnings and they are just buying like 8-9 to even 10% of the outstanding shares and every single year while the net cash position of 10% while they are.

00:52:04 PIeter

Still growing organically with with five 6% per year. So I think they're definitely still attractive opportunities, but that is true.

00:52:15 PIeter

I have a hard time finding plenty of opportunities in the logical space, and when you find them, it's more in the in the mid cap space so. So that's also an interesting thing I'm seeing right now and.

00:52:30 PIeter

We always seem to remember those stocks are like hamburgers. The longer they go, the better, especially when they're not buying stocks over the next few 10 years. So hopefully the the stock market goes down a bit more and you can keep adding to to some of the great businesses.

00:52:45 PIeter

At the at cheaper prices.

00:52:47 Dave

I thought I might never heard the stock market referred to compared to a hamburger. That's awesome. I was going to say is Berkshire Hathaway, would that be considered a quality company?

00:52:58 PIeter

Make sure actually it's a difficult one as it's income levels. So I think the, the, the main problem Berkshire has right now is just that they've become so large. So the last large numbers and anyone who says that the size doesn't hurt performance. The sign, I think that's exactly true so.

00:53:19 PIeter

Obviously is definitely equality.

00:53:21 PIeter

Manager, usually admiring him, but I'm afraid that the returns of Berkshire will be more or less in line with the S&P 500.

00:53:29 PIeter

Just because they have.

00:53:30 PIeter

Become so so so.

00:53:32 PIeter

Large and well and that it is probably a better investor than than 99% of all other investors. Well, what is one of the key exceptions?

00:53:41 PIeter

That we have.

00:53:42 PIeter

So hopefully you have is one.

00:53:45 PIeter

Hopefully or investment holds on a slow roll so that we can still invest longer than than one benefit can. Second point is we don't have, uh, billions and billions of dollars to to invest or at least I don't know about you, Dave, but I don't. So so we are able to to still invest in, in.

00:54:05 PIeter

Somewhat small companies are different. Basically, can't investing company with a market cap #1 billion. So that's something that's definitely, definitely interesting. But you ask some people.

00:54:18 PIeter

While using the basic philosophy we we don't manage the the billions and billions of dollars that make sure and manages, so that's also very interesting to to take.

00:54:29 PIeter

A look at.

00:54:30 Dave

That those are all great points. One of my last questions, what kinds of tools do you use to research businesses?

00:54:39 Dave

And I'm also curious, I have a lot of international listeners and so I'm always curious what kind of brokerage you use.

00:54:45 Dave

To buy companies.

00:54:47 PIeter

Sure. So when I still worked in the industry before I start working on on company quality, I always use Bloomberg, which is maybe one of the OR maybe the only thing I miss from from leaving the Bloomberg costs around 25,000 years, so bit expensive and right now.

00:55:07 PIeter

I'm very.

00:55:08 PIeter

Happy and that I did. I found out about friendships, so I'm really happy and I'm using that for all my my research. So within same chat you can find all the fundamental data the the estimates from analysts and so on. So readers of component quality will notice that I use plenty of data, charts and so on and.

00:55:28 PIeter

It's also a funny thing because I left the industry. I tend took a subscription myself on the infinitive or icon, which is basically something very similar to Bloomberg, but I actually cancelled that one just to to use friend chat, so I think.

00:55:45 PIeter

In chat, I only say it's it's the blue book for retails, it's way cheaper. It has all the data, so I'm really happy there. And regarding the broker, well to me personally I'm using Interactive Brokers. The main reason for that is that.

00:56:02 PIeter

I'm not going to.

00:56:05 PIeter

It might be likely that in three years from now, five years from now, friends accompany quality friend or something like that will be launched and 1:00 we will use Interactive Brokers for all data are there and it counts already a bit as your official track record, so we can show a proven track record of investing by so many years.

00:56:26 PIeter

And the performance has been like this and this is out of combustion SMP 500. So that's basically.

00:56:31 PIeter

The directional wire choice for for Interactive Brokers there.

00:56:35 Dave

Oh, that's awesome. I I wasn't aware of that that particular feature. So that's that's awesome. Alright. So I guess my last question for you is we've had a fantastic conversation. I've really enjoyed talking and I know our listeners are going to learn a lot from everything you've been laying down today. So where if people want to learn more about what Pieter's got going on, where could they find?

00:56:56 PIeter

Thank you. Yeah, I'm also happy to always happy to discuss with with other investors so. So feel free to yeah, to e-mail me and send me the on, on Twitter and stuff like that or even when you just reply to an e-mail which you get via company called the website, it will I will I will get it and I will answer you. So yeah.

00:57:16 PIeter

Just waste, probably via website compoundingquality.net and otherwise via via Twitter and panel quality as well, or via LinkedIn, which is it's a difficult last name for for Americans. Exactly it's Pieter Slayers, but they can also.

00:57:32 PIeter

And me and like I said, I'm really happy to connect and if I can help in any way, please let me know and I'll always try to answer on every.

00:57:43 PIeter

Question or e-mail I get. So it was amazing and it's fun to compound together with other people would like to invest.

00:57:52 Dave

Yeah, exactly. And Pieter is a fantastic resource by far. He's easily one of my favorite followers on on LinkedIn and on X or two.

00:58:01 Dave

And is is newsletter is fantastic as well. So the all written resources and of course new book the art of quality investing. Those of you on the podcast can't.

00:58:11 Dave

See it, but you will in.

00:58:11 Dave

The video so with. With that, Pieter, thank you very much for taking time out of your day to come talk to me and our listeners. I know I greatly appreciate it. And with that, I'll go ahead and sign us off. You guys go out there and invest with the margin of safety.

00:58:23 Dave

Thanks. This on the safety, have a great week and we'll talk to you all next week.

We hope you enjoyed this content. Seven steps to understanding the stock market shows you precisely how to break down the numbers in an engaging and readable way with real-life examples. Get access today@stockmarketpdf.com until next time have a prosperous day. The information contained just for general information and educational purposes. Only it is not intended as a substitute for legal, commercial, and or financial advice from a licensed professional review, our full disclaimer@einvestingforbeginners.com.