What Makes a Company Good? It Depends.

Artisan International Explorer Strategy

PORTFOLIO MANAGER
Viewpoints

March 2024

Our four key investment criteria for the portfolio—good business, good management, good balance sheet and good price—never change. But how we interpret "good" varies by circumstance. There are rules, heuristics and patterns we use to determine what constitutes "good," but for almost every rule or pattern we apply, there are exceptions we make.

So that is to say—it depends.

Portfolio Managers (L-R):

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18 Years Investment Experience

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19 Years Investment Experience

High return vs. low return?

A business with a high return on capital is of course more desirable than one with a low return. We generally look for high-return businesses, but occasionally we have purchased those with historically mediocre returns on capital, particularly if low returns were due to poor prior management. Many of these companies have transitioned to new management teams who employ strategies we believe can materially increase their returns over time.

High market share vs. low market share?

High market share indicates the strength of a business franchise, and we love identifying leaders in their respective niches at a good price. On the other hand, we own Glenveagh, an Irish homebuilder. While it is one of the biggest homebuilders in the country, the business only has mid-single digit market share. Nonetheless, Glenveagh continues to gain ground in a structurally supply-constrained market, not to mention it's gaining share in a capital efficient manner without hoarding excessive land bank. We like businesses such as Glenveagh, which has low market share in a fragmented market, but due to a better mousetrap versus peers is poised to gain share over many years.

High switching cost vs. low switching cost?

High switching cost shows the stickiness of a business and is a desirable trait. Yet, what we feel is one of the best businesses ever created and one many of us use daily has virtually zero switching cost—Google! You could easily switch to a different search engine like Microsoft Bing or Yahoo, but few of us do. For similar reasons, we own Despegar.com, the largest online travel agency in Latin America—think of it as the Expedia of Latin America. The business has a low switching cost, and 70% of its consumer traffic is organic or unpaid. Despegar users could easily switch to competitor websites or mobile apps but choose not to do so. Consumer loyalty is not due to a lock-in effect but is instead a consequence of Despegar's high brand awareness and superior user experience.

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Asset heavy vs. asset light?

All else equal, you would be better off owning an asset-light business, because it consumes less capital and thus delivers a higher return on capital. As a result, the world has become enamored with software businesses. We have asset-light businesses in our portfolio including commercial insurance broker Steadfast. The Australian-based business' core asset is not physical but lies in entrenched relationships it has built over the years as a broker between a fragmented SME customer base and dozens of insurers.

But not all asset-heavy businesses with high capital expenditure requirements are bad businesses. A few are phenomenal. While not a current holding, TSMC in Taiwan, the largest semiconductor foundry in the world, is arguably the best example despite being one of the most capex intensive businesses. Major railroads in the US are another example that exhibit good pricing power in the current inflationary environment given insurmountable barriers to entry.

Founder run vs. professional CEO run?

Our ideal type is a CEO with an owner-operator mindset who can hold people accountable and make tough decisions for the long term, sometimes at the expense of short-term profit. There are pros and cons for each: founders tend to be more long-term oriented and inclined to focus on longevity through generations, whereas professional CEOs tend to be more short-term focused especially when they lack skin (i.e., an equity stake) in the game.

Conversely, founders could lack openness to change and foster an insular culture, while professional CEOs could use their fresh perspective to institute long overdue initiatives. One could argue both ways.

In short, a good business for us does not always mean high return, high market share, high switching cost, asset light or professional management. So we say it depends, since each business is *sui generis*. There are certainly generalizations and patterns we can apply to one business from another, but we hardly make a blanket call and declare "here are the required attributes for a business." **We believe it is the nuanced decision-making process we undertake in each circumstance that is the source of our alpha.**

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