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Stock picking through COVID – beyond the stay at home basket

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RLAM's Global Equity investment process focuses on identifying companies with superior long-term shareholder wealth creating businesses. We have a proprietary framework to help us do this. One aspect of our analysis is the quality of management – especially its strategy, capital allocation and incentivisation. We have found that attaching our clients capital to superior wealth creating businesses with a valuation discipline can be a powerful way of driving long-term absolute and relative performance, as demonstrated by our successful track record. Great shareholder wealth creating companies at good or better prices.

In our view one of the reasons for this outperformance potential is that our clients are invested in what we believe to be higher than average quality management teams that are doing the right things day in day out for shareholders. This can be particularly helpful at a time of massive disruption like the COVID crisis.

We certainly have seen the quality management teams come to the fore in our portfolio holdings but nevertheless we've been surprised how significant and powerful this has been during COVID. Three examples particularly stand out for us – a trucking logistics firm, a metals processing company and an internet giant… To paraphrase a common saying: When the going gets tough, the quality management get going.

Old Dominion Freight is a $22bn market cap trucking business in the USA. It has a national network of depots and trucks and moves pallet size consignments around for clients. It is in our Compounding corporate Life Cycle category and it can win by strategically compounding success and by allocating capital to high value add growth opportunities. The company has one of the best management teams we have ever come across and thanks to the service quality of the business (99% on-time deliveries) and their expertise in managing their logistical network (including pricing decisions) ODFL generated a record operating margin during Q2 and the COVID crisis. This is a staggering achievement given lock-downs and speaks to the quality management has built up in the business. The market has somewhat reflected this performance and the shares are up significantly this year (see chart 1).

Chart 1: Old Dominion Freight Line share price

Source: Bloomberg

Past performance is not a reliable indicator of future results.

Reliance Steel is not a steel manufacturer (despite the name) but a US processor of steel and other metals. If you want a specific iron girder for your house extension with three specific holes drilled in it – Reliance Steel is someone who you could go to (assuming you lived in America). It is in our Mature corporate Life Cycle category and it can win by focusing on strategically improving its business quality and by prioritising capital allocation towards efficiency and effectiveness rather than growth. Again, we consider the management team high quality for a variety of reasons but we were impressed with the speed and effectiveness with which they reacted in Q2 and during the COVID crisis. They permanently closed a small number of franchises in very challenged end markets like shale gas/oil and furloughed a huge portion of staff rapidly and effectively. As demand has recovered the company has been equally effective at bringing staff back in line with demand. They also focused on cash generation with inventory and working capital management such that Reliance was able to generate 7% of its entire market cap in free cash flow to equity holders in the quarter. So incredible cost control, cash generation and operational effectiveness securing the business through the crisis and leading to a 240% beat in EPS during Q2.

Amazon, the well-known internet giant with online retail and the cloud computing business in AWS is another example of a quality management team alongside an effective culture when it comes to strategy and capital allocation. As an Accelerator in our corporate Life Cycle framework it can win by continuing to disrupt and innovate and allocating capital successfully to growth projects and its network. Given the nature of the services provided by Amazon and positive demand growth for online retail and cloud computing under lock-down, management did the right thing which was to accelerate growth. Amazon added nearly quarter of a million temporary and permanent workers and invested $7.5bn in capital expenditure in Q2 alone to meet demand and accelerate its growth. Amazon was also effective in focusing on genuinely socially useful activities to support COVID responses (and PR around this) with a view to highlighting its value to society. Clearly it's a complex scorecard when it comes to ESG risks/opportunities but one can't blame Amazon for highlighting how it genuinely believes it adds value to society during a crisis.

Chart 2: Amazon share price

Source: Bloomberg

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So three companies, and while one is part of the 'stay at home' basket it's interesting to us that beyond the secular theme management quality (operational, strategic and capital allocation) was also a massive determinant of how stocks reacted and therefore stock picking progressed during COVID. We've always integrated subjective forward-looking management assessments into our investment process and used the unique benefits of our corporate Life Cycle framework to do that with investment insight. We've done it because we think it important to future share price potential, and Q2 during COVID was a proof point as to the value of that that arguably exceeded even our high expectations.

Contact us

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