16 Favorite Annual Letters from an Investor Who's Read More Than 1,000

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Image credit: Johannes Vermeer, "Girl Reading a Letter By an Open Window," ca. 1657, Gemäldegalerie, Dresden, Wikimedia Commons / Google Art Project

By Jason Zweig | Apr. 1, 2016 1:45 pm ET

Portfolio manager Geoffrey Abbott, who is reading 3,000 annual letters to shareholders to find the best, says 16 have stood out for him so far. With the caveat that he owns only one (Credit Acceptance Corp.) and won't invest in any without much more thorough research, here is his annotated subjective summary of his personal favorites from the first half of the alphabet:

Activision Blizzard – "The 2014 annual letter clearly outlines the company's strategy. Explains how creating and nurturing video game franchises drives a high level of customer engagement, leading to strong and sustainable financial results over the long term. Management seems owner-oriented, having purchased a stake in the company in 1991 and run it since. There isn't much in the letter about capital allocation, but the discussion of the business inspires me to learn more."

Actuant – "Discusses how its leading market positions and incentive-compensation program have contributed to long-term performance. Focus on free cash flow (rather than EBITDA or some other flawed metric) is positive. Perhaps a good sign that free cash flow has exceeded net income for 15 years, though this could indicate they're highly acquisitive and intangible amortization accounts for the persistent gap between the two metrics. Though capital-allocation philosophy isn't groundbreaking, it is surprisingly rare for a company even to state a philosophy. More often, you see something like "we reward shareholders with dividends and share buybacks" or "our dividend payout ratio target is 45%" without any explanation why the chosen strategy is optimal."

Alleghany – "The long-term thinking is immediately obvious (a three-to-five-year horizon is "relatively short"), and Alleghany's performance during the financial crisis lends credence to its ability to manage risk. Broadly speaking, discussion of risk is as thoughtful as I've seen. Also, an excellent job explaining its businesses and bridging the gap between reported earnings and economic results. About as comprehensive a letter as I've seen."

[For more on Mr Abbott and his reading list, see It's Time for Investors to Re-Learn the Lost Art of Reading.]

Amerco – "The 2015 letter is only one page, but the company's long-term owner orientation seems obvious. Its 'Shareholder Value Proposition' is rational, and I like that it's unchanged from 2004. It's much easier to know how people will behave in the future when they've been consistent and disciplined in the past."

Atlantic Power – "The Outsiders [the book profiling eight unconventional CEOs, by William N. Thorndike] is one of my all-time favorite investing books, so I was immediately intrigued by this reference. Discussion of corporate overhead is excellent and supports the CEO's claim that he cares more about growing per-share intrinsic value than enlarging his managerial fiefdom. A CEO who moves corporate HQ from Boston's financial district to a much smaller space in suburbia is my kind of guy!"

AutoZone – "Inventory discussion is interesting and helps explain that strength of the business model. Easy to see how the hub-and-spoke system is an advantage. Often I'm struck by how different time horizons prescribe different corporate strategies. AZO's increased per-store inventory is a good example. A manager focused solely on maximizing near-term cash flow would never raise inventory levels, but a manager experimenting with different ways to maximize long-term performance might."

W.R. Berkley – "Most letters lead with one-, three- or five-year financial results. WRB presents results from 1974 to the present. The track record is excellent, and the long-term orientation is obvious. In the 2014 letter, I particularly like the discussion of how excessive reliance on quantitative models can cause costly underwriting errors. Management's business approach seems highly rational."

Capital One Financial – "Nothing particularly groundbreaking in this letter, but I did come away with a good understanding of the business and management's strategy. It's conceivable that COF's growth will allow it to fund higher marketing spend, which in turn could drive growth. Business discussion motivated me to learn more about COF's credit selection and capital allocation."

Cimpress – "Overall, this is probably the best letter I've read so far. The first paragraph of the 2015 letter grabbed me immediately. CMPR's goal is to maximize per-share intrinsic value over a 20 year horizon. Though the entire letter is great, I particularly liked the 'Steady State Cash Flow' explanation. It significantly enhances the reader's understanding of the business, and I appreciate management's humility in admitting the subjectivity and imprecision of this metric."

Credit Acceptance – "Long-term performance is excellent, and its capital allocation philosophy is highly rational. The discussion of competitive and economic cycles is particularly good. It provides the reader both with a clear understanding of the industry and a sense for the time horizon over which the company manages its business. Also, the adjusted results add to the reader's understanding of the financials."

Culp – "The letter is good, but I'm more impressed by the 'Capital Allocation Strategy' slide deck on their IR website. It's the first of its kind that I've seen, and their philosophy seems very rational. I particularly like that incentive compensation includes a cost of capital charge. This is exceedingly rare in corporate America, and as a result, many companies earn worse returns than they otherwise might."

eBay – "This is the EBAY business after the PayPal spinoff. I like the 'Gross Merchandise Value' metric. This is the fuel for the company's revenue, and the depth of eBay's marketplace makes it increasingly attractive to both buyers and sellers. The same is true of StubHub, which I've long suspected is a great business. This letter explains the business well, but it would be nice to have a section on capital allocation."

Everest Re Group – "Many companies seem to focus on efficiency only when operating results are bad. The CEO's letter highlights RE's efficient operations as a source of durable advantage. The long-term financial results seem to support this claim. Also, I like that he highlights 2014's low cat losses in the first sentence rather than taking full credit for excellent results that were partly due to good luck. The capital allocation section is good too."

ExamWorks Group – "I tend to be very skeptical of roll-ups and, more broadly, of any highly acquisitive companies, but I found the chairman's business philosophy quite interesting. He seems more focused on understanding and improving business fundamentals than on indiscriminately cutting expenses and centralizing authority. I particularly like that he thinks about how to foster owner orientation at every level of the company."

Fossil Group – "This is an example of a good letter in an industry that I (probably) won't touch. I like the discussion of how its design, sourcing and distribution network gives FOSL an advantage in partnering with brands seeking to enter the watch business. I was shocked to learn that this CEO has refused all compensation for years. He owns 12% of the company, having helped found it. It's very positive (and exceedingly rare) to see a manager refuse money. The proxy statement says that the CEO believes 'his primary compensation is met by continuing to drive stock price growth, thereby aligning his interests with stockholders' interests.'"

Hingham Institution for Savings – "This letter is only one page, but the chairman highlights his long-term orientation and his dedication to owners and customers. The financial track record seems excellent, which the company highlights by printing a 20-year performance chart. Not too many banks increased book value and generated a double-digit return on equity in 2008!"

Source: WSJ.com, MoneyBeat blog

http://blogs.wsj.com/moneybeat/2016/04/01/16-favorite-annual-letters-from-an-investor-whos-read-more-than-1000/

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IT'S TIME FOR INVESTORS TO RE-LEARN THE LOST ART OF READING

Posted by jasonzweig on Apr 4, 2016 in Articles & Advice, Blog, Columns,
Image Credit: Christophe Vorlet
By Jason Zweig | Apr. 1, 2016 1:02 pm ET

Fund manager Geoffrey Abbott is extremely committed. Or maybe he needs to *be* committed.

Every day for the past seven weeks, Mr. Abbott has read an average of 39 letters that CEOs write to shareholders in their companies' annual reports. His goal is to peruse the annual report from each of the 3,000 largest companies in the U.S. This past week, Mr. Abbott, who runs a small New York investment partnership called GCA Capital, plowed through the I's and moved into the J's. That puts him him on track to finish with Zumiez, Zynerba Pharmaceuticals and Zynga by the end of May, when Mr. Abbott will turn 30.

Thus, in a financial world driven largely by mathematical formulas and computers trading thousands of times a second, a young investor is searching for investments in the most old-fashioned way possible: by reading.

Warren Buffett doesn't think Mr. Abbott is crazy. The chairman of Berkshire Hathaway himself spent much of the early 1950s reading every single entry in the thousands of pages of Moody's manuals, the corporate encyclopedia of that era. He still spends most of his time reading — including the letters to shareholders in companies' annual reports.

"Over the years, there have been multiple times" when reading the annual letter "has been a factor in my deciding to do something or not to do something," Mr. Buffett told me this past week when I mentioned Mr. Abbott's project. Reading a letter was never "the deciding or dominant factor," he said, "but it was definitely often a factor."

Not many investors seem willing to do that sort of digging anymore. Timothy Loughran, a finance professor at the University of Notre Dame who studies corporate disclosure, has analyzed computer records for the Securities and Exchange Commission's **filings website**. He says only 29 people a day download the average annual report when it comes out. Even General Electric's annual report was downloaded from GE's website **only 800 times in 2013**, according to the company.

Mr. Abbott hopes to discover promising companies he might not have noticed by other means. He wants to see whether the managers are focused on the long term, care about investors, and can clearly explain how the business makes money and how they measure its progress toward their goals.

Mr. Abbott has read roughly 1,500 letters so far. Only 16 jumped out as outstanding. "I've been flabbergasted at how low the average quality is," he said.

Common red flags include bragging about earnings that went up mainly because of accounting changes and blaming disappointments on outside factors like weather.

His 16 favorites so far: Activision Blizzard, Actuant, Alleghany Corp., Amerco, Atlantic Power, AutoZone, W.R. Berkley, Capital One Financial, Cimpress, Credit Acceptance Corp., Culp, eBay, Everest Re Group, ExamWorks Group, Fossil Group and Hingham Institution for Savings. (He leaves Mr. Buffett out of his analysis, because "everyone" knows he writes a great letter.)

[**RELATED:** *Read what made Mr. Abbott nominate each company in "**16 Favorite Annual Letters from an Investor Who's Read More Than 1,000**."*]
"Writing an extensive letter helps me clarify our strategy and put signposts on the map of where we're trying to go in the long run," said Weston Hicks, chief executive of Alleghany Corp. "If you attract short-term shareholders, you can be forced to do things that aren't in the company's best long-term interest."
Mr. Abbott owns only one of those 16 stocks — Credit Acceptance, which he bought years ago, before he began his reading project — and might not invest in any of the others after he studies them more thoroughly. He sets a high bar and holds just six stocks in his fund. But the best letter writers will go on his list of companies to learn more about.

"It's my duty to provide the shareholders with an informative, accurate and transparent report," says Robert Wilmers, chief executive of **M&T Bank**, whose **blunt and thorough annual letter** isn't (yet) on Mr. Abbott's list — but is on Mr. Buffett's. "That's what they need to make sound investment decisions."

It makes some sense to start your search for companies this way, Mr. Buffett said. "Where I'm the junior or silent partner" as a minority investor, he said, "I feel better if I'm in partnership with someone who's on the same wavelength I am and has a sense of stewardship. You can pick up some sense of that from reading the letter."

"I write it for people like my sisters," Mr. Buffett said of **his own annual letter**. "They're smart, they read a lot, they have a lot invested in the company.

They don't know all the financial jargon, but they don't want to be treated like five year olds. I try to let them know on paper what I'd tell them about the business if we sat down for the afternoon."

More than 1,600 years ago, St. Augustine was converted to Christianity when a voice came to him chanting, "**Take up and read.**" In a short-term world, that's righteous advice for long-term investors, too.

Source: *The Wall Street Journal*
http://blogs.wsj.com/moneybeat/2016/04/01/its-time-for-investors-to-re-learn-the-lost-art-of-reading/