FUNDS ON FRIDAY
by Glacier Research

glacier
by Sanlam

15 July 2022
Volume 1144

The importance of variant perception and investment edge

Author: André Steyn CA(SA), CFA, Chief Executive Officer and Chief Investment Officer at Steyn Capital Management

In order to generate alpha in financial markets, you must have a view that differs from the consensus, and of course, you have to be correct (it's even more fun if you're correct quickly, too). Generally, following what is being reported in the news will get you, at best, the market's return, and, much more likely, a lower-than-market return. In investing, this differential view is referred to as having a variant perception.

Find your edge – and articulate it simply

Of course, it's easy to have a view that is different from the market, especially if you are a stubborn killjoy, but you have to build that view on high-quality research work that allows you to generate an "edge" over the consensus view. This "edge" allows you to see things differently and means that you can see the reality versus the perception of reality that others see. It follows that you are not going to be able to build a true edge in every investment, and the investment practitioner needs to be highly selective where he or she spends time. The interesting thing about investing is that you can spend your entire career looking at just one stock, given the plethora of new incoming information. This is why your return on time is incredibly important – you have to decide very early on where you might have the ability to create an investment edge within a reasonable amount of time. Simplicity is also key; we find that if you can't articulate your edge in an investment in one simple sentence, then you probably don't have one.

How your edge can emerge

An investment edge can arise either from obtaining information that isn't generally known or understood in the market (legally, of course), or from a superior analysis of information that is already extant in the market. A good edge from superior analysis of existing information often requires a deep specialisation in certain key areas, for example applying rigorous forensic accounting analyses of reported earnings statements or analysing managements' responses to conference call questions through the prism of behavioural psychology analysis in order to detect evasive responses. There is ample evidence of accounting sleuths detecting financial fraud in a variety of companies globally over the last several decades, with recent examples including Wirecard, Tongaat, and EOH. It certainly does seem to be a persistent source of investment edge. Similarly, since a team of former CIA interrogation analysts started applying behavioural psychology in management interactions two decades ago, there has been a variety of successes in this field as well.

Look beyond the obvious – with collective wisdom

Financial markets have a large number of smart participants, so we would argue that a stronger investment edge comes from unearthing new information. This involves using a team of analysts that are well-versed in looking beyond the obvious information sources and can build a value-added research network of industry contacts, identify second derivative sources of information, and are adept at using big data sets extracted from web scraping. Chances are that, if you have an analyst with a strong network in Ghana, you are going to be more likely to get a handle on how MTN's business in Ghana is performing. Reading the stories of the investment legends like Warren Buffett and Jim Simons from Renaissance Technologies, it is interesting to note that the identification of new pieces of information has changed significantly over the past several decades. Simons wrote about how they obtained previously unknown information by just sending people down to the Federal Reserve to do photocopying. It's a little more competitive nowadays, but I'm sure that in a decade or two, investment analysts will marvel that we got new information simply through scraping a few dozen websites for statistics.

Trust your (calculated) instincts

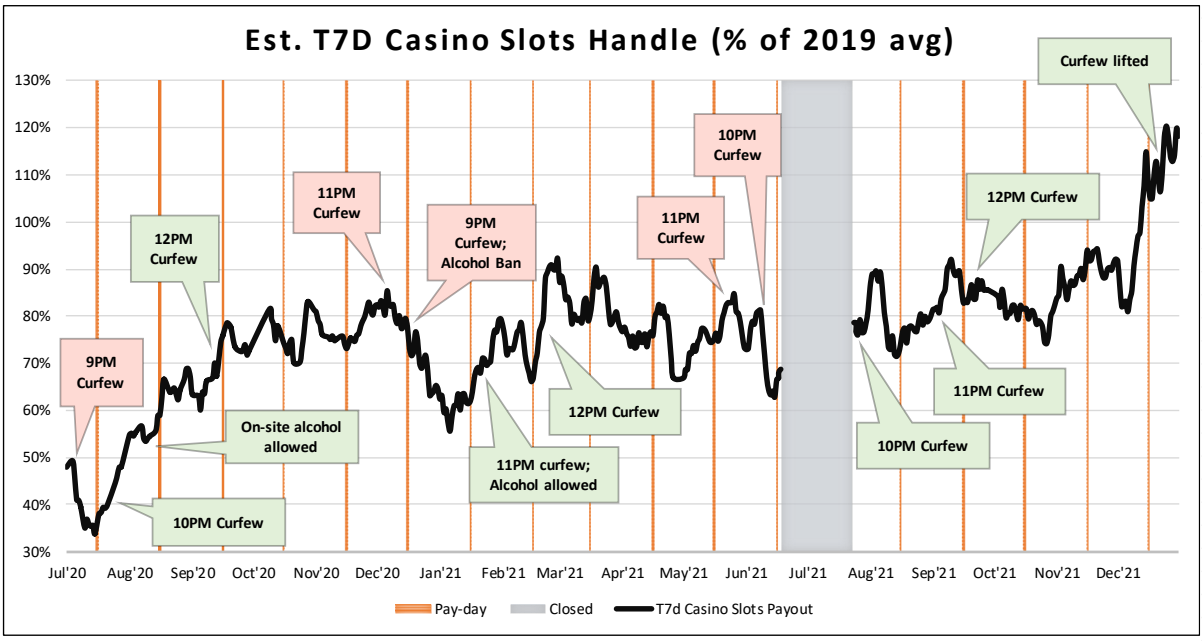
A good recent example of variant perception and edge in action is our investment into the casino operators, Tsogo Sun Gaming and Sun International. When these businesses were shut down in the hard COVID lockdown, the consensus was that these companies were at a high risk of a debt default. Our variant perception was that these businesses were unlikely to face foreclosure, and that they would bounce back very quickly once restrictions were lifted. The key asset within these casino businesses are the casino licenses themselves, and any bankruptcy process would have placed these licenses in jeopardy. The banks had no choice but to ease the covenants and wait for the government to reopen the business. Our case study analysis of the shut-down and reopening of other casinos serving local markets, as opposed to travel destination casinos like Las Vegas, demonstrated that these businesses rapidly recovered to revenue levels which were close to pre-COVID levels. We also knew from our interactions with company management that the cost base had been materially reduced, allowing strong profitability and cashflow at revenue levels that exceeded half of pre-covid levels.

Our true edge, however, came from our superior data and analysis that gave us a credible view of daily revenue progression, which was crucial given the myriad changes in restrictions and opening hours. The casino businesses report their revenue and earnings on a bi-annual basis, but a variety of gaming boards publicly report revenue statistics on a more frequent basis. Furthermore, there are a variety of casino websites that report a daily win rate, in an effort to entice punters. Our innovation was combing all of this data with a back test to produce an algorithm which estimated daily casino revenue based on the publicly available information scraped off

websites. This information is presented in a graph below, which is framed as the percentage daily revenue as a proportion of 2019 average revenue. The data is fascinating as it shows the rapid recovery of the business post re-opening in July 2020, despite the incredibly onerous restrictions and the prevailing environment of fear at the time. It also demonstrates the impact on revenue of a variety of COVID-related restriction changes and ends with the current revenue being at or near pre-covid levels after the relaxation of the curfew.

Recovery in casino revenues

Despite restrictions, revenue levels recover as customers adapt



Source: Steyn Capital Management, based on publicly available data from company reports, regulatory disclosures, and slot pay out numbers

The strength of the conviction that we had in this work allowed us to not only continue buying the shares of Tsogo Sun and Sun International on market, but also prompted us to co-underwrite the Sun International rights offering in August 2020, to the tune of R200 million, earning our investors an underwriting fee in the process, and allowing us to double our stake at an incredibly attractive price.

There are several other concepts that are important in investing, though in our opinion there are none more paramount for a truly active investor than establishing a real edge in each and every one of your investments. It is important to consider the words of American author William Feather: “One of the funny things about the stock market is that every time one person buys, another sells, and both think they are astute.”

Glacier Research would like to thank André Steyn for his contribution to this week's *Funds on Friday*

André Steyn CA(SA), CFA
CEO & CIO,
Steyn Capital Management

André started his investment management career in 2002 as a dedicated short selling analyst at Ziff Brothers Investments, a multi-billion dollar hedge fund, where he employed forensic accounting analysis to identify short sale candidates in markets outside of the US. He then joined Temujin Fund Management UK, as CEO & Partner, where he was responsible for non-US Investments. André founded Steyn Capital Management in 2009, where he has been CIO and portfolio manager since inception. Andre is a qualified CA(SA) and CFA, having completed his B. Accounting (Hons) degree at Stellenbosch University in 1997 and Audit Trainee articles at Andersen in 2000.