Investor interview:

Ulf Hedlundh

Introduction

For almost 30 years, Ulf Hedlundh has been in charge at Stockholm-based investment company Svolder AB. While few people outside the investment community may have heard of him, he has generated outstanding returns averaging around 15 % CAGR over the period by investing mainly in Swedish small- and mid-caps. Doing so with great integrity and an unusual ability (and willingness) to communicate with shareholders means he is a great role model for what a true steward of capital should look like.

Ulf kindly sat down with IBTB (via video) to discuss a range of topics including permanent capital, succession planning and the use of leverage. It seems to me that there are a few key aspects to Svolder's success including creating the 'right' structure, a talented and passionate team lead by Ulf, a healthy dose of conservatism (e.g. when it comes to the balance sheet and return expectations) and strict adherence to their 'circle of competence'; we touch on these below. We would like to thank Mr Hedlundh for taking so generously of his time. While he seems perfectly happy to fly under the radar, we hope this interview can trigger interest among IBTB readers in his and Svolder's thinking and methods.

Creating the 'right' structure

Svolder operates as a listed investment company which effectively means permanent capital and certain tax benefits in exchange for requirements on public ownership, minimum dividend distributions etc. The idea of 'permanent capital' was key in creating the Svolder structure back in the early 90s and has been significant in enabling management to generate the very attractive returns we have seen over the last 30-odd years.

We began our conversation by discussing how he sees Svolder compared to other investment companies.

Ulf recognises that while Svolder, like most of the listed investment companies on the Stockholm exchange, has a long-time major shareholder (in their case in the form of the Lundström family since 2004), management has significant freedom to operate and is absolutely in charge of investment decisions. One of the reasons for this is that the family does not impose its will when it comes to stock picking. Also, says Ulf: 'Some other companies tend to become somewhat more of vehicles for exercising influence' (historically, examples of this have been e.g. the Wallenberg family's Investor).

I asked Ulf whether he feels that being a listed entity comes with certain restrictions that wouldn't apply had the company been private.

'No. I don't think so. I actually believe that the public environment is very supportive'. Compared to what is sometimes a very transaction-driven private environment, he feels that the public environment often supports the long-term development of a business (although family controlled private businesses also often tend to have the 'right' structure). In a world where the public vs private debate is often very black or white, Ulf is as always thoughtful and expresses a much more nuanced view. I think there's a lot to be learned from his attitude which mirrors that of many other successful investors when it comes to first principles thinking.

I also asked Ulf why he thinks there are so few other vehicles with 'permanent capital' in Sweden unlike e.g. the investment trusts prevalent in the UK. His view is that this is partly a cultural matter i.e. open-end structures have, mainly pushed by the large banks, become the norm. For Swedish investors the alternative to open-end has often been ETFs. The increased popularity of investment companies however could mean that we see the emergence of investment trusts and SPACs in Sweden; in the case of the former it is something Ulf would welcome given their permanence of capital etc.

'Serial acquirers' as an alternative to investment companies

Our conversation touched on so-called 'serial acquirers' as an alternative to investment companies and the attractiveness of public vs private assets.

Ulf's view is that unlisted assets always gain in popularity in ageing bull markets. While there are some truly skilled operators in this arena, Mr Hedlundh's view is that the success of these companies has largely been driven by 1) accounting treatments and 2) low interest rates; given that combination, almost all transactions will look immediately accretive to EPS. 'You almost can't make an acquisition without increasing your EPS' says Ulf. He is also not convinced of the logic of the 'arbitrage' between private market valuations and the ratings enjoyed by these serial acquirers in the public markets. One issue in this context for instance is around the valuations these assets would achieve in a sale; Ulf questions whether they are as high as usually reflected in the NAVs of the 'topcos'. One reason that the party may nevertheless continue is that there is an army of advisers in the form of investment bankers, consultants and lawyers that encourage deal-making and who depend on churn for their living.

The real question is what happens to all the acquired businesses once consolidated; in some cases e.g. Indutrade, there is no integration, while in other cases e.g. Addtech, there is more of an effort to integrate acquired businesses. More broadly, Ulf feels there is a slight inconsistency in the way the market appraises these businesses compared to e.g. some of the traditional conglomerates where the mantra for a number of years has been to divest and focus.

Leverage

Like most of the other investment companies listed in Stockholm, Svolder does not employ any leverage (although it did so to some extent for a few years until 2011) and usually operates with a 5-10 % net cash position.

'In 8 out of 10 years, leverage is not an issue. However, it can be a real issue in 1 or 2 years when the market environment is really difficult'. Once again, higher leverage has worked well in an environment of declining interest rates but it remains to be seen for how long that is the case.

Mr Hedlundh also says that the leverage, when it comes to investment companies, typically belongs in the portfolio companies as opposed to in the holding structure. Any leverage at 'topco' needs to consider the relationship between dividends received from portfolio companies and service on debt; as long as portfolio companies have the ability to pay dividends, Svolder can sit through market downturns. This is especially important given the focus on small- and mid-caps; 'We have an asset base which is not terribly easy to sell in difficult market environments'. In other words, the combination of sustainable dividend streams from portfolio companies and lack of leverage at holding level creates meaningful staying power for the group.

It is clear from speaking to Ulf that there is relentless focus on asset/liability dynamics at Svolder; he does not want to ever end up being a forced seller. While this is a theme we may recognise from many great investors, there are also endless examples of where lack of attention to this dynamic has been the undoing of previously great investors. A recent example of this is of course Woodford Investment Management in the UK.

Long-term total returns

Svolder has compounded investors' capital at around 15 % CAGR since inception in 1993, a return far ahead of benchmarks and a truly phenomenal level of wealth creation over almost 30 years. I asked Ulf about the return drivers e.g. earnings growth, multiple expansion and dividend yield.

While there is no formal breakdown of returns in this way, Ulf says that ‘in recent years, most of value creation has come in the form of multiple expansion in a few growth companies’ (especially in the cases of Troax and GARO where Svolder was an anchor investor). This is in line with a general rerating of growth companies and especially those with an ESG angle to them.

Over a longer timeframe, the real value creation in Svolder has come through its investments in industrial businesses (as opposed to real estate, financials or other various types of service businesses). It is also instructive that the great track record has been built without being an early investor in various technology businesses etc. To me, this sounds like a great example of discipline in sticking to ones ‘circle of competence’.

However, Mr Hedlundh also recognises the importance of pragmatism; ‘We also live in a constantly changing world and it is an art form in some sense to always strive to change and develop. I think that’s key in money management, to always be aware of market dynamics’. Indeed, looking at Svolder’s portfolio over the years there is clear evidence of ‘evolution’ in terms of what types of businesses it includes while at the same time being a reflection of a very consistent philosophy and methodology.

Succession

Just like in the real estate sector, investment companies often tend to become almost synonymous with their founders and management. Given Ulf’s long and successful involvement with Svolder, I asked him about how well he thinks performance can be replicated once he has moved on.

Mr Hedlundh says that for one thing, the team at Svolder is very experienced and his closest associates have also been at the firm for a very long time. He also says that, while still keen to carry on for a while longer because he enjoys it so much, at some point it is right to pass the baton. Characteristically, Ulf’s view is that as long as the portfolio is full of great businesses it shouldn’t matter too much who is in charge of running Svolder.