

## Interview – Part 1

### Geoff Gannon

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Below is a Q&A we recently held with Geoff Gannon. It brings us great pleasure to bring the below to our readers. Enjoy.

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*Investingbythebooks: Could you please introduce yourself for our readers?*

**Geoff Gannon:** Sure. I co-host the Focused Compounding podcast with Andrew Kuhn. And I write-up stock ideas at [FocusedCompounding.com](http://FocusedCompounding.com). The first 2,000 words of each of those stock write-ups goes out in a free version each week via email. You can sign up for those free emails at [FocusedCompoundingGazette.com](http://FocusedCompoundingGazette.com). I also manage accounts for investors at Focused Compounding Capital Management. Basically, I'm a guy who talks about value investing, writes about value investing, and manages money using a value investing approach.

*IBB: What's the story behind how you found your investment style?*

**GG:** I got started investing around age 14. I would talk stocks with my dad each week. And he happened to read a magazine article about Benjamin Graham and thought Graham's approach – especially his “Mr. Market” metaphor sounded like the way I invested. I read the magazine article. And Graham sounded interesting. So, I went out and bought Security Analysis and The Intelligent Investor. I read them both that weekend. After that, I was hooked on value investing.

*IBB: How has it evolved over time? Is there a right style, or will it always change, i.e., a key trait is to be able to change over time?*

**GG:** There was probably a period where my style shifted from just being about owning a few simple businesses I knew well mostly on qualitative grounds – sort of the “Warren Buffett” approach – to more of a scattershot “Ben Graham” approach of buying a wider range of stocks that were statistically cheap.

There's more than one right style. High quality works. And low-price works. If the price is low enough, you can afford to get a little less quality. And if the business's quality is high enough, you can afford to pay a higher P/E.

No. There's no need to have a style that evolves. Buffett's style evolved. But Walter Schloss's style never did. Schloss had much better results with an investment style that never changed than most investors had with their changing styles. If you find a style that suits you, just stay focused every day on applying that style. Tune out the market. There will be periods where you underperform the market for a few years in a row. But, who cares? If you're managing money for yourself – that's your big advantage. An individual investor can afford to underperform for a few years. Only long-term performance matters to you. I have clients that may fire me after a year where I underperform. You don't. I don't think an evolving style is something you should be proud of. Buffett had to evolve, because he got to a point where he was managing too much money. You don't have that problem. There's no need for your style to evolve.

*IBB: I really like that you stress, the need to do the work, and at the minimum read more 10-Ks than books! Still clearly you have read a lot of books & I just love your article which is about the books you recommend! So in order to get better at reading 10-Ks, are there any books about that? What companies have produced the overall most readable 10-Ks, and can you give an example or two, of your own research that can inspire other?*

**GG:** I can't recommend any books that are specifically about reading 10-Ks. But, I can recommend investing books that focus on case studies. So, anything where a fund manager takes you through his day-to-day. Two examples are: "You Can Be a Stock Market Genius" by Joel Greenblatt and "Common Stocks and Common Sense" by Edgar Wachenheim.

I'm not going to recommend any most readable 10-Ks, because I think that's a trap value investors fall into. They learn about a company because that company does a good job explaining itself in the 10-K. The real money in investing is made in cases where you are right about something other people aren't right about. Other investors are less likely to be right in cases where the company is complicated, the 10-K isn't very communicative, the accounting is unusual, no analysts cover the stock, etc. So, it's best not to look for the 10-Ks that read the easiest. Anyone can understand those. Instead learn to really dig into situations where the company isn't going out of its way to clearly communicate with investors. Learn to do the work yourself. You want to become an investigative journalist, basically. So, don't look for the 10-Ks that are easy to read. Just find an industry you want to learn about and then read the 10-K of every company in that industry back-to-back over a few days, weeks, etc. By the time you've read about every publicly traded supermarket or coal miner or TV station owner or whatever – you can go back to the first 10-K you read in that industry and re-read it. You'll find you understand it better now that you've homeschooled yourself in that industry.

Yeah. I'll give one example of my own research. I heard a company called NACCO – the name stands for "North American Coal Company" was spinning-off a small appliance maker (so things like toasters, microwaves, coffee makers, and blenders) business called Hamilton Beach Brands (HBB). A bunch of special situations value investors were interested in the spin-off company: HBB. I was interested in the remaining company: NC. I got interested in the remaining (coal) business after reading the 10-K. The way the company's accounting worked kind of disguised how big a business it was. Under U.S. GAAP

(Generally Accepted Accounting Principles) a company can't consolidate a subsidiary that the parent company would be unable to sufficiently capitalize itself. NACCO had a 100% equity ownership in its coal mines – but, in all but one case, it didn't provide any of the capital for those mines (the power plants buying the coal from NACCO put up all the capital). As a result, the company's worst mine was fully consolidated in the financial statement. But, all the best mines weren't consolidated. Their earnings appeared at the bottom line. But, the revenue of those subsidiaries didn't appear at the top line. I read about the length of the contracts, their terms, etc. in the 10-K. I became convinced it was a predictable business with an adequate return on equity. Regular coal miners (ones that don't have long-term contracts at fixed real prices) aren't predictable and don't earn good ROEs over a full cycle. So, NACCO's 10-K told me that what would be left after the spin-off was the best coal mining business I knew of. I suspected the stock price would be low post spin-off (since most investors liked HBB better). And it was. NACCO was an idea I think you could only get from a 10-K. Most people would just hear the company is a coal miner and stop right there. But, the 10-K was clear that this wasn't a company exposed to the market price of coal in any way. Not a lot of people understood that. Maybe they didn't read the 10-K. There were some questions on the company's first earnings call as a standalone company where the questioner (an investor in the company) didn't understand the fact NACCO wasn't selling any coal at the market price of coal (it was selling everything under long-term contracts). So, a lot of people who don't read the 10-K assume that every business model in an industry (like coal) is the same. Every investor who doesn't read the 10-K – which is most investors – is going to assume a coal miner's profits are tied to coal prices. You have to read every 10-K to find situations where that's not true. NACCO was one of those situations.

*IBB: When do you admit that you have been wrong? Didn't meet your numbers, initial thesis didn't play out, or found something better?*

**GG:** I wrote an article one asking “Have My Sell Decisions Really Added Any Value?”. I looked back at 3 stocks I had owned as a teenager. I owned those stocks 17 years before writing that article. And I sold them at different points over the following 17 years. The conclusion I came to is: No, my sell decisions don't add value – in cases where I was right about the business. You sell a stock when you realize you've misjudged the business. Selling is usually best when you do it quickly. So, you buy a stock and hold it for 3 weeks or 3 months or 3 quarters or something short and decide you were wrong. Selling after 3 years? I'm less convinced that's a good idea. Once an investor really gets to know a stock and own it and is comfortable with the business – it's often a mistake to sell a business like that. It's not always a big mistake. But, the reasoning is usually that the investor thinks the stock has gone up a bit too much, it's a little expensive, etc. If you have a much better idea – sell the worse idea to buy the better idea, absolutely. But, most investors sell a stock because of some combination of A) The stock went up since they bought it and B) They're bored. Those aren't great reasons for selling a stock. So, be quick to admit mistakes about your misjudgment of a business. But, be forgiving about a business you like a lot that has gotten a bit more expensive while you've owned it. And always try to do less than other investors. Most of the buying and selling I've done over the years has accomplished nothing. All the good results can be traced to a few situations where I was really right in a big way about a business and didn't let myself sell the stock too soon.

*IBB: Spend time on new ideas or existing portfolio?*

**GG:** New ideas. I try to spend as close to 100% of my time on new ideas as possible. All of your future profits come from your new ideas. Very few investors are good at selling old ideas at the right time. So, always spend time on new ideas. Don't waste time watching the portfolio you have today. If you chose the right business in the first place you'll almost never need to read the latest quarterly results. The right business shouldn't change rapidly. If you feel like you need to read the latest quarterly press release to feel confident continuing to hold a stock you bought – sell the stock now. You shouldn't have bought it in the first place. Any business you need to check in with more than once a year is a business you shouldn't own.

*IBB: How to combat key biases, for ex confirmation bias.*

**GG:** I'm not as big on behavioral finance stuff as other value investors. In most cases, even if you could be confident the bias existed – I don't think knowing a bias exists does much to reduce the bias. I don't know if it reduces bias: but I know I look at stock prices a lot less than other value investors. I'm the portfolio manager for Focused Compounding Capital Management – but, I leave the actual trading to my partner (Andrew Kuhn) to avoid focusing too much on short-term price movements. We have a once a week meeting on Fridays after the market has closed where I give him all the trading instructions for the week ahead. I don't check in on the price of the stocks we want to buy or sell during the week. I'll recommend that approach to all investors. Your investment results won't be any worse if you check stock prices once a week instead of once a day. And your mind will be more focused on what matters: reading a new 10-K, deciding if it's a business you want to own, and then deciding what price you'd be willing to pay for it. Any activities that take your attention off those tasks are a waste of your time.

*IBB: What do you know today that you wished you would have known at an earlier stage in your career?*

**GG:** I wish I had known more about how driven people – like insiders, portfolio managers, etc. – are by non-financial incentives. In predicting behavior – I have probably underestimated people's concerns for being liked by others and overestimated their desire to maximize their own wealth. I invested in a couple situations where this misjudgment was costly, because it meant that insiders were willing to do things that would cost them – and their shareholders – a lot of lost time and money. Basically, most people don't want to do hard things that might make some people like them less. Even in cases where know they need to do those hard things – they delay. So, it's easy for an outside investor to overestimate how quickly a company will make the changes it knows it needs to make. Knowledge often translates into action slower than an outsider might expect.

***Bo Börtemark***

***InvestingByTheBooks***, June 2019

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