Sunday, April 15th – Computer Services, Inc. (CSVI) by Jayden Preston

Sunday, April 15th – AutoNation (AN) by Dave Rottman

"Fear, Greed, and Boredom"

April 15th, 2018

To Focused Compounding members:

In a recent interview, I said: *"Stocks bounce around due to fear, greed, and boredom. You can make a lot of money being greedy when others are fearful. But, you can make at least as much money being bored when others refuse to be bored. There are a lot of boring stocks in the OTC market. They're not cheap because people are afraid of them. They're cheap because the people who own them are tired of them always being cheap…In listed stocks, you get bargains when people are scared. In OTC stocks, you get bargains when people are bored."* There are, of course, even some listed stocks that investors get bored with. Andrew and I just did a podcast about one such stock: Tandy Leather Factory (TLF). Tandy is a microcap. But, it's not so illiquid as to be "uninvestable" for most individuals. An individual who decides not to invest in Tandy can't really make the argument that illiquidity is the culprit. So, what is? For most people, I think it's boredom. Some stocks just bore people even when they're good businesses selling at a good price. Tandy is one example. It dominates leathercrafting retail in the U.S. It has a professional investment manager as its Chairman (Jeff Gramm's Bandera Partners owns 31% of the stock) and it has a deal with a bank to borrow quite a bit of money to buy back quite a bit of its stock should the board decide to do so. So, Tandy checks the Warren Buffett boxes of wide moat and rational capital allocation. And yet it trades at maybe 1.2 times book value, maybe 1.5 times net current assets, and maybe 5 to 6 times EBITDA. Those levels aren't quite cheap enough to attract deep value investors. But, the company's competitive position is far stronger than any stock a deep value investor would get the chance to buy. Breeze-Eastern (this is the helicopter rescue hoist maker Andrew and I did a "post-mortem" episode about) falls into this same "boring" hidden champion group. No one I mentioned the idea to ever thought it was a bad stock to buy. But, I also never heard anyone say it was their favorite idea. It was a solid idea they weren't in any great hurry to go out and buy. It was boring. Boring stocks do remarkably well. The best screens I can create for small, illiquid, consistently profitable stocks always have the same pattern in their back tests: as the screen's alpha rises, its beta falls. You'll find that a good, solid screen – like a low price relative to net current assets and a long history of profitability (in other words, something that picks stocks like Tandy) – will tend to have both less volatility and higher returns than a screen that focuses on even cheaper, even more exciting (that is, more controversial) stocks. This week's boring stock write-up is definitely Computer Services, Inc. (CSVI). Computer Services, Inc. is more commonly known as "CSI". It's a core processor for small U.S. banks. Basically, it's a pint-sized peer of Jack Henry & Associates (JKHY). The stock is "dark". It doesn't file with the SEC. But, it's more predictable than 99% of the companies out there that do file with the SEC. The company has raised its dividend every year for the last 45 years. Sales, profits, etc. have risen in 20 of the last 22 years including during the financial crisis. The company's tax rate will drop from about 40% to about 25% this year. That'll give it an unleveraged P/E of 15. Here's the problem: CSI isn't cheap enough to interest value investors, it's not growing fast enough to interest growth investors, and it's not well-known enough to interest dividend investors. It has just one thing going for it. It's boring enough to interest me.

Geoffrey Gannon