Taking a look under the hood of active management

Model Portfolios are specialised investment vehicles designed to deliver a wide range of financial goals, at pre-agreed risk tolerances". Sounds good doesn't it? I often like to remind clients that a good model portfolio can consist in excess of 350 underlying companies.

In this respect it can, on occasion, seem a little curt to validate a portfolio of businesses against a single benchmark over a six or twelve-month period. Make no mistake, having a short-term comparator is very important, but over the long term, it's active management in fantastic business opportunities which is going to be the driver of strong returns.

In this note, I want to move away from top line gains, alpha, beta or political risk and instead give investors a feel for what active management really looks like by taking a look at one of the many brilliant companies which our clients are invested into within TAM's funds.

If someone asked you if your Eldar Wraithknight was powerful enough to take on a Daemon Lord of Chaos, what would you say? Or perhaps, asked if your band of Chaos space marines had gained favour

with the dark gods yet? Confused? I certainly was. However, if you are one of a growing consumer market buying into the strategy game "Warhammer" then these questions are so elementary one would be considered a novice for even asking them.

Personally, I thought they sounded far too similar to exotic derivatives like butterfly spreads, Iron Condor's and short straddles. I suppose that makes me a nerd of a different kind.

To the laymen, "Warhammer" is a strategy game akin to the old game of "Risk". It's played on a large topographical battlefield with trees, hills, and buildings. The game pitches players' self-customised armies against one another. Think "Lord of the Rings" meets "Alien" and you will be in the ballpark.

Players must purchase, collect and hand paint their own army which can stretch well past 100 individual pieces. Gamers can select figures from a colossal array of figurines and militarised units all with different back stories, skills and powers. After a gamer has spent well past £1,000 to construct a hand painted army, they are pitched against each other at organised tournaments where, outside of COVID, thousands of gamers would attend.

The business behind the game, whilst not magical, is just as enticing to those who want to invest in a solid business. Games Workshop is the company behind Warhammer and remains the global leader in "tabletop miniature gaming", its niche but the fastest growing part of the wider $12 billion "non-digital games" market. It came as a surprise to find the "tabletop miniature gaming" market didn't exist before Games Workshop stepped into it and that Games Workshop still remains the only listed company in a market growing over 8% a year and worth well in excess of £8 billion. Talk about a monopoly.

The business is a veritable masterclass in vertical integration. Games Workshop controls every aspect of its entire route to market, from concept, character and game design, high quality figurine manufacture, distribution hubs and end consumer sale at one of their 400 physical stores globally. Online retail is rapidly growing with the business now seeing over 76% of its £250 million 2020 revenue coming from overseas. The kicker is Games Workshop own the IP behind the game as well as the physical stock enabling the company to charge royalty income on top of sales.

Games Workshop has beaten its earnings forecasts in six of the last eight years, doubled its profits in the last two years and delivers a healthy 3 year compound growth rate of 70%. With net cash growing to £52 million the business has a very healthy cash buffer and very low levels of debt. As such, the business yields an enviable 4% and delivers a return on equity in excess of 25%. In the UK market, the stock was the fifth highest returning stock in 2019, the eighth highest in 2018 and the second highest in 2017.

In the world of fund management, businesses with high cash, low debt and 20%+ return on equity and a stable dividend are considered the gold standard of investing.

So why isn't Games Workshop owned in all funds? It's still a relatively small UK company with a market cap of just £1 billion. To put it into context, EasyJet have a market cap in excess of £4.5 billion and BP a market cap of £60 billion. So, Games Workshop is still a small stock in the grand scheme of things and its size means it simply slips beneath the radar of many funds looking at bigger fish.

So why are we talking about Space Marines and Daemon Lords? Games Workshop has been one of the core holdings in a fund which we have invested in for our clients over the last five years. Over the last 5 years the Games Workshop stock has rallied over 200% and those invested have enjoyed the gains coming from this fascinating little business.

If TAM simply invested solely into passive ETFs for our clients, the relative exposure to opportunities like Games Workshop would be nothing more than fractional percentages and in extreme situations could be accompanied by investments into volatile and/or fraudulent businesses.

TAM's clients are invested in active funds who not only have decades of investing experience to jump on opportunities like Games Workshop but also have the expertise to walk away from the stocks which look like time bombs, a luxury which passive investors cannot lay claim to.

To TAM, buying into the best opportunities on the market will always form a core principle of how we deploy our client's capital and I hope the Games Workshop story has peaked your interest to take note of what other businesses your capital is invested into.

Kind regards,

James Penny
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