Sunday's Idea Brunch

Dashboard

Idea Brunch with Joe Frankenfield of Saga Partners

Joe Frankenfield shares his approach to tech valuation, research process, and his favorite idea

Edwin Dorsey 33 min ago 1

Welcome to Sunday's Idea Brunch, a weekly interview with underfollowed investors and emerging managers. We are very excited to interview Joe Frankenfield!

Joe is currently the lead portfolio manager of Saga Partners, a long-only investment fund he launched at the beginning of 2017. Since inception, the Saga Portfolio has provided a 34% annualized return net of all fees, compared to 16% for the S&P 500.

Joe, on The Acquirers Podcast you mentioned that you always knew you wanted to launch a fund and "wanted to manage other people's money the way I managed my own." What did you mean by that and how has your experience launching a fund been so far?

First of all, thank you so much for having me! I am honored to be a part of Sunday's Idea Brunch.

So, there are many different ways to go about trying to solve the problem of how to invest one's savings. Each person has to invest in a way that makes sense for their personal goals and suitability. I have always approached that problem from a first-principles basis since I started as an individual investor. While I studied finance and business in school, I consider my investing philosophy largely self-taught rather than learned through working within the investment management industry.

My personal investing goal was simply to try to compound my savings at an attractive rate over the long term. I think one of the things that most of the investment management industry does is mix short-term and long-term money which then obscures two different buckets of capital that may have very different goals. In my opinion, short-term money should be optimized for liquidity or lack of volatility, while long-term money, money that one doesn't need for many years, should be optimized for return based on opportunity costs. Most of the investment products available are tailored to trying to limit total portfolio short-term price volatility which naturally limits both downside as well as upside potential returns.

This attempt of limiting volatility also applies to equity funds in their attempt to prevent short-term underperformance to their benchmark. It essentially reflects the significant principal-agent problem that exists in many relationships throughout the world but is very real in portfolio management. If one starts to really worry about the risk of underperforming a benchmark any given quarter or year, it distorts the whole investing process. Rather than thinking what a company will be worth in five or ten years, which is how a real investor would think, portfolio managers begin to focus on what shares will do next quarter which then devolves into a game of mass psychology of trying to guess what other people will guess share prices will move in the near future. That is a very crowded game that is hard to have any edge or execute successfully with any degree of consistent accuracy. This is one of the reasons 90-95% of mutual funds underperform the market over the long-term after fees.

So, when I looked out in the investment management industry, I didn't really like what I saw or portfolios that aligned with the way I would manage my own money or how I thought money should be managed. There was an interesting survey that asked professional investment managers what they would do differently if they didn't manage money for others. The top three answers were 1. concentrate more on their best ideas, 2. trade less, and 3. care less about volatility and relative performance to some benchmark. While managing money for others does have a different feeling than simply managing your own money privately, I think with the right approach, right alignment, and right investors, that it is possible to effectively manage other people's money in this way.

While I continued to manage my personal portfolio over the years, I was gaining a greater level of confidence that I could outperform the market over the long term as long as I was able to invest in the way I thought made the most sense. In 2016, I left my job in sell-side equity research to start my own portfolio full-time. I started very small and essentially boot-strapped the Saga Portfolio from scratch. So far, I couldn't be happier with how things have turned out. I have fantastic, very aligned investors in the Saga Portfolio, and I get to do what I love every single day.

You seem to focus a lot on high-growth tech (Carvana, Trade Desk, GoodRx, Roku, Redfin, Facebook, etc...). In a market that is increasingly short-term oriented, how do you think about valuing companies over a long-term horizon?

I don't preemptively decide to invest in any specific category of company/investment. I simply look for the best opportunities that I can understand and that look attractively priced. When one categorizes something as "high growth tech" it may have the connotation of being higher risk. It is true that historically "tech" has been considered risky because it was very susceptible to change, and change is hard to predict. While change (i.e., disruption) is great for society, it is terrible for the owner of the company that gets disrupted. Rather than categorize a company based on its designated industry, I like to think about it based on its business model, value proposition, and durability of its value proposition.

Over the years, I have grown increasingly comfortable with two different types of business models which the companies in the Saga Portfolio consist of today; 1. platforms or marketplaces and 2. scale economies shared businesses. Much has already been written about these business models and I've discussed them to some extent in our investor letters but in my opinion, companies that exhibit these types of business models have greater durability or lower risk of disruption which is exactly what I am looking for. The companies you mentioned, among the other ones in the Saga Portfolio, often have some aspects of one of these two business models.

Platforms/marketplaces have qualitative characteristics that behave more like cities while more common traditional linear businesses behave like living organisms. Cities scale super-linearly meaning they have increasing returns to scale. They get stronger the larger they get. Living organisms scale sub-linearly. Eventually, size weighs them down meaning they have a ceiling to growth and a finite lifespan. Platform businesses, 1. reduce frictional costs by connecting users and producers, often benefiting from some type of network effect, 2. typically do not own supply, therefore, have low marginal costs of supply and distribution. This network effect, combined with the ability to effectively scale due to nominal costs of supply/distribution, often leads to a winner take most effect in the spaces they compete. Controlling distribution by aggregating both supply and demand is as close to a natural monopoly a business can get. Like cities, platforms/marketplaces are very difficult to destroy because of these qualitative characteristics.

I believe "scale economies shared" is a term originally coined by Nick Sleep who managed Nomad Investor Partnership, although the business model has been around for a long time. Standard Oil and Ford are great examples from the early 1900s. Essentially as a company grows it can benefit from economies of scale meaning as sales grow it reduces costs per unit. As a company benefits from lower costs of production it can pass on those cost savings to its customers by reducing the price per unit, therefore, offering an increasingly better value proposition when compared to smaller less advantaged competitors.

In regard to valuing companies, the exercise of valuation is tricky because we are always dealing with a very complex, foggy future. The one law of investing that will always be true is that the intrinsic value of any asset is the net cash it returns to owners over its remaining life. Valuing a company is the same exercise whether one analyzes a business that is considered to be a tech company, an industrial company, or a health care company. It doesn't necessarily matter whether a company is highly cyclical, high or low growth, etc. The question is when and how much cash gets returned to owners. That is what I am always trying to calculate in any valuation exercise.

The return of any stock over its total life will be the dividends it pays out per share plus the change in its earning power, or its ability to pay out dividends over time. Berkshire and Amazon have never paid dividends historically, but their *ability* to pay dividends continues to grow each year.

I am not a growth investor. I am simply looking for the most attractive mispriced opportunities that I can find based on today's prices. I would be perfectly happy to invest in a no-growth company if I had conviction in the cash I would receive as an owner *and* it sold for an attractive price relative to that cash received. The thing is, when looking across the universe of available public equities, it is pretty rare, though not impossible, for the market to value a fairly predictable and stagnant business at a price that would provide an overly attractive long-term rate of return.

For companies earlier in their life cycle that have a lot of attractive opportunities to reinvest cash for growth, they may not necessarily be cash generative and can even be consuming cash as they scale. However just because a business has negative cash flow does not necessarily make it a bad business. Distinguishing between maintenance costs vs. growth costs is important in determining the unit economics of a business and its potential growth prospects. What are the key drivers of revenue? Are they subscriptions, physical stores, gross merchandise value, a specific product/service? What are the future volumes of that unit likely to be and how does that drive the sales and related costs needed to support that volume? That essentially gets into the operating leverage of the business.

For companies earlier in their life cycle that are scaling their product/service, total addressable market (TAM) analysis can provide better context for how long and how large the company may be able to scale. There is a ton of room for interpretation/error in analyzing TAM but it helps to understand the entire market dynamics. Is the end market stable (is the company stealing market share from incumbents?), a greenfield opportunity (creating a new market?) or growing the TAM, so potentially stealing share but also growing demand (think Uber and Airbnb). Why is this specific company's value proposition better than others? Why will they be able to grow market share AND keep that market share from competitors that realize the company is having success? Those are the key questions I try to think through.

Michael Mauboussin just came out with his updated book *Expectations Investing* and I like this mental model. It's essentially a reverse discounted cash flow. What assumptions must happen in order to justify today's current valuation? If a company is currently valued at $X and you want a 15% IRR, then the company will have to distribute 15% of $X price to owners into perpetuity. If the company retains earnings next year, then it will have to distribute 17% of $X the following year and into perpetuity to earn a 15% IRR. If it waits another year, then in year 3 it will have to distribute 20% of $X into perpetuity for a 15% IRR. I don't think many people think through this simple math when they value certain companies, especially based on where many companies sell today. It is a pretty simple concept and an insightful exercise. Once you establish a certain outlook/expectations, you can use base rates, or what Mauboussin calls the outside view to see how other companies with similar characteristics/patterns have been able to do what you are modeling them to do?

I know that isn't a simple and easy answer about how to go about valuing a company, but that is because if there was a simple and easy model/formula to just plug some variables into, or some simple ratios/multiples, then investing would be easy and everyone would have the correct answer which would negate the benefit of the whole exercise. Discounted cash flow models are the right idea for how to go about valuing a company, but I've seen many poor investment decisions made because of a bottom-up, DCF analysis where a few flawed variable assumptions potentially spit out a bad answer. Buffett says he looks for things that are so obvious you don't need to get down to the decimal point. That is how I like to think about it. You don't have to know someone weighs exactly 455 lbs. to know they are obese.

What is an interesting idea on your radar now?

One of the investments in the Saga Portfolio that I think is not well understood is **GoodRx** (NASDAQ: GDRX -- $16.5 billion). I wrote about it in our last investor letter which gives a more in-depth background on the company but I'll provide some color here. For those that are not familiar with the company, GoodRx is similar to an Expedia.com or Bookings.com but for prescription drugs, although with some very important differences.

It's no secret that prescription drug pricing in the United State is pretty inefficient and opaque. The prices of drugs sold at pharmacies are often not determined by the pharmacy itself but through contracts the pharmacies establish with third parties. The majority of people in the U.S. have insurance that covers prescription needs provided by either their employer or a government program such as Medicare or Medicaid. Consumers largely rely on these third parties to determine which drugs are covered by their health plan, and therefore which drugs may or may not be affordable.

Readers can go back to our GoodRx write-up where I provide more detail surrounding the role of pharmacy benefits managers (PBMs), explain MAC and U&C prescription pricing, insurance copays/coinsurance, and the other prescription industry jargon but the important thing to understand is that there has been little to no price transparency for prescription drugs in the United States. Consumers, pharmacists, and healthcare providers have not had the ability to know how much a drug will cost for a specific customer until it is rung up at the register.

This problem has been difficult to solve because the contracts that typically determine prescriptions drug prices between PBMs and pharmacies are confidential and PBMs continually are adjusting the prices for their covered members. The price of the same exact prescription for the same patient can vary significantly at two different pharmacies that are just across the street from each other and can even vary from week to week. For those that don't have insurance, the price of a drug can easily exceed 10x the pharmacy's wholesale acquisition price. It's a very inefficient system.

GoodRx helps solve this problem by aggregating the prices that all PBMs offer on their platform. The contracts PBMs have with pharmacies allow PBMs to offer their negotiated prescription prices to people that are not a part of their covered insured members. PBMs can provide people outside their insurance network a code to access their negotiated prices at the pharmacy and then pay the price out of pocket. Consumers get access to lower drug prices and the PBM can earn adjudication fees for people outside of their network that they wouldn't be able to access otherwise.

About a decade ago, a bunch of discount cash card companies entered relationships with PBMs to access the PBM network rates. Discount card companies were lead generators that directed demand to PBMs, initially targeting the uninsured population who significantly benefited from accessing these lower prices.

While it was initially difficult for these prescription discount card companies to differentiate, GoodRx emerged as the industry leader for a few key reasons. They established relationships with the most PBMs early on which provided them access to the best prices available on average. In 2014, GoodRx patented the ability to contract with multiple PBMs and to show the lowest price for each pharmacy on a single interface. They also worked well with the different players within the pharmaceutical value chain including the PBMs, pharmacies, and healthcare providers creating mutually beneficial relationships.

GoodRx's ability to provide the most accurate data and typically lowest pricing for consumers on a seamless user-friendly interface helped them emerge as the dominant leader of the pack. No other discount card is able to work with multiple PBMs and therefore is not able to provide as low of prices on their platform. The next largest direct competitor of GoodRx is SingleCare which is integrated with its own single PBM and is estimated to be a quarter of the size of GoodRx.

Going forward, GoodRx's customer value proposition is only going to become stronger as it grows its consumer prescription marketplace. Because GoodRx has relationships with the most PBMs it can offer the cheapest prices on average which drives more consumers to GoodRx's platform, which encourages PBM suppliers to price more aggressively on GoodRx to win more demand, which then attracts more consumers to GoodRx.

I think the market believes it is difficult for GoodRx to potentially force PBMs, which historically have been in the power position within the prescription value chain, to compete for customers by lowering prices. While PBMs are benefitting from the incremental demand and associated adjudication fees paid by pharmacies, they will find they are losing their legacy power position within the prescription value chain as GoodRx is shining price transparency in a space that has historically been a black box. For the first time in recent history, PBMs are competing for demand that has become increasingly price-sensitive as consumers carry more of the burden of healthcare costs.

I also think the market believes GoodRx's service is only applicable to a smaller percentage of the population such as the uninsured. However, increasingly insured consumers, which currently make up ~74% of GoodRx users, are finding that prices on GoodRx are cheaper than their insurance copay. In a June 2021 paper, GoodRx reported that over 55% of prescriptions filled using GoodRx were cheaper than the average commercial insurance copays for the 100 most purchased medications. The best discount available on GoodRx beat the average insurance copayment 89% of the time. The average discount on GoodRx has increased to 79% off list prices compared to 59% in 2016. This supports the thesis that as GoodRx scales, competition amongst PBMs is increasing and the pricing they offer on GoodRx is getting more aggressive and more favorable than the prices offered to insured customers.

As mentioned earlier, GoodRx is like the Bookings.com or Expedia.com of the prescription drug industry. However, unlike airlines or hotels, the suppliers of prescription drugs (the pharmacies) do not control the prices they can charge. Customers can not disintermediate GoodRx by going straight to the supplier and therefore cutting out the middleman. Similarly, Google is not able to access these prices and disintermediate GoodRx. Prescription drugs are also a commodity with no differentiation. With the minor exception that customers typically prefer going to their local pharmacy, they are very price-sensitive since it does not matter whether they buy a specific prescription drug through one PBM or another. The lowest available price is increasingly only available through GoodRx since they aggregate all of the PBMs. The only way efficiency and transparency can come to the market are through a platform such as GoodRx.

GoodRx is only scratching the surface of the prescription market. Including the prescriptions that go unfilled, the total U.S prescription market is over $500 billion. Excluding specialty drugs, branded and generic drugs make up ~$350 billion of spend per year; meaning prescriptions transacted over GoodRx consists of just over 1% of the market. In 2020, an estimated $3.4 billion in U.S. prescriptions were transacted over the GoodRx platform, providing nearly $500 million in fees earned from PBMs. In 2021, these numbers are expected to grow to a respective $4 billion and $600 million. Total revenues are expected to pass $1 billion in 2022. As a marketplace, GoodRx has limited costs of supply, providing 90%+ gross profit margins. Sales and marketing are the largest operating expense at nearly 50% of sales. Management is targeting adjusted operating margins of over 40% at scale as sales and marketing costs decline as a percent of sales.

GoodRx is selling for ~23x on an enterprise value to trailing gross profit basis and 18x consensus next twelve-month gross profits. Given that GoodRx has established itself as the winning discount prescription card, has a long runway to grow, and requires little incremental capital or costs to scale, these multiples appear very attractive in my opinion. If GoodRx continues to be successful in lowering drug prices and providing a great consumer experience, it is highly likely that the company will be worth a multiple of its current ~$16 billion enterprise value.

Joe, how do you come up with new ideas to research? Are there any publications, websites, or tools that help you find new companies that are interesting?

I don’t have any undiscovered secrets for how to find great ideas. I think it’s important to always be curious, ask questions, and continually try to turn over a lot of rocks. The market is just one big complex puzzle and I am just trying to find mispriced anomalies. The best way to go about that exercise is to always be looking and trying to figure out how the world works.

Ideas have come from all different sources whether that is through reading the various books or publications I come across, someone tells me about an interesting company, or just following the scent of an interesting idea that comes about while doing the normal maintenance work of monitoring the companies the Saga Portfolio already owns.

One of my favorite activities is just going down the list of every publicly traded company by industry with the past 20+ years of historic operating metrics. I can see interesting things happening at a high level and sometimes something sticks out that makes me want to dig deeper. I also can see which companies have been so dominant in certain spaces and then I'll go about trying to answer why certain companies have been able to be so successful for so long. I will also see previously dominant companies that fell from grace and then I'll try and understand why that may have happened? Understanding why businesses have historically succeeded and failed is very important when I am trying to predict which companies will succeed and fail far into the future.

Investment portfolio presentations will often have a slide that explains their investing process and how they filter ideas. There's typically a big funnel on the slide that explains how they start with a large universe of companies that gets narrowed down further and further until all of the best ideas pop out at the bottom of funnel like clockwork. Investing doesn't really work like that, at least in my opinion. It is messy. It is serendipitous. Great ideas don't come just because you want them to.

If I woke up every day saying I must find my next amazing opportunity today, I'd continually be disappointed. I think a better and more realistic approach is to just continuously be looking, learning, opportunistic. Knowledge you learn today may not be useful for many years in the future. I think it was Charlie Munger who said something to the effect that a few major opportunities will come to those who continuously search and wait with a curious mind, and then have a willingness to bet heavily when the odds are extremely favorable. That is essentially what I set out to do over time.

For researching companies and industries I use Factset which helps aggregate all publicly available information on companies and industries. I've found expert networks like Tegus and Stream by Mosaic really helpful in getting insight from company's customers, suppliers, former employees/execs, and competitors. It saves countless hours of trying to do this type of important scuttlebutt work myself. Sometimes there are insightful research reports on Value

Investors Club or Seeking Alpha. I can't name all the many blogs, substacks, and other sites that provide great research but a few I like and subscribe to are Stratechery, Scuttleblurb, and MBI Deep Dives.

What are some of the first things you do when researching a company? What does that first hour of research look like for you? Do you do anything that few others do?

When I first come about an interesting company, I am trying to understand two main questions:

1. What is the problem the company is trying to solve for customers? What problem are customers outsourcing to this company? and,
2. Why do customers decide to outsource this problem to this specific company? What are the other options available to customers to help solve that problem? Why can't other companies provide a similar solution to that problem today or far into the future?

I am essentially trying to figure out the quality of the business. The first question gets into the demand for a certain product or service and the second question focuses on the potential supply for that product and service. I'm trying to understand the customer value proposition and then if the company has a unique/differentiated way to offer that value proposition compared to other available options customers have.

I didn't really touch on this earlier when I discussed valuation, but the quality of a company is extremely important for the way I approach investing. If I plan on being an owner of a company and not a renter of its stock, then I need to rely on the cash the company generates and returns to me as an owner over its life rather than try to play a speculative game of greater fool theory in the hope that someone else will bail me out at an inflated stock price at some point in the future.

It is true that there is a price low enough to make a low-quality company a good investment, but that price is often much lower than most believe, and there does exist a price high enough to make a high-quality company a bad investment, but that price is often much higher than most believe. I am attempting to do two things, buy very high-quality companies where its market price does not fully appreciate its quality.

Of course, there is a lot of room for interpretation for what makes a quality business. How do you evaluate the quality of a GoodRx vs. Carvana vs. Facebook vs. Trade Desk, etc. The hard quantitative investing definition of quality is the return on invested capital. However, that is simply the financial output and that calculation is dependent on numerous factors such as where a company may be in its lifecycle. The key is figuring out the qualitative inputs over the long term that can provide that desired output.

The way I like to think about it is companies lie on a spectrum between being a perfect commodity to being a perfect monopoly. No company is a complete commodity and no company is a complete monopoly. I am trying to find companies that are as close to a natural monopoly as possible which simply means that a company provides a product/service that is highly desired or needed and there are no close alternatives for customers to get that product/service. The reason why that is important is because customers will likely go to them regardless of what happens in the macro environment and therefore the company has some type of pricing power.

On the opposite side of the spectrum, a commodity-like company has many similarly positioned undifferentiated competitors. Customers don't care about if they get their widget from one company or the other, therefore the company has little pricing power and will likely earn average returns on invested capital over its life at best and therefore likely provide average returns to owners over its life at best.

For the companies that do have a differentiated value proposition, the key is understanding the durability of any competitive advantage, and even more importantly whether that advantage is growing or shrinking over time. Anytime a company is having a lot of success by earning attractive unit economics, it flashes a signal to the rest of the market that big profits are to be made doing this activity. It will inevitably bring competition so it's important to try and understand why a company is able to fend off competition. In my opinion, it is more important to understand whether the advantage is growing stronger or weaker over time rather than how that advantage looks today. How will this advantage look ten years from now?

Once I start building a potential thesis surrounding a company's differentiated value proposition, I go about testing that thesis. If I am starting to put together the qualitative story, I then look for evidence in the operating results, unit economics, and key performance indicators of the business. What is the operating leverage built into the cost structure? What are the long-term multi-year trends, competitive dynamics, market share analysis?

While trying to answer those questions I like to listen to management's commentary surrounding the company's strengths and weaknesses, its position in the value chain, and how they see the space evolve into the future? I look back at management's track record. Have they been transparent and straightforward? I love when a CEO writes a shareholder letter that clearly explains these things each year. I look for management that views the company as their life's work, not as a nice paycheck. When things get tough and potentially the stock price is down >50%, it helps to have a deep trust in management to do what is in the best interests of the company, customers, and shareholders. If I don't have that trust in management, it makes those inevitable drawdowns or difficult macro environments which even the most successful businesses of all time endure that much more unsettling.

To sum it up, I don't necessarily think that I do anything different when I start my research process compared to what others may do. I do like to stress qualitative factors first before I ever move on to breaking down the quantitative analysis. There's no magic formula or secret to success. It just takes a lot of investigative work, digging, researching, thinking through the thesis and then testing that thesis from all angles to then make a probabilistic bet on how the future will unfold.

If there is one thing I may emphasize more than others, it is forming this long-term view. If I can't get a decent level of conviction in understanding how a company will be positioned economically in 10+ years then it's a pass for me. That means I pass on nearly everything because 10 years is a long time. If you go back to 2010, were you able to predict what happened in 2020? Now go back to 2000. That helps give some context for what things you may or may not be able to predict through 2030 or 2040. This long-term investing filter does mean I will likely miss a lot of big winners over the next decade, but more importantly, it means I will hopefully miss many losers. The risk to investing in the equity of companies is in getting that terminal value wrong. It is also where the opportunity lies since most of Wall Street typically anchors on recent fundamentals. Every company will inevitably get disrupted at some point but if you can determine the few that are more durable than the market may believe, then the portfolio should do very well over the long-term on average.

What are some of the common developments that make you sell a stock you own? Are there any common red flags that you find particularly problematic (e.g., missed guidance, executive resignations, insider selling, etc…)?

Portfolio managers will typically say they sell if they discover they made a mistake, or a stock hits a certain price target, or they find a better idea. All those reasons are based on opportunity costs. Every single one of my portfolio decisions, whether it is buying, holding, or selling, is based on opportunity costs. If I sell a position in the Portfolio, then I have to buy something else to replace it whether it is another company or simply cash. If that potential new holding is relatively more or less attractive is what determines if it makes sense to sell.

When reallocating the Saga Portfolio, I prefer just saying it is based on opportunity costs than if it truly was a mistake. I have found calling something a mistake can be more painful to psychologically admit than simply saying I readjusted my long-term expectations, although I do write about some of our larger mistakes in our investor letters as a way to keep me honest. But if new information materially lowers my long-term expectations for the worse and the current expected returns are no longer attractive relative to the current price and other available investments, it would be a second mistake to not reallocate the portfolio.

Similarly, if the price of a stock rises to the point where the long-term expected return no longer looks attractive i.e., it was a successful investment outcome from the initial purchase price, then it would no longer make sense to hold those shares assuming there were other relatively more attractive investment opportunities. All that matters is what are the best opportunities available going forward from today, regardless of past decisions, prices, performance, etc.

There are certain red flags that potentially make me question my investment thesis and long-term outlook. Missing guidance is not one of them. I try to not partake in the quarterly or annual guidance game. I prefer to ignore guidance and just look at the results and how those results trend over the long term. Similarly, insider selling is rarely a red flag. It can sometimes mean management is bailing, but there are a ton of different reasons why insiders may sell some of their shares.

A significant red flag is if there was a completely unexpected change in executive management. If there is an unexpected management change that likely means there are a lot of other problems going on below the surface of the company. As I mentioned earlier, the longer I invest the more I have come to realize just how important it is to have trust in management and their judgment. If you do not trust management to allocate your capital on your behalf, then it’s a non-starter/deal-breaker. I think I have continued to get better at knowing where to place my trust and can almost tell immediately whether management is trustworthy and competent.

Another red flag that goes in a similar bucket is if there is a significant misallocation of capital such as a large acquisition that may not make a lot of strategic sense relative to the core business. That goes into trusting management to make logical business decisions. It is important for a company to experiment and test different products/services or potentially acquire assets that make strategic sense. However, if you look back at the history of corporate acquisitions, large-scale bet the company type of pivots rarely work out well, and it is usually the shareholders left holding the bag.

Something that isn't necessarily a red flag but would potentially make us revisit our thesis is if fundamentals, or the key performance indicators, started to trend far off from what the original long-term expectations were. I would have to try to understand if these trends are longer-term in nature and if I potentially misevaluated the company's intrinsic value. While I place much more weight in understanding the qualitative drivers of value, but at the end of the day, the value of a company is the quantitative net dollars that it distributes to owners per share over its remaining life. If a management team is always thinking 5-10 years out, eventually those decisions will have to start gaining some traction through quantitative results. After a long enough test period, if those dollars or earning power is much lower than originally believed, it would make sense to reevaluate.

Joe, thank you for the great interview! What is the best way for readers to follow or connect with you?

Thank you again for having me and asking some great questions. Readers can reach me at my email joe.frankenfield@sagapartners.com or on Twitter at @sagapartners. They can also go to our website www.sagapartners.com and send a message under the contact page.

Editor's Note: Tegus Free Trial

Hi there, Edwin here. I reached out to the team at Tegus after a number of Idea Brunch interviewees recommended them and the Tegus team was kind enough to offer readers a free trial of their platform. Tegus is an insanely cool product that lets you find dozens of expert network call transcripts on any company in seconds. If interested, please email tom.preziose@tegus.co (.co not .com) and mention "Idea Brunch Tegus Free Trial" in the subject line.

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