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Value Investment Firm Saguaro Capital Management Launches

A value investment firm led by former members of Vulcan Value Partners has launched.

Saguaro Capital Management is launching with all-cap, large-cap and small- to mid-cap strategies that build off the success of Vulcan's investment approach that saw the firm grow to \$20 billion in assets under management.

"We are trying to build our own firm with a lot of the great experience that we learned from Vulcan and throughout other parts of our career and maybe do things slightly differently and hopefully improve some areas that we think we can do better," said John Collier, principal and director of investor relations at the Phoenix-based firm.

The firm is led by James Falbe, managing principal and portfolio manager, who spent eight years as a member of the senior investment team at Vulcan, and the team also includes Bruce Donnellan, principal and strategic advisor, one of the original Vulcan partners; Bryan Tsiao, principal and research analyst, a former associate analyst at Vulcan; Tyler Thomas, principal, data science, previously a data scientist at Vulcan; and Emily Cranton, principal and director of operations, previously a project manager at the Indiana Finance Authority in the water resources and infrastructure division.

Falbe called the firm a "natural evolution" of the products the team was working on at Vulcan. Among the main differences is the incorporation of options into the investment portfolio. "Instead of an SMA structure, let's use a GP/LP structure so we can have a margin line, not for the sake of having leverage, but for the sake of executing an options strategy while still being fully invested," he said.

Falbe also led the development of data science and machine learning capabilities at Vulcan and said the combination of fundamental analysis with modern data science tools and proprietary machine learning models will be an emphasis of the firm.

"You always want to be on the side of technology," he said. He noted that the firm is still 100% human-driven and AI is used to add value to the process, particularly in sourcing ideas, but that the team is open to expanding and enhancing its use of technology as it evolves.

The firm's focus is on "trying to find the best business on earth, buy them at a once in a decade type discount

and then allow them to compound for as long as possible," Falbe said, noting that when looking back at Vulcan's success, the firm's ability to generate alpha was primarily driven by identifying high quality businesses.

"While valuation is important, if you have long-term invested capital, true compounding is about quality, quality, quality," he said.

The firm's investment research process involves creating lists of the top 100 companies across the three strategies, with smid-cap looking at companies with market caps of \$20 billion and below, large-cap looking at \$20 billion and above and all-cap encompassing the best 100 companies across all capitalizations.

The lists are looked at in weekly research meetings, with new ideas voted on and ranked relative to other companies on the list. The firm also will look to revisit all names at least once a year to evaluate the thesis, underwrite the idea and reiterate the valuation ranges.

The valuation ranges constructed by the investment team are critical to the process.

"Instead of thinking with point estimates of value, let's think in ranges. Let's acknowledge that companies that are highly levered are going to have a wider range than companies that have net cash on the balance sheet. Companies that grow rapidly are going to have a wider range than companies that are very, very stable with the same amount of free cash flow every year. Our buy and sell discipline acts at the outer bands of these ranges," Falbe said.

The firm also incorporates options to support its views.

"We prefer to make our buy and sell decisions in advance, while we are calm and steady in the research room," Collier explained.

The firm may have leverage up to the 10% to 15% range in environments where markets are selling off and in a normal environment should not have any.

"On balance, over a full market cycle we expect to be fully invested, but we will have these pockets of opportunity where we take on a small amount of leverage and others where we build a little excess cash when the markets are too euphoric and things are overvalued. High quality strategies often perform the best when markets recover from their drawdown," Falbe said.



James Falbe

The strategies will typically each hold 10 to 15 companies, with a normal full weighting of 10% per holding that can range from 5% up to 15% for the highest conviction ideas.

"We are committed to building a world class investment manager and we want to find partners who have seen it done at a high level. We have a great background from a place that did it the right way that we are very proud of and we have a lot of wonderful things we can emulate. But at Saguaro, one of our values is that great isn't good enough. We also want to partner with those who can give us advice, tell us areas where we're weak and need to shore up and invest because we're committed to doing that," said Collier, previously a principal and relationship manager at Vulcan.

Collier said that the endowment and foundation space is likely to be the most natural fit for the firm. "The E&F world is where we have our most natural fit. They love less constraints and very concentrated managers. They have plenty of diversification, so they don't need a portfolio with 50 or 60 names," he said, noting that the firm is also looking for institutions that do not focus on style boxes and discretionary outsourced CIOs.

"There's that drive in the institutional allocator space to look for that next interesting idea. And they have the conviction and the ability to be early and those are the kind of people I think that we'll be spending our time trying to meet and build relationships with," he said.



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