

KILL ZONE

Counter Ambush Doctrine & Behavioural Value Investing



Drone footage, Brovary, Ukraine, March 2022

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Kill Zone

The first target is the vehicle at the front of the column... Once disabled by an anti-tank missile, the following vehicles have only two choices; attack directly into the ambush, a common counter-ambush infantry doctrine, or, reverse out of the kill zone... a potentially deadly alternative since this escape route is almost always covered by another anti-tank missile team. In this case, attacking directly into the direction of fire proves to be impractical for the Russian column because of the buildings on either side of the road. The armored column is trapped in the kill zone.

Tom Demerly, Commentator / former US Army Ranger, 10 March 2022

Faced with uncertainty, the tactically sound decision is often the emotionally difficult one. Just ask a behavioural value investor. Or, for higher stakes, a commander who has led their unit into an ambush.

Behavioural value investing involves identifying opportunities where other investors are selling for emotional rather than rational reasons. We call these 'capitulation events', and they often result from profit warnings, accounting misstatements, management change or concerns about a company's balance sheet.

An ambush is a surprise attack from a concealed position with overlapping arcs of fire creating a 'Kill Zone'.

Contact, wait out

7 June 2019

Somero Enterprises, Inc.
("Somero" or the "Company")

Trading Update

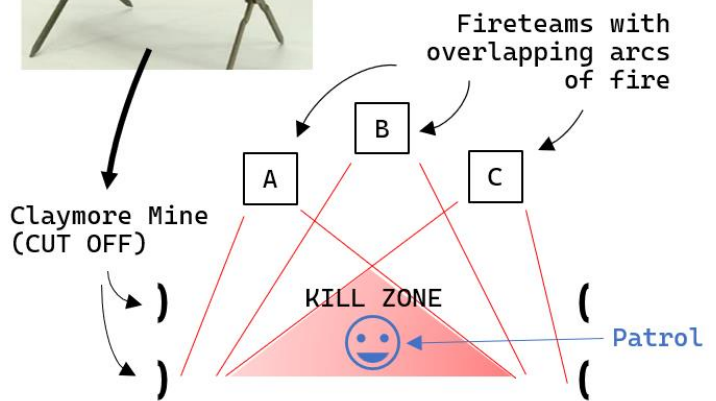
Somero Enterprises, Inc. (the "Company") provides the following trading update in advance of its upcoming Annual General Meeting scheduled for 11 Jun 2019.

Trading during the five month period to the end of May 2019 has fallen below management's expectations, primarily due to adverse weather conditions in the US, the Company's largest market. Broad sections of the US experienced the highest levels of rainfall on record.*

Profit Warning



Ambush



In a complex adaptive system, the individual components of the system interact interdependently, with outcomes that are hard to predict. This describes both the battlefield and the market.

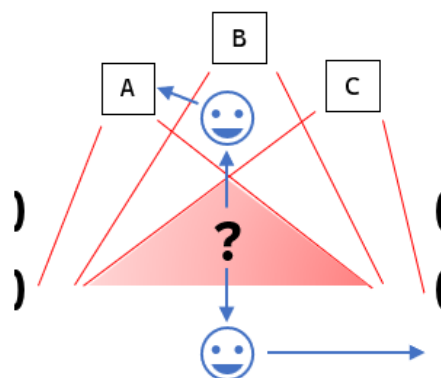
In the market, investors have philosophy and process to guide their decision-making. On the battlefield, commanders use a Tactical Aide Memoire. The platoon commander's Tactical Aide Memoire will advocate either retreating from, or advancing through, the Kill Zone. For the commander caught in an ambush, and the investor caught by a profit warning, the 'do nothing' option is likely to be as tactically dangerous as it is behaviourally compelling.

Counter Ambush Doctrine

Advance through point where the enemy is at risk of firing on own positions

OR

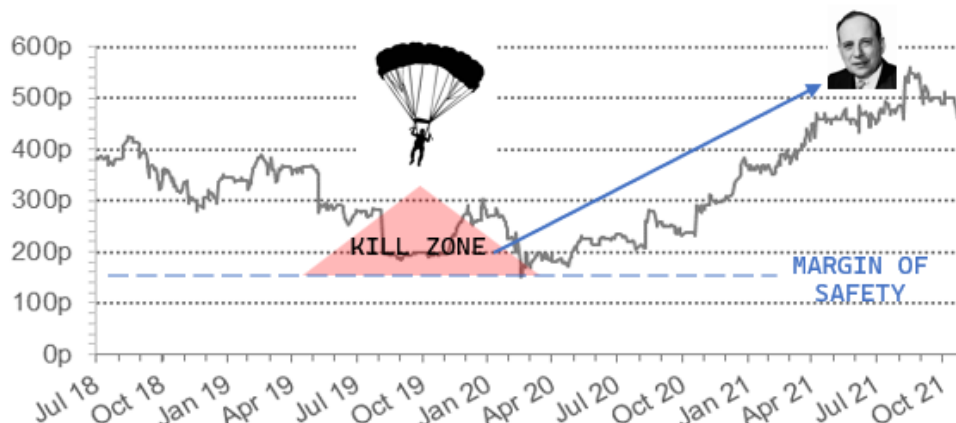
Retreat beyond range of enemy fire



Contrary to other investment approaches, the behavioural value investor seeks out capitulation events and looks for opportunities to actively *parachute into the Kill Zone*. What would be foolhardy on the battlefield can provide the experienced investor with excellent risk-adjusted returns. The key is to identify what Ben Graham called a 'Margin of Safety', which helps to limit downside risk.

A Margin of Safety can take numerous forms. On the balance sheet it could be a robust cash position, or a working capital profile that strengthens the business if trading deteriorates. On the income statement it may be high margins or modest operational gearing. In the cashflow statement it may appear in a clear conversion of earnings to cash thanks to the conservative application of accounting policies. In valuation it may be found in the market value of assets on the balance sheet, or in annuity-type cashflows. In the business profile it might be stable end-markets or a strong competitive position. In the C-suite it could be a founder-CEO with soul in the game.

Ben Graham parachutes into the Kill Zone – with a Margin of Safety



Factors affecting a company interact interdependently. Some factors reinforce each other to mitigate risk; other factors may mislead the investor. This is the terrain navigated by the behavioural value investor.

As the saying goes: *there are old soldiers and there are bold soldiers, but there are few old, bold soldiers.* This applies to the stockmarket as to the battlefield. Focusing on the Margin of Safety ensures that the behavioural value investor's contrarian inclination is carefully calibrated, whilst also providing clients with a highly differentiated approach in an often homogenous manager universe.

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Adam Rackley

Investment Director / former Platoon Commander

March 2023