GuruFocus Value Insights: Old West Investment Management on Investing Alongside Proven Owner-Managers

The firm sees opportunity in the basic materials space

By Sydnee Gatewood

Old West Investment Management recently honored GuruFocus with the opportunity to ask questions about the firm's strategy, outlook and stocks they see value in currently, among other topics. We are pleased to share the firm's responses.

Founded in 2008 by Joe Boskovich Sr., who serves as chairman, chief investment officer and portfolio manager, Old West oversees more than $400 million in assets under management as of June 30, 2024 across long-only and long-short investment strategies based upon the companies that it uncovers through its simple yet sound investment process. Its investment strategies are focused on uncovering value and special situation opportunities, and it is concentrated in its best ideas.

Previously, Joe Boskovich Jr., the firm's co-founder and partner, was a guest on our Value Investing Live series. He is joined by his father as well as Chad Cook, Old West's chief compliance and financial officer, and co-CIO, portfolio manager and partner Brian Laks.

GuruFocus: As a refresher from our last conversation, please tell us about Old West's strategy. What metrics or factors are you most interested in when evaluating a potential investment?

Joe Boskovich Jr.: Our strategy focuses on the people in control of our capital and their abilities to efficiently and effectively allocate that capital. As a first principle, we believe that the surest way to protect and grow our capital is by aligning ourselves with management teams who have high stock ownership and smart pay. One of the first documents that we turn to is the proxy statement, and in the time that it takes us to print out the proxy, study stock ownership, pay levels and the business metrics that drive incentive pay, we are able to intelligently eliminate the vast majority of the potential companies that would otherwise absorb much of our time and resources. Simply, we seek to invest alongside great and proven owner-managers.

A second and equally important consideration is valuation. At our core, we are value investors, so not only do we seek to invest in companies where management is among the largest shareholders and incentivized more from their stock ownership than they are from their compensation, but we also want to buy into those businesses at substantial discounts to our assessment of intrinsic value. With that said, it's often not enough to buy something just because it's cheap, so we also spend a lot of time trying to understand what will make a company's stock price appreciate. In general, cheap stocks are cheap for a reason, and there is little insight to gain from basic valuation screens using backward-looking data. As such, we try to identify situations where we believe we have unique insights or can identify catalysts that the market will eventually recognize.

GuruFocus: How do you generate investment ideas?

Joe Boskovich Sr.: We find potential investment opportunities in a number of ways. We read a lot of industry periodicals, we talk to our network of business leaders from varying industries, and we talk to other like-minded and value-oriented investors.

Many of our best ideas are sourced from Form 4 filings and 13-D filings. We monitor every purchase or sale of stock by insiders, every day. If a CEO and/or several directors purchase millions of dollars of their own stock in the public markets, we will print out the proxy statement to determine if we, too, think it might be an attractive investment. Once the proxy is printed, we will look at total stock ownership by management, study how that ownership was accumulated and, most critically, seek to understand total stock ownership as it relates to compensation.

A great example of this would be when we saw Abbott Laboratories (ABT) CEO, Miles White, purchase $31 million of Abbott Labs stock on the open market in July 2016 followed by another open market purchase of $15 million that November. Purchases of that magnitude force us to take a closer look at the company and try to figure out why Miles White would make such large purchases. Abbott Labs has been a great long-term investment for Old West.

Brian Laks: As value investors we also find actionable ideas from looking at parts of the market that have undergone sharp corrections or prolonged downturns where the underlying value may be obscured. We also look for companies that have some sort of structural growth tailwind or asymmetric upside, or where we have a view that the company is misunderstood or mispriced.

A great example of this would be our investments in the nuclear power and uranium mining industry, which had been in a severe downturn for nearly a decade. Demand for uranium has been steadily growing as the developing world strives to generate clean electricity from nuclear power. At the same time, supply had been cut dramatically as a decade-long bear market had ravaged the industry. From several hundred companies and a market cap of $150 billion, the industry had shriveled to a low of $5 billion and only a few dozen companies. We believed the excess of demand over supply would force prices to rise to encourage the development of new supply. Since that original thesis, our positions have multiplied in value and the patience of our investors has been greatly rewarded. As an added benefit, it was the research we did into that industry that originally opened our eyes to the much larger theme around energy transition materials that led us to a number of our other current investments.

GuruFocus: How has your approach been impacted by the market environment this year?

Joe Boskovich Sr.: For the past 10-plus years, trillions of dollars have poured into stock index funds and investors have done very well with passive investing. As such, this has been a difficult and frustrating time period for active managers. Although we are disciplined value investors, we have also managed to outperform our benchmarks over various time intervals. We do believe that value investing will be greatly rewarded over the next many years, so we expect that our outperformance will be more noticeable as the general markets have a more difficult time moving forward. Our portfolios are full of companies selling at large discounts to their intrinsic value with bright prospects, regardless of the macroeconomic risks.

GuruFocus: Your latest equity portfolio shows a large exposure to the basic materials sector. What do you find favorable about this area currently?

Brian Laks: This was not the result of a top-down decision, but rather stemmed from our process of looking for high-quality businesses trading at attractive valuations. Of specific interest to us are niche commodities where supply/demand imbalances can form with relative ease, leading to either current or expected shortages. This could be from falling supply due to natural depletion or lack of investment during a low-price environment. Alternatively, technological developments may lead to an increase in demand for certain materials faster than supply can respond. This has certainly been the case for a wide variety of specialty metals necessary to enable the global transition to clean energy. In certain parts of the resource industry, we see an unusual combination of strong fundamental outlook and low valuation. The supply of many metals is insufficient to meet future demand, and prices are too low to give an incentive for new development. We believe prices must rise to levels that make development projects economical, and we believe that the companies that can deliver supply into that environment will benefit.

GuruFocus: Over the past several quarters, you have been adding to a position in Enovix Corp. (ENVX). As a manufacturer of silicon lithium-ion batteries for a number of applications, including EVs, what advantages does it have over competitors?

Joe Boskovich Sr.: Enovix has a safer and higher-density next-generation lithium battery technology that uses silicon anodes versus industry standard graphite anodes. Enovix is the only company that has succeeded with a 100% active silicon battery; they've taken their battery technology from R&D to commercial production in recent quarters, and the company says it is five years ahead of competitors.

The TAM (total addressable market) is huge. The current focus for Enovix is in consumer electronics, and the company has a number of battery cells targeting internet of things, smartphones, laptops, wearables and eyewear. Next, Enovix sees giant opportunity in the electric vehicle space given its higher energy density and fast charging capabilities, and they are in active discussions with electric vehicle customers. As a sidenote, Elon Musk recently endorsed 100% silicon anode lithium-ion battery technology as what is needed in the EV space.

But perhaps the company's biggest advantage is its management team, which is a great illustration of our investment process of investing with owner/managers in action.

In 2017, Old West purchased a company called Enphase Energy (ENPH), which makes a piece of equipment known as microinverters for the solar industry. We were initially led to Enphase when we saw a large strategic investment from T.J. Rodgers, who was the founder and former CEO of Cypress Semiconductor. As part of his investment in Enphase, he was appointed to the board of directors, and he was an integral part of the company's turnaround. From the time of Rodgers' initial January 2017 investment in Enphase, the stock has gone from $1.54 to over $100 per share. Rodgers has a long history and iconic reputation in the technology industry. He founded Cypress in 1982 and grew it into a multibillion-dollar company before he retired in 2016. He also has experience in the solar industry as chairman of SunPower during its IPO.

This long-time following of T.J. Rodgers is what made us first dig into Enovix. Rodgers was named executive chairman in late 2022, and we added Enovix to our portfolio in March 2023. Rodgers holds over 21 million common shares or approximately $300 million of Enovix stock.

GuruFocus: Another holding you have been building up is U-Haul (UHAL). After a strong year in 2023, the stock is down year to date on the back of sluggish demand and a slowdown in the housing market. Based on these factors, what makes the company appealing for the long term?

Joe Boskovich Sr.: U-Haul is another great example of our focus on owner/manager run companies. CEO Joe Shoen’s huge ownership stake in their company really made us want to know the company better. Shoen owns 55% of the company, with his stake valued at nearly $6 billion, and his total annual compensation is $1 million. He clearly has more to gain from a higher stock price than his paycheck.

U-Haul is based in Reno, Nevada, and is North America’s largest “do-it-yourself” moving and storage operator. U-Haul is synonymous with self-moving and is four times larger than its biggest competitor, Penske Truck Leasing. U-Haul was founded in 1945 by Shoen’s father as a trailer rental company and began renting trucks in 1959. In 1973 they began their network of U-Haul managed retail stores where they rent trucks and trailers, self-storage units and moving supplies like boxes and tape. U-Haul has 23,000 locations in North America, of which 2,200 are company-owned and over 21,000 are independent franchised dealers. U-haul’s rental fleet consists of 192,000 trucks, 138,000 trailers and 44,000 towing devices.

A major growth area for the company has been the self-storage business. Most locations have large property footprints, and with a captive audience walking in the door it made the storage business a natural. They now operate 1,900 self-storage locations with 950,000 storage units.

The pricing of U-Haul moving trucks has recently been coined the UHAL growth index. It can cost $1,200 to rent a truck from California to Texas, and as little as $400 from Texas to California. It has become a useful tool to track migration patterns between states. Last year, the leading migration growth rates were Texas, Florida and North Carolina. The states suffering the most losses were California, Massachusetts and Illinois.

For fiscal year 2023, U-Haul had $5.75 billion in revenue and $923 million in GAAP net income. Revenue has grown 70% over the past five years. GAAP earnings per share were $4.71 and with today's share price at $67, the shares are trading at 14 times earnings. U-Haul's share price has doubled over the past five years. One negative of its financial performance has been the lack of free cash flow. This is due to huge capital expenditures of more than $2 billion per year due to the build-out of their self-storage business. This is expected to subside in the future as the build-out develops. U-Haul has a strong balance sheet with net debt at 2.10 times Ebitda and interest coverage of 8.50. The current market cap is $12.8 billion.

While many money managers are happy to invest in money-losing tech companies trading at a high multiple of revenue, we prefer to invest in solid companies like U-Haul run by owner/operators like Joe Shoen.

GuruFocus: Are there any investments, whether new or long-standing, you are particularly excited about? Please tell us a bit about them.

Brian Laks: As mentioned previously, we currently have a large weighting to metals and mining companies. We believe the case for certain commodities is the most compelling we have ever seen as they are near 50-year lows relative to overall equity markets. We think the rush to clean energy and the billions of dollars being thrown at technologies that require these various metals will lead to much higher prices, and we believe the biggest movements will be concentrated in specific metals. Our current portfolio exposures are mainly in the producers and developers of uranium, copper, tin and silver. For our core weightings, we are focused on low-cost producers and developers trading at what we view to be attractive valuations. Companies that share both of these characteristics are difficult to find and we spend much of our time trying to uncover such unique opportunities.

Copper is often considered the prime example of an energy metal because of its growing use for electrification. Overall demand today, however, is still dominated by traditional end uses which makes it much more sensitive to changes in general economic activity than some of the other niche metals we follow. For this reason, we prefer to invest in situations where there are company-specific value creation levers rather than solely focusing on leverage to the commodity price. In this regard we remain intrigued by what the Lundin Group (TSX:LUN) is doing in South America, having discovered what appears to be a new copper-gold-silver mining district and taking a methodical approach to consolidating the region. One of our largest positions, Filo Corp (TSX:FIL), was recently the target of a takeover bid by a joint venture between Lundin Mining and BHP (BHP).

Tin is another area we find attractive, and it has been one of the best-performing metals this year as resilient demand from things like solar power and semiconductors confronts persistent supply challenges. Alphamin Resources (TSXV:AFM) recently opened their second mine, which is expected to increase production by 60%. With their low cost of production, the company is set to generate a significant amount of free cash flow, the majority of which they plan to pay out as a dividend. Even at the current price of tin, which we view as unsustainably low, it would likely represent a double-digit yield. We think the price of tin has to rise materially in the coming years to balance a projected supply shortfall and companies that can produce at low cost will greatly benefit.

Outside of copper and tin, we have been longtime holders of precious metals and are particularly interested in silver, which has a large industrial component to its demand. One of our core holdings, Adriatic Metals (LSE:ADT1), is an underfollowed European project with a very high-quality polymetallic deposit trading at a low valuation. The company recently commissioned its mine and is currently ramping up to full run rate. Silver is expected to generate a third of its revenue, with gold contributing another 25%.

GuruFocus: Your portfolio appears to be fairly diversified, but are there any areas or sectors you avoid? Why?

Joe Boskovich Sr.: Our strategy is unconstrained, and we will look at companies in any sector. With that said, we want to buy into businesses at substantial discounts to our assessment of their intrinsic values and it's often difficult to find companies not trading at premiums in certain sectors.

GuruFocus: There has been a lot of hype around artificial intelligence over the past year or so. What are your thoughts on its prospects and impact? Are there any aspects of it that concern you?

Joe Boskovich Sr.: The money being invested in the AI revolution is nothing short of staggering. In the past few months, the following projects have been announced or updated:

- Taiwan Semiconductor (TSM) is investing $65 billion in a chip manufacturing plant in Phoenix. Nvidia (NVDA) is a major customer.
- Samsung (XKRX:005930) is investing $44 billion to create a semiconductor hub in Texas.
- Microsoft (MSFT) is investing $100 billion in building an AI data center. This project is 100 times more advanced than current cutting-edge data centers.
- In addition to these projects, you have Amazon Web Services, Oracle (ORCL) and others building new data centers.

The trillions of dollars invested passively in index funds feed into all of the mega-cap tech companies driving the AI machine. But very few investors own companies producing the metals necessary to compute, store and network data. These facilities are loaded with copper, tin and silver, and possibly receive nuclear-generated power. We believe we are in the early stages of a multiyear bull market in these industrial metals.

GuruFocus: The legendary Charlie Munger passed away last year. In your opinion, what was his most significant contribution to the investment community?

Chad Cook: Charlie Munger was one of the greatest minds in all of history, not only to investing and his limitless remarks through the years about investing, but also to philosophy, science and humanities, among many others. While Charlie was a "Jack of All Trades," he was certainly not a "Master of None;" he was a master of all, and I think his greatest contribution to the investment community was his ability to take that universal mastery of all topics and link them together. He really was the first great consilience of investment rationale and we often remember him and his wisdom each and every day, particularly whenever we encounter the irrational, or at least the characteristics of irrational behavior and the sorted pathway to making the best decisions possible.

Joe Boskovich Jr.: Charlie Munger clearly had a giant impact on the global investment community, and I have had the privilege of having many of those contributions reinforced to me through various interactions with a family friend, Peter Kaufman. Peter was a close associate of Charlie's and is probably his most notable biographer, capturing much of Charlie's wisdom in his book, "Poor Charlie's Almanack." Charlie is probably most well-known for shifting Berkshire Hathaway's (BRK.A) (BRK.B) mandate from favoring troubled companies at low prices to focusing on higher-quality and reasonably priced businesses, but in large part because of my association with Peter, I have an appreciation for some of his other investing wisdoms. There are hundreds, but here are a few that are noticeably reflected in our investment process:

A big one would be Charlie's multi-disciplinary approach to investing. Peter talks about this a lot in his book. Charlie has said, "To a man with a hammer, every problem looks like a nail." I think every situation is unique, and trying to have a multidisciplinary approach to investing enables us to approach each situation differently. We try and think this way when approaching our investments.

Another notable one would be Charlie's advice, "If you have a dumb incentive system, you get dumb outcomes." As we discussed earlier, our investment process really focuses on the management teams in control of our capital, and we want to invest in companies where management teams are aligned with us, the shareholders. We closely follow insider activity and are very focused on management incentives.

And the last tenet that I'll mention, which we haven't done a very good job at, is what Charlie referred to as, "Sit on Your Ass" investing. As a fund manager, doing nothing is the hardest thing to do. We're always trying to maximize performance for our clients, but looking backward, some of our biggest mistakes have been selling a stock too early. You can always be a better investor, and hopefully our investment process becomes even better learning from this mistake. Generally, if you've made good investments, they will last for a long time.

GuruFocus: Value stocks have lagged growth stocks for more than a decade. Do you believe that the reversal of the mean will occur at some point, and value will start outperforming growth going forward?

Joe Boskovich Sr.: We do. The fact that interest rates were so low for so long due to Federal Reserve bank manipulation resulted in extreme risk-taking by investors of all types. Trillions of dollars were invested in the bond market at near zero percent interest rates, trillions more dollars were dumped into the stock market, private equity and venture capital with little attention paid to valuations, and investors foolishly gambled on all sorts of speculative investments like cryptocurrencies and NFTs.

Our value bias should serve us well in the next few years as we are expecting a difficult investing environment. Investing in companies run by owner-managers with strong balance sheets, actual versus adjusted earnings and a moat around their business will prove to be far superior compared to blindly buying an index fund.

GuruFocus: What would you say is the biggest concern for investors in the current market environment?

Joe Boskovich Sr.: There is a lot to worry about in today's world, but there is no greater threat to our country and our markets than our out-of-control budget deficits. Total government debt has surpassed $34 trillion. The U.S Treasury market is now 14% bigger than our banking system. As a reference point, in 2006, the Treasury market was only 44% of the total banking system. The U.S. Treasury Department has a massive task before it. We need to fund this year's $2 trillion deficit, fund $1 trillion in interest on our debt and we have $7.6 trillion in maturing debt next year (31% of the total debt). In the past we were able to depend on China, Japan and other foreign governments to participate in our debt offerings, but that is no longer the case as both China and Japan have massive debt problems of their own. The business media pays a ridiculous amount of attention to the Fed and speculation as to when the Fed will begin cutting rates. At Old West, we believe the Fed might lose control of the interest rate narrative as massive government debt issuance causes rates to stay higher for longer. A very likely outcome is that the Fed becomes the buyer of last resort, akin to Japan, to fill the gap of a lack of buyers for our debt. This will be extremely bullish for gold and commodities.

Our portfolios have significant exposure to metal-producing companies that will greatly benefit from a weakening dollar and the pending commodity super cycle. We are in uncharted waters with this debt situation. There has never been this much federal debt relative to GDP, and the debt interest expense has never been this high relative to the budget. The current average interest rate on the federal debt is 2.60%. As I said earlier, we have $7.6 trillion maturing this year, which will be refinanced at rates exceeding 4%. Add to this state and local government borrowing needs and you can see a debt crisis brewing. One more tidbit…there is $500 billion of commercial real estate debt coming due in 2024, followed by another $500 billion in 2025. It's amazing to me that this issue is not getting more attention. The media is obsessed with how AI is revolutionizing our lives while turning a blind eye to this brewing crisis.

GuruFocus: In light of this, what advice do you have for individual investors?

Joe Boskovich Jr.: Our team has never been comfortable investing alongside the masses, and the masses are all on the same side of the boat. Our portfolios are full of great companies run by great owner-managers trading at valuations with tremendous upside potential. I have witnessed many market cycles in my career, and although history does not repeat itself, the current market feels a lot like 2000. Value investors have always been scorned and ridiculed in past bubbles, only to be vindicated when common sense returns to the market.

GuruFocus: Whether they are investing related or not, please recommend three books for our readers to check out. Could you also share why you like them?

Joseph Boskovich Jr.: We've talked a lot about the book "The Outsiders" by Will Thorndike as being one of the best business books. The book discusses management's dual role of running their operations efficiently and deploying the cash generated by those operations. If you study the most successful businesses, that success didn't come from owning a unique asset or happening to be in a rapidly growing business. Rather, much of what distinguishes one business from another is management's capital allocation skills, or the process of deciding how to deploy the firm's resources to earn the best possible return for shareholders.

Management has five choices for deploying capital:

1) Investing in existing operations
2) Acquisitions
3) Pay dividends
4) Pay down debt
5) Repurchase stock (repurchase their shares when prices were well below intrinsic value. sometimes the best investment is your own stock)

Over the long term, return for shareholders will largely be determined by which of these five capital allocation decisions management chooses to use.

Brian Laks: "The Dao of Capital" by Mark Spitznagel is an interesting read for investors, especially those with longer time horizons. The idea that one can use short-term weakness as an indirect path to greater long-term gain is useful for investors in cyclical industries where the best entry points are often when conditions are at their worst. Some of our most profitable investments have come from these situations, where short-term dynamics differed greatly from long-term fundamentals, allowing us to build positions cheaply in advance of the market pricing in our views.

Joseph Boskovich Jr.: And then lastly, I would just say that the investment business is unique in that there is really no need to reinvent the wheel. The last 100 years has produced a handful of great investors and investment historians. Studying all of them and drawing from their successes and failures can help shape a great investment methodology. I would say to read everything by and/or about Warren Buffett, Seth Klarman, Joel Greenblatt, Ben Graham, Howard Marks, Phil Fisher, Peter Lynch and Bruce Greenwald.

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