There's Always Something to Do

THE PETER CUNDILL INVESTMENT APPROACH

Christopher Risso-Gill

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Frontispiece: Peter at base camp on the 1989 Everest expedition

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Foreword
Prem Watsa

CHRISTOPHER RISSO-GILL has written this wonderful book on Peter Cundill, my friend of thirty years, which I recommend highly. Like Warren Buffett and John Templeton, Peter Cundill was a legendary practitioner of the "Value Approach according to Ben Graham."

Like many "value" investors, Pete's "road to Damascus" occurred in late 1973 when he came upon *Security Analysis* written by Ben Graham (the same thing happened to me a year later, in 1974). Fully charged, Pete took control of the All-Canadian Venture Fund in 1975 – a value investor's dream – which had fallen from $6.00 per share in 1969 to $2.00 in 1974. Changing the name to Cundill Value Fund, he went on to establish one of the best long term investment records in the business – a track record of 15.2% per annum compounded over the next thirty-three years! An investor who invested $10,000 in this fund in 1974 and kept it there was worth more than $1 million in 2007 – an increase of more than 100 times! Of course, this success resulted in the Cundill Funds growing from $8 million in 1974 to nearly $20 billion when Mackenzie Financial purchased the management company in 2006. Peter popularized the concept of "Buying a dollar for 40 cents" – which is still the slogan of the Cundill Value Fund.

Pete was always a sporting and fitness enthusiast although it was not until he was thirty-eight years old that he ran his first marathon – Buffalo to Niagara Falls. He was hooked after that, completing another twenty-two marathons over the years, all over the world.

Fortunately for us – and for Christopher Risso-Gill – Peter Cundill kept a daily journal for forty-five years. Chris's book reminds us why the investment business is so fascinating: it's always changing and there's always something to do! True to his value investment philosophy, Pete's first investment was Bethlehem Copper, a company with no debt which he bought for less than cash per share, thereby getting a producing copper mine for free. Within four months, the stock doubled and he was on his way. He then purchased Credit Foncier, which had a liquidation value of $150 per share, for $43 per share. He sold it at a multiple of his cost and the long term value investment philosophy was firmly ingrained in his mind.

True to form, Pete never bought a share of Fairfax for its first fifteen years – because it was too expensive! However, when we hit an air pocket, he loaded up on Fairfax and now has been a long term shareholder for the past ten years. We have benefitted greatly from his wisdom.

In 2001, Peter Cundill was presented with the Analysts' Choice Career Achievement Award as the greatest mutual fund manager of all time. During the ceremony, Pete was characterized as the Indiana Jones of fund managers – which he quite liked! More significantly, he was recognized as follows: "Peter Cundill has excelled as few of us can imagine and influenced a generation of investment managers while at the same time creating wealth for his investors."

In 2006, Pete was diagnosed with Fragile X, a degenerative neurological disorder. Unlike most, he took it in stride. He never moped, he founded the Cundill History Prize at McGill University, his alma mater, and he continued, as he had always done, to live his life passionately and to help others in their lives. He has always had a certain gleam in his eye when talking about investments. As Kipling said in his poem "If," Pete has always "filled the unforgiving minute with sixty seconds worth of distance run."

On 16 September 2010, we had a dinner for Pete to celebrate his life's accomplishments. The best and the brightest from the Ben Graham value school of investment attended the dinner, including Charles Brandes, Michael Price, David Winters, and the Cundill team, now led by Andy Massie and Lawrence Chin, both able successors to Pete. It was a fitting tribute to Peter Cundill's achievements. He inspired us over the past thirty-five years with his investment acumen and since 2007 he has also inspired us with his courage and determination to handle whatever cards were dealt him.

I know you will enjoy reading this book.

PREM WATSA
Toronto, 2010

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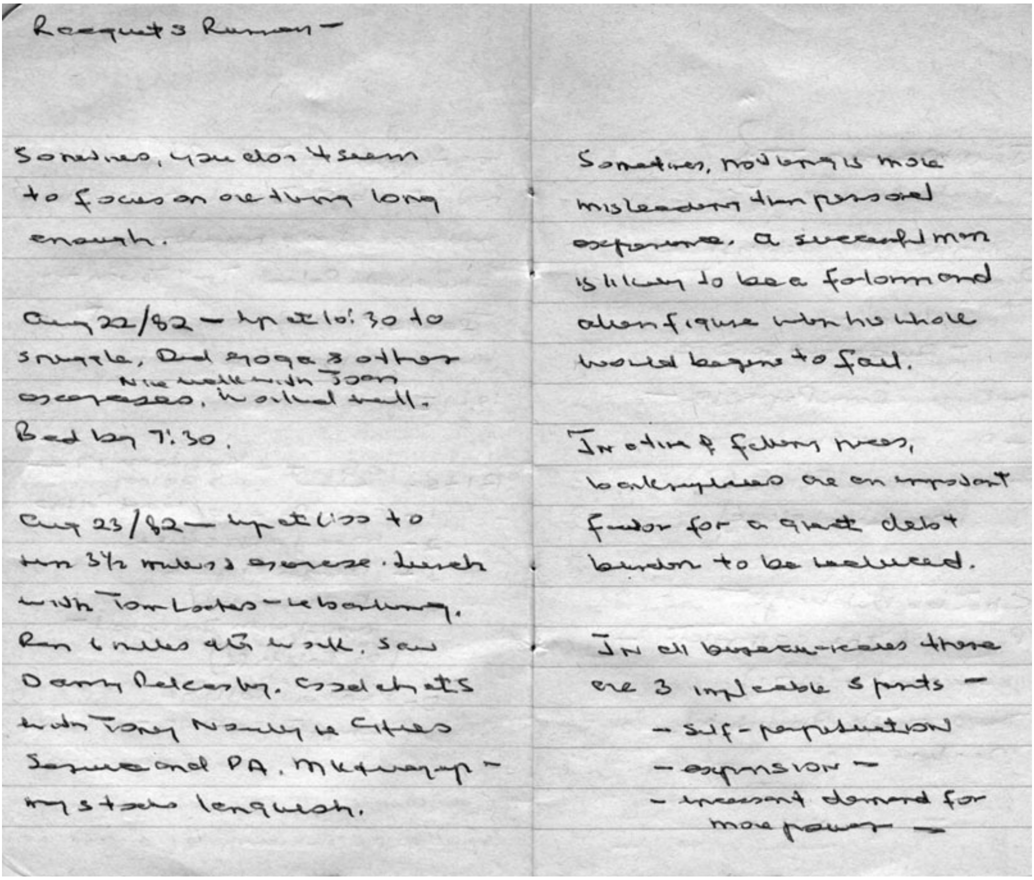
THERE'S ALWAYS SOMETHING TO DO

"There's always something to do. You just need to look harder, be creative and a little flexible."

Irving Kahn



A page from Peter's daily journals, 1963–2007. There are well over 200 of these handwritten books.

1

The Eureka Moment

ONE EVENING IN DECEMBER 1973 Peter Cundill boarded a flight from Toronto to Vancouver to return home for Christmas. He was nursing a monumental hangover and plagued by a growing sense of frustration that, having reached the mature age of thirty-five and accumulated considerable business and investment experience, all his efforts to come up with a satisfactory formula that would identify undervalued shares in the stock market with a reasonable degree of safety and consistency seemed to have led him down a series of blind alleys.

By chance he happened to be clutching a copy of *Super Money* by George Goodman; the book had been pressed into his hand by a colleague just as he was leaving the AGF Management office in downtown Toronto and, as he settled into the flight, he began rather idly to leaf through it. Within minutes his attention was riveted and he could barely contain his excitement. That night he wrote in his journal:

> Goodman devotes chapter 3 to Benjamin Graham and Warren Buffett and "the margin of safety." It struck me like a thunderbolt – there before me in plain terms was the method, the solid theoretical back-up to selecting investments based on the principle of realizable underlying value. My years of

apprenticeship are over: "THIS IS WHAT I WANT TO DO FOR THE REST OF MY LIFE!"

Peter refers to this as his moment of "epiphany" and so in many ways it has turned out to be.

What was revelatory in this chapter was surprisingly simple. A share is cheap not because it has a low price earnings multiple, a juicy dividend yield, or a very high growth rate, all of which may often be desirable, but because analysis of the balance sheet reveals that its stock market price is below its liquidation value: its intrinsic worth as a business. This above all is what constitutes "the margin of safety."

It would, however, be wrong to think that at this point Peter was in any sense an investment debutant; he rightly came to regard the entire period that preceded the epiphany moment – when the penny, so to speak, dropped – as a learning curve involving a great deal of hard labour acquiring the skills which make it possible to read a balance sheet with real understanding and a forensic attention to detail. These, of course, are the tools of the profession, but what seems to be common to nearly all the great investors is an attitude of mind that in some measure derives from family background and circumstance.

In Peter Cundill's case there were some distinctly unusual features. The family originally hailed from Yorkshire in the north of England, where they had lived for many generations as prosperous tenant farmers until they became impoverished by the long decline in agricultural prices that followed the end of the Napoleonic wars in 1815 and the gradual landlord encroachment that was a feature of the industrial revolution in England.

The result was that Peter's great-grandfather arrived in Montreal in the early 1860s with little more than a sound education and good commercial instincts, but determined to escape the poverty trap that had engulfed his family in the "old world."

He succeeded remarkably quickly, building up a very successful business importing goods from Britain to supply the needs of the fast-growing Canadian economy and the tastes of the increasingly well-to-do citizens of Montreal and beyond. He married well and was very soon adopted into the Anglo-Montreal establishment. His eldest son, Peter's grandfather, was initially even more successful, becoming a real "tycoon," who was known in New York City, to which he moved, as the "King of Camphor." By the time Peter's father was born in 1902, the family boasted all the trappings of substantial wealth: a large house in a fashionable part of Manhattan, a mansion on Staten Island looking across to the newly built Statue of Liberty, a seaside home in Connecticut staffed by numerous servants, and governesses and tutors for the children.

As a result Peter's father, Frank, was brought up as a young gentleman of wealth and privilege who could expect to choose the career that he would pursue without much regard for earning his bread. He chose the Navy, but by the time he had completed his cadet training his father's business was beginning to feel the effects of the discovery of synthetic camphor and he abandoned the idea of a career as a naval officer to help his father. Grandfather Cundill, however, was not familiar with the adage "always change a winning game" and he persisted as the business went into terminal decline, exhausting his capital and credit until in 1927 he was forced into bankruptcy.

The fairy tale life evaporated overnight and the family retreated to Montreal to live with great-grandmother Cundill. Although Frank was devastated, he immediately rolled up his sleeves and made his way out west to Alberta, for a time becoming a cowboy and rodeo rider, before returning to Montreal and finding a job with Kingstone Mackenzie Securities, eventually becoming a trader for them. He survived the crash of 1929, by his own admission largely because he had very little money to lose, but the memory of it and the anguish he witnessed remained with him for the rest of his days. In 1937 he bought a seat on the Montreal Stock Exchange, becoming an independent floor trader, and felt financially secure enough to marry early the following year. Peter was born that October.

By 1940, before Peter was even out of diapers, Frank had left for the war and the small family would not be fully reunited until 1946, when Peter was nearly eight years old. In the meantime money had been extremely short and mother and son had led a semi-nomadic existence, moving from the home of one relation to another; of no fixed abode. While not uncomfortable or necessarily unhappy, because most of the relations were well off and all were kindly disposed, they lacked a home they could really call their own.

Even after Frank was demobbed it was some time before the family's economic circumstances began to improve. The contrast between their standard of living and that of most of their friends and relations was readily apparent during Peter's boyhood and early adolescence.

Peter's professional preparation began with a Bachelor of Commerce degree from McGill, after which he decided that what he wanted was to embark on a career in the investment industry. In this he was probably influenced more by the example of his uncle Pete Scott, who was a partner of Wood Gundy and eventually became its chairman, than by his father. But he paid attention to Frank's remark that the investment business was a gamble and, if he were going to be a gambler, he would do well to have a professional qualification to fall back on, should the need arise. It was sound advice. Peter qualified as a chartered accountant, serving his articles at Price Waterhouse. This was to be invaluable, not because he ever practised but as his basic working tool.

2

Getting to First Base

AS SOON AS PETER qualified he joined the well-respected Montreal investment firm of Greenshields, where he formed an immediate bond with Frank Trebell, its youthful general manager, and secured a coveted place in the firm's Special Projects department. The group was in the initial stages of promoting the formation of the Mortgage Insurance Company of Canada (MICC) and as a CA, albeit newly qualified, Peter was charged with producing the projections for the business plan and then presenting them at board level to the prospective investing institutions, which included Alcan, the Bank of Nova Scotia, Air Canada, and the CN Pension fund. The fundraising was a success and resulted in Trebell taking Peter under his wing.

This was to have momentous consequences as Trebell was already planning his next move along the corporate ladder and wanted to take Peter with him. The result was a move out west to Vancouver where, through his relationship with Maurice Strong, who was then the CEO of Power Corporation, Trebell had engineered a takeover of the Yorkshire Trust Company, a mini-financial services conglomerate that was also Vancouver's oldest financial institution, founded at the end of the nineteenth century, coincidentally with Yorkshire money from the wealthy textile city of Huddersfield. Peter moved to Vancouver as Trebell's executive assistant, although in reality his role was more in the nature of business development. His focus had started to gravitate away from mortgages, fixed interest instruments, and real estate towards equities, which he now believed were likely to offer the most attractive investment returns over the long term. He was prompted to confide in his journal:

> My primary objective is to make money for my clients and then to make my business profitable. I believe that the way to achieve this is through associating with truly competent people with unshakeable business integrity, to ensure strict financial controls, a culture of thoroughness, a measured capacity for action; i.e. no seat of the pants stuff and a spirit of humility and cohesive teamwork. What I am beginning to perceive is that investors tend to follow trends and fashion rather than taking the trouble to look for value. This must offer opportunity for the professional investment manager, as a result of the short term mispricing of securities.

During his early days at Yorkshire Peter wrote and passed the Chartered Financial Analyst Association exams as part of one of the first groups to qualify. The work involved elicited another important comment.

> I think that intelligent forecasting (company revenues, earnings, etc.) should not seek to predict what will in fact happen in the future. Its purpose ought to be to illuminate the road, to point out obstacles and potential pitfalls and so assist management to tailor events and to bend them in a desired direction. Forecasting should be used as a device to put both problems and opportunities into perspective. It is a management tool, but it

can never be a substitute for strategy, nor should it ever be used as the primary basis for portfolio investment decisions.

One can see that, almost by default, Peter was even then veering toward a value approach and in fact his first major equity investment exhibits most of the characteristics that are associated with a value-based purchase. Peter was already looking out for solid companies in unfashionable industries whose shares had fallen sharply and Bethlehem Copper came to his attention. In the absence of negative corporate news justifying the price decline, he suspected that the shares might be cheap. Quite how cheap they were did not become clear until he had subjected the company to his own brand of exhaustive analysis, which made it apparent that the shares were trading at the price of the cash on the company's balance sheet, on top of which it had no debt and owned a profitable producing mine with solid long-term contracts for the purchase of its copper production. Peter quietly built up a significant position in Bethlehem for clients of the Yorkshire at an average cost of around $4.50 per share.

Both Bethlehem and mining stocks in general were totally out of favour with the investing public at the time. However in Peter's developing judgement this was not just an irrelevance but a positive bonus. He had inadvertently stumbled upon a classic net-net: a company whose share price was trading below its working capital, net all its liabilities. It was the first such discovery of his career and had the additional merit of proving the efficacy of value theory almost immediately, had he been able to recognize it as such. Within four months Bethlehem had doubled and in six months he was able to start selling some of the position at $13.00. The overall impact on portfolio performance had been dramatic.

In later years Peter became well known as an inveterate traveller who would routinely clock up well over a hundred thousand miles a year in the quest for bargains in international markets and especially for his habit of making a special effort to visit whichever country had had the worst performing stock market in the previous eleven months. His professional curiosity was boundless, but it was far from being confined only to strictly professional matters. Peter's approach had much in common with that of the old style merchant banker, who believed it was as important to sniff the air and gauge the commercial temperature as it was to examine the numbers. He always felt that an understanding of local politics and the culture and character of the people was an important factor in inspiring enough confidence to make investments in unfashionable and even positively outlandish locations and, even when the numbers might appear compelling, if he became uncomfortable with the "feel" of a place, he would pass on an investment.

Peter made his first visit to Japan in March 1969 and his immediate impressions are worth quoting in full, not just because Japan was to become such an important factor in his investment success but for the insight they offer into the entirely open-minded way in which he habitually engaged with whatever new territory he might be exploring. The visit had been organized by his friend Yuge-san, an executive with Nippon Steel who had become a good friend in Vancouver over many late evenings and much sake and gin.

> My first impression of Tokyo was of a busy, bustling, construction crazy city, glazed and diffused through an orange sky. Snow is still very much in evidence with the temperature in the mid 40s. The Otari hotel has over 1000 rooms and a sushi restaurant. Yuge-san took me for drinks and dinner in the Chinese restaurant in the basement – absolutely first class – and then downtown for a steam bath; relaxing even when the masseuse was walking on me. As Yuge-san observed it was

> a pure steam bath, like a Turkish bath, not what he called an "obscene" one. He suggested that we might have an "obscene" one later in the week! I was struck by the contrast between the frenetic movement all around me and the stillness of the people's quiet courtesy – also by the Western influence evident everywhere, which I had not quite expected. I am in no doubt *this is a major economic power*!

The visit included a formal tea in the oldest part of Tokyo with Yuge-san's mother and sister, exquisitely dressed in beautiful kimonos, and dinner at home with his wife and two small children, as well as a formal meeting with the Nippon finance team. In the course of the week Peter had felt able to ask a number of the sort of questions that would be considered completely inappropriate in Western society. He established that Yuge-san earned 300 yen per month; far from a fortune despite being quite senior. Once the rent on the Nippon apartment and the lease on the car had been paid there was not a great deal left over for anything else. The family's entertainment, as well as any of the very brief holidays that there might be, were Nippon organized and sponsored as a kind of family corporate activity. Peter drew some interesting conclusions from the information.

> This is clearly still a paternalistic society which, despite war and industrialization on a vast scale, retains many quite feudal characteristics.
>
> The conditions of employment actually go a long way towards explaining how it is possible for Japanese industry to be so price competitive. It enables the cost of labour to be strictly controlled and kept at minimum levels, while at the same time corporate loyalty is very carefully nurtured by fostering the idea that the corporation itself, with all of its employees,

> their wives and their children, represents a kind of extended family, or clan, with all of the old fashioned obligations that this implies in both directions. I get no feeling that there is the slightest undercurrent of discontent lurking, so it seems possible to imagine that this personnel culture still has plenty of life left in it, despite the abundant evidence of western influence in Japanese consumer culture.
>
> This trip [which had included Hong Kong and Thailand] has given me a whole new set of perspectives. I now see Canada as really tiny, although affluent. If these mainland Asian countries, and especially China, were ever to get their act together economically like Japan they could rival the whole of North America and the rest of the developed world without even blinking. There have to be investment opportunities both in Japan and in mainland China – perhaps through Hong Kong.

The next significant step that Peter took with portfolio investment was to buy into a most unusual equity that, as it were, fell into his lap. In 1970 Maurice Strong had left Power Corporation to work for the Canadian Government and corporate enthusiasm for their investment in the Yorkshire Trust had departed with him. Placing the Power Corporation's shares did not prove to be difficult. One of the Yorkshire's new shareholders turned out to be a curious sort of hybrid known as Credit Foncier Franco Canadien. In his habitually thorough fashion Peter took the trouble to scrutinize the Credit Foncier annual report in considerable detail. What he discovered was intensely exciting. The company was, as he described it, "a treasure trove of wonderful assets."

It had been founded towards the end of the nineteenth century by the powerful French banking group Compagnie Financière de Paris et des Pays Bas, colloquially known as Paribas, with the idea of entering the mortgage lending market in Quebec and the Maritimes and had been encouraged to make loans with a more entrepreneurial, risk-taking approach than the Canadian Chartered Banks. As a result it had become a key player in the Prairie provinces just at the time that those vast areas, hitherto the untamed domain of the buffalo herds and the Plains Indians, were gradually being converted into one of the world's greatest grain-producing expanses. Credit Foncier had been substantially involved in financing pioneer farmers and had done extremely well out of the enterprise: the profits had enabled it to acquire a significant commercial real estate portfolio in the fast growing cities of eastern Canada.

When the depression struck at the end of the 1920s, Credit Foncier foreclosed on many of the farmers, who had been unable to keep up with their mortgage payments, but in doing so it followed an unusually enlightened policy, allowing the farmers to remain as tenants on very favourable rental terms rather than insisting on an eviction followed by a fire-sale. Many had opted for this tenancy deal and Credit Foncier had thereby become the owner of swathes of farmland, including the underlying mineral rights, and whenever the land had been sold, they had kept those rights. By the early 1970s, as commodity prices, including oil, began to rise, the company, somewhat unexpectedly, found itself sitting on a very considerable portfolio of highly prospective mineral wealth. As well, as Peter immediately saw, their accounting policies had remained ultra conservative, with the entire real estate portfolio carried on the balance sheet at book cost with no attempt to put a realistic value on the mineral rights.

Credit Foncier's corporate structure was also most unusual. Although Paribas was the controlling shareholder, the shares of the Canadian entity were listed in Montreal and Paris and there was a float of about 30%, the majority of which was held by institutions in

Paris, especially by some of the more exclusive private banks. There were two boards, a Canadian board of directors, which ran the Canadian operation, and a French board, whose members had the unusual entitlement of benefitting as individuals from 20% of the profits generated in Canada.

Naturally enough there was a good deal of competition at senior management level within Paribas to secure a seat on the Credit Foncier board and this privilege had come to be regarded as a special reward for particularly valuable service and sometimes as a retirement perk. But times were changing and the Canadian board members were becoming restive over this arcane and unconventional structure, which did not sit entirely comfortably with prevailing Canadian corporate practice. To Peter it seemed like a license to loot the candy store: neither the cash nor the real value of the assets was even remotely adequately reflected in the share price and, given the tension that was beginning to emerge between the two boards, it was not hard to envisage that in the foreseeable future there might be a clash that could act as a catalyst to draw public attention to the underlying value or perhaps eventually precipitate an outright disposal by Paribas, which would immediately unlock shareholder value. The more that he looked, the more perfect the opportunity revealed itself to be: Credit Foncier ticked all the boxes, having been consistently profitable and paying dividends for many years.

A reasonable estimate of liquidation value appeared to be in excess of $150 per share. Within days Peter began quietly to accumulate a position at around $43 per share. For Canada the discount was undoubtedly extreme, although, as Peter was to discover when some years later he began buying shares in Europe, luckily it was not quite so uncommon in those markets. Peter found the Credit Foncier experience totally engrossing and from that point onward was com-