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Disruption in Sleepy Sectors

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My research focuses on capital-intensive sectors such as real estate and utilities, which doesn't sound very exciting. But many of these companies are doing some innovative things, like driving the use of renewable energy and catalyzing the last mile of e-commerce. The challenge is finding those companies that generate strong corporate performance and can stand the test of time.

Searching for Quality

Our overarching philosophy is simple: strong corporate performance drives superior investment returns. That's a simple core idea, but we apply a complex engine to finding those companies, and it revolves around quality.

No manager wants low-quality companies, but our quality philosophy is unique because it is multipronged.

First, we look at quality through a defensive lens. We believe companies that have strong balance sheets and generate high cash flows generally perform well consistently, and that helps protect the core. It's a form of risk mitigation.

But we also look at quality through an offensive lens. Companies that can reinvest, reinvent, and grow. So, we look for both sustainability today and the ability to grow tomorrow.

Industrial Warehouse—Retail Disruption 2.0

In real estate, industrial warehouse companies are a good example. The real-estate sector has high barriers to entry created by land banks. Companies that have land close to dense urban nodes are able to execute and create a moat around their business opportunity, and leading warehouse companies have such land banks.

Industrial warehouse doesn't sound "growthy" or sexy, but it actually catalyzes the last mile of e-commerce. With the right land bank, these companies have a strong competitive advantage. They have a lot to do with Amazon's ability to get you a package the same day or next day. Amazon has a partner on the ground that's located next to a densely populated urban center. That disruption is the 2.0 of retail.

Renewables: Disrupting a Sleepy Sector

In utilities, the disruption is different. Utilities are typically considered a very sleepy sector, but within utilities we have renewables. And as growth investors, we're very interested in renewables, because the market opportunity is dynamic.

The global power-generation mix currently consists of 38% coal, but by 2050 it is expected to fall to 19% coal. Taking the place of coal in that mix are renewables—wind, solar, and hydro power.

Because of that backdrop, we believe the runway for growth in renewables is strong. They are some of the most interesting companies in my universe.

Finding Gems

Because we focus on capital-intensive sectors—where we see companies that consume a lot of capital as they grow—it's important to find companies that generate a return in excess of their costs, i.e., a return on capital that is greater than the weighted average cost of capital.

We also look for management teams whose strategy balances protecting the core (defending the moat that they've created over time) and thinking about how they might deal with the disruption that could lead to the destruction of that competitive moat.

Business durability is also important for the companies in which we invest because we're long-term investors and our focus on offensive quality helps us identify durable businesses.

Client Outcomes

We believe our clients should benefit from our focus on quality because it's an all-weather strategy.

In down markets, our focus on the defensive aspects of quality can help protect portfolios because companies with strong balance sheets and strong cash flows tend to outperform when the markets are facing headwinds.

And when the markets are strong, our portfolio has the potential to benefit from our attention to the offensive aspects of quality—high returns and high margins. We believe this can provide downside protection and upside potential. This can lead to better portfolio outcomes over time.

Alaina Anderson, CFA, partner, is a research analyst on William Blair's Global Equity team.

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