Building a Business on a Passion for Value Investing

'We have a lot of conviction in what we do,' says Ryan Batchelor of Clifford Capital Partners.

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Photo by Kim Raff

Undiscovered Manager is a regular profile of a noteworthy strategy that hasn't been rated by Morningstar Research Services' analysts.

Clifford Capital Partners' strong performance over the past year owes a lot to stocks like GameStop (GME) — but it has nothing to do with recent meme-stock momentum. Portfolio manager Ryan Batchelor had sold the stock at around $18 in December.

Batchelor says he took some ribbing from his kids for selling before the stock's Reddit-driven surge into triple-digit territory. However, it was still a success story for Clifford Capital: "We were buying when it was in the single digits and everyone hated it."

GameStop typifies the deep-value approach that is a component of Clifford Capital's process. The company was unloved by the market but "it had a great balance sheet and management was shutting down underperforming stores—which increased profits because sales would often go to another store nearby," Batchelor recalls. There were also what the firm terms "key thesis points"—a few long-term catalysts. In this case, a new console cycle played out well.

This kind of contrarian play has a lot of upside if all goes well. But it is the riskier end of value investing, which is why Clifford Capital offsets deep-value plays with a core value portfolio of quality companies with moats against competition. "These are the types of companies that grow intrinsically over time," Batchelor says. "If you can buy them at a discount, you can generate alpha."

American Express (AXP), another top performer over the past year, exemplifies a core value pick. The stock dropped several years ago after its relationship with Costco COST ended, threatening earnings, but the Clifford Capital team saw past that. "The Costco loss was actually a sign of strength. The deal was uneconomical and Amex walked away," says Batchelor. "American Express has tremendous brand and they earn returns on capital far above their cost of capital."

The Making of a Value Investor

Batchelor credits his eye for a bargain and contrarian streak to his parents: "My mother grew up humbly, the daughter of a dairy farmer in a one-bedroom house with three siblings. My dad was a successful businessman, but she was very frugal and would drag me around shopping for bargains. They both taught me to think independently."

While earning his MBA in finance, Batchelor honed his interest in value investing working on the student-run portion of Brigham Young University's endowment with Brian Yacktman (son of Don Yacktman). He also read the classics, including Warren Buffett, Phil Fisher, Marty Whitman, David Dreman, and Seth Klarman. He planned then to start his own investment-management firm after gaining some experience.

That started in Chicago at Morningstar in 2004, where Batchelor covered financials. The next stop, in 2007, was an analyst role on a value strategy run by Bob Costomiris at Wells Capital Management. "It was a great time to cut your teeth on the buy side during one of the greatest financial crises of modern history," he laughs. "My job was to pick through the rubble for good financial stocks."

Batchelor cites noted investor Dick Weiss, a Wells Capital colleague, as another key influence. In turn, Weiss admires Batchelor's value style: "When the market drives a stock down, Ryan can pick out the truly valuable assets in a company and determine what they should be selling for."

After Batchelor left Wells in 2010 to start Clifford Capital, Weiss invested some of his own money with the young firm. "They've run this company the right way from the beginning, and they heavily invested in the business," he says. "It never felt like a small firm to me."

Building a Business

Batchelor co-founded the firm with his father-in-law Wayne Pierson, an experienced institutional investor. His nephew David Passey was in at the start, too. Passey, who had started his own investment career at a large bureaucratic Brazilian bank, was eager to get in on the ground floor of a growing business.

"We joked that with David we got tremendous talent for a bargain price, but it was part of the culture of teamwork and selflessness," says Batchelor. "Wayne and I bootstrapped the firm with our own internal resources for several years."

In its first year, the team launched an all-cap value strategy, which became available as mutual fund Clifford Capital Partners CLIFX in 2014. Batchelor and Passey rented an office on the 84th floor of the former Sears Tower for a while—in an interior space without views, to save rent — but relocated to Alpine, Utah, in 2018.

"Utah is an independent-minded state, more entrepreneurial. There are a lot of benefits to being off the beaten path, although I still miss the Chicago food," says Batchelor. The move also made sense for his family—he and his wife, Dawn, have six kids now ranging from 10 years old to 22. They enjoy the outdoors lifestyle, and the move proved fortuitous during the pandemic.

"We were able to get out hiking and stay active," Batchelor says. "That grounds me and clears my head. It just helps to be out in nature."

Established in Utah, Clifford Capital was ready to expand—the team hadn't set out to run a family business. They needed outside funding, and they found the right fit in WCM Investment Management, based in Laguna Beach, California, which bought just under 25% of the firm in 2018.

WCM has some Morningstar alumni on its team, and co-CEO Paul Black says they "felt a cultural kinship" with Clifford Capital: "They are passionate about what they do, and they have a camaraderie. When things get rough, they will endure."

The investment catalyzed growth and today, the firm has about $300 million in assets under advisement and nine staff members. In 2019, they launched Clifford Capital Focused Small Cap Value FSVVX, a mutual fund version of a separate account launched in 2016. Black, himself a growth investor, invested his own money in the small-cap fund.

"I took a position in January 2020, and when everything sold off hard, I added to it," says Black. "They'd been fighting a huge value headwind, but they stayed in there and they finally have a tailwind—and are doing better than most value investors."

To build out the investment team, Batchelor turned to former Morningstar colleague Allan Nichols. "Allan brought new perspective and insight, given his international expertise," he says, "and philosophically, it would be hard to find a better fit."

"I was at a fairly deep-value buy-side shop and then at Morningstar was introduced to moats and high quality," Nichols says. "Ryan's strategy was a perfect marriage for me."

Because the strategies are highly concentrated in 25 to 35 stocks, that kind of compatibility is helpful. "We have a lot of conviction in what we do, and it's hard to be on an island if your thesis is taking longer than expected, or heaven forbid, you're wrong," Batchelor says. "We want a culture where we can support each other's independent thinking, backed by data, research, and analysis."

The Right Balance

While Batchelor makes final portfolio decisions, he, Passey, and Nichols collaborate on ideas.

"We are usually playing in the same sandbox when we are digging up ideas, looking for mispriced investments wherever they are," says Passey. "We have an open-door policy, and the truth is we just love to talk stocks all the time."

Nichols tells the story behind Big Lots BIG, another deep-value success story. The company had had no store growth to speak of for nearly a decade and had fallen out of favor. "We saw assets on the balance sheet, some warehouses and such, that we thought weren't valued well," says Nichols. There was also a catalyst: a new management team, which set about remodeling stores and acquired the rights to the higher-quality Broyhill brand. Because Big Lots was deemed an essential retailer, it remained open during the pandemic and had its best sales year ever.

Deep-value picks like GameStop and Big Lots are limited to less than 50% of the portfolio, but the sleeve came close to that ceiling in 2020. The reward/risk ratio was so promising that it made sense to tactically overweight it, Batchelor says: "The bargains we found in March of last year were among the best I've ever seen."

It paid off: Clifford Capital Partners returned more than 75% from April 2020 through June 2021, and Focused Small Cap Value was up nearly 100%. Batchelor attributes the outperformance to the deep-value sleeve, and the team still sees better opportunities there today.

"Not that we are negative on core value," he adds. "We love owning great businesses that compound over time." The team has built a watchlist of about 135 high-quality companies that they are ready to buy if a stock's price drops into their range—provided the moat remains intact and they have identified key thesis points.

Passey offers Stericycle SRCL as an example: "I was reading the 10-K, looking at the margins, and I commented to Ryan that this would be a great company to own. It was trading at 35 or 40 times earnings, and he said, 'Let me know when it's at 20.' We laughed, but five years later, it was at 18 times earnings. That's when we sharpened our pencils."

Management had added more debt to the balance sheet, and there were some pricing pressures, but the Clifford team believed these were short-term problems. They first bought in 2016 and it's still in the portfolio today. While the team sells deep-value plays once they hit fair value, they allow core value picks a longer leash provided there isn't a better opportunity to be had.

A Solid Foundation

While the past year's outsize returns are exceptional, both Clifford Capital strategies have strong risk-adjusted performance relative to their Morningstar Categories over the long term. That track record is just part of the reason Biltmore Family Office in Charlotte, North Carolina, chose Clifford Capital for client portfolios about a year ago. "Performance isn't the sole determinant in our diligence process," investment research analyst Emma DeMane says. "We like that they are market-cap-agnostic—able to go where the opportunities are."

Coyle Financial Counsel in Glenview, Illinois, has been investing with Clifford since 2014. "Their investment thesis is simple to understand, and they are true to their mandate," says chief investment officer John Finley.

Given the resurgence of interest in value strategies and its own great run, Clifford Capital may be poised for growth. Meanwhile, an international strategy is on the horizon.

Batchelor believes a foundation has been laid to support such growth: "Every key person at the firm has equity. We want to build a firm and a culture that can transcend me and Wayne."

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