“SOTT” - Something off the Top

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One of my investment heroes is Mr. Marty Whitman, the founder of investment firm Third Avenue based in New York. Mr. Whitman quite literally wrote the definitive guides on distressed and credit investing, while also contributing meaningfully to the global body of knowledge on his unique approach to contrarian long-term value investing. Apparently even well into his 90’s he could still be seen grafting through stacks of annual reports.

From studying his extensive and highly technical writing I first learnt about what he termed “SOTT”, which was his own acronym for “Something off the Top”. In a nutshell, it represents the many potential tangible and intangible benefits from owning large enough stakes in companies. From the perspective of a minority share owner, some of these benefits can be positives, for example the significant premium that a control owner can unlock for all shareholders in an outright sale of their controlling stake.

However, some of these benefits can be negatives, in some cases significantly so, for example if the controlling owner insisted on family members being employed by the company in key leadership positions even if they were not the best choice for the job at hand. To be clear, this is not an illegal activity, but it is most likely a dumb idea.

In South Africa, I can point you to two quite interesting and current examples.

Deep in the **Caxton** annual reports, it can clearly be seen the controlling owner partnership received cash payments of R47,9mn in FY2018 and R52,6mn in FY2017 as “*commission on the group’s advertising revenue*”, “*in terms of an agreement concluded in 1985…*”

If you ever feel like developing a legal ice-cream headache, dig through the Memorandum of Incorporation (MOI) of any company. Deep in **Shoprite**’s MOI, clause 9.2 deals with a separate class of shares called “Deferred Shares”. These shares all belong to Thibault Square Financial Services (Pty) Ltd, which in turn belongs to Dr. Christo Wiese. Basically, these deferred shares give Dr. Wiese 42% voting power whilst only owning an economic interest of 14%.

I submit the importance of paying attention to and carefully considering these finer details. It most certainly impacts upon the way we evaluate and value companies and make investment decisions.

Our work continues...

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