Why we love *lazy* Balance Sheets

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Anything that is not *prepared* for adversity will struggle to or fail outright to *survive* adversity. This is true in nature and it is also true in business.

Several things can give a business staying power. Great products & services, great leadership, an ability to renegotiate key agreements, cut costs or sell assets quickly, and supportive customers, suppliers or shareholders are all valuable in handling adversity.

Even if it is a great business with all the above, if it has a highly geared balance sheet it is incredibly vulnerable to adversity. This 'here today, gone tomorrow' reality has been unfolding all over the world in the past 4 months, including at **Edcon** in South Africa. Particularly noteworthy are infrastructure investors who geared up hugely working on a key assumption that businesses like airports and toll roads were bullet-proof. Oops-a-daisy.

Textbook business theory and a never-ending army of helpers will have us believe 'lazy' balance sheets with low net debt levels or, heaven forbid, net cash, is sub-optimal. Complex financial spreadsheet modelling shows how blending debt and equity results in higher returns for shareholders. I politely submit this is complete rubbish. High gearing only works when almost everything goes *right*. What these complex models fail to consider is the simple question; "What happens if anything goes properly *wrong*?"

The reason helpers will only attempt to answer this simple question under duress is because they are *negatively* incentivised to answer it. They will lose their fees if their advice is not followed.

We think the leadership of businesses operating with 'lazy' balance sheets are being smart and sensible. Firstly, they can have much better staying power. Secondly, they can gain significant strategic and operational competitive advantages when their highly geared competitors struggle or fail outright.

Lastly, they can acquire dirt cheap assets, including their competitors or their own undervalued shares, from distressed sellers at the bottom of the cycle in order to meaningfully grow per share long-term business value.

In closing, while they may not have anything else in common, we do not believe it a coincidence that the world's most successful and durable long-term investors tend to operate with 'lazy' or net cash balance sheets. Perhaps one day common sense will make a bit of a comeback.

Our work continues...

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