

AA-rated PM: ‘There will always be a role for disciplined stock selection’

Buffett acolyte Paul Meehan explains his investment approach and why he’s recently bought an energy company.

BY JOHN COUMARIANOS

Warren Buffett famously told investors in 1988 that his ‘favorite holding period is forever.’

It is one of his many pieces of wisdom that the father-and-son team of Thomas and Paul Meehan have taken to heart in running their \$104.9m Meehan Focus fund (MEFOX).

Their 26-stock fund focuses on finding businesses with competitive advantages and aims to hold them indefinitely. To this end, the fund’s annual turnover is 13% and it has held Buffett’s Berkshire Hathaway (it’s fifth largest position at 8.06%) since inception in 1999. Its largest position is also Berkshire’s biggest holding, Apple, which accounts for 9.52% of the Meehan fund and which has been in the portfolio since 2011.

The Buffett-like approach has paid off with the fund delivering a 12.47% annualized return for the five years ending on May 18, 2023, landing it among the top 3% of funds in

the Large Blend category.

Citywire asked Paul Meehan about how he picks stocks, how markets have changed since 1999 and why he recently added Shell to the portfolio, breaking with a long-held habit of avoiding commodity businesses.

Citywire: Describe your investment process, including the sell discipline. Do you start with simple screens? And what is your maximum level of cash?

Paul Meehan: We take a bottom-up approach to stock selection, focusing on the fundamentals of individual companies. We look for companies that possess some or all of the following attributes: low price-to-earnings, a strong franchise or moat, excellent prospects for growth, consistent free cashflow, high returns on equity and invested capital, a solid balance sheet, and qualified, shareholder-friendly management.

Once we’ve identified a

potential investment, we look at their competitors and dig into both quantitative and qualitative factors to arrive at an estimate of the company’s intrinsic value, which drives our decision to buy or not. Most potential investments we analyze do not pass these final hurdles.

We sell a stock when our thesis changes regarding its outlook. This may be driven by a sharp rise in valuation or by changes in a company’s competitive or financial position. We are comfortable letting our winning ideas run as long as the reasons for purchase remain intact. For example, we purchased Berkshire Hathaway on the fund’s first day of operations and have continued to add to the position, most recently in December.

We don’t have a maximum cash target. Our aim is to be fully invested, however, there are times when our cash level may rise to between 5% and 10%.

CW: Some say markets are more efficient now because

of the availability of information. But others say the high level of portfolio turnover shows human irrationality is alive and well. Are things different than at the beginning of your career?

PM: Markets today are definitely different than when the fund was opened in 1999. In the past, information relating to the markets and public companies, such as Securities and Exchange Commission filings and quarterly earnings releases, was not readily available to all investors. Market inefficiency is expected in situations where some participants have access to information that others do not.

The advent of the internet and widespread availability of high-speed connections fundamentally changed that, democratizing access to this information. Today, the average investor has access to essentially the same data as the professional investor which has made markets more efficient. It has not, however, removed human emotions, another

source of market inefficiency, from the equation.

We view the high level of portfolio turnover today as a reflection of human emotions and the many different ways all the information investors now possess can be put to use. We believe there will always be a role for fundamental analysis and patient, disciplined stock selection, which is what we have done for the fund since its inception.

CW: What are the prospects for CVS in its capacity as a pharmacy benefits manager (PBM) given the March news that Eli Lilly would cap the cost of insulin?

PM: PBMs are third-parties that manage relationships between drug manufacturers and health insurers. By negotiating with pharmacies and drug manufacturers, they can reduce the overall cost of drugs for consumers. In recent years the PBM industry has consolidated into three top players, of which CVS is one, and they collectively control roughly 80% of the prescription drug market.

Lilly's recent announcement of a price cap on insulin will increase price competition in the market and could pressure other insulin makers to make similar reductions. According to CVS, many of Lilly's insulin products are not part of its formulary, or list of drugs that may be prescribed, so the immediate direct negative impact is likely to be small. If more insulin makers follow Lilly's lead, the potential impact on CVS would likely increase.

Despite Lilly's decision and its uncertain impact on PBMs, we believe PBMs will continue to play an important role in the health care system. Adjusted operating income at CVS' PBM segment grew 7.2% in 2022 and is projected to grow at a mid-single digit rate in 2023.

CW: You have nearly 20% of the portfolio in Apple and Microsoft, and you began your positions in each stock over a decade ago. Give the thesis for those two stocks.

PM: We first purchased Microsoft in 2008 and Apple in 2011. Our positions in these two companies have compounded at an annual rate of 20% for Microsoft and nearly 23% for Apple, outperforming the S&P 500 by a wide margin. Both companies were trading at very appealing valuations when we initially purchased them and had additional characteristics that set them apart from competitors.

For Microsoft, it was the dominant position Windows held in the PC operating system market and Microsoft Office held in office productivity software. Over time, our investment thesis for Microsoft has changed as the company has shown an impressive capacity to adapt to the changing marketplace.

Central to this success was the decision to elevate Satya Nadella to CEO, clearly one of the best moves the company has ever made. He ushered in the shift to mobile and cloud applications and cloud services, which has been crucial to Microsoft's

growth in recent years. Looking forward, its recent advances in generative AI software have the potential to be a major revenue driver for years to come.

What initially attracted us to Apple were its strong brand identity and a reputation for quality and innovation which drove almost fanatical customer loyalty. These characteristics have allowed Apple to sell its products at premium prices, generating industry leading profit margins.

Similar to Microsoft, Apple has also benefited from strong leadership at the top with CEO Tim Cook successfully guiding the company in the post Steve Jobs era. He has spearheaded Apple's development of new devices and services, bringing more aspects of customers' lives within the ambit of its iOS ecosystem and diversifying its revenue stream beyond the iPhone.

CW: Shell looks like your most recent acquisition. Why Shell over other oil companies?

PM: The fund has historically not owned many energy stocks, as we have tended to shy away from investing in commodity businesses which are typically capital-intensive, low-margin, and cyclical. However, given the supply/demand imbalance that has occurred in various energy markets over the past couple of years, as well as an industry shift to focus more on profitability and returning cash to shareholders versus overspending on unending capital investments, we decided to take a closer look at the industry.

After doing a thorough comparison, we believe Shell has some of the most attractive assets in the global energy business, specifically in the liquefied natural gas market, where it was an early pioneer. As a result, Shell should continue to be a beneficiary of the favorable long term demand trends in that market.

In addition, over the past couple of years the company has embarked on several shareholder friendly practices. In late 2021 the company announced the simplification of their share structure, eliminating the old A and B shares, established a single class of common shares, and shifted their corporate residency to the UK from the Netherlands. The company also has reduced debt significantly and committed to paying out 20-30% of operating cashflow to shareholders through dividends and share buybacks. Recent restructuring has successfully reduced their annual operating costs and improved capital efficiency around the world.

At the time the fund purchased the stock, Shell was generating a double-digit free cashflow yield, which was increasingly being returned to shareholders, and yet the stock was trading at a 50-60% discount to the comparable US-based integrated oil and gas companies. We thought that discount gave us a significant margin of safety at the time of purchase.

Investors should consider the investment objectives, risks, and charges and expenses of the Fund before investing. The prospectus contains this and other information about the Fund and should be read carefully before investing. The prospectus may be obtained at <https://meehanmutualfunds.com/assets/pdfs/Meehan-Fund-Prospectus.pdf> or by calling 866-884-5968.

Important Information:

Past performance is no guarantee of future results. Investing involves risk, including loss of principal. The value of the fund's shares, when redeemed, may be worth more or less than their original cost.

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A list of the Fund's top 10 holdings can be found at <https://meehanmutualfunds.com/>.

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