

# QV UPDATE

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Ram Zilka, CFA | Mathew Hermary, CFA



## The Value of Models

*"All models are wrong, but some are useful."*

– George E.P. Box

In my free time this week, I worked through an online course called "Model Thinking" by Scott Page. In its simplest form, a model is a representation of how something works and what criteria are required for it to work. You may have heard the idiom, "too many cooks in the kitchen spoil the broth," but you may have also heard that "more heads are better than one." While both can be true when it comes to models, the next step should be to ask why and under what criteria the output will be valid.

Today we live in a world where more data is being measured, counted, and aggregated than ever before. Models are a key tool we can use to analyze data and make sense of what is happening and why. Models do not need to be complex for them to work well. Personally, I have found the combination of several simple models to be more helpful. Evidence from books such as "Superforecasting: The Art and Science of Prediction" by Phil Tetlock have shown that people who think with models consistently outperform those who don't, and that people who use lots of different models tend to outperform those who use fewer.

At QV, we generally agree with this approach and utilize a variety of models to assess how well a business meets our seven investment tests. Financial models are utilized to estimate value, assess downside risk, and business durability. Different models can also help us to catch our own mistakes or identify areas where incremental work is required. We use a variety of frameworks to assess the quality of a management team, its strategy, and the business model. These models aren't a perfect tool by any means, but they do help us clarify our thinking about a company. With endless amounts of data available, a whole industry has been built around gathering data and interpreting the results.

## Data Driven Value Creation

Tesco PLC, a QV Global Equity Strategy holding, is a prime example of a company that is utilizing data to drive strong results. The company has grown its consumer data business from the United Kingdom to over 75 countries

across the world. They estimate they have analyzed data from nearly a billion customers. This has allowed the company to gather an enormous amount of insight on retailing around the world which it can then use to stock the right products, optimize pricing and run appropriate promotions. The combination of in-store, brand and online data is not an easily replaceable asset, in our view. The company has even utilized its data and knowledge to meet the needs of a variety of other retailers and global brands. For example, Metro, a Canadian grocery business, partnered with Tesco when it launched a loyalty program in the past. Seeing competitors on a different continent using their product is a positive indicator of a strong asset. Today Tesco's valuation remains depressed, due in part to concerns surrounding Brexit. However, we believe this is a management team that will continue to find new ways to create value over the long-term.

American Express is another example of a QV holding that has effectively used data to create value for shareholders. The company employs a differentiated approach compared to other credit card payment peers in that it operates a "closed loop." In simple terms, it means they can gather cardmember and merchant data over the entire payment chain. In contrast, competitors are typically only able to gather data on one side of the transaction. Starting in 2010, the company has been using this growing amount of data in conjunction with artificial intelligence and machine learning to generate better insights. The most valuable use of this data has been to reduce and prevent fraud-related costs. Furthermore, they have used this data to better target areas where they can grow their customer base, using this information to send targeted offerings based on customer spending history. The company has been operating since 1850, and its ability to continue to adapt and innovate in different environments is a characteristic we value in the company.

Today, current trends in data are likely to continue to create new opportunities and risks for our companies. Partnering with the right management teams who have specialized skills and track records for creating value is a prudent way we can continue to generate strong risk-adjusted results for clients.