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Niche investment partnership finds value in special situations

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By Beverly Chandler

Eschler Asset Management is a five-year old niche hedge fund, run by founder and fund manager Theron de Ris (pictured), who is ex-Indus Capital, Goldman Sachs and Morgan Stanley.

After a stint as a senior analyst at Indus Capital, de Ris founded the firm in 2010 to deploy a contrarian investment philosophy that grew out of his experience of the dot com bust and was later honed in the aftermath of the global financial crisis.

October 2011 saw Indus pulling out of this first fund with the market down, an experience that taught de Ris a lesson or two about the vicissitudes of investment capital and catalysed a re-think of the investment process and the target investor profile. By 2012, de Ris was back on the Indus payroll in business development.

But, energised by the continued commitment of an original investor, de Ris launched Eschler Recovery Fund in 2012 with friends and family capital. The resulting simplified strategy deploys a concentrated value discipline – and a much reduced balance sheet - to primarily cyclical industries as well as selected special situations with catalysts in place for recovery, with an industry focus on financials, materials, energy and consumer discretionary. The universe is primarily North America.

Since the October 2012 launch of Recovery Fund, the gross return has compounded in the low double digits with a low 6 per cent correlation of monthly returns to those of the S&P 500. Last year saw a 48 per cent gross return.

de Ris says: "The fund is a concentrated portfolio of special situations that are generally strong businesses, but in industries that are under a cloud, affording a price paid that is at a significant discount to private market value creating assymetric risk vs reward."

As an example, de Ris cites his holding in Bank of Cyprus. "I look at macro and micro and both sort of line up," he says. Around four and a half years ago the country was bailed out and the banks, full of Greek debt, were recapitalised as foreign investors came in.

Bank of Cyprus remains the dominant lending and depositary franchise in Cyprus and now, de Ris says, the management is deliberately restructuring the non-performing loan portfolio and making continuous progress.

"The bank's fundamentals are stabilising while those of Cyprus are actually robust," de Ris says. "The perception is that Bank of Cyprus has a loan book full of loans whose value won't be recouped but the reality is quite different."

The bank was recapitalised three years ago at over EUR4.80 a share and now trades at EUR2.70, despite having made headway at improving its position. "In my view the risk to shareholders' equity is manageable," he says. Time will be the catalyst that brings the holding back to book value (150 per cent above recent prices) he believes, pointing to the similar experience with Bank of Ireland.

de Ris's process is to start with a strategic framework and try to understand what the expected returns are at the overall market and industry level. Unloved, capital-starved industries and regions, where an argument can be made for high prospective returns, are of particular interest.

Out of favour industries currently in de Ris's strike zone include energy, precious metals, banking and consumer cyclicals.

de Ris's bottom up strategy relies on what he calls the 'scuttlebutt' approach, building a watch list of individual ideas through reading, basic research and contacts.

The fund remains small, in single figures, and largely comes from family offices, high net worth individuals and contains de Ris's own capital in the 'eat your own cooking' tradition.
He is expecting new commitments in the near future and may launch a long only strategy to complement the fund. It best suits investors who take a long-term approach to value creation, he says.

As a hedge fund, the short book is generally modest, having averaged 15 per cent of NAV over the past five years. de Ris sees the short book boosting results in bear markets and otherwise breaking even.

"For the short book I am evaluating companies that have high projected growth rates embedded in the valuation. Great businesses are not always great stocks; it's all about the price you pay. Companies which may also be facing strategic secular problems are also of interest, in which case valuation is less relevant," he says.

He describes himself as applying a private equity mindset to the listed market. However, he uses little to no leverage and, as a passive minority investor, requires that investees have a capable management in place which is aligned with the shareholders.

The 6 per cent correlation with the S&P 500 shows that the fund has behaved very differently than the broader stockmarket and, de Ris says, should be considered complimentary to equity index exposure and a diversifier of more growth-oriented traditional equity portfolios.