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How important is management in the analysis of a company? We have thought about and discussed this topic extensively over the years. Disney recently experienced an unexpected shake-up at the top, and we decided to use that event as the starting point for exploring the importance of management in stock analysis. We discuss the management assessment portion of our stock analysis checklist, the quantitative metrics we focus on to assess management, management's influence on company culture, industries in which management has greater influence over company success, and the idea of following a great CEO. We close with our final thoughts on where management stands in the hierarchy of items that determine if we will or will not invest in a company.

Disney COO unexpectedly steps down – should we care?

Disney saw its stock price take a minor hit recently when Thomas Staggs, Disney's chief operating officer (COO), unexpectedly announced he was stepping down from Disney. Normally, a COO stepping down is not enough of an issue to affect the stock price, but Staggs was expected to take over as CEO in 2018. Uncertainty over succession at large companies can be a major source of investor concern, particularly when the current CEO has been successful, and investor reaction here proved the point.

Bob Iger has been Disney CEO since taking over from Michael Eisner in 2005. Iger has already announced he will retire in 2018, and Staggs was assumed to be his successor. Iger has been a very effective and popular CEO. He patched up Disney's frayed relationship with Steve Jobs, then CEO of Pixar, upon assuming command in 2005 and acquired Pixar in 2006. Under his leadership, Disney also acquired Marvel in 2009 and Lucasfilms (i.e., Star Wars, Indiana Jones) in 2012. All three acquisitions have been grand slams already with very long runways of profitability ahead. These acquisitions have brought more than incredibly valuable franchises – they also have come with exceptional talent in John Lasseter (Pixar), Kevin Feige (Marvel), and Kathleen Kennedy (Lucasfilms). John Lasseter became creative director at Disney Animation and shepherded in the second Disney Animation renaissance, which saw a string of successes, starting with movies "Tangled" and including "Wreck-It Ralph," "Frozen," "Big Hero 6," and "Zootopia."

All aspects of Disney have grown under Iger – from parks to media to film to merchandising to games. Since Iger took the helm, revenue has grown approximately 5% on average every year. Due to the fact that Disney has a relatively high degree of operating leverage (park maintenance and production budgets are generally the same regardless of revenue levels), net income has grown over 11% annually during Iger's tenure. If Iger retired today, he will leave an incredible legacy. He will be adding to that legacy over the next two years as the ambitious and highly anticipated Shanghai Disney opens, the new Avatar section comes to the Animal Kingdom theme park at Disney World, and Star Wars Land comes to both Disneyland and Disney World, not to mention the slate of highly anticipated movies coming from Disney's various production studios. Thus, Disney now is faced with a popular and successful CEO retiring in 2018 - and no apparent successor in the wings.

With no apparent successor, is Disney still worth it?

I have been fascinated by the business side of Disney for roughly a decade, since I read *Disney War* by James Stewart. The book chronicled the rise and fall of Michael Eisner as CEO of Disney over a 20-year period. However, we did not invest in the company until last August, when it dipped to the mid-$90s from a recent high of over $120 on fears of cord cutting impacting ESPN. In our view, cord cutting fears are far overblown, and ESPN will be successful in any distribution model regardless. ESPN's brand and telecast rights in sports are unmatched. Moreover, because 96% of sports are watched live, the benefit of models such as Netflix over traditional cable is significantly reduced. In fact, over 80% of cable subscribers tune into ESPN each quarter, and “wanting to watch sporting events live” is the primary reason given for not cutting the cord. However, this newsletter is not meant to debate the future of television. For anyone interested, I highly recommend Michael Wolff’s *Television Is the New Television*, which came out last summer and heavily influenced our thoughts on the matter.

While ESPN is a very important part of Disney’s financial results, there is more to Disney than ESPN. Consider: No company on earth can monetize a franchise like Disney can. Disney has 11 different franchises that generated over $1 billion in retail sales in 2015 - each. These franchises require significant up-front costs, but result in revenue streams that last decades. Mickey Mouse is a prime example. He was created in the late 1920’s and is still incredibly popular and valuable. Each new generation is introduced to Mickey Mouse via TV shows, movies, and toys. Mickey is a self-perpetuating money machine.

Another great example of long-term success is the animated film "Snow White." It cost $1.4 million in production costs leading up to the movie’s 1937 release. It has earned Disney billions of dollars in revenue since then and still is a popular character, generating revenue for Disney at very high incremental margins.

Disney's continuing franchise successes generally begin with the theater box office results. Revenues in the near-term can be many multiples of that original box office result. Take "Frozen" as an example. Its box office revenue was an animated movie record $1.276 billion, but merchandizing revenue was many multiples of that. Additional revenue comes from little girls wanting to meet Elsa and Anna at Disney World or Disneyland or on Disney Cruises or from watching TV shows, specials, and straight-to-DVD movies or from playing mobile or console games.

In addition, the majority of Disney merchandise sales are via licensed products, which command industry-leading licensing rates yet remain highly sought after and valuable. Just look at what happened to Hasbro's and Mattel’s respective stock prices when Mattel lost the Disney Princesses licenses to Hasbro (they each moved over 30%, but in opposite directions). The benefit of licensing out its products is that Disney takes on zero risk of loss or market acceptance as well as no required investment in working capital, but again reaps monetary rewards.

Given the incredible structural advantages at Disney, one has to wonder if it even matters who is leading the company. The short answer is that it matters to some degree. Iger clearly has added tremendous

value to Disney, but Disney also survived the final 10 years of Eisner, as well as the 15 seemingly lost years between Roy Disney and Eisner. During that period, the animation department was so unsuccessful that it nearly was shut down and had to be saved by Roy Disney Jr begging Eisner not to close it.

How important is management really?

Kevin and I enjoy debating this issue because there is a lot of rich history and great examples, both good and bad. I recently watched a two part, three-plus-hour documentary on Walt Disney from PBS. Shortly after watching it, Kevin and I were discussing the CEO of one of our investments in the greater context of the importance of management to a company's success. The CEO clearly had made a mistake the previous year, and Kevin asked if that mistake was enough to put him in the "bad CEO" pile? I responded with the following hypothetical drawn from the PBS documentary on Walt Disney:

> *Imagine we are living in the early 1940s and are considering The Walt Disney Co.'s preferred stock. Disney had done very well with Mickey Mouse and his friends Minnie, Donald, Goofy, etc. over the past decade. Disney was a proven innovator, beginning with the groundbreaking cartoon "Steamboat Willie," the first cartoon to include sound. Further, "Snow White," the first full-length animated movie (originally denounced before it was released as "Disney's Folly" for being a ridiculous idea), trounced all expectations and proved a box office hit at the time. Flush with cash and a proven concept, Disney began production on multiple full-length animated movies, including "Bambi," "Pinocchio," and "Fantasia." In fact, Walt Disney had to take the company public because they burned through their "Snow White" cash to make these movies and needed the funds to complete them. All three movies lost money at the box office, in part because World War II took away the European Market. The preferred shares dropped to $4 from the initial price of $25. Disney was treading water with government contracts to aid the war effort as their life vest. If we were considering the stock, we would be questioning Walt Disney's ability despite his past successes and innovations. Would we have passed on the shares at that time?*

Obviously, hindsight is 20/20. Disney went on to massive success after the war, starting with another animated movie "Cinderella" in 1950; the "Wonderful World of Disney," which was the number one show on TV for a time; and the new and ambitious theme park that opened in California in 1955 (also considered a ridiculous idea by detractors). It was not until Disneyland opened that Disney finally had a steady stream of cash, which Walt then used to buy up land in Orlando about a decade later to begin his next visionary concept – the Experimental Prototype Community of Tomorrow, or EPCOT. Unfortunately, Walt died just a year into this new project. His older brother stayed on as CEO, a post he technically held since 1929, to finish Walt Disney World before retiring in 1971.

The question of "would we have passed on Disney's stock in the early 1940's?" was not posed with a right or wrong answer in mind. We don't know all the facts available at the time and certainly could not predict that Disney would one day be #1 in both sports media and theme parks, two business lines not even contemplated at the time. The point is that assessing management is a very difficult process and placing too much emphasis on recent events can often be a mistake.

I brought up a few other examples as well. Warren Buffett is on the Mount Rushmore of CEO's, but even he made a huge mistake that costs Berkshire shareholders more money every year. He made the mistake of buying a bad business in the early 90s in Dexter Shoes and compounded that mistake substantially by issuing Berkshire stock to do so. Dexter eventually was shut down and folded into H.H. Brown, another Berkshire subsidiary. Buffett issued 25,203 shares in 1993 to acquire the company, worth $420 million at the time. Today, Dexter Shoes has little value but those shares are worth $5,368 million and counting. The cost of that acquisition has increased nearly 13x while the value has gone to around $0. Warren clearly made a mistake, but that does not mean he should have been ousted from the company or that investors should have stayed away.

Warren Buffett himself seems to take both sides of the argument on the importance of management. On the one hand, he espouses adages that seem to belittle the importance of management:

> *"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."*
>
> *"I try to buy stock in businesses that are so wonderful that an idiot can run them because sooner or later, one will."*

On the other hand, Buffett constantly sings his managers' praises in his annual letters. He discusses the tremendous value that the likes of Ajit Jain, Tony Nicely, and Matt Rose have brought to Berkshire. This seeming contradiction further proves how complicated the issue is.

A business does not start great. It takes good to great leaders to create the structural advantages that will allow subsequent average to below average management to maintain success. While a truly wonderful management team can take a company to new heights and realize sustained success for many years and a horrendous management team can drive a good company into destitution, the reality is that most management is somewhere in between.

In some ways, CEOs are similar to NFL QBs. They receive too much credit when they win and too much blame when they lose. A small percentage of elite men and women at the CEO position (and men as QBs) seem to lift the team to great heights single handedly, elevating the play of everyone around them. However, you do not need to have Peyton Manning as your QB to win the super bowl. In fact, Peyton Manning has only ever won the super bowl when he did not have to carry the team on his shoulders every single game. On the opposite end of the spectrum are your Curtis Painters, who took over for a team Peyton led to the playoffs the year before and, with essentially the same roster and coaching staff, went 2-14, and earned the number one pick in the draft. There is one major difference between CEOs and NFL QBs – it is far harder to remove a poorly performing CEO than it is a QB.

Management should not be the primary reason for an investment (unless, of course, you happen to stumble upon the next Warren Buffett…unlikely). The fundamentals of the business and industry should prevail over the acumen of management, which is what Buffett is alluding to with his two quotes cited above. However, management remains an important factor and should be considered as part of the

overall analysis. Exceptional management warrants a higher valuation, while poor management should be avoided. We consider several factors in this analysis.

"Me first" management – stock analysis checklist

First and foremost, we want to avoid what we call "me first" management. We wrote an article outlining the pitfalls of "me first" management, which was published in Accredited Member magazine in 2012. You can find a pdf of the article here: http://www.boothlaird.com/2012/08/me-first-management/. Accredited Member magazine has a focus on micro-cap stocks. Therefore, the article focuses on the problem from a micro-cap stock perspective, but the concepts apply regardless of company size. In short, as the name implies, "me first" management has no interest in protecting and growing shareholder value but is only concerned with their own interests, often treating the company as their personal piggybank. Due to less stringent corporate governance, you more often find this type of management in smaller companies, but it still can occur in large organizations.

We have created a stock analysis checklist for all potential investments. The checklist has over 40 questions on it culled primarily from Philip Fisher's *Common Stocks and Uncommon Profits*, from Robert Hagstrom's *The Warren Buffett Way*, and from personal experience. Our checklist has a section dedicated to assessing management that includes the following 10 questions:

1. **Is management overpaid? Assess management's compensation structure and as a percentage of income before management compensation.**
   Management that takes a large percentage of income as their salary generally are more interested in their salary than in growing shareholder value. We prefer management that owns a significant portion of company stock and strives to increase the value of that stock. We also prefer management compensation to be structured with a significant portion in long-term incentives that are earned over a multiple-year measurement period, including clawback provisions. We particularly despise management salary that is based on a peer group. We discussed this issue in the "me first" management article linked above.
2. **How much stock does management own?**
   See the answer to #1. Management should be fellow shareholders, and their investment should comprise the vast majority of their net worth. We appreciate companies that require management to own in stock a certain multiple of his or her base salary.
3. **Has management been buying or selling stock?**
   As the adage goes, management can sell stock for many reasons but only buys stock for one reason. To be clear, we are referring to open market purchases as opposed to exercising stock options.
4. **Any unique arrangements or related party transactions with management?**
   We are not a fan of management owning property or assets and leasing it to the company. On very rare occasions, management actually leases the assets at below market rates, but more often than not it is at above market rates. It is just another potential way for management to take more money from the company's coffers. We also discussed this issue in the "me first" management article linked above.

5. **How candid is management when things are going poorly?**
   Management will make mistakes sometimes. The industry occasionally will face difficult headwinds. The economy sometimes may be in a recession. We want management that acknowledges these issues without sugarcoating. You would never know some management teams are underperforming or facing difficult circumstances based on their communications – everything is all roses and sunshine in their view. A candid management team is generally more transparent with other aspects of the business and more trustworthy.
6. **Looking back over previous management communications, how honest have they been in what the company plans to do in the future?**
   We look at a few years of management communications to see if subsequent events match up to what management communicated to investors. We certainly understand many things are out of management control, but we want to see that management understands their business well. For example, we analyzed LeapFrog a couple of years ago when it was trading for $8. We looked back on the previous 10 years of annual reports. It was amazing how many different products management had tried, often numerous times over multiple years, which never worked out. The subsequent communications never acknowledged that revenue peaked in 2003 or that they were trying something again that previously failed. For instance, the Leap TV, a gaming console for kids introduced in 2014, was very reminiscent of a product described around 2005. Management was equally excited about that product beforehand, but it ultimately failed. Likewise, Leap TV does not appear to have been the success management expected. We ended up passing on LeapFrog with management communications being a major factor. LeapFrog dropped all the way to under $1 in the subsequent 18 months, before being bought out for $1 by a competitor.
7. **Is management consistent in its communications?**
   We like to see management expound on the same long-term goals and driving factors of the business's success year after year. When the targets seem to change year after year, that is often a bad sign that management may not really have a firm grasp of the business or the industry or may not have a long-term perspective.
8. **Does management evidence a "me first" attitude or is it truly shareholder friendly?**
   "Me first" management does not have the same interests and goals as the shareholders, which can lead to disastrous results. See the article linked above.
9. **Does management resist the institutional imperative?**
   This is a term we took from Warren Buffett. The institutional imperative is the behavior exhibited by some management teams who feel compelled to constantly acquire new businesses, often at ridiculously high prices, in an effort to grow their own sense of importance and/or their salaries. This type of management would certainly qualify as "me first."
10. **Is there a dual class structure that benefits one group to the detriment of another?**
   One of our biggest pet peeves is a dual class structure that contains wildly different voting rights, especially when the class structure with excessive voting power is owned entirely by management or by the founders of the business. We discuss this in the "me first" management article as well. Often the sole reason that a company has two classes of stock with unequal voting rights is to enrich unjustly the original owners of the company upon going public. The original owners want you, the

shareholder, to give them your money but do not want to give you any say in the use of that money. These managers do not understand that they sold the company and are now merely employees. We passed on Discovery because it had 5 separate classes of stock, each more privileged than the next. That transgression was unforgivable to us.

Creating and maintaining the proper culture

One of management's most important tasks is cultivating and sustaining the appropriate culture. You may have heard the term "tone at the top," which means that management's behavior will influence the entire organization. Therefore, it is particularly important for management to both talk the talk and walk the walk. Behavior and attitude that is not constantly reinforced will drift naturally over time.

As investors, however, it is almost impossible to evaluate culture truly within an organization. There is no aspect of a company more abstract than culture. Little things can give you clues, such as annual improvement in safety metrics, high customer and employee satisfaction, and high rankings from third parties for product quality or reputation. Berkshire Hathaway subsidiary Mid-American Energy is a great example. It acquired two gas pipelines that, upon acquisition, were ranked 9th and 42nd, respectively in independent surveys of customer satisfaction. Per the most recent update from Mr. Buffett, those pipelines now rank 1st and 3rd, respectively. That is a major improvement that indicates management is likely setting a very strong tone at the top and spread throughout the organization.

One resource we always try to look at is www.glassdoor.com, which contains reviews from employees on the companies for which they currently or previously worked. The reviewers also can separately rate the company's CEO. Naturally, some disgruntled employees will not speak favorably of the company, and a company's culture is not for everyone. However, generally there are enough reviews of mid-cap companies and higher to get a decent understanding of how employees like (or dislike) working for the company and for the current CEO. We might have passed on Payless ShoeSource (PSS) had we known how disliked its CEO was. He talked a great game on calls and appealed to our organized accounting brains. Imagine our surprise when, within months of our investment, he was abruptly fired by the board. We still made money on the investment because it was beaten down so much when we invested, but we altered our management assessment process as a result of that surprise.

Key metrics

ROIC

As mentioned earlier, we also focus on a few quantitative factors to evaluate management. The most important is return on invested capital ("ROIC") because management's primary role is to allocate capital, and ROIC is the best long-term measure of capital allocation. We believe ROIC is superior to return on equity ("ROE") for most industries because it removes the impact of different capital structures to allow for better comparison across companies and across time. ROE can be highly inflated if a company is highly leveraged compared to a competitor or to their former selves.

We look at ROIC three different ways to better assess management:

1. **Did ROIC exceed WACC?** ROIC should at least exceed a company's weighted average cost of capital ("WACC"), meaning the returns generated by employing the company's capital exceed the cost of obtaining or maintaining that capital.
2. **How does the company's ROIC compare to peers over time?** One year's ROIC is itself not overly informative. It can be influenced by one-time accounting choices, deep write-offs of goodwill the previous year, and other items that artificially boost the numerator or suppress the denominator. Those items tend to even out over time, so we look at a minimum of five years in comparison to peers.
3. **How does the company's ROIC hold up after a major acquisition?** Acquisition and integration expenses likely will suppress ROIC in the year of an acquisition and the year following it. However, if ROIC drops significantly after a major acquisition and stays low after a few years, then the company likely has overpaid, meaning they misallocated capital. The primary reason a company ends up overpaying is due to overestimating "synergies", or the cost reductions that can be achieved at a new company. Companies rarely achieve the synergies they expect. A few management teams, however, have shown a proven ability to acquire a company and drive out significant costs. Precision Castparts, recently acquired by Berkshire Hathaway, has a strong track record under the current CEO of making great acquisitions and maintaining ROIC, after driving out costs at the acquired company.

Cash Conversion Cycle

The cash conversion cycle is rarely discussed by either management or by analysts. We think it is wildly underrated. The cash conversion cycle measures the time it takes to convert an investment in inventory and other resource inputs into cash. Investopedia has a good breakdown of the cash conversion cycle here: http://www.investopedia.com/terms/c/cashconversioncycle.asp. Here is an excerpt from that link that summarizes it well:

> *The cash conversion cycle is a metric used to gauge the effectiveness of a company's management and, consequently, the overall health of that company. The calculation measures how fast a company can convert cash on hand into inventory and accounts payable, through sales and accounts receivable, and then back into cash. By combining these activity ratios, the measurement indicates the efficiency of the management's ability to employ short-term assets and liabilities to generate cash for the company. The CCC entails the liquidity risk associated with growth by measuring the length of time that a firm will be deprived of cash if it increases its investment in resources in an effort to elevate sales. It can be especially useful for investors who wish to draw a comparison between close competitors, as a low CCC signifies a well-managed company, and thus can be used to help evaluate potential investments.*

There are three parts to the cash conversion cycle: days inventory outstanding; days sales outstanding; and days payables outstanding. The link above goes into the formulas and the different aspects of it for anyone interested.

We have found that companies with lower cash conversion cycles than their peers tend to realize higher profit margins, which result in the company generating higher returns on the same amount of capital employed compared to their peers.

A company with a negative cash conversion cycle, meaning they get paid by their customers in cash before they have to pay their suppliers and are effectively financed by their suppliers at no cost, have a huge advantage over peers with a positive cash conversion cycle. Apple is our favorite example. Its cash conversion cycle averages negative 50 days, while all of its major competitors have positive cash conversion cycles. Cash is king in any business, and that amount of financial flexibility is difficult to compete with. It is also evidence of sustainable structural advantages compared to its peers. We view negative cash conversion cycles as indicative of a durable competitive advantage.

Of course, the cash conversion cycle doesn't apply to every industry. It means little for finance and insurance companies. It is more meaningful for companies that actually manufacture or sell a tangible product. It is important to understand the nuances of the industry for assessing the cash conversion cycle. For example, some companies get paid before providing the service, such as in subscription models, resulting in deferred revenue. Deferred revenue represents a future obligation to perform and should be factored into the calculation, but often we see it left out.

Management matters more in commoditized industries

Management matters more to a company's sustained success in commoditized industries. It is nearly impossible for a company in a commoditized industry to develop an economic moat by virtue of the fact that everyone is selling the same product. To expand upon the economic moat analogy (i.e., companies with durable competitive advantages have a moat around their business that keeps competition at bay), when a company cannot rely on a structural advantage such as a moat, it must have better warriors (i.e., management) to keep back the invading hordes. Often, management is the only differentiator for these businesses.

Most people think of oil & gas, minerals, or chemicals when they hear "commodity." However, "commodity" also includes most financial services – banks and insurance. A bank loan or an insurance policy is pretty much the same from bank to bank or insurance company to insurance company. The difference is the brand behind it, the terms offered, the customer service, and the company's expense structure. It is no accident that the managers Buffett praises most often are his insurance managers.

It takes a very good management team cultivating a strong culture over a long time to generate excess profits in a commoditized industry. We typically avoid these industries, in part due to the importance of management and in part because it is difficult to determine what price a company can charge for its product in the future. All participants in these industries are price takers because they deal in commodities – if you charge above the market price, the customer can just walk down the road to a competitor and get the same product for a better price.

The lone exception we make regarding our ban on commoditized industries is to invest in financial services companies, namely insurance. We have developed a strong understanding of insurance companies and how to assess management of those companies. We focus on a few key metrics unique to the insurance industry and know what words and actions on which to focus. However, that is a topic for another day. The key takeaway today is that management moves up the importance hierarchy when analyzing companies selling a commodity.

Following a great CEO

There are a few truly wonderful CEOs who cast a long shadow and are difficult to follow. Steve Jobs, Warren Buffett, Jack Welch, and even Bob Iger all come to mind among the more well-known CEOs. This type of CEO generally has been in office for at least a decade, often has become synonymous with the company, and has generated a substantial average ROIC during his or her tenure.

Ironically, these CEOs' successes can hurt the stock price as they near the end of their tenures and eventually step down. There is a great deal of uncertainty about how much of the company's success is due to that one person and if that success can continue without him or her. I would venture to guess that Berkshire Hathaway suffers from a Warren Buffett discount. The stock appears inexpensive right now, but Buffett will turn 86 in August while his partner, Charlie Munger, just turned 92. Similarly, when Apple slightly fell short of expectations in one quarter soon after Steve Jobs died, Apple's stock dropped 30%. We took advantage of these opportunities at Berkshire Hathaway recently and at Apple in 2013 after the drop.

The key question to answer in this situation is whether the current CEO and his or her team are time tellers or clock builders. This concept was developed by Jim Collins and explained in his book *Built to Last*. Below is an excerpt from a Jim Collins article from 1995 on the subject:

> *Imagine that you met a remarkable person who could look at the sun or the stars and, amazingly, state the exact time and date. Wouldn't it be even more amazing still if, instead of telling the time, that person built a clock that could tell the time forever, even after he or she were dead and gone?*
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> *Having a great idea or being a charismatic visionary leader is "time telling;" building a company that can prosper far beyond the tenure of any single leader and through multiple product life cycles is "clock building." Those who build visionary companies tend to be clock builders. Their primary accomplishment is not the implementation of a great idea, the expression of a charismatic personality, or the accumulation of wealth. It is the company itself and what it stands for.*
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> *Take for example, T.J. Rodgers, founder and CEO of Cypress Semiconductor. Brilliant, self-assured, technically sophisticated, and guided by a fierce "take no prisoners" drive to win. Rodgers came to Jerry and me several years ago. "I want to go beyond the fast-growing entrepreneurial success," Rogers told us. "I want to build Cypress into a monument company."*

“Tell me, T.J.," I responded, "what is the most important product you are working on right now?” He threw out a highly technical name. I disagreed with him.

“How can you?” he asked. “You don’t know the technology. You don’t know my business the way I do. You don’t know the market."

I then told him how David Packard, when asked to name the most important product decisions contributing to Hewlett-Packard's remarkable growth rate, answered entirely in terms of the attributes of the Hewlett-Packard organization—the importance of granting immense operating freedom within well-defined objectives, the pay-as-you-go policy that enforces entrepreneurial discipline, the critical decision to enable all employees to share in the company's financial success. David Packard was clearly a clock-building leader.

Now, whenever T.J. Rodgers is asked about the most important product he is working on, he answers firmly, "Cypress Semiconductor Corporation." By making the shift from time telling (being a great product visionary) to clock building (creating a great organization), he has taken perhaps the single most important step in transforming his hot-growth company into a visionary company that's built to last.

Achieving that transformation requires turning the world upside down and inside out, seeing products and market opportunities as vehicles for building a great company, not the other way around. In fact, only 3 of our 18 visionary companies began life with a "great idea." As we move into the 21st century and products, technologies, and markets blast through their life cycles, clock-building styles of leadership will become even more important.

The key to determining whether a CEO is a time teller or a clock builder is to listen closely to his or her communications as well as the communications of subordinates. It is very clear that Buffett has created a wonderful organization that has everything in place to sustain success for decades. Similarly, we felt Jobs had created a highly effective organization. It helped that he had taken long leaves of absence since 2004 and that Tim Cook had been semi-running the company since then.

As noted above, Disney was already a company with durable franchises and unique advantages long before Bob Iger came along. He did his part to further widen the moat around the business, and Disney should prosper long after he is gone.

The final analysis

Management is important, but they often receive too much credit when times are good and too much blame when times are bad. Business and industry fundamentals and, above all, price paid vs value received should be the primary focus of an investment decision. Management matters more for a company selling a commodity, but we generally stay away from those industries in part due to the importance of management.

We would rather have an average management team of a great business available for a good price or an average management team of an average to subpar business at a wonderful price than hold out for only that rare Warren Buffett-type manager. Of course, we want to avoid poor managers under any circumstance. Therefore, sizing up management is still a key part of any stock analysis, just not the most important part of that analysis.

To bring it back to the original example, as Disney investors, our reasoning on why Disney is a good investment did not change at all when the COO announced he was stepping down. We believe the business and industry fundamentals are just as strong without that particular COO and, more importantly, the current price presents substantial upside with limited downside risk. We are unlikely ever to invest in a company based on the COO and, therefore, unlikely to change our opinion of a company when the COO steps down.

Disclosure: Long DIS, AAPL, BRK/B

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