Statewide

BUSINESS NEWS FROM ACROSS NORTH CAROLINA

Food for thought

John Day moved past restaurant stocks to build a hot investment firm.

By DAVID MILDENBERG

It hasn't stopped the presidential candidates from hatin' on them, but most hedge-fund managers have struggled in recent years to match the Joe Sixpacks who buy and hold the basic stock-market indexes. Raleigh money managers John Day and Sheldon Fox have proven the exception, ranking first in North Carolina and 39th nationally among managers with more than $300 million in assets, according to a survey by *Barron's* magazine that tracked performance between 2012 and 2014.[i] Toppping the averages was not easy in that period, as the stock market soared. But Day and Fox made enough smart selections that KDI Capital Partners Inc.'s main fund had an annual average return of 20.2%,[ii] almost triple the 7.4% average of U.S. hedge funds, according to *Barron's*. KDI looks even better stretching back to 2008, when the U.S. stock market plunged. Since then, it has gained almost 10% a year, compared with about 7.3% for the Standard & Poor's 500 Index.[iii]

Money management is a huge business in North Carolina with about 20 money managers

John Day, left, and Sheldon Fox

PhotograPhy by John gessner

KDI Capital's 10 largest holdings

(June 30,2015)

Company	Type	Position size (million)
McKesson Corp.	Drug distribution	$37.3
Stock Building Supply Holdings Inc.	Building supplies	29.5
Watsco Inc.	HVAC supplies	26.4
CVS Health Corp.	Drugstores	25.9
Pool Corp.	Pool supplies	23.3
Whole Foods Market Inc.	Supermarkets	19.8
Lawson Products Inc.	Industrial supplies	19.3
T. Rowe Price Group Inc.	Financial services	16.5
BlackRock Inc.	Financial services	15.9
LKQ Corp.	Auto parts	14.4

Source: Company regulatory filing

based in the state each overseeing more than $1 billion in assets, according to market researcher BrightScope Inc. That doesn't include national giants such as Morgan Stanley or Vanguard. With about $430 million as of June 30, KDI doesn't even rank among the 30 biggest managers in the state, but its partners hope that changes as more wealthy individuals and institutions learn about their history. "We've been very much under the radar," Fox says, though both are longtime members of Raleigh's finance community. Day, 61, has worked in investments since 1980, starting as an analyst at former Raleigh brokerage firm Carolina Securities Corp. In 1990, he joined Investors Management Corp., the holding company owned by James Maynard that is best known for its ownership of the Golden Corral steakhouse chain. Maynard wanted Day to help analyze private-equity investments and invest some cash into publicly traded restaurant stocks. By 1996, Day had devised a strategy of focusing on 15 to 25 stocks that he believed could grow by 10% or more annually over a seven-year period. "We question if the stock is a company we'd like to own completely, and it doesn't matter if it is large or small," he says. "Our goal is to have double-digit returns with less risk than the overall market, and our history has shown we can do that."

In 1998, the money-management business was spun out as a separate company, Maynard Capital Partners, then nine years years later changed its name to KDI, which stands for knowledge, discipline and integrity. Day is now majority owner, while Fox and Investors Management have minority stakes. The company has about 65 clients, including wealthy individuals, a few private companies and insurance companies. James Maynard's company accounts for less than a quarter of KDI's business.

Fox, 55, is a former accountant and banker, having worked for KPMG for 16 years, then as chief financial officer at Durham-based Central Carolina Bank and Trust Co. and its successor, Memphis, Tenn.-based National Commerce Financial Corp. Anxious to return to the Triangle after SunTrust Banks Inc. bought the Tennessee bank, he joined Day in 2004 and became a partner three years later. With investors panicking during the financial crisis of 2007-09, the company started a second fund that uses a combination of stock and option investing aimed at earning 4% to 8% annually. Most of its investments are giant companies such as Google Inc. "In part the strategy involves not picking stocks that we think are going up as much as getting stocks that we don't think are going to go down significantly," Day says. The fund, managed by Fox, has reached $100 million in assets because of customers who want a more conservative approach than aiming for double-digit annual returns, Day says. "We have given our clients a safe place to go instead of cash," he says.

Among its biggest investments this year was Raleigh-based Stock Building Supply Holdings Inc., which is merg- ing into a privately held peer, Building Materials Holding Corp., to create the second-largest U.S. distributor of lumber and materials. The combined company will trade publicly, though its headquarters is moving to Atlanta. "Their merger will make them a much better competitor, and because it's such a fragmented industry, we expect them to do more deals," Day says. KDI's largest investment, San Francisco- based McKesson Corp., is the nation's leading drug distributor, while another big holding, Miami-based Watsco Inc. is the biggest vendor of heating and air-conditioning equipment.

Superb stock-picking alone isn't enough to reach the $1 billion mark

KDI started as a part of James Maynard's orbit. "Our track record shows we can compete," co-founder John Day says.

that some large institutional investors require before they assign funds to a money manager, says Andy Silton, former chief investment officer at the state of North Carolina's pension fund who lives in Chapel Hill. "Having a track record is important, but you also have to get acceptance from more investors and develop different distribution channels. None of that is a slam dunk," he says. For companies like KDI that almost exclusively invest in stocks, "it's a much more difficult business than 20 years ago because people have so many other options on how to deploy their capital."

Reflecting its desire to grow, KDI last year hired a director of client relations and development, John Pitt, and earlier this year cut a provision letting it retain 20% of profits if the fund outperformed the S&P500. For example, if KDI had a 10% return when the index gained 5%, it would get one-fifth of the incremental gains. Under pressure from clients, more investment firms are dropping or reducing the so-called carried-interest fees. KDI will continue to assess a management fee of as much as 1% of assets, typical of the industry.

Day says the company is poised to manage as much as $750 million in its main stock fund without changing its strategies, which rely on investing ideas uncovered by three analysts. While the fund only gained 0.2% in the first half this year, as U.S. stocks wavered, he remains optimistic that there's lots of growth potential. "Our track record would show we can compete, and the best way to do it is to get our fair share in up markets and then lose less during the down times." ■

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i. There were 100 companies listed in the Barron's magazine ranking. KDI Capital Partners did not pay for the survey. The results are based on one of KDI's strategy's, the Concentrated Equities Strategy (CES). The results were based on calendar years 2012 -2014.

[ii] Annual returns for the Concentrated Equities Strategy (CES) and the S&P 500 Index (with dividends reinvested).

Annual Returns	YTD 06/15	2014	2013	2012	2011	2010	2009	2008	2007	2006
CES	1.2%	10.4%	30.9%	17.0%	3.6%	5.0%	38.3%	(26.1%)	(11.7%)	15.9%
S&P 500	.8%	13.7%	32.4%	16.0%	2.1%	15.1%	26.5%	(37.0%)	5.5%	15.8%

[iii] The 10% per year net return for the Concentrated Equities Strategy and the 7.3% per year return for the Standard and Poor's 500 Index is for the period January 1, 2008 through December 31, 2014.

The KDI Strategies performance shown above represents the past performance of accounts managed by KDI using concentrated equities strategy. The KDI Net performance results are actual investment results net of expenses, including maximum investment advisory fees of 1% and performance fees. The performance results reflect annualized returns and are unaudited. The index is presented for comparative purposes. All investments are subject to risks of loss, and past performance is not indicative of future results. An investor's actual performance may differ from the performance shown.

KDI Capital Partners, LLC is a Registered Investment Advisor. More information regarding the firm, its investment strategies, objectives, and fee schedule, can be found in its FORM ADV PART 2, which is available upon request.