The Blue Chips
Investor Letter
Winter 2019

"Education is not to teach men facts, theories, or laws; it is to teach them to think, to think straight if possible; but to think always for themselves."

Robert M. Hutchins

Statement from the Chair

Chairman of the Investment Committee: Rishi Krishnan

Unlike in previous editions, this investor letter's quote is not from an investor nor someone even tangentially related to the business world. Robert Hutchins was the President of the University of Chicago from 1929 to 1951 and is well known for a series of significant reforms that are responsible for much of what we associate with the university today, including the Core Curriculum. Despite the fact that Hutchins predated most modern investors, he couldn't have summarized their most valuable trait better: they must always think for themselves.

I believe that the missions of the Blue Chips and the Core have a lot in common. Most are understandably skeptical when they hear that claim, but Hutchins's quote could be applied with equal accuracy to our organization's purpose. In New Member Education we teach concepts in accounting, valuation, and competitive strategy, but not for their own sake – they are simply frameworks for understanding value. If someone leaves our club with ten different valuation methodologies but has never taken a critical lens to the stock market's consensus on a business, then we have failed. Great investing is built on the same quality that the Core aspires to imbue in all of us: the ability to think independently, free from the chatter of the crowd. This is a high aspiration, but I cannot think of a more important or fitting one for a value investing club at the University of Chicago.

Our purchases this quarter reflect our commitment to this pursuit. Lumentum (NASDAQ: LITE), the premier manufacturer of lasers that allow 3D sensing in mobile phones, has been intimately tied to Apple's performance over the past couple of years. While iPhones make up a large portion of current laser sales, the nascent Android market in 3D sensing represents a new market with compelling upside that we believe is not reflected in Lumentem's valuation. In a similar vein, Covetrus (NASDAQ: CVET) represents the spinoff and subsequent merger of Henry Schein's Animal Health arm with Vets First Choice, a SaaS provider of veterinarian customer management solutions. As vet prescription sales continue to see competitive pressure from online pharmacies, we believe that Vets First Choice will be able to piggyback off of Henry Schein's global sales team to maintain its rapid growth across veterinary practices here and abroad, in turn driving incremental revenue to Henry Schein's Animal Health business. Finally, Service Corporation International (NYSE: SCI), the largest provider of funeral and cremation services, has built a strong moat over decades and continues a slow but steady consolidation of the funeral home industry. We maintain that SCI's pricing power and inorganic growth potential in attractive geographic markets has been unappreciated by the current market valuation.

This investor letter contains each sector's pitch and Investment Committee decision, along with other updates about the portfolio. If you have any questions, please don't hesitate to reach out to me at rishikrishnan@uchicago.edu.

Lastly, I want to express my gratitude one final time to the committed members and alumni of the Blue Chips. Your engagement and support have made being a part of this community a deeply rewarding experience. We've made incredible progress in my four years here and I look forward to seeing all that's yet to come.

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Winter Pitches

Aspen Technology, Inc. (NASDAQ: AZPN)

Industrials Sector Leader: Richard Archer

Company Overview

Aspen Technologies was founded as a joint project between MIT and the U.S. Department of Energy in an attempt to foster long term efficiency in traditional energy sources and in American production more broadly. The backing of MIT and the DoE has allowed Aspen to act as one of the pioneers of the industrial optimization market, which has placed them in an interesting position between legacy industrials sub-sectors and newer, more agile business models. Aspen makes software that helps optimize and manage industrial assets.

Investment Thesis

The Industrials Sector recommends a BUY in AZPN for the following reasons:

1. <u>Winner-take-all dynamics within subsectors:</u> We expect each individual niche of cost-saving software to be dominated by a single player, as the greatest cost saving equates to the strongest value proposition. Aspen has established that it is well positioned to continue to capture sub-sectors; for example, Aspen currently serves all twenty of the largest Engineering and Construction companies, as well as nineteen of the largest twenty chemicals companies.

2. <u>Excessive concern with ties to commodity markets:</u> We believe that many investors are overly concerned with Aspen's connection to commodity prices, where we see no fundamental reason that Aspen's performance should be so closely tied. The revenues they earn from their software are not directly tied to oil production, and marginal changes in aggregate production should not have meaningful changes in Aspen's performance. Aspen has a highly stable installed base that demonstrated a robustness against commodity price volatility, as shown by the consistency with which Aspen has historically exercised pricing power (2-3% annual increases).

3. <u>Network effects/tipping points within optimization software:</u> The most uncertain but also potentially the most interesting thesis point is as follows: we view Aspen's business as one with substantial network effects that deepen the potentially winner-take-all nature of the markets they compete in. For example, many engineering students are trained on Aspen software (especially within the E&C realm), which we think could lead to substantial upside for Aspen. The Asset Performance Management (APM) market is still underdeveloped and predicting industry dynamics too far into the future is perhaps an exercise in futility, but we believe that Aspen is well positioned to capture a majority of the APM market within the E&C/O&G spaces.

Key Risks and Considerations

1. <u>Recent increases in valuation:</u> The Industrials Sector began seriously considering this business towards the end of 2018 when it was trading just under $80. When we pitched it, it had traded up to $100, dramatically reducing our margin of safety. We understand that at these levels, many or most may not feel comfortable investing.

2. <u>Deterioration in key performance metrics:</u> One of the key points of NME is distinguishing between short-term advantages and true competitive moats. If Aspen experiences the kind of network effects that we anticipate, I believe it will be considered to have serious economic moats; without those network effects, it still has fantastic margins and short-term growth potential, but we would then anticipate decay in those metrics.

Decision: NO PURCHASE

Chairman of the Investment Committee: Rishi Krishnan

The Industrials Sector pitched Aspen Technology (NASDAQ: AZPN) as a buy in General Meeting on Wednesday, February 6th, 2019, proposing a 5% position. After review, the Investment Committee decided not to purchase AZPN. Our reasons are as follows:

FIRST: We are less confident than the sector in the ability for AZPN's asset performance management (APM) suite to take over several end markets. Based on what we understand about APM, it appears that AZPN is continuing to ensure that its software is compatible with many different hardware manufacturers. Additionally, the CEO has spoken about creating "data pools" with other members of the asset software ecosystem to share the data that software collects and hardware sensors generate. If software is modular and AZPN possesses no proprietary data, the company has no leverage to lock in customers. In other words, while APM may be the best product in its nascent space and gaining customers right now, it imposes minimal switching costs on customers. As a result, when competitors catch up we don't forsee an obvious reason why AZPN would maintain market share. We do not agree with the sector's argument that AZPN's presence in schools creates a real moat – the sector itself held that asset optimization software can create significant, durable cost savings for customers and help avoid machinery failure, which is a much more serious cost than basic training costs (and is supported by AZPN continuing bake-offs versus competitors). While AZPN is the clear first mover and leader in this space, we do not think product or industry characteristics are conducive to a long-term moat.

SECOND: We are not convinced by several aspects of the sector's valuation projections. Across valuation approaches, the sector suggests that AZPN will recognize huge cost leverage on line items that feel aggressive, especially considering the business model. We are not confident that AZPN will see improved sales and marketing efficiency as it grows – while the company's products may be more established, the marginal holdout customers who have not been added yet seem hardest to convince. More significantly, we are very skeptical of the significant cost leverage to R&D that the sector projects. Even many dominant SaaS companies struggle to realize leverage on this line item. AZPN is no different – while the company may currently be ahead of its competition, staying there requires constantly upgrading features to keep up with changing software and hardware requirements. Consequently, we don’t think it makes sense to assume leverage on these line items, which, if adjusted, has a material impact on the upside.

THIRD: With AZPN trading at 13.5x revenue, we have virtually no margin of safety with the current price. Even if the business is very successful in cross-selling its current customers on APM, most of that growth is priced in already. Any upside beyond that would come from mostly speculative applications of AZPN's software into new markets we don't currently have a lot of information on. As such, we don't feel comfortable with the matchup of returns and the range of potential outcomes.

Lumentum Holdings (NASDAQ: LITE)
Tech, Media, & Telecom Sector Leader: Henry Gao

Company Overview

Founded from the JDSU spinoff in August 2015, Lumentum (LITE) is now a leading provider of optical and photonic products for industrial and consumer markets. It operates in four main revenue segments: TeleCom (e.g. carrier networks), DataCom (e.g. data center), Consumer & Industrial (e.g. 3D Sensing), and Lasers (e.g. industrial manufacture). The company has ~$1.25 bn of revenue LTM and minimal net debt of ~$150 mm compared to its $3.71 bn market cap. LITE historically has had a modest single digit revenue growth and EBITDA margin, but was recently revitalized by its pioneering position in 3D Sensing. The company's revenue grew at ~20% and EBITDA margin increased to ~18% over the past two years.

Investment Thesis

The Technology, Media & Telecommunications sector recommends a BUY in LITE for the following reasons:

1. Unrealized Long-Term Market Potential of VCSEL: LITE's VCSEL technology enables modern application of 3D sensing, such as Apple's FaceID. The near future market potential is massive as Apple expands 3D Sensing technology to all of its smartphones, Android smartphones producers adopt the technology, and manufactures employ rear 3D Sensing. These factors will lead to a $3.0+ bn addressable market (33x of current production) in the smartphone market alone, without considering tablets, robotics, autonomous driving, and more.

2. Monopoly Position in VCSEL/Improving Other Segments: LITE currently has a monopoly position in the VCSEL industry (e.g. sole provider for Apple), while no competitors have successfully developed comparable technology. Even if runner-up II-VI finally succeeds in its VCSEL research after numerous years of failure, LITE will most likely benefit from a rational pricing competition under the duopoly. In the other segments, LITE has high exposure to cyclicality, but is relatively well protected due to its size and continuous consolidation in these industries.

3. Mispriced due to Inaccurate Market Perception: LITE's stock has an exceptionally high correlation with Apple to a degree that is largely unjustified. On a qualitative level, research analysts virtually treat LITE as proxy of Apple as indicated in earnings calls. On a quantitative level, LITE has a 0.96 correlation with Apple after controlling for market variance and appears to be just another Apple supplier, despite contracts with other larger smartphone suppliers (Huawei, Vivo, Oppo) and Apple's modest 20% smartphone market share.

4. Attractive Valuation and Margin of Safety: LITE is trading at an attractive level from both a fundamental and relative perspectives. Our bottom-up operating model projection shows that the market's bearish view stems from over-emphasizing the TeleCom, DataCom, and Lasers segments which are fundamentally less attractive but ought to have decreasing impact on the valuation. As the vast majority of LITE's future value will come from its 3D Sensing operation, we conclude that LITE is trading at a sizeable discount. Compared to the peer group (~23x EV/EBIT TTM), LITE as a fundamentally stronger company trades merely at 11.5x which further confirms our valuation.

Key Risks and Considerations

1. Cyclicality Exposure: LITE is exposed to high cyclicality in the three segments (TeleCom, DataCom, Lasers) other than 3D sensing. We acknowledge the less attractive nature of these cyclical industries where competition is highly fragmented and products are virtually commoditized. While the on-going consolidation and LITE's comparably large market position provide a shield against cyclicality and evidence suggests that these industries have not arrived at cyclical peaks, we were not satisfied solely by these reasons.

2. Disruption of VCSEL Technology: Speculation exists about a transition away from 3D sensing in the next generation of identity security (e.g. improved fingerprint technology replacing FaceID), which would hurt the VCSEL industry. Since our investment thesis heavily relies on the value realization of VCSEL, we cannot effectively diversify away from this seemingly idiosyncratic risk.

Decision: BUY

Tech, Media, & Telecom Investment Committee Representative: Nick Nigro

The Technology, Media and Telecommunications sector pitched Lumentum Holdings, Inc. (NASDAQ: LITE) on Wednesday, February 6, 2019 in General Meeting as a Buy. The Investment Committee (ICOMM) decided to follow the recommendation and purchase LITE. Our reasons are as follows:

1. Dominant player in a duopolistic, rapidly-growing industry: LITE's most important business segment is its consumer and industrial segment, which is responsible for producing VCSELs—laser diodes that can engage in 3D sensing. Currently, VCSELs' most prominent use is in Apple's Face ID system. Apple is currently the only major buyer of LITE's VCSELs and was responsible for 30% of LITE's FY 2018 revenue. The VCSEL industry is attractive primarily because competition in it is minimal. Currently, there are only three companies known to be pursuing VCSEL technology: LITE, Finisar, and II-VI. Although VCSELs were used in commercial products as early as 2010 (in the Xbox Kinect), Finisar and II-VI remain unable to produce them economically. As a result, LITE is currently a monopoly provider of the technology. Finisar and II-VI recently agreed to merge, and we do expect the combined company to develop a marketable VCSEL technology sometime in the next several years. But even after this happens, the market will remain an attractive duopoly, in which LITE is likely to have the more advanced technology. On top of this, we expect the end-market for VCSELs to grow significantly over the next decade. First, a large number of Android smartphone manufacturers have expressed interest in incorporating LITE's front-facing VCSELs into their phones, and the company has already signed contracts with Oppo, Vivo, and Huawei to provide them with VCSEL modules. Second, the addition of rear-facing 3D cameras to phones has the potential to double the number VCSELs sold per phone. Moreover, rear-facing sensors require better technology than front-facing ones and are more expensive than front-facing ones as a result. Apple has stated a desire to include a rear-facing 3D camera in the iPhone by 2020, and we expect premium Android phone manufacturers to follow suit. And third, we expect some further market expansion to come from the addition of VCSELs to certain tablets. In total, we believe that these three sources of growth—Android devices, rear-facing cameras, and tablets—will be responsible for an approximately 5x increase in the size of the end-market for VCSELs over the next 5 or so years. Looking past that, leading self-driving car designs currently rely heavily on VCSELs. As a result, we expect the VCSEL market to grow significantly when cars with advanced self-driving technology are eventually brought to market. Finally, it is likely that VCSELs will eventually be used in other scientific fields (e.g. robot vision), although any specifics associated with these types of applications are impossible to pin down. As a result of the duopolistic nature of the VCSEL industry and the rapid growth in end-market demand, we expect competition between LITE and the merged Finisar/II-VI to be friendly. The two companies should have no problem tacitly colluding to keep margins attractive and profits high. As a result, we expect both companies to earn significant economic profits as the industry grows, with LITE's established production process and more advanced technology leaving them in a stronger position.

2. Less attractive legacy businesses will become increasingly less important: LITE's three legacy segments (Telecom, Datacom, and Lasers) are much less attractive than its VCSEL business. We believe that in these three segments, LITE operates commoditized businesses in cyclical industries. Although LITE's scale may provide them with advantages in parts of these industries, we don't expect these advantages to give rise to significant economic profits in the long-run (although neither do we expect them to meaningfully destroy value). Currently, VCSELs are responsible for approximately 30% of LITE's revenue. By FY 2023, we expect them to responsible for over 70% of revenue (and due to their higher margins, a greater percentage of gross profits). Thus, in the long-run, we expect the vast majority of LITE's value to come from VCSELs, not its unattractive legacy businesses.

3. Attractive valuation: LITE currently trades at a trailing EV/EBIT multiple of 11.5x, compared to a mean total market multiple of 23x. We believe that is an (approximately) reasonable multiple to pay for LITE's legacy businesses, but drastically undervalues LITE's VCSEL business, whose growth prospects and attractive competitive position justify at least a mean market multiple. We believe that LITE is currently trading at such a low multiple because of investor concerns around several short-term risks to LITE's VCSEL business (primarily concerning its relationship with Apple).

Key Risks and Considerations

1. New entrants in VCSELs: The primary risk to LITE is a breakdown in the duopolistic structure of the VCSEL industry, leading to increased competition and an accelerated trend toward commoditization. Although we certainly expect VCSEL production to eventually develop into a commoditized industry in which economic profits are approximately zero (as is the case with most industries), the existence of a duopolistic structure will delay this eventuality and allow LITE to earn large economic profits in the meantime. We're not currently aware of any other companies seeking to develop VCSEL technology, and we believe that it is unlikely that any new competitors will successfully enter in the foreseeable future. We consider two possibilities: 1) a large semiconductor company attempts to enter the VCSEL market, and 2) a small to mid-sized semiconductor company (one of a similar size to LITE) attempts to enter the VCSEL market.

   We think the first case (entrance by a large competitor) is unlikely in the short-term because the market for VCSELs isn't big enough. We expect the market for VCSELs to be approximately $2.5 billion in 2023, which represents a significant growth opportunity for LITE, but which isn't enough to get any of the large semiconductor companies interested. In the longer-term, if growth in the market for VCSELs accelerates (e.g. due to their use in autonomous cars), some of the larger semi-conductor companies may become interested in entering; however, LITE will be making so much money if this happens that a new entrant would really only cost us a little bit of the upside. Moreover, in both the short-term and long-term, it would make a lot more sense for a large competitor seeking to enter the VCSEL industry to acquire either LITE or II-VI/Finisar than to attempt to develop the technology and productive capacity on their own. Perhaps the biggest risk associated with this first case is that at some time in the future, China could decide that VCSELs are a strategically important technology and invest in the ability to produce them domestically—for strategic, not economic, reasons.

   We think the second case (entrance by a smaller competitor), is more likely to occur but less likely to be successful. Finisar and II-VI have been unsuccessfully trying to develop a marketable VCSEL product for close to a decade now; we expect that any new competitor seeking to enter would face similar problems. Although we generally don't see technological advantages as particularly strong competitive advantages, they can be so in certain semiconductor-based industries. Finisar and II-VI provide one example of this, while Intel's difficulties developing 10nm technology demonstrate that a strong technological advantage can be an effective competitive advantage even against companies with access to a massive amount of capital. Thus, although the market for VCSELs represents a potential source of growth for smaller semi-conductor companies, we believe that the significant risks associated with developing VCSEL technology will deter any new entrants and that, even if someone does decide to enter, they are unlikely to be successful.

2. Technology Change: We're not currently aware of any technologies which pose a direct threat to VCSELs; however, if a superior 3D sensing technology is developed, it would pose a significant threat to LITE.

3. Exposure to China: Recent trade tensions between the U.S. and China pose a threat to LITE's business, as LITE is exposed to both the Chinese market in general and Huawei—which constituted 11% of FY 2018 revenue—specifically. We don't believe we have any particular advantage in evaluating the risks arising from LITE's exposure to China. However, recent market action suggests that the risks associated with China are priced in—after news broke that Trump would be unlikely to meet with Xi prior to the March 1 deadline for tariff increases, LITE's stock dropped approximately 9%. Moreover, although a deterioration in U.S.-China relations would certainly be painful for LITE, it would in no way be fatal to the business.

Covetrus, Inc. (NASDAQ: CVET)

Special Situations Sector Leader: Lance Hao

Company Overview

Covetrus (CVET) is a global animal-health technology and services company supporting the companion, equine, and large-animal veterinary markets formed from the merger of two industry leaders, Henry Schein Animal Health (HSAH) a veterinarian major supply distribution, and Vet's First Choice (VFC), the only clinic integrated software and prescription management service. The core business of HSAH revolves around aggregating supply from the fragmented manufacturer market and distributing these veterinary products to clinics. VFC's main business revolves around managing and filling patient prescriptions – however it is unique due to its integration with back office clinical logistics and its revenue share with practicing veterinarians.

Investment Thesis

The Special Situations Sector recommends a BUY in Covetrus for the following reasons:

1. Spinoff unlocks value: Oftentimes, we see that spinoffs act as catalysts for increased managerial focus on each respective segment. In this case, not only has the spinoff led to the creation of the first pure-play animal health player, it also represents a focus on a more attractive industry in animal health as opposed to dental health. Not only are there slightly favorable industry growth tailwinds, but the dental health industry is also facing structural decline and aggressive consolidation.
2. Recapturing prescriptions: Historically, veterinarians served as pharmacists for pet prescriptions along with offering clinical services. However, the rise of portability regulations and online pet pharmacies has decreased demand for veterinary prescriptions and increased competition in this space. Retail pet pharmacies source drugs through secondary markets and have been aggressively stealing market share from veterinarians. Through the merger with VFC, CVET becomes the only integrated solution for supply infrastructure and facing online order fulfillment. As VFC brings more prescriptions back to clinics, HSAH will have the opportunity to fulfill more of this demand.
3. Leveraging clinic growth: The biggest driver for revenue growth will be how quickly and to what extent VFC can leverage the HSAH connection in order to penetrate the veterinary clinic market and achieve economies of scale. Currently, VFC has captured less than 25% of total veterinary clinics in the U.S., however, HSAH has already established a 100,000 strong supply chain customer base that can benefit from integrating with the VFC platform. Expansion into Europe and long term revenue per customer potential indicates even further upside.
4. Quality business fundamentals: First mover advantages and lack of competitors allows VFC to entrench itself as the premier vertically integrated prescription management software for vets and capture the large growth trend in online pharmaceutical retail. Product stickiness arises from switching costs associated with data and lack of opportunity cost (no subscription fees, opt out mechanics). Strong, friendly middleman dynamics facilitate the promotion of VFC to regular consumers – not only does VFC enhance the clinic experience of the patient, it boosts revenues for clinics.

Key Risks and Considerations

1. Failure to realize synergies: Current prices forecast significant levels of clinic growth and synergies. If management is not able to leverage existing relationships enough (perhaps because of the differences between supply distribution and software services), then VFC may not be able to penetrate the U.S. clinic base as quickly or as deeply.

Decision: BUY

Chairman of the Investment Committee: Rishi Krishnan

The Special Situations Sector pitched Covetrus (NASDAQ: CVET) as a buy in General Meeting on Wednesday, February 13th, 2019, proposing a 4% position. The Investment Committee decided to follow the sector's recommendation and purchase CVET, although at an increased position size of 5%. We believe that CVET represents an opportunity to seize on the uniquely positioned merger between Henry Schein's Animal Heath arm (HSAH) and Vets First Choice (VFC) in a fast growing industry. We agree with the sector's rationale and summarize the most important reasons in our decision below:

1. <u>Compelling revenue synergies between HSAH and VFC:</u> Given management's inclination towards building corporate empires and empirical work that suggests that synergies are often overstated, it is important to be skeptical of synergies that a management team proposes. However, we believe that the business models of HSAH and VFC possess significant revenue synergies when combined. From the perspective of VFC, HSAH sells to 90% of veterinarians in the United States, allowing VFC to plug into a much larger sales team and advantage itself over competitors, although none of equal size or product quality exist. Similarly, international expansion can often be challenging and HSAH's strong presence in Europe and Asia offers the potential for HSAH's sales reps to introduce VFC to these untapped markets. VFC, in turn, can allow vets to better manage patients and thus drive increased visits and prescription sales, the latter of which HSAH can supply. We believe that this, if successful, could help vets (and thus distributers like HSAH) avoid the continued loss of market share to online pharmacies.

2. <u>Value chain positioning insulates against online pharmacy growth:</u> The rise of online pharmacies has put pressure on the value chain that CVET occupies, as vets have seen steady market share declines in the past two decades. First, it's important to remember that these are market share declines – with solid industry growth, HSAH has continued to increase sales even as market share has been lost. However, we maintain that CVET is actually relatively insulated against this threat because of the structure of its value chain. If vets find it easy to sell prescription drugs to customers, VFC's value proposition is relatively little – in a world of shrinking market share, the customer management platform provides a clear benefit to vets. Additionally, we believe that under greater pricing pressure, given the market power of supply aggregators like HSAH, the markup that vets charge (estimated at 120% over cost) will be the first place that prices are cut.

3. <u>Tremendous growth potential of VFC:</u> We suspect that much of the difference between our valuation and the market's can be attributed to our assessment of VFC. We believe that VFC is an extremely attractive business with significant upside. While little data on customer attrition exists, we suspect that the company has very little (perhaps negative) churn due to the important customer data it collects and generates. In just a few years, the company has penetrated almost 25% of practices in the United States and faces no substantial competition. Even with conservative market share growth over the next few years, at any reasonable multiple for a SaaS company with strong unit economics and plenty of runway, we see VFC driving a material upside to the current valuation.

Key Risks and Considerations

1. <u>The rise of online pharmacies:</u> While we do believe that CVET has a buffer against the rise of online pharmacies, they remain a significant threat. The story of online marketplaces offering cheaper options than traditional distributors, amassing consumers, and leveraging that to bring supply online has been repeated across many industries over the past decade. While online pet pharmacies have been dogged by cases of fraudulent drug distribution and have not substantially pushed into more specialized prescription drug territory yet, it is hard to imagine those issues not being resolved in a few years. We are less confident than the sector that the "trust" in a vet will allow them to maintain their unique markup in the value chain.

2. <u>Lack of information on VFC:</u> We have relatively little information on VFC since it was previously a private company. The initial filing for CVET has some historical financial information on the company, but most of our quantitative and qualitative assessments on the strength of the product itself (e.g. attrition) come from indirect evidence. This is not necessarily bad since it poses a similar challenge for the larger market, but it does create a layer of risk based on our hampered ability to judge the company's quality.

Senior Housing Properties Trust (NASDAQ: SNH)
Financials Sector Leader: David Ozen

Company Overview
SNH is an equity real estate investment trust that owns a portfolio of Independent Living, Assisted Living, Skilled Nursing Facilities, Wellness Centers, and Medical Office Buildings. SNH rents their properties to nursing home operators, hospitals, life sciences corporations, and other research institutions.

Investment Thesis
The Financials Sector recommends a BUY of SNH for the following reasons:

1. Distress in the SNF & Assisted Living Industry: There are important distinctions between the three different segments on Senior Living. Independent Living are collections of apartments for independent seniors who do not require specialized care. Assisted Living are facilities that provide basic daily care for seniors who can no longer live at home alone. Skilled Nursing Facilities are facilities that provide 24/7 specialized medical care to residents with a typical stay of less than 3 months. Recent legislative and patient mix changes have caused widespread distress throughout the space. SNH is exposed to this distress through their tenant, Five Star. Importantly, SNH overall has very similar exposure to the troublesome SNF and Assisted Living space as their peers, but trades at a significantly higher discount to NAV. We believe SNH's exposure to Five Star creates a unique opportunity to buy high class MOB assets for cheap.

2. Market Overemphasis of Senior Housing Segment: Analysis of earnings calls and analyst reports demonstrate that the majority of focus by market participants is on SNH's senior housing segment even though it only accounts for 29% of total NOI. SNH in recent years has been diversifying by expanding into the high-end MOB space. MOBs are incredibly attractive due to their long-term leases and many high credit-quality tenants. Cap rate analysis shows that MOB NOI justifies anywhere from 60% to 90% of current Enterprise Value. Using current broker average cap rates to value MOB and Independent Living NOI, we find that the current market valuation attributes no value to the Skilled Nursing Facilities and Assisted Living segments. Thus, we believe we can purchase a collection of high-quality MOB assets and Independent Living homes and get any value generated by the SNF and Assisted Living facilities for free.

3. SNH is Resilient to Rent Cuts: We have identified three possible scenarios as the Five Star situation continues to develop. Either SNH and FVE can come to an out-of-court rent cut agreement. If these negotiations fail, FVE has no choice but to file for bankruptcy. Once in bankruptcy, SNH will the FVE's largest creditor. SNH then has the choice to absorb FVE's assets and operations or to absorb FVE's assets and try to find a new tenant for the new facilities and the facilities that were once rented to FVE. In the case of rent cuts, we found that depending on the cap rate used to value MOB NOI, SNH has a significant margin of safety at the current valuation. In the case of SNH absorbing FVE's assets and operations, there is significant uncertainty, but our estimates show a dividend cut of around 21%. Significantly, this creates an absolute worst-case scenario to dividend cuts in the case SNH and FVE cannot come to an agreement.

Key Risks and Considerations

1. The RMR Group: SNH is one of many REITs controlled by the RMR group through an almost impenetrable management contract. RMR is paid through a variety of different incentive fees. It is unclear whether RMR's contract is aligned with SNH's shareholder interests. Historical precedent has made this unclear, though we view this risk as mitigated through the legal requirement of REITs to pay dividends.

2. FVE Operations: The major risk to most REITs is whether tenants will pay rent. In the case that SNH is forced to absorb FVE's operations, SNH would expose itself to operational risks. If this happened, SNH could see higher growth versus the 2% to 3% rent increases they currently receive from leases. However, in the context of the significant industry headwinds facing SNFs and Assisted Living facilities, absorbing operational risks may be unattractive.

3. Credit Rating Downgrade: REITs need reliable access to the capital markets in order to continue to make opportunistic acquisitions to expand and to refinance their debt burden. SNH currently has a credit rating of BBB-, the lowest investment grade rating available. If SNH's credit rating falls into non-investment grade, SNH will have a harder time finding favorable terms for future re-financings and capital raises. As heard on recent earnings calls, management is similarly aware of how significant maintaining and improving their current credit ratings is.

Decision: NO PURCHASE

Financials Investment Committee Representative: Abhi Sharma

The Financials Sector pitched SNH on Wednesday, February 13th, 2019 in General Meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase SNH. Our reasons are as follows:

FIRST: Fundamentally, we remain concerned about eroding trends within the senior living community property market. Firstly, low net absorption rates, relative to steadily increasing inventory growth, indicate a persistent oversupply within the market. Secondly, declining occupancy rates coupled with rising costs within key geographical markets related to SNH have further contributed to the fundamentally weak industry dynamics. Within this context, we are especially concerned that the property portfolio managed by Five Star, SNH's largest tenant, will be absorbed into SNH's current RIDEA structure. This would result in not only a dividend cut of between 25-40% but also a drop in margins due to the high operating costs associated with moving away from the lucrative triple-net leases.

SECOND: While the SNH's Medical Office Building portfolio seems to be the fastest growing as well as the most attractive part of its business, there remain underlying uncertainties within this part of the business as well. Namely, Reliant Medical Group and Scripps have recently decided to not renew their property contracts. While the combined revenue from these tenants make up ~5% of total MOB rental income, we see this as a potential cause for concern. Moreover, over the last few years, investor demand for MOBs has increased substantially as institutional investors have looked to diversify portfolios away from traditional office spaces. As a result, the cap rate gap between MOBs and traditional office spaces has decreased over time.

Overall, while REITs are a safe investment and mimic the cash flows provided by bonds, the premium paid for REITs is derived from a potential appreciation in the dividend payout. From a valuation perspective, SNH has historically traded within a fairly tight range of 7.5 – 9x P/FFO, and we do not see a cause for this to change in the future.

Service Corporation International (NYSE: SCI)
Consumer Sector Leader: Melaina Rapisarda

Company Overview
SCI is the largest funeral home operator in the United States and Canada, offering a wide range of products and services within the realm of professional services, merchandise, and cemetery property. The company operates primarily through its Funeral and Cemetery segments, accounting for 59% and 41% of revenue, respectively. Revenue is generated within these segments through at-need and pre-need contracts, as well as through returns from invested pre-need funds. The average length of pre-need contracts is 10-12 years for the Funeral segment and 12-14 years for the Cemetery segment.

Investment Thesis
The Consumer Sector recommends a BUY of SCI for the following reasons:

1. <u>Roll-up model generates economies of scale, resulting in above-average operating margins and ROIC:</u> SCI primarily drives growth through acquisitions of smaller, family-owned funeral homes. This is attractive because: (1) SCI maintains the local brand while maintaining scale advantages that manifest in location-based cost-savings, (2) there are network effects in play, as new customers are more likely to want to be buried with loved ones on existing cemetery property, and (3) communities can support a limited amount of funeral homes, creating high barriers to entry for new competition. Thus, SCI's economies of scale allow the company to command a substantial price premium in specific regions versus independent homes (~46% on average). Lastly, we believe there is substantial runway for growth, as the market is still extremely fragmented, with independent funeral homes accounting for ~86.9% of market share.
2. <u>Core business is insulated from economic recessions and the threat of new entrants:</u> Although macroeconomic downturns historically have affected pre-need purchases (~30% of revenue), at-need purchases (~70% of revenue) are insulated from these pressures and are linked solely to population growth and death rate. Moreover, we expect the unprecedented growth in population during the baby boomer era to soon begin impacting backlog revenue growth, reinforced by higher projected mortality rates in the next decade. Lastly, this industry is highly resistant to technical change. Most consumers tend to use the same burial methods used by their deceased family members and religious requirements provide a guaranteed funeral customer base.
3. <u>Morbidity of the business has deterred investors, resulting in undervaluation:</u> We view the deathcare industry as a quasi-sin industry. The deathcare industry has nearly quadrupled the S&P since 2004, despite generally low P/B ratios across industry players. Moreover, the business model itself is very complex, likely further deterring investors.
4. <u>Multiple catalysts to help market realize undervaluation:</u> First, the significant growth of the deferred revenue backlog implies substantial recognized pre-need revenue growth moving forward. The backlog of unfulfilled pre-need funeral and cemetery contracts has grown solidly at ~5% CAGR over the past 5 years, reaching $11.1B as of 2018. Moreover, increasing death rates over the next couple decades will trigger significant revenue growth. This will increase the investable float for SCI. Second, intense lobbying in the past few years has loosened trust reimbursement regulations, enabling SCI to transition from the yield-focused asset mix to one more focused on total returns. Lastly, we believe the stock price will appreciate in light of continued share repurchases.

Key Risks and Considerations

1. <u>Threat of Substitutes:</u> The main threat here is a potential paradigm shift to cremation over a traditional in-ground burial. Over the past 5 years, there has been increased demand due to low costs, which may decrease customer stickiness. However, we believe this risk is mitigated by the fact that (1) most cremations still require high-margin funeral services and ceremonies and (2) several religions ban disruption of bodies and cremation. SCI also has positioned itself well to capture this market growth as the dominant cremation market player (~20% of market).
2. <u>Negative Press:</u> Given the highly sensitive nature of the products and services, any errors made by SCI's funeral homes leads to strong PR reactions. This could potentially cause negative investor sentiment regarding internal controls. However, we note that, while this is possible, SCI does not have a demonstrated pattern of instances indicating a lack of internal controls.

Decision: BUY

Consumer Investment Committee Representative: Katherine Gerdes

The Consumer Sector pitched Service Corporation International (SCI) on Wednesday, February 20, 2019 in General Meeting as a Buy. The Investment Committee (ICOMM) decided to follow the recommendation and purchase SCI at a 5% position. We believe SCI is attractive for the following reasons:

1. Benefitting from economies of scale in a fragmented industry: SCI is the only player of scale in what is still a very fragmented industry with regulatory barriers to entry (such as zoning laws and licensing requirements). SCI's size allows them to benefit from economies of scale by clustering funeral homes and sharing operating costs, as evidenced by their industry-leading operating margins. Furthermore, in markets where SCI has acquired enough funeral homes and achieved a critical mass of market share, they are able to charge price premiums in excess of 40%. Competition is conducted on a local level since people will not travel more than a few miles for a funeral home or burial site. SCI has more than 10% market share in just 8 of the 46 states they operate in. In the remaining 38 states, SCI still has a substantial growth runway to capture more market share and exercise more pricing power.

2. Guaranteed demand insulated from macroeconomic downturns: The expected rise in death rates thanks to the aging baby boomer generation is a source of virtually guaranteed growth for SCI over the next 5-10 years. The deathcare industry is truly a unique corner of the consumer sector in that it is not exposed to fickle changes in consumer preferences and is not being disrupted by rapid advances in technology. Funeral and burial practices have not changed substantially in over a century, making us confident that SCI can continue to maintain their dominant position in the years to come. Regardless of macroeconomic downturns, death care will always be necessary, and while SCI may see a decrease in pre-need sales during a recession, there will be a concomitant rise in at-need sales.

3. Shareholder-friendly management: When holding stocks for the long-term, it's crucial to invest with shareholder-friendly management teams. It's impossible to foresee all the challenges SCI will face over the next 5-10 years, but regardless of what challenges arise, we want to be confident that SCI's management team will be good stewards of our capital. SCI's management has a track record of smart capital allocation decisions, as evidenced by their high-teens IRRs on acquisitions over the past 20 years and the fact that they return money to shareholders in the form of dividends and share buybacks when competition for acquisitions stiffens. They have been open about mistakes they made overpaying for acquisitions in the 1990s, and their candid recognition of their mistakes makes us confident that they have learned from them and will vigilantly protect ROIC going forward.

Key Risks and Considerations:

1. Cremation on the rise: Since 1960, the US cremation rate has risen from 4% to 49%, and cremation is forecasted to continue growing in popularity over the next decade due to environmental concerns and affordability. Despite SCI's strong foothold in the cremation industry, this trend could have a significant negative impact on SCI's bottom line, given that the average cremation customer spends just half of what they would have spent on a traditional burial ($3.5-4k as opposed to $7-7.5k). Margins on the two services are about equal. In order to offset the lower sticker price, SCI has started to expand their line of cremation memorialization products in an attempt to increase revenue per cremation.

2. Heightened competition for acquisitions: In 2018, SCI stepped up the amount of money they're spending on building new funeral homes from scratch. This could be a sign that SCI is seeing increased competition for acquisitions and that the M&A pipeline isn't as full as it used to be. Given that about half of SCI's growth over the past decade has been inorganic, the continued availability of attractive acquisition targets is crucial to SCI's success. Although SCI is the largest player in the industry, they are often not the only bidder on the funeral homes they acquire. If a small family business of 1-5 funeral homes is for sale, a lot of players smaller than SCI have the ability to purchase that business. There is nothing stopping a smaller, regional player from trying to copy SCI's roll-up business model and driving up acquisition prices. We will keep an eye on the multiples SCI is paying for their acquisitions going forward.

3. Regulation changes: The FTC's Funeral Rule requires that funeral homes disclose prices to customers over the phone and provide detailed, written price lists to customers who visit the funeral home in person. However, the Funeral Rule does not require funeral homes to disclose detailed price lists online. The FTC is scheduled to review the rule in 2019, and given that customers often research funeral homes online before choosing one, there is some concern that the FTC will require funeral homes to disclose their complete price lists online as well as in person. Currently, only 16% of funeral homes do so. While we agree with the sector that SCI's customers are relatively price inelastic, if price discrepancies become easier to recognize, consumers might start to shop around more. This could force SCI to decrease their price premiums in markets where they are the dominant player, which would be detrimental to both revenue growth and margins.

The sector's valuation was very conservative in that they projected no increases in pre-need funeral sales over the next 5 years and did not account for any inorganic growth. Even so, the sector's valuation implied a 9% upside for SCI at the current price, convincing us that this is an attractive entry point. As discussed above, we will closely monitor the rise of cremation rates, SCI's ability to upsell cremation customers, the availability of attractive acquisitions targets, the prices paid for acquisitions, and any changes to the FTC's Funeral Rule going forward.

Bausch Health Companies Inc. (NYSE: BHC)

Healthcare Sector Leader: Matene Alikhani

Company Overview

Bausch Health (BHC) is a Canadian specialty pharmaceutical company which develops, manufactures, and markets pharmaceuticals products in the sub-industries of dermatology, gastroenterology, ophthalmology, neurology, and branded generics. Its premier division is Bausch & Lomb, a premier eyecare provider around the world. Notable other divisions include the high-growth, gastroenterology focused Salix and the Ortho Dermatologics and Diversified Products segments. Since the firm's scandal in 2015, management has actively focused on growth through Bausch & Lomb and Salix while moving away from the remaining two division.

Investment Thesis

The Healthcare Sector recommends a BUY in BHC for the following reasons:

1. Capital Structure and Turnaround: In 2015 Bausch Health Care, then known as Valeant Pharmaceuticals, was involved in multiple scandals. While being investigated for worrying amounts of price fixing, short-sellers came to find that Valeant was billing fake sales through a pseudo division of specialty pharmacies known as Philidor. Following the stock's more than 90% decline in early 2016, new management has worked tirelessly to weather the storm of Valeant's heavy debt load. By focusing on core product lines and with a key shift in business strategy towards the traditional pharmaceutical procurement model, BHC has fixed its broken balance sheet and strategically used leverage to improve its once-worrying capital structure.
2. Organic Growth: When current CEO Joe Papa took over Valeant in 2016, the company was facing mounting debt maturities and seemingly no way out. Through over $7bn in divestment of non-core business lines, Papa was able to take Valeant through this liquidity crunch. A significant result of this is that the company created an important focus on strong business lines with consistent organic growth. This already strong growth is expected to be further augmented by the introduction of new products, including the "Significant Seven" which are expected to generate an additional $1bn in revenue by 2022.
3. Financial Flexibility: As mentioned previously, Joe Papa took over Valeant during a time of deep financial distress. The firm's turnaround process was broken up into three main parts. From the time of Papa's instatement until end of 2017 was the period of stabilization, while 2018 was the year the business expected (and saw) a significant turnaround. Going forward, BHC was entering a period of transformation. The firm expects to see meaningful growth alongside important de-levering, and the rollout of new products represents a significant catalyst for growth. Thus, the current period is the ideal time to invest in BHC's emerging new business model and product line.
4. Management and Debt Paydown: When Papa took over Valeant in 2016, the most imperative issue was the company's debt load. Operational excellence and prudent debt management have allowed BHC to first stabilize and now expand. These debt payments and refinancing have been executed by a top-notch treasury team with an eye on long-term success.

Key Risks and Considerations

1. FDA Approvals: Duobrii, one of the Significant Seven, has run into issues with FDA approvals. Any delays in the rollout of new products can be problematic for BHCs expansion goals.
2. Refinancing: Much of the change in BHC's capital structure has been through debt refinancing. While these have extended maturities, BHC must maintain their credit agreement and maintenance of these covenants must take first priority over organic growth initiatives.
3. Organic Growth: There is a risk that debt and maintenance of covenants restricts the ability to focus on R&D spend and in-house drug development. Failure of new products could put an even greater burden on debt repayment.

Decision: NO PURCHASE

Healthcare Investment Committee Representative: Sam Zager

The Healthcare Sector pitched Bausch Health Companies (NYSE: BHC) on Wednesday, February 27th, 2019 in general meeting as a Buy. Though we find BHC's turnaround story compelling, ultimately the Investment Committee (ICOMM) decided not to purchase BHC. Our reasons are as follows:

FIRST: Based on the ICOMM defense and research conducted by the sector and ICOMM, we are not confident enough in margin of safety for this business given the projections for operating performance provided by the sector. The sector assumes that management will hit key objectives outlined in their earnings presentation, but we do not feel that such certainty is warranted. Given the limited background information we have on the Significant Seven products introduced in the last 24 months by BHC and limited understanding of the many industries BHC operates in, we do not feel we can assume such strong incremental revenue and favorable margins. Further, we are concerned about the potential for income lost from loss of exclusivity BHC faces and future litigation against the company.

SECOND: We believe much of the value from this investment will stem from BHC's ability to delever and lower its cost of capital. However, in order for that to occur at a sufficient pace to yield an upside for our investment, BHC will need to throw off significant free cash flows in the near future, which is heavily reliant on the continued success of the Significant Seven and core product lines. Additionally, the cost of delivering as fast as the sector predicts could be significant, given the numerous prepayment penalty covenants attached to BHC's debt. Finally, management has not indicated they would like to pay down $1B in debt per year beyond 2019, and their incentives are not tied to delevering.

THIRD: We do not feel that the market is as bearish about BHC's prospects as the sector does. At the time of pitch, BHC was trading at roughly 9.5x EV/Adj. EBITDA, which is relatively in line with competitors, some of whom are not levered to the same degree and have more flexible capital to work with. We also do not believe that the market is pricing in a significant risk of bankruptcy for BHC, and seems to expect moderate to significant growth moving forward.

In summary, we do not feel that we have an adequate margin of safety derived from a superior understanding of the business or otherwise. We are not inclined to accept management's guidance for the future without more evidence to support those claims, and therefore do not see a reason to fundamentally disagree with the market's pricing of BHC.

International Flavors & Fragrances Inc. (NYSE: IFF)

Natural Resources Sector Leader: Cale McCormick

Company Overview

International Flavors & Fragrances is an American firm founded in 1889 that produces chemicals designed to enhance smell and taste of products sold by their clients. They are the second-largest player in the flavors & fragrances space and are geographically diverse, with 31% of their revenue derived from EMEA, 27% from North America, 27% from Asia, and 15% from Latin America. IFF recently expanded their market position with the $7.1B acquisition of the Israeli based firm Frutarom.

Investment Thesis

The Natural Resources Sector recommends a BUY in IFF for the following reasons:

1. IFF is able to protect profit margins through stable competitive advantages: Customers rely on an industry created "core list" of 2-4 players for flavors and fragrances solutions. Due to the enormous opportunities the core list provides, few companies can gain the foothold required to compete against established players. Furthermore, flavors and fragrances products only make up 1-2% of costs of IFF's customers, while playing an integral role in the attractiveness of the consumer's product, largely deterring switching during a product lifetime. Additionally, IFF prevents infringement on its products with international patents on hundreds of products and processes. These competitive advantages have manifested in stable EBIT margins and ROIC levels in the mid to high teens.
2. The Frutarom acquisition provides significant avenues for growth and synergies: Frutarom specializes in natural products, an increasingly integral component of the flavors industry. Frutarom also mostly sells to small and midsize companies and companies in the Middle East, both groups which IFF does not currently target. Furthermore, Frutarom's fragmented and mostly outsourced R&D can be integrated into IFF's fully in-house R&D machine for increased efficiency in R&D spending.
3. IFF's advantages in global specially segments allow for profitable expansion: Targeted acquisitions of flavors players, such as Mighty Thailand and Powder Pure, as well as Frutarom, have given IFF the ability and geographical presence and technology lead to produce savory and natural food solutions at a cost and quality advantage to its competitors. These sub-verticals are becoming increasingly important in emerging markets and are projected to grow at 5-6%, providing IFF with a multi-billion-dollar market opportunity with above average future growth rate.

Key Risks and Considerations

1. Raw Material Costs: Inputs to flavor and fragrances products have increased in 2017 and 2018 and may continue to increase into the future. IFF can mitigate the cost to their business by leveraging its pricing power and its access to new suppliers resulting from the Frutarom acquisition.
2. Failure to Realize Synergies of the Frutarom Acquisition: IFF depends on cost and revenue synergies to justify its recent acquisition of Frutarom. IFF has no history of large acquisitions to evidence management's ability to successfully integrate Frutarom and to deal with the newly acquired $3.1B debt. However, the Frutarom acquisition was largely in line with management's plan and IFF has significant cash on hand and cash generation abilities to adequately deal with the debt.
3. IFF loses market share due to changing demand dynamics: We have identified two factors necessary to sustain IFF's market share. Firstly, IFF is an established core list player, and losing this status for an extended period of time would put them at a disadvantage to their competitors. However, IFF has only briefly lost its core list status once and was quickly reinstated. Since then, IFF has significantly increased their product portfolio, further cementing them as a necessary core list supplier. Secondly, IFF could fail to keep pace with consumer demand trends. IFF's long track record as well as their large amount of research render this possibility extremely unlikely in our view.

Decision: NO PURCHASE

Consumer Investment Committee Representative: Katherine Gerdes

The Natural Resources Sector pitched International Flavors & Fragrances, Inc. (IFF) on Wednesday, March 6, 2019 in General Meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase IFF. Our reasons are as follows:

FIRST: We see no significant competitive advantages for IFF versus the other two main players in the industry. Givaudan and Symrise benefit from placement on customer core lists just as much as IFF does. IFF has to compete against other core list suppliers for a contract on every new product, and that process can be lengthy and expensive. While we agree that there are switching costs for a single product (given that consumers become accustomed to a specific taste and fragrance), there are no switching costs for IFF's customers when it comes to new products. Even if IFF has had a strong relationship with a specific customer in the past, that customer could easily go with one of IFF's competitors for a new product if IFF performs poorly in the bidding process. Since the sector could not provide any quantitative evidence of a high win ratio or low customer churn, we are not sold on the customer stickiness story. We do not know how often IFF beats Givaudan and Symrise for new contracts, and we do not know how loyal customers are to providers that have given them good flavors and fragrances in the past. The lack of such quantitative evidence makes us unable to verify that IFF has any sustainable competitive advantages.

SECOND: We believe that IFF overpaid for their acquisition of Frutarom, and we are concerned this could be a sign that the company is running out of attractive reinvestment opportunities. IFF paid 26.5x trailing EBITDA for Frutarom, excluding synergies. The company would need to see significant synergies and growth at Frutarom to justify the price paid, and we are uncomfortable assuming that everything will go completely right at Frutarom. The sector did not have a differentiated view on synergy opportunities, and positive expectations for the Frutarom acquisition based on management's estimates are already priced in. Furthermore, IFF has never done an acquisition of this size before, and there seems to be some serious cultural differences between IFF and Frutarom. For example, IFF does the majority of their R&D in-house, while Frutarom prefers to acquire patents through acquisitions. In addition, IFF is tougher on the sales side while Frutarom has a more laid-back sales culture. Therefore, we are concerned about IFF's ability to overcome these cultural differences and integrate Frutarom successfully. While management talks about learning from each other's strengths, we worry that combining these two different businesses could result in an unclear corporate strategy.

For these reasons, we chose to not invest in IFF. Overall, when we compare the risk/reward profile of IFF with the entire universe of other possible investments, we think there are better uses of our capital.

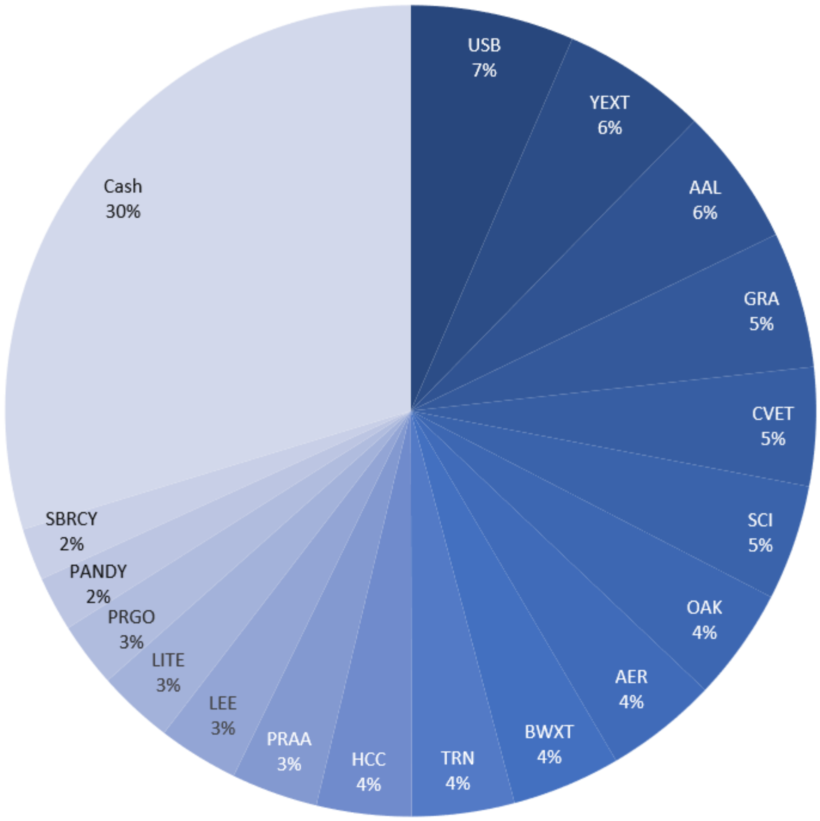
Exited Positions

<u>Sold Deere & Company</u> (NYSE: DE) for $156.36

Bought at $85.04 (97% total gain, 16.6% annualized)

We purchased Deere in late 2014 as the company began to hit a cyclical downturn, highlighting the company's compelling business model and growth opportunities that we felt were being discounted in the valuation, even after adjusting for cyclicality. Almost five years later, the stock has more than doubled and the position became the largest in our portfolio. While much of the decline in Deere's financial performance can be attributed to a cyclical trough, we view recent market share declines as very concerning, especially given the historical advantages in brand name and dealership distribution that the company has benefited from. Overall, we feel that our thesis has played out and are less certain about the current valuation in the face of growing competitive threats. As such, we believe that now is an appropriate time to exit.

Portfolio Weightings


USB
7%
YEXT
6%
AAL
6%
GRA
5%
CVET
5%
SCI
5%
OAK
4%
AER
4%
BWXT
4%
TRN
4%
HCC
4%
PRAA
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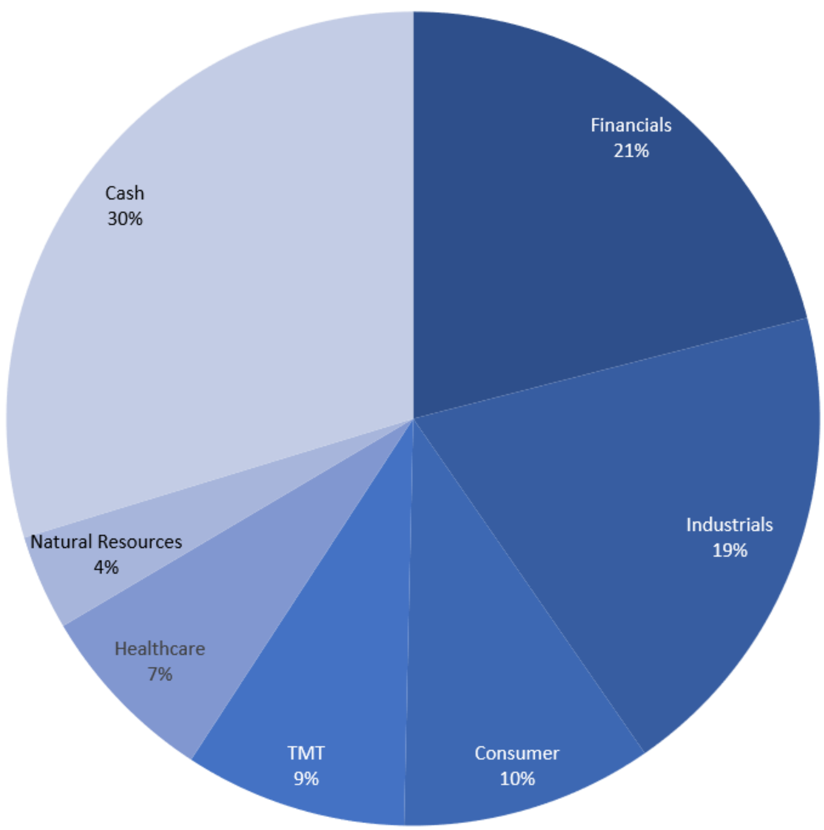
LEE
3%
LITE
3%
PRGO
3%
PANDY
2%
SBRCY
2%
Cash
30%


Financials
21%
Industrials
19%
Consumer
10%
TMT
9%
Healthcare
7%
Natural Resources
4%
Cash
30%