"You can get in more trouble with a good idea than a bad idea, because the good idea works…and then people go crazy sometimes."

Warren Buffett

Statement from the Chair

Chair of the Investment Committee: Ricardo Mestre

The quote for this year's investor letter (pulled from a CNBC interview on February 24, 2020) has its origins in a Benjamin Graham quote: "You can get in way more trouble with a good idea than a bad idea because you forget that the good idea has limits." A bad idea is often less dangerous than a good idea because it is rejected immediately when the public recognizes that the argument or claim being made is ridiculous. Much more dangerous are ideas that are generally "good", but that are extended to a point where they no longer hold– with devastating consequence. People can continue to go along with good ideas turned bad for much longer because they are based on a seemingly sound premise. For example, Warren Buffett and many other value investors have often spoken about the boom of the so-called "Nifty Fifty" stocks in 1960s and 1970s—these were blue chip stocks with good growth prospects that ended up getting priced very aggressively and ultimately crashing in the late 1970s and early 1980s. The "Nifty Fifty" was based on a sound premise: high quality companies tend to compound earnings at high rates over time and investors should be willing to pay a meaningful premium for these companies. As Howard Marks noted in his most recent memo, the "Nifty Fifty" was a good idea in the sense that the most competitively advantaged companies went on to justify their peak valuation. However, the idea was extended too far and many companies that were good (but not great) ended up receiving high valuations that simply were not justified. A good idea (i.e. I am willing to pay more for this business because it is higher quality than the market) can end up turning out very badly if investors do not place limits on the price that they are willing to pay.

I believe that we see much of this logic playing out in the market today. Investors have recognized that companies with a high total addressable market (TAM) and favorable unit economics have the potential to be worth a lot in the future. It seems to be in vogue today for many businesses to discuss their extraordinarily large TAM (sometime in the trillions) and heavily adjusted unit economics in order to justify their lofty valuations. I am sure that many of these companies will end up being resounding successes, but it appears to me anecdotally that many investors are paying too much based on a reasonable risk-adjusted assessment of the returns they are likely to achieve from their investment. While the math that 20% of a "$100Bn market" is in fact $20Bn of sales, I feel that investors should more intensely question whether the market is actually $100Bn and if 20% is an achievable market share. This is especially true when 12% market share in a $75Bn market would prove to produce a disastrous investment result.

As investors, we must continue to search for businesses that are undervalued based on a reasonable assessment of the present value of their future cash flows. Better companies with higher returns on capital and less risk should be rewarded with higher multiples and worse companies with lower returns on capital and higher risk should be given lower multiples. While this might sound old-fashioned, it is the only way that we as investors can understand the value of an asset. In purchasing World Wrestling Entertainment and Thales Group, we found two high-quality assets at reasonable prices with continued opportunities to reinvest into their business at attractive rates of return. We believe that both of these companies have a very long growth runway and that we will be rewarded as shareholders for having a long-term outlook. Eventually, we will realize our return on this investment as the underlying earnings power of each company grows and they return capital to shareholders through dividends and share buybacks.

In other news, as the COVID vaccine becomes more available and people get vaccinated, it seems that the United States may finally be returning to some sense of normalcy—the light at the end of the tunnel is near. Hopefully, in the Fall of 2021 TBC will be able to meet in person and a full year's worth of new members will be able to experience the club as we have all experienced it for many years. As I have mentioned before, being a member of TBC over Zoom is no substitute for being together. We miss out on much of the pre-general meeting conversations, sector mixers, and overall atmosphere that have made this group such an important part of the UChicago experience for many of our members. I promise to all of you that have yet to experience the club in person that the wait is well worth it!

I want to thank everyone for continuing to stay committed to the club despite a very difficult year. It has truly been a great experience leading TBC despite the many obstacles that we have encountered along the way. I joined TBC passionate about

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investing and at every turn this organization has provided me with resources and mentors that have furthered that passion. I can think back to so many people in the club who have sacrificed their time to provide me with valuable advice, perspective and partnership along the way, and for this I am truly grateful. I hope I have been able to return this excitement for our work and help members discover new areas they are passionate about, both within and beyond investing.

Finally, I want to take a moment to reiterate what I believe makes this organization so special. To me, it is the people. The people who bring their viewpoints to general meetings; the people who give presentations on their interests; the people who speak up in sector meetings and bring in new perspectives; the people who argue about their ideas during ICOMM defenses; the people who have dedicated their time to mentoring so many of us. It is in this spirit that I hope TBC continues to aggressively pursue initiatives to improve our diversity, equity, and inclusion (DE&I) so that any person can feel invited, comfortable, and valued in our organization. I strongly believe that having a great diversity in experience, outlook and perspective will only make our organization better. Building on the progress we have made, I encourage TBC to make a public commitment to diversity, equity, and inclusion. Members of TBC and the wider UChicago community should hold the club accountable to this commitment. I believe that TBC should publish demographic statistics and distribute a club DE&I climate survey every year so that people inside and outside of the organization can see the progress that we are making and ensure continuous accountability. I look forward to seeing TBC continue to center inclusion in our core values, and how each of us will exemplify those values beyond the club and college, extended into our careers and daily lives.

In this letter, you will find the sector leaders' summaries of their pitches this quarter, the Investment Committee's decisions on those pitches, and explanations behind exited positions. If you have any questions, please feel free to contact me at rpmestre@uchicago.edu. Thank you for the great year!

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Winter Pitches

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Fortinet Inc. (NYSE: FTNT)

Technology Sector Leader: Emily Ballinger

Company Overview

Fortinet was founded in 2000 in Sunnyvale, California and offers a suite of integrated and automated cybersecurity solutions for medium and small enterprises. They have over 450,000+ customers globally and hold 702 global patents. Their flagship fire wall platform FortiGate includes packet filtering, network monitoring and IPP mapping to defend against malware, fishing and internal threats as well as broader visibility of the security fabric. Their products also encompass individual applications such as FortiSwitch, FortiWeb, and FortiMail designed to protect a particular point of network intrusion.

Investment Thesis

The Technology Sector recommends a MONITOR in FTNT for the following reasons:

1. Fundamental Strength as a traditional and Next-gen service provider: Despite several strong competitors in the industry Fortinet differentiates itself with the breadth and depth of its security offerings. Seamlessly integrating onto a single management platform, its products offer centralized management and deployment of security products to encompass the increasingly complex IOT faced by modern enterprise. As such they are well suited to the small to medium enterprise needs and are well positioned to capture significant growth in the rapidly growing SD-WAN and network security industry.
2. Service based business model and industry leading partnerships: The ability to combine with existing infrastructure fits the slower and less specialized transition of smaller enterprises to IOT security needs. Additionally, partnerships with Cloud providers streamline the security setup and maintenance process for technologically less sophisticated customers by layering a secure network on top of existing infrastructure. Hardware partnerships with leading firms like Arista Networks further lock in customers to Fortinet infrastructure while partners have little incentive to switch away due to costs incurred in specializing products for Fortinet software.
3. Three-pronged switching costs: Setting up and maintaining network security has significant learning curves and severe financial and strategic consequences for failure. As such parties responsible for network security at a particular enterprise are incentivized to work with software, they are most comfortable and skilled in. Fortinet offers training courses and certifications that bring employees into the Fortinet network at their firm and incentivize them to try to use the software in current and future security needs. This makes it particularly difficult for companies using Fortinet to switch away as it not only leaves networks and sensitive data unprotected but requires additional training of employees and leaves room for additional human error.

Key Risks and Considerations

1. Highly competitive landscape: The enterprise security market is highly competitive with many competitors offering similar products. Further the market for small and medium enterprises mainly operates through networks of resellers who often sell competitors' products alongside Fortinet. This forces firms to compete on pricing and marginally different product offerings that may or may not entice customers.
2. Unstable Growth: Lastly although past growth has been high it may become increasingly difficult to maintain due to a high number of firms already committing to a particular security software limited upselling opportunities as firm's security needs remain stagnant without significant technological innovation or firm expansion.

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Decision: MONITOR

Technology Investment Committee Representative: Chris Sun

The Technology Sector pitched Fortinet Inc. (NASDAQ: FTNT) on Wednesday, February 3rd, 2021 in General Meeting as a buy. The Investment Committee decided to monitor FNT. Our reasons are as follows:

FIRST: At the time of investment, we believed that the margin of safety was not sufficient. FTNT is currently trading at premium multiples relative to what we believe the intrinsic value truly is. Changing model inputs for revenue and margins quickly diminishes an already narrow margin of safety, following the stock's performance YTD since mid-March. We believe that with an attractive valuation, the stock could be a buy as a growth performer.

SECOND: The company is heavily embedded in the cybersecurity of large enterprise customers, resulting in low churn and attractive barriers to entry. With few competitors capable of offering similar technological expertise, FTNT is a high performer that will continue to gain market share. With an attractive business model, we're looking for a better entry price before purchasing.

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Coherus Biosciences (NYSE: CHRS)

Healthcare Sector Leader: Austin Wang

Company Overview

Coherus Biosciences is a leading developer of biosimilars that has recently entered the immuno-oncology market. Coherus's flagship immuno-oncology biosimilar, Udencya, was able to capture over 20% market share within two years, making it the most successful biosimilar launch to date. Building off their commercial success, Coherus has shifted its business model to end many early-stage biosimilar development products in favor of licensing or purchasing later stage products.

Investment Thesis

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

1. Contrarian view on positive pricing and market trends: We agree that Coherus has no long-term pricing power. However, we believe that price declines in the biosimilar market will unroll much more slowly than many predict. Due to a lack of research on non-medical switching for biosimilars, healthcare providers are unwilling to switch biosimilars and prefer to use the biosimilar drugs they are most familiar with rather than the cheapest ones. Thus, Coherus has been able to grow market share without making drastic concessions in average sales-price. Furthermore, biosimilar market penetration rates are expected to increase drastically due to various policy implementations, shifts towards value-based oncology models, and growing physician education.
2. Attractive late-stage pipeline: Coherus has multiple late stage biosimilars as well as licensing deals for popular foreign biosimilars and immune-oncology drugs.
3. Competitive advantage through commercial experience: While the market believes Coherus has little to no competitive advantage and sells a commoditized product, we believe Coherus's expertise in the biosimilar industry represents a short-term competitive advantage. Coherus is one of the only companies to have a support system specifically tailored to the dynamic biosimilar-specific reimbursement policies. Furthermore, physicians who are weary of new drug options value experience, and Coherus's team has established a reputation as the U.S.'s largest and most experienced biosimilar pure-play. We attribute Coherus's unprecedented commercial success as a second mover to investments in market education and experienced sales staff rather than the failures of their competitors.
4. Long term reinvestment potential driven by partnership with Junshi Biosciences: Coherus's proven ability to take market share from larger drug companies has helped it land a long-term licensing partnership with Taiwanese immuno-oncology drug developer Junshi Biosciences. We believe Coherus's shift towards licensing foreign immuno-oncology drugs represents a shift towards Coherus's core competencies in commercialization. Furthermore, this partnership provides Coherus with additional options to reinvest capital after biosimilar prices decline.

Key Risks and Considerations

1. FDA approvals: As with any drug company, Coherus faces significant regulatory risk from the FDA. However, Coherus's pipeline is mostly late stage and has a very low risk of not getting FDA approval.
2. Uncertain penetration in incumbent markets: Much of Coherus's reinvestment potential comes from licensing agreements to commercialize late-mover drugs. While Coherus only needs to capture a fraction of the market to make these investments worthwhile, it is unclear whether Coherus's marketing efforts will always be successful. If Coherus is unable to successfully execute in commercialization, their licensing agreements will be highly value destructive.

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Decision: NO PURCHASE

Healthcare Investment Committee Representative: Neha Kavi

The Healthcare Sector pitched Coherus Biosciences Inc. (NASDAQ: CHRS) on Wednesday, February 10th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided to not purchase CHRS. Our reasons are as follows:

FIRST: In the biosimilar market, there is a significant first mover advantage that the sector addressed. While Coherus' primary drug, Udenyca, was able to gain significant market share, it is unclear that this result is replicable. Although Coherus has several drugs in its pipeline, biosimilars for many of them currently exist in the market. Given the stickiness doctors and patients have to drugs that work, it is unclear that the drugs currently in the pipeline will succeed the way Udenyca did if they come to market. The sector attributed Udenyca's success to the marketing capabilities of Coherus, but with limited evidence of a strategy that competitors could replicate, the lack of first mover advantage that Coherus would have with its current pipeline drugs posed a concern for us.

SECOND: Although seemingly conservative assumptions made Coherus appear undervalued, the implied assumptions from the model require a greater margin of safety than we have. As mentioned, there are significant first mover advantages in this industry, so the timing of drugs coming to market greatly affects their success. When this is considered in the context of delays that commonly occur in this space, the adjustments to market share after delays and without a first mover advantage mean we cannot be certain Coherus' new drugs will reach the market share they need for Coherus to justify its value.

THIRD: Part of the thesis for this investment is that Coherus has shifted away from focusing solely on research and development by outsourcing part of this and its main advantage has shifted to its marketing strategy. While the market has punished Coherus for this, the sector advocated this is why Coherus is a good investment, since its less dependent on the risky parts of the timeline of development and has shown itself to be unique in its marketing ability. However, Udenyca alone is not evidence of a successful shift in strategy, so an investment in Coherus would be an investment in a business model shift that we do not yet know would work. Given the limited margin of safety and uncertainty regarding how much marketing could be considered a competitive advantage of Coherus, it was not a risk we believed we should take.

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Compass Minerals International (NYSE: CMP)

Natural Resources Sector Leader: Frank Li

Company Overview

Compass Minerals is a diversified global minerals company. It is a leading producer of salt for highway deicing and other consumer and industrial uses in North America and the U.K. It also operates a Plant Nutrients segment, producing sulfates of potash (SOP) and providing premium fertilizer for high-value crops. The business is divided into three segments—Salt, Plant Nutrition North America, and Plant Nutrition South America, which accounted for 57%, 18%, and 25% of the firm's Revenues in FY 2020 respectively.

Investment Thesis

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

1. Economic Moat from Advantaged Salt Assets: CMP possesses an economic moat due to the geographical proximity of its salt assets to its customers. As a commodity, salt is costly to transport due to its low value per ton, and land transport is only efficient within about a 150-mile radius. CMP's salt mines are located close to waterways like the Great Lakes and the Mississippi River, which puts CMP lower on the cost curve than their mostly landlocked competitors. CMP also benefits from its scale—it owns the largest rock salt mine in the world, the largest dedicated rock salt mine in the U.K., and the largest solar salt production site in the Western Hemisphere. For example, the Goderich mine has an estimated remaining lifespan of eighty years, which allows for long-term investments that cannot be made at other mines. As a result, CMP can produce salt at this mine at a lower cost than competitors in the long term. CMP has also pushed to decrease costs and increase efficiency in their operations, which has allowed them to continuously increase earnings in challenging demand environments.
2. Beneficial Bidding Process and Demand Stability: CMP's position on the cost curve and large scale significantly benefit them in the salt bidding process. As governments send out bid requests by location in the summer or fall annually, and salt suppliers send in blind offers at fixed prices, companies compete heavily on prices and low-cost producers like CMP are benefitted by the process. Moreover, because bids occur well before winter, governments have to estimate salt demand, which makes the actual demand quantity less volatile than weather changes. Governments are also incentivized to over-estimate, given that underestimation of the salt needed could lead to lawsuits, safety concerns, and higher prices on the open market. These factors have driven the salt price to steadily rise at a 4% CAGR over the past two decades. The contracts include minimum purchase requirements, which further shields the sales of CMP from demand fluctuations. As a matter of fact, CMP holds many multi-year contracts at a fixed price and minimum quantity, which would provide stable revenues and earnings in the near future.
3. Growing demand for SOP Fertilizers and Market Mispricing: SOPs are high-quality fertilizers that are sold at a premium, as they are mostly used on high-value crops (e.g. fruits, vegetables, nuts, tea, coffee, and tobacco) to increase crop yields or to increase resistance to droughts, frost, insects, and disease. They are not substitutable by MOPs, and there is an increasing premium on SOP products. As the global food demand has been rising over the past several decades, and desertification and climate change have reduced the amount of arable land per capita available, there is an increasing demand of the SOP fertilizers around the world. Of all three processes to produce SOP fertilizers, solar evaporation is the most energy and cost efficient, and CMP owns the largest solar-evaporation facility in North America. In addition, there has been a growing demand for high-potassium fertilizers like SOP in Brazil due to acidic soil and low fertility. And CMP has been investing aggressively in the highly fragmented Brazilian market, which gives them a significant cost advantage, especially considering that CMP's largest competitor SQM has been focusing more heavily on lithium-related projects. We believe that CMP's Latin American operations are mispriced due to the currently depressed commodity prices after extreme agricultural events and significant amount of CapEx that CMP has been deploying to develop regional sales infrastructure that will be beneficial in the long term.

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Key Risks and Considerations

1. Weather Conditions: Wintry events can significantly impact salt demands, but the salt bidding process and the contract structure—which makes CMP's customers to set minimum purchase quantities months in advance—help to smooth out the demand. Global warming might hurt the business in the long term but could cause extreme weather events, which increase the demands of deicing salt in the near term. Moreover, hot or cold temperatures as well as rainfall and drought could affect the demand and production of SOPs, but CMP has historically been able to take advantage of the down seasons to build inventories and make necessary upgrades to its production sites.
2. Other Fertilizer Segment Risks: There has been increasing competitions in the SOP markets, but CMP's position on the cost curve could shield them from competitive pressure. Moreover, price differences between MOPs and SOPs could incentivize switching, but SOP has a guaranteed niche given that not all crops can handle chloride-based fertilizers and it is widely used in organic farming.
3. Financial Security: CMP had a relatively high leverage at the end of 2019, with a 3.98x Debt/Equity and a 5.74x Net Debt/EBITDA. However, the firm has been taken initiatives since to strengthen its balance sheet. Its Cash Flow from Operations increased by 93% in 2020 compared to 2019 as a result of it proactively reducing CapEx and discretionary spending. As a result, it anticipated its Debt/EBITDA to improve to 3.9x by end of 2020. Given the firm's $220 million in total liquidity, it should be to meet its liabilities in the short term with ease.

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Decision: NO PURCHASE

Natural Resources Investment Committee Representative: Parth Patel

The Natural Resources Sector pitched Compass Minerals International, Inc (NYSE: CMP) on Wednesday, February 10th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided to not purchase CMP. Our reasons are as follows:

FIRST: Limited margin expansion and growth opportunities in a commoditized space. CMP's salt business is benefitted by the company's premier salt mines (such as the Goderich mine) that have both a size and geographic advantage. CMP has lower cost of production than its public competitors but given the commoditized nature of salt it has no control over price. The runway for cost cuts is growing more limited resulting in stagnant margins. When this is paired with low overall growth of the US salt demand/production (1% yoy), despite CMP's advantaged market position and stable cash flow stream, ICOMM is not confident that CMP is undervalued at the time of the pitch.

SECOND: Weakness in the Plant Nutrition segment. CMP's Plant Nutrition business was launched over ten years ago and currently makes up around 40% of the company's revenue. Much of its growth relies on demand for SOP fertilizer in Brazil due to the country's scarcity of arable land. The Brazil operation's early promise has not manifested over the past few years and the major SOP player in Brazil is pivoting away from the business, signaling the reality of diminishing opportunity. ICOMM believes the South America Plan Nutrition segment is overvalued and too volatile to invest. Generally, we believe that this segment is outside of CMP's core competency and their attempt to diversify their main business away from salt was ineffective because they hold limited competitive advantage in the new space, evident in their historical segment returns.

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World Wrestling Entertainment, Inc. (NYSE: WWE)

Communications Sector Leader: Will Reid

Company Overview

WWE is the largest professional wrestling league in the world – a $4B family company controlled by generations of the McMahons. In normal years, they hold over 450 live events which are also available via PPV, cable, and streaming to over 800M homes worldwide. They operate with very few competitors domestically and internationally and the theatrical experience differentiates them from substitute traditional sports leagues like the NFL and UFC.

Investment Thesis

The Communications Sector recommends a BUY in WWE for the following reasons:

1. <u>Operating at Efficient Scale with a Strong Brand:</u> WWE benefits from all the usual advantages of an incumbent sports league – efficient scale, low competition, pricing power – and has managed to prove this over the decades by crushing nascent competition.
2. <u>Increasing Value Proposition of Live Sports:</u> The rights to live sporting events are becoming even more critical to traditional cable companies in the face of the cable cutting trend and are quickly becoming an important differentiator for the highly competitive streaming space. Within this rapidly changing industry the best thing to be is a content owner, and live sports is the most valuable content of all. The value of WWE's IP will continue to compound over the long run regardless of the platform that carries them at any given time and WWE is doing a good job of transitioning more of their business towards long-term licensing agreements.
3. <u>Market Mispricing:</u> The market did not react well to WWE's recent $1B deal with NBC to host their network on Peacock even though the economics of this deal are good for WWE, it will be much easier and cheaper for WWE fans to access the content, and it will expose said content to the 30M+ Peacock subscribers. Further, that the benefits of a more fully licensed model were not being adequately appreciated at the time of the pitch, with the company trading at a large discount to its historical valuations and those of other content owning licensing companies. Due to all of these factors we recommended a buy at $47.

Key Risks and Considerations

1. <u>Licensing Risk:</u> Though we think the licensing model is good for WWE in the long-run, it does mean that a large portion of the economic value of the company is wrapped up in 2-3 contracts to be renewed every 5 years or so, which introduces some contract risk.
2. <u>Concentrated Shareholder Structure:</u> CEO Vince McMahon controls about 80% of the voting power of the company, and that number climbs even higher when you consider the whole family. He has historically worried some investors with his large and sometimes ill-advised investments in non-core assets, but we believe his track record over several decades is unparalleled in the sports world and the company is in good hands.

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Decision: BUY

Communications Investment Committee Representative: Jacob Tucker

The Communications Sector pitched World Wrestling Entertainment Inc. (NYSE: WWE) on Wednesday, February 17th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided to **BUY** WWE. Our reasons are as follows:

FIRST: We believe that WWE's efficient scale represents a reliable moat that will be able generate consistent lofty returns on invested capital. There are several instances throughout WWE's history where upstart firms have attempted to cut into WWE's devoted fan base – each of these attempts was met with failure. Even adjacent sporting events, such as UFC, have not been able to peel away viewership from WWE. We believe that there is ample opportunity to capitalize on this moat in newer markets such as India, and continue to reap meaningful returns as the brand expands its global presence.

SECOND: Live sporting events represent a beacon of hope for legacy cable providers, as well as a source of opportunity for streaming businesses and advertisers. WWE boasts a diversified plan of attack in both streaming and licensing. Armed with meaningful leverage due to the scarcity of their high-value content, WWE is poised to continue to strike attractive agreements with distributors that depend on their content.

THIRD: While we see potential dangers in believing that the negative market performance in the weeks leading up to the pitch are limited solely to temporary earnings shocks, we do agree that the recent Peacock agreement should assuage some other fears that we have regarding the business and provide us with a meaningful margin of safety from a valuation perspective.

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Thales Group (EPA: HO)

Industrials Sector Leader: Darius Hong

Company Overview

Thales Group is a French multinational company that designs and builds electrical systems and provides services for the aerospace, defense, transportation, and security markets. Its 2020 revenue was split among its four operating segments as follows: Defense & Security (48% of 2020 revenue), Aerospace (25%), Digital Identity and Security (18%), and Transport (10%). The French state owns 26% of Thales, while Dassault Aviation owns another 25%. Thales has a diversified customer base and serves the following end markets: armed forces (44%), operators of critical infrastructures (21%), commercial customers (20%), and government agencies (15%).

Investment Thesis

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

1. Attractive Positioning Guaranteed by Political and Technological Interdependencies: France's centralized defense procurement system ensures that its long-standing contractors like Thales retain their positioning. Additionally, European companies in the aerospace and defense industries have a long and successful history of cooperation. NATO has selected Thales to provide its first deployable defense cloud, and Thales' capture of a €1.5 billion contract to equip German MKS 180 frigates establishes Thales as the de facto naval combat system provider for NATO. Just one major systems contract win means that other systems must be able to communicate with that system, so over time and with more contracts, Thales' product will become the locus of the entire network's demands.
2. Tailwinds from Overhaul of French Defense System and Cross-Selling: The French defense system is starting to undergo a massive overhaul, with a record €26.7 billion being used just for modernizing equipment in 2021, greatly benefitting Thales. This overhaul touches all aspects of the French military (including communications and digital security) and involves greater cooperation with Germany and Belgium, with most of these joint contracts being exclusively bookmarked for French firms. Relatedly, the French government has shown increased willingness to export modified Thales products abroad, especially to European defense partners, expanding Thales' addressable market. As an additional tailwind, Thales can leverage its relationships with clients, as well as the data and clearances they have acquired through past engagements, to cross-sell its wide range of products.
3. Market Misperception Regarding Effect of Chinese Investment in West Africa: The market believes that Thales' prospects in West Africa rely on the outsized influence of a Western government in the region and that Chinese inroads threaten Thales' success. However, we disagree and believe that the influx of capital generated by Chinese investment is beneficial to French firms in the region – recent examples include Vinci SA winning a €388 million contract to build Sambangalou Dam in Senegal (financed by Eximbank) and Thales being contracted to build a TER rail system in Senegal for an estimated €225 mm due to its existing relationships with Shanghai Electric Group. While Thales certainly benefits from Western influence in West Africa, the aforementioned contracts (and many others) represent greenfield opportunities that would be impossible without Chinese investment.

Key Risks and Considerations

1. Influence of Major Shareholders: It is unlikely that the French state would utilize its influence over Thales in a way that would harm the company because France has a vested interest in the success of Thales, especially as Macron pushes for the rejuvenation of the EU led by France, in which Thales will play a critical role. Similarly, Dassault's stake is unlikely to be problematic as Thales does not directly compete with Dassault, and the two often win contracts together.
2. Effect of Brexit on United Kingdom (UK) Revenues: In 2019, 7% of Thales' revenues came from the UK. Brexit will result in a change in regulations between the UK and the EU, which will affect Thales' ability to sell to UK firms and also incentivize UK firms to shift more of their spend to UK defense contractors like BAE Systems. While the market has accounted for the probable decline in Thales' UK revenues, we believe that it has not sufficiently noted that Brexit will *also* result in less competition from the UK for continental European deals, as many UK companies no longer have sufficient clearance to win EU contracts. This has proven to be advantageous for Thales, as seen in their win of the Second-Generation Galileo Satellite Contract.

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Decision: BUY

Industrials Investment Committee Representative: James Young

The Industrials Sector pitched Thales Group (EPA: HO) on Wednesday, February 17th, 2021 in General Meeting as a buy. The Investment Committee (ICOMM) decided to purchase HO. Our reasons are as follows:

FIRST: Thales has very attractive positioning in its industry. Thales has strong political interdependencies that guarantee competitive positioning in the NATO defense sphere. The company is entrenched and integrated with many financial institutions, mobile operators, and other companies in the data protection markets.

SECOND: Favorable industry tailwinds will drive value in the future. The massive overhaul of the French defense structure is only in early innings and there is further runway for growth in the NATO Defense Cloud along with demonstrated cross selling opportunities.

THIRD: The market misunderstands the implications of the Chinese presence in West Africa and Southeast Asia. French firms, including Thales, have landed massive contracts with Chinese capital. Western responses to China's influence in West Africa offer opportunity for more security contracts for Thales. Catalysts for fair value realization include consistent quarterly earnings performances, signing of new contracts, and the significant political events such as the likely chancellorship of Armin Laschet in Germany.

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WP Carey Inc. (NYSE: WPC)

Financials Sector Leader: Adam Keller

W. P. CAREY

Company Overview

W. P. Carey ranks among the largest net lease REITs with an enterprise value of approximately $18 billion and a diversified portfolio of operationally critical commercial real estate that includes 1,215 net lease properties covering approximately 142 million square feet as of September 30, 2020. For nearly five decades, the company has invested in single-tenant industrial, warehouse, office, retail and self-storage properties subject to long-term net leases with built-in rent escalators. Its portfolio is located primarily in the U.S. and Northern and Western Europe and is well-diversified by tenant, property type, geographic location and tenant industry.

Investment Thesis

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

1. <u>Unjustified price decline due to Covid-19:</u> WPC's portfolio is heavily allocated towards warehouses, non-warehouse industrial properties, and office space, with more limited exposure to retail and hospitality properties. Only 2% of properties experienced a 5% or greater decline in cash collections. WPC still trades 20-25% below its pre-Covid share price, which makes little sense given the composition of the firm's real estate portfolio.
2. <u>Accelerated warehouse growth and further cap rate compression:</u> the Covid-19 pandemic has significantly accelerated the adoption of e-commerce platforms in the US and elsewhere. In the real estate markets, this trend has manifested in an incredible period of outperformance for warehouses, which now trade at far lower cap rates than most properties. Our belief is that a) the market has not given WPC enough credit for its warehouse portfolio, and b) secular trends will continue to push warehouse cap rates lower.
3. <u>Reinvestment opportunities through sale-leasebacks (SLBs):</u> central banks' liquidity provision policies have created a bifurcated world: the largest American and European companies enjoy easy access to cheap debt, while mid-sized and smaller companies still face somewhat challenging financing conditions. SLBs provide an attractive mechanism for these types of firms to convert real estate into liquid cash. In 2020, WPC signed a number of attractive SLB deals including a Spanish grocery store chain and a global cold storage logistics provider. While the SLB market is highly competitive and undifferentiated, we still expect WPC to benefit from an increased demand for capital.

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Decision: NO PURCHASE

Financials Investment Committee Representative: Nathan Nangia

The Financials Sector pitched W.P. Carey Inc. (NYSE: WPC) on Wednesday, February 17th, 20201in General Meeting as a buy. The Investment Committee (ICOMM) decided not to purchase WPC. Our reasons are as follows:

FIRST: Although we believe that WPC broadly has an attractive and diversified portfolio of existing assets, we believe that the value of these assets on a sum of the parts basis are not worth substantially more that the price where the company is currently trading. There are many reasons why WPC portfolio is attractive: high occupancy rate (~99%) despite the many disruptions COVID-19, rent escalators tied into 99% of leases offering sustainable growth over time, and an attractive portfolio positioning that has enabled the company to take advantage of macro-economic trends such as the growth of e-commerce. Despite the many things that make the company's assets attractive, we believe the current price of the stock at least fully accounts for all of these attractive elements.

SECOND: While the past purchases of assets may have been on attractive terms, there is little assurance that future growth will be nearly as attractive. With many high-quality businesses, strong past performance may be indicative of a competitive advantage that will enable the business to reinvest back into itself at elevated rates. The sector mentioned that WPC was able to enter into some attractive sale lease-back transactions with the likes of Orgill and Lineage Logistics but, we do not believe that these transactions or similar transactions are indicative of any significant or sustainable moat. In case of most REITs (including WPC), re-investments into their business occur by purchasing new properties. I believe that banking on attractive economics on these future reinvestments is highly speculative because there is little competitive advantage in purchasing assets within competitive markets. Thus, we cannot bank on any economic value being achieved from re-investing into the business; instead, the only source of value for the company is from their existing assets. As stated in the first point, we viewed the existing assets as at least being fully accounted for within the company's current price making the investment unattractive.

THIRD: Finally, we believe that the price of this stock is highly dependent on interest rates—something we nor anyone has the ability to forecast—demanding an additional margin of safety. While an investment in any asset is dependent on interest rates, we believe this business to be uniquely sensitive. The company requires a significant amount of debt in order to purchase assets and the pricing of the company as a yield heavy investment is likely highly influence by yields available in the bond market. The sum of the parts valuation for this business was conducted using industry average cap rates which are at historical lows given the historically low interest rates that are prevalent in the market. While even on this basis the company was fully priced, I believe that the current aggressiveness of pricing in the overall real estate market requires us to demand an additional margin of safety. We have no idea whether cap rates will go up, down or side-to-side; however, given the historically low levels of cap rates, the significant influence that it will have on our valuation, and the fact that it remains a significant unknow, I believe it is prudent to add an additional layer of conservatism to our valuation.

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The a2 Milk Company (OTCMKTS: ACOPF)

Consumer Sector Leader: Will Noddings

Company Overview

a2 Milk is a New Zealand-based dairy producer that specializes in the production of dairy products that are free of A1-casein proteins. A1 proteins are blamed for many digestive issues which are associated with milk consumption (separate from lactose intolerance) and a2 possesses a specialized test which can test if cows produce milk without the A1 protein. The majority of their operations are in Australia/New Zealand, and their primary markets include these home markets, China, and the U.S. The product mix is primarily split between infant formula (about 80% of revenue) and liquid milk products.

Investment Thesis

The Consumer Sector recommended a BUY in ACOPF at $8.40 for the following reasons:

1. Strong Competitive Positioning: a2 benefits from patented tests that identify whether or not cows product A1-free milk or not. While they are not the only company to offer A1-free products (Nestle has notably tried to enter the space) Nestle has struggled significantly to find success within China, demonstrating some barrier to entry within the space. a2 has also positioned themselves as a premium dairy product. This is evidenced by strong customer reviews not only on an aggregate level from online markets such as Amazon and Walmart, but also from glowing reviews by mommy bloggers. This premium label and foreign background is especially important in China, as a 2008 deadly milk scandal led to distrust of Chinese suppliers. Because of this scandal, Chinese mothers are especially likely to seek premium foreign brands for their children.
2. Growing End Market/New Market Entry: a2 has been rapidly growing their Chinese presence through several different distribution channels and a multi-pronged marketing effort. The different distribution channels and different product lines (which are functionally very similar) allow a2 to price discriminate effectively in China. This, combined with expanding product lines in China and favorable population trends, have led it to be a rapidly growing market for a2. This expansion has been continued in the U.S., as a2 has gone from presence in ~500 stores in FY15 to ~20.3k stores in FY20. Dairy markets are continuing to grow worldwide, and a2 sees many possible continuing avenues of expansion, with South Korea and Canada being the most immediate markets.
3. Pricing Power/Resiliency: As mentioned before, a2 uses differentiated labeling and distribution to price discriminate in different Chinese cities. a2 has also demonstrated the ability to charge a significant pricing premium in China, as evidenced by our research regarding online alternatives. However, even this is likely not the ceiling on their effective price, as they are still cheaper than Nestle's A1-free Chinese brand, which doesn't have the same domestically targeted marketing or premium perception.

Key Risks and Considerations

1. Nestle's Competitive Entry: In 2018, Nestle introduced their own lines of A1-free products in China, targeting similar channels as a2. However, we don't believe this risk is overwhelming due to Nestle's poor performance to date. They do not have the same brand equity, as there is much more transparency regarding sourcing, and Nestle has poor perception regarding being a health-conscious, forward-thinking brand. These are key variables for the target demographic, health-conscious mothers.
2. Regulatory Risks: China's FDA has strict registration policies regarding infant formula products. While there are no concerns on the immediate horizon, the threat of Chinese regulation could cause significant harm overnight. Furthermore, a2's position as a foreign company could lead to import regulations. However, market research suggests that China would be reluctant to disrupt products associated with infant health.

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Decision: MONITOR

Consumer Investment Committee Representative: Joshua Soong

The Consumer Sector pitched A2 Milk Company (OTC: ACOPF) on Wednesday February 24th, 2021 as a buy. The Investment Committee decided to monitor ACOPF. Our reasons are as follows:

FIRST: We are attracted to the Company's dominant position in the Oceanic region and its growing market share in the burgeoning Chinese market. The Chinese market in particular is highly fragmented but A2's branding as a premier foreign producer has enabled it to rapidly grow sales in Tier 1 and, increasingly, in Tier 2 cities without eroding margins. However, the Company's reliance on the daigou sale channels is of concern especially in light of the large, pandemic-driven decline in 2020 daigou order volumes. While the Company has publicly stated it believes the daigou channel will recover and that it will prioritize the daigou channel – even going so far as to state it is willing to sacrifice CBEC volume to protect daigous – we would like to see this strategy generate results before committing ourselves to A2.

SECOND: Although we perceive milk and infant formula to be relatively counter cyclical products, the pandemic showed this was not the case. Revenues declined significantly in 2020 and are not expected to recover for some time. This was made clear during the 2021 sales forecast, a statement we take with a grain of salt given the Company's two relatively large earnings misses this year. More importantly, while we are attracted to the high margins on infant formula, we want to better understand whether the pandemic-driven decline is structural or if demand is simply taking longer than expected to recover.

THIRD: The base and bull case models imply A2 is significantly undervalued but suggest a quick return to growth in all markets. If the pandemic-related decline is indeed a hiccup (so to speak), then we concur that A2 is a good buy. The risk is in the bear and zero-growth scenarios which model in 2020 as a speed bump that causes growth to decelerate or even stagnate. In such cases, without its growth engine, A2 is in a much more precarious position. Combined with its recent purchase of Matura Valley – which is expected to be cash flow negative for several years – such scenarios contribute to our Monitor decision. We hope to reevaluate A2 in the near future after the Company has had time to revamp its daigou sales channel to better assess if growth has been affected by the pandemic.

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Portfolio Weightings

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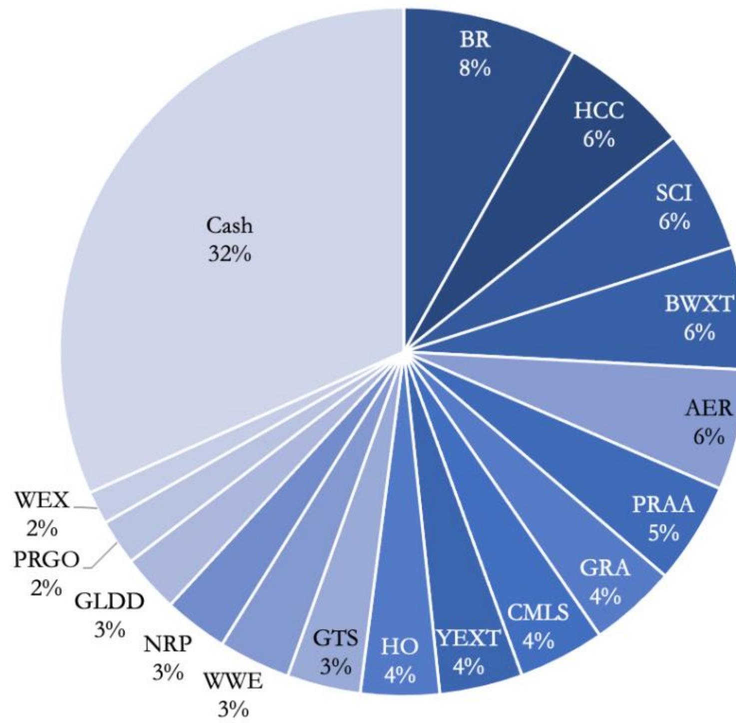

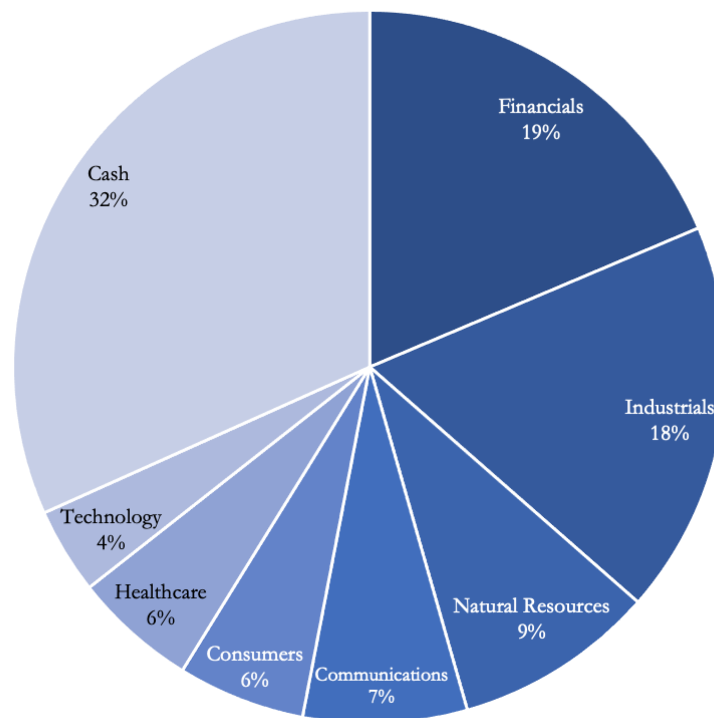

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