



The performance of securities mentioned within this conference call transcript refers to how the security performed in the market and does not reflect the performance attributed to the core equity portfolio. Please see the chart at the end of this transcript, which reflects the full list of contributors and detractors based on each security's weighting within the core equity portfolio.

Sean Stannard-Stockton:

Hi everyone, thanks for joining us this afternoon. The structure of this call will be a little different than in the past due to us having hosted a special Coronavirus focused call on March 20th. On that call, we laid out how we are thinking about this unprecedented crisis and how we are positioning our portfolio both to get through the crisis and to thrive on the other side. We also talked about a selection of our holdings with a focus on how we see them performing both during and after the crisis. On our call today, I'll provide comments on the first quarter performance of our strategy, discuss the fiscal and monetary responses to the crisis that occurred after our last call, and we will focus the balance of the call on discussing all of our holdings that we did not cover during our Coronavirus call.

The performance of our equity strategy this quarter was down significantly along with the market. After outperforming significantly during the strong rally of 2019, our strategy finished the quarter down approximately the same amount as the market in the first quarter. While the final calculation of our equity composite will not be available until later this month, our current estimate is that our equity portfolio composite was down 19.47% vs the S&P 500 down 19.60%. Over the last year, this brings our equity portfolio composite to down 4.84% vs the S&P 500 down 6.99%.

Past performance is not an indication of future returns. Our composite performance is reflected for the quarter and year to date period ending March 31, 2020 and is shown net of fees and expenses and includes the reinvestment of dividends and income. Please refer to important disclosures at end of this transcript.

While we report our composite performance on a quarterly basis and we think this is the appropriate cadence on which our clients should evaluate us, we saw a significant impact on our relative performance over the last four days of the quarter that we thought would be worth sharing as it speaks to some of the unique dynamics driving market performance during this unprecedented event.

First of all, it is worth noting how volatile the market was in February and March, and how this volatility was apparent in our relative performance, not just absolute performance. During 2019 for instance, the excess return of our strategy vs the market on any given day tended to be much less than half a percent. While the last two months have seen many days on which our strategy under or outperformed by a full percentage point or more. During the six-week period after the market began to decline in mid-February, we saw our relative performance vs the market swing by 1.5% or more on six separate occasions. These swings were caused by the highly unusual market volatility which saw days on which many stocks were up 10% while many others were down 10%. Historically, the volatility of our strategy has been similar or somewhat less than the market and in the last quarter it continued to display similar relative volatility. So these big price swings and shifts in our relative performance were a function of broader market volatility, not a function of our portfolio of holdings exhibiting higher than normal relative volatility.

From the market high on February 20th through Wednesday March 25th, we saw our relative outperformance expand materially. This was true during the selloff, as well as during the first leg of the market recovery



through March 25th. But the last four days of the quarter saw a large decline in our relative performance of approximately 2.7% which led to us finishing the quarter only slightly ahead of the market compared to having been materially ahead just a few days earlier.

There is one highly unusual statistic to know about the market recovery at the end of the quarter that speaks to why our strategy did not keep up with the overall market during the last few days. The utilities sector of the S&P 500 only makes up 3.5% of the index and so the performance of these stocks does not by themselves influence overall returns all that much. However, these stocks are generally considered the safest stocks in the market having exhibited far less volatility than the overall market during the past twenty years. But during the sharp 15.6% rally in the S&P 500 off of the lows, the utilities sector exhibited much higher volatility than the market while rallying 23.8%.

The unusually strong performance of low volatility stocks, of which utilities are one example, was most pronounced during the last four days of the quarter, the period during which our strategy rallied significantly but not as strongly as the market. We believe that this unusual dynamic was a function of the massive, forced rebalancing by many allocators who have a mandate to maintain a pre-set allocation between stocks and bonds. With forced selling of bonds and many investors still terrified of risk, these bond sale proceeds appear to have been dumped into low volatility, “bond proxy” type stocks that offer the closest risk/return profile in the equity market to what investors might otherwise find in bonds.

We like low risk investments as much as anyone. In seeking out companies to own, we put a high value on businesses which exhibit stable, long duration cash flows that can be depended on. But we also pay close attention to how much in the way of potential returns we must give up in order to reduce risk. So it is very notable to us that the utilities sector finished the quarter trading at a valuation that puts it at the average level seen over the past 30 years, while the overall market is trading about 10% cheaper than the 30 year average and more economically sensitive sectors such as Industrials are trading at a nearly 25% discount to average valuation, at levels only seen during the depths of the Great Recession.

As we move forward, we are focused on owning companies which we strongly believe can make it through this crisis as well as thrive on the other side in an environment in which many of their competitors may be deeply damaged. But we will also seek to control risk by refusing to overpay for perceived safety. Balancing these three considerations; near term resilience, long term opportunity and current valuation are all critical to investment success during this crisis and we urge investors to not overly focus on any one of these attributes to the exclusion of others, which is what appeared to happen during the last four days of the quarter as investors became willing to pay a significantly higher valuation for stocks offering perceived short term resilience even in the absence of any compelling long term opportunity or particularly attractive current valuation.

During our March 20th call, we focused our commentary almost entirely on Coronavirus. But unprecedented events should be expected to be met by unprecedented reactions, which is what we’ve seen from both monetary and fiscal authorities and these reactions have been the main driver of the large market recovery which saw the S&P 500 go from being down nearly 34% from the highs on March 23rd to closing the quarter down 23%. While it is often easy in retrospect for market moves to seem logical and even predictable, for those of you who joined us for our March 20th call you can imagine how naively optimistic we would have



sounded had we said that we expected the market to bottom on the following trading day and rally by more than 15% over the next week and a half.

But what may not have been well understood by many market participants was that the nearly 34% decline from the highs was of course due to Coronavirus, but also due to the liquidity crisis brewing in credit markets that had been unleashed by the panic caused by the viral outbreak. It wasn't just that businesses that might have trouble paying back their debt saw a lack of bids for their bonds, it was even high-quality bonds with government guarantees backing them that suddenly saw an absence of buyers. So when the Fed announced they would begin buying investment grade bonds of nearly every type, even going so far as buying investment grade bond ETFs, this had the effective of mostly extinguishing the liquidity crisis in high quality credit. With order restored, at least for now, equity investors could have continued confidence that companies with good credit quality could continue to access credit markets on reasonable terms. This is exactly what our high credit quality holdings Mastercard and Home Depot did with both companies issuing billions of dollars of new debt with maturities going out as much as 30 years and interest rates well below 4%.

This monetary intervention removed a portion of the reason for the market decline, which in our view is why there was such a strong rally despite no particular new evidence that the health impact of the pandemic may not be as bad as feared.

We also saw unprecedented efforts by Congress to enact fiscal stimulus. We recognize that few people have any intuitive feel for numbers once we start counting in trillions (with a t). So here's a quick way to comprehend how just how unfathomably large a trillion actually is. A million (with an m) seconds ago was March 27th. A billion (with a b) seconds ago was 1989, when I watched the San Francisco Giants play in the World Series against the Oakland A's during which an earthquake shattered the city. But a trillion (with a t) seconds ago, humans hadn't invented agriculture yet. In fact, our species was still a thousand generations removed from learning how to plant and cultivate crops. The earth was going through an ice age, the Sahara Desert was wet and fertile, and humans had not yet crossed the Bering Strait from Asia to the Americas. The number a trillion is unfathomable large.

So with that context, it is striking to realize that the fiscal stimulus passed during the early stages of the 2008 Financial Crisis totaled just \$150 billion (with a b). The balance of the fiscal stimulus during the Great Recession was not passed until four months after Lehman Brothers failed. That second package totaled less than \$800 billion (with a b) and less than \$200 billion of it was actually spent in 2009 with the rest being deployed in successive years. In total, less than \$1 trillion was deployed.

But in the final days of last quarter, the US government passed a \$2 trillion (with a t) stimulus package. And rather than fighting over whether it was too large, Nancy Pelosi, Donald Trump and Mitch McConnell are already working together on another package with additional spending. While the bulk of the stimulus during the Great Recession came four months after the crisis had really exploded, the stimulus package this time passed on the very first week that Americans began being laid off of work due to the mandated shutdowns.

The US economy is about \$20 trillion in size and so this stimulus package equates to about a 10% boost to GDP. When you hear various estimate of what GDP will be in the second quarter keep in mind that these estimates are being stated at an annualized rate. This means that, for instance, when you read that Goldman Sachs thinks GDP might decline at a 30% rate, they mean that they expect 2nd quarter GDP to contract by



8.5% vs the 1st quarter. If you annualize that rate of decline for a full year, you would get a 30% reduction. But of course, most economists currently believe that even if any recovery is weak and delayed, the second quarter of this year will almost certainly be the worst period of GDP contraction during this crisis.

Fiscal stimulus is such a dry phrase that covers so many different types of spending or tax cuts that it can be difficult to compare it to the very tangible signs of economic weakness seen in people being laid off at record numbers and stress being put on small and medium size businesses that require their stores to be open to generate revenue. So it is worth highlighting two key aspects of the stimulus plan; enhanced unemployment benefits and the Payroll Protection Program. My comments are only meant to provide a high-level overview to illustrate the nearly instantaneous and very tangible benefits these two programs will create. Together they make up about 35% of the total stimulus plan so there is a lot more going on than just these two programs.

The enhanced unemployment benefits will add an additional \$600 a week to the unemployment benefits already offered by states. This will bring unemployment benefits up to a level of about \$45,000 annualized, or about the same level of median individual compensation in the US. The program will last for four months and so this means that for Americans who get laid off and who were making about the median level of income, the government will be essentially maintaining their pay level for four months until hopefully shutdowns are over, the economy is restarting and businesses such as restaurants that needed to at least temporarily close have an opportunity to attempt to reopen and begin hiring back employees.

Of course, it is reasonable to worry that many businesses might not be able to reopen and hire back employees later this year. But it is notable that in California, where employers are required to notify the government when they engage in plant closures or mass layoffs and to deem those layoffs either permanent or temporary, that prior to March nearly all layoffs were deemed permanent while the tripling of layoff notices filed in March were driven nearly entirely by what the companies deemed temporary layoffs.

In addition to the enhanced unemployment benefits, the stimulus plan also includes the Payroll Protection Program. These are the loans that small and medium sized businesses are frantically applying for that you may have read about in the news over the last week. But while these are described as loans, if the company that receives them does not lay off their staff, the loan is completely forgiven transforming it into a direct cash payment, not a loan. The size of the payment is calculated to be enough to pay as much as two and half months of payroll expenses for employees making less than \$100,000 a year.

So on the one hand the government is going to pay for four months of median wage salaries for people who lose their job and on the other hand, they are paying two and half months of salary costs to small and medium size businesses in an effort to help them reduce laying people off in the first place.

But while we believe the stimulus package and follow on packages that are still being crafted are necessary to attempt to provide a bridge for the economy over the government mandated shutdowns, we are not at all pinning our hopes on successful government actions to protect us. Instead, we are completely focus on making sure that the twenty or so companies in our portfolio have the financial flexibility to get through this crisis on their own. We believe they will be well positioned on the other side of this crisis, whether that comes later this year, in 2021, or after a couple of years of recession, and that they will thrive amidst a competitive playing field in which weaker participants are more permanently impaired.



On our last call we discussed why we felt that way about Starbucks, Mastercard, Google, Broadridge Financial, Landstar Systems, Paychex, Masimo, and Booking Holdings. For the balance of this call, Arif, Todd and I will share our views on the rest of our holdings. Because we are going to be covering so many of our investments, this call will be a bit longer than normal.

We're going to rotate through our holdings with Arif going first, then Todd and then myself on the first three, but we won't reintroduce who is speaking before each company. So go ahead and kick us off Arif.

Arif Karim:

Thanks Sean.

As the leading streaming video provider around the world with over 160 million paying subscribers, Netflix has seen a huge increase in engagement as a result of global lockdowns. A recent estimate we saw indicated 4 billion people have been ordered to restrict their movement. And what do people do when they stay home? Well, one thing they have been doing is watching a lot more Netflix. In fact, so much so that it's put a strain on regional internet networks that have also seen a surge in capacity utilization from work at home and school at home activities such as video conferencing.

As a result, in parts of the world including Europe, Netflix has voluntarily reduced video streaming quality to free up bandwidth for other productive uses. This indicates strong user engagement, which is always the first level proxy in value creation in a service that is about consumer attention at its core. And the more valuable a service, the less likely the consumer is to drop the service for any reason and the higher the pricing power the service builds up.

So, from our reading, the value of Netflix has gone up tremendously for its users as they stay in and socialize less. In the meantime, with economic pressures on consumers globally, we think it's reasonable to expect that Pay TV subscriptions like cable and satellite, could see accelerating declines, especially here in the US where that trend has already been in place. This would free up five to 10 times more budget than cancelling a Netflix subscription of \$13/month. Netflix is more likely to be near the bottom of costs to cut and near the top of services to add in our view.

Finally, Netflix announced it would spend \$100 million to support out of work members of the creative community as a result of the impact of Coronavirus. This is a strong show of support for creative partners and potential partners on the production side of its business but also demonstrates the company's financial strength and culture. It undoubtedly wins Netflix even stronger sway as the preferred partner for creators to help Netflix fill its growing global audience's appetite for new content across categories.

Todd Wenning:

We've previously discussed our interest in finding idiosyncratic businesses, or companies that aren't easily compared to others. NVR is one such company. While it is a homebuilder and is impacted by macroeconomic trends in housing, it has a unique culture and business model that is primed to not only survive near-term shocks but thrive on the other side.

Most homebuilders started as land developers and later got into homebuilding. As such, land development is in most homebuilders' DNA. Owning and developing land has its benefits, especially in boom times when



land values are appreciating and property is scarce. This works both ways, however, and as we saw during the housing crisis in 2008/2009, land-heavy homebuilders are often forced to write-down land values and some go out of business. In fact, the largest homebuilders were more land-heavy going into the COVID downturn than they were in the years leading up to the housing crisis.

Rather than owning land, NVR's long-time strategy has been to option its land, providing it with more financial flexibility when times get tough. Further, NVR had over \$500 million of net cash at year-end 2019. During the housing crisis, NVR expanded into new territories and in the coming quarters we expect management to once again capitalize on opportunities to both expand and consolidate share of key markets.

When the market gets concerned about homebuilding, NVR often gets thrown out with the bathwater and we believe this has been occurring again. Going into the economic pause, there were several strong tailwinds supporting new home builds including the largest cohorts of millennials moving into household formation and prime earning years, a lack of existing home inventory, low mortgage rates, and low unemployment. Indeed, in February, monthly new home sales hit their second-highest level in 12 years. Though unemployment is a big question mark over the next few quarters, the demographic, existing home inventory, and low interest rate tailwinds remain in place. In fact, the rise of remote work during COVID quarantine may be another tailwind for new home sales (which are typically in suburban and exurban areas) as more workers may find they do not have to live close to companies' urban headquarters to do their job.

Sean Stannard-Stockton:

First Republic is a bank that caters to high net worth families. They are widely seen as the most conservative bank in terms of underwriting loans and over the long term, including during the housing bust and financial crisis, they have seen a rate of losses on their loans at about 1/5th the level of losses reported by the big banks.

There is no doubt that First Republic will earn less this year than we would have expected them to earn prior to Coronavirus. The main reason for this is the rapid decline in interest rates and thus the rate of return they can earn on the home loans they offer their clients. Yet it is important to note that it is the spread between the amount they earn lending money vs the rate they pay on checking and savings account deposits that drive earnings. While this spread will narrow, part of the decline in mortgage rates will be offset by a decline in the interest the bank pays on deposit accounts. In addition, the drop in rates has triggered a boom in refinancing and as we saw during the refinancing surges in recent years, First Republic is typically a net winner as more people with loans at other banks refinance the loan over to First Republic rather than refinance their First Republic loan to another lender.

In making the decision to invest in First Republic years ago, we certainly did not forecast a viral outbreak occurring. But we did assume that there would be deep recessions and ever financial crises that may occur while we owned the stock. Their strong credit profile is important not just from a financial modeling perspective, but in attracting customers. For as long as we've been invested in First Republic, the bankers' desks at the local branch near our office have displayed a one-page summary of the company's credit ratings, illustrating how they are better capitalized than all the well-known big banks. It is the companies that recognize the importance of being safe and secure all of the time that are best positioned to retain their customers' trust during a crisis. So when Americans started thinking about sheltering in place and wondering



if their cash in the bank would still be there after the crisis, knowing that First Republic has always stood for risk avoidance and high levels of service provides their customers with the confidence they need to keep their assets with the company or even consolidate other loans or deposit accounts they might have elsewhere.

Arif Karim:

We'll talk about Ferrari next. Obviously being located in one of the hardest hit countries, Italy, has had a major impact on Ferrari's ability to operate its production operations normally. This hits right at the heart of its ability to supply customers with its highly coveted products.

Given Ferrari's high average selling price and margins, we believe the company is resilient enough to see through a multi-month period without severe cashflow issues while we expect demand to be fairly inelastic given its long 12-24 month waiting lists across 6 recently launched and limited supply models, all supported by the wealth of its clientele.

So, while supply will be even more constrained at both Ferrari's and its suppliers' production facilities this year, we believe demand will be generally resilient. As a datapoint, even during the depths of the Great Recession in 2009, unit sales only declined 4%. Coming out of the current disruption, we expect a reasonably quick ramp in production to fulfill that pent up demand.

To understand why that might be, let's revisit the core value proposition of Ferrari. Though Ferrari builds and sells cars, the cars are conduits to deliver a great experience to the world's wealthiest and most elite clientele. Buying and driving a Ferrari is an experience that combines many characteristics including automotive driving and racing passion, status, and an appreciation of design and engineering craftsmanship. Buying a Ferrari also buys membership into an elite global network of peers who share the passionate and thrilling desire for driving and racing. Being a part of this club and being invited to Ferrari's events provides a lot of value to clients, while working their way up the loyalty ranks earns them the privilege to buy exclusive, limited series models. These limited series models are the most coveted and most restricted in supply. Some of these become collectibles over time and can see strong appreciation in value upon delivery.

Because of the general supply/demand imbalance Ferrari usually favors to maintain product exclusivity, a practice inherited from its founder Enzo Ferrari, those who cancel their order while on the waiting list, do so only reluctantly since there is likely to be someone else nipping at the chance to take their place. And this could also impact their opportunity to buy the next exclusive model creating a strong motivator to follow through on delivery of their orders.

Sean Stannard-Stockton:

First American Financial, along with their competitor Fidelity National Title, control most of the title insurance market in the United States. When you buy a home with a mortgage, the lender requires title insurance to make sure that the seller actually has full and clear title to the property. While it is just one small piece of the overall home buying transaction, when you sit down to sign the final closing paperwork to buy a house you will generally find yourself sitting in the office of First American or Fidelity National as title companies provide the escrow services to allow the buyer and seller to transfer cash and title to escrow before each is released to the other side.



Of course, the number of home sales is going to drop dramatically during this spring selling season. It is not legal in many parts of the country to host or attend an open house. But the fact is Americans are still going to want to buy and sell homes in the future. Indeed, while home prices have increased a lot in recent years, the number of home transactions, the primary driver of First American's business, have run at historically low levels. The rate of growth in January and February was actually heating up and growing at the fastest rate since prior to the housing bust over a decade ago. So while home buyers may spend shelter in place browsing Zillow and Redfin in search of their next home, when economic activity returns, we expect First American to benefit greatly from the pent up demand that will be even stronger given even lower rates on mortgages.

While there has been little in the way of new competition to title companies, we expect that many of the small digital first startups that are interested in competing will not be able to survive. Instead, industry participants will be far more focused on staying loyal to First American knowing that in a crisis as well as when trying to emerge from a crisis, if you are engaging in multimillion dollar complicated transactions such as buying and selling homes, you want to work with a trusted leader. As an aside, it is worth noting that title services along with many of the functions involved in home transactions have been deemed essential services and thus are allowed to continue during shelter in place.

Arif Karim:

With \$4 trillion in custodied assets, Schwab is one of the largest financial institutions in the US and among the fastest growing. It has two main lines of businesses that generate substantially all of its revenue, its asset management and advisory business, which collects revenue from a fee charged as a percent of assets under management, and its bank business, which collects a spread between the interest it pays clients for their cash balances and the rate it collects from investing that pool of cash in predominantly low risk bonds issued or backed by the US government.

Schwab has a long history dating back to the 1970's and has lived through many recessions and shocks. Consistent along its history has been the ability to adapt and grow by winning for its clients and itself by delivering valuable services more cost effectively as it has leveraged its growing asset and operational scale.

We believe its business model is built for both growth and resilience. The combination of the AUM based asset management business and the spread based bank can create a balancing dynamic, though with the fed funds rate cut this year at 150 basis points, both businesses will be pressured but with some offset as clients raise cash due to uncertainty and market volatility.

Net-net, we expect to see Schwab's revenue decline relative to 2019 in one of the most severe economic periods in history, while operating margins are expected to remain robust even after declining materially.

On the other hand, we believe many of the FinTech startups competing in this space will see a much harsher impact in their ability to continue serving customers and investing in their businesses during this period of tighter capital availability and their subscale, developing business models. This will earn Schwab even greater competitive advantage exiting this period.

Arif Karim:

Lets talk about Fastenal next.



Fastenal is a distribution service business for industrial manufacturing companies in the US. They make it possible to economically and efficiently move lots of small, heavy, high volume, low value parts across vast distances from Asia to the US and then coast to coast. These include things like screws and rivets to gloves, tools, and janitorial supplies. Its network of 2,100 free-standing company stores, 1,100 stores onsite at customer factories, and 100,000 vending machines at customer facilities creates a vast embedded distribution network that physically maintain the company's relationship with its customers on a daily basis as a critical part of their manufacturing operations.

However, in this time, we know that manufacturers of all sorts of physical goods that are non-essential in the present moment are taking a big hit to demand. But many of these products wear out over time, need refreshing, repair, or fulfill new needs in consumers' and business' lives. As life returns to normal over time, whatever that new or old normal may look like, we know that consumers and businesses will have a pent up demand to fill or replace those product needs. Exactly what products they will need to fill is unknown at this time, but because Fastenal serves thousands of manufacturing customer across industries, Fastenal's services will be needed and will shift to fulfill where the demand is.

The key to benefiting from this resurgence in the future will be the ability to serve customers well as they ramp up their production. We estimate it would take a sustained revenue decline more than twice as deep as was seen during the Great Recession for the company's profits to fall to zero while a strong balance sheet can tide the company through an extended recessionary period. On the other hand, the company's strong culture and renowned service performance mean that it can leverage its balance sheet strength to continue investing in new customer relationships and distribution categories while weaker competitors in this very fragmented market are caught on their back foot over the next few quarters.

Todd Wenning:

Competitive moats are not common in restaurants. Margins are typically low, and customers are fickle. But if you drive down Main Street America, you'll find that most of the national chains you grew up with are still around. One thing we've come to appreciate is how difficult it is for a restaurant concept to emerge from local or regional prominence and onto the national stage. But with that national scale comes myriad benefits including spreading advertising dollars over a wider base of stores and bargaining power with suppliers and delivery aggregators.

It's particularly difficult to scale freshly prepared food with no freezers, preservatives, or microwaves. This is one reason why we believe Chipotle is an exceptional business and started building a position in the first quarter. Indeed, it was in trying to scale freshly-prepared, quickly-served foods that Chipotle experienced the major risk of the process, namely foodborne illness. It's hard to overstate the impact of the negative headlines that followed in 2015 and 2016. That event would have destroyed most restaurants, but not Chipotle. The company improved food handling processes and aggressively sought to win back customer trust and was successful.

Operating company-owned restaurants (as opposed to franchises) allows Chipotle to adjust quickly to changes in the market. We were impressed, for example, by how quickly the company mothballed its planned Queso Blanco marketing plan to offer free delivery during March and April to reach customers staying home. To that point, Chipotle's delivery and mobile order capabilities are exceptional because most of its locations



have second lines to prepare mobile orders without complicating the in-store order process. In addition, about two of every three Chipotle orders are bowls, which travel better than most other quick-serve foods. Suffice it to say that Chipotle is well positioned to capitalize on delivery and mobile order trends. Before COVID, we believed Chipotle customers would slowly shift toward more digital orders and pickups – Chipotle’s highest margin order type – and delivery. Post-COVID, we believe this trend will accelerate now that more customers became used to mobile ordering during their time in quarantine.

The coming months will undoubtedly be challenging for Chipotle. Fortunately, Chipotle has a solid balance sheet with no debt. Indeed, while Chipotle qualified for government assistance through the Paycheck Protection Program, it turned down the offer. Because of Chipotle’s financial strength, we think COVID-related commercial real estate turmoil will allow Chipotle to accelerate its store buildout into excellent locations at attractive lease terms.

Before I hand it over to Arif, it’s worth noting that both NVR and Chipotle are partially exempt from business shutdown rules because both are considered essential services.

Arif Karim:

Intuitive surgical makes robotic minimally invasive surgical systems and tools. For any of you who have watched a popular medical series in the past 5 years, you’ve probably seen an image of this 4-armed robot hovering over a patient with long pointed tools at their ends.

In a very real sense, Intuitive’s DaVinci surgical robot allows the surgeon to gain bionic powers while improving patient outcomes. From a patient perspective, the use of previously unavailable minimally invasive surgery for traditionally open surgeries means lower infection rates, lower blood loss, quicker recovery, and lower complication rates. For the surgeon, instead of leaning over the patient and using physical strength and stamina to manipulate a patient’s tissue for hours, she sits off to the side looking into a console and controls the robot remotely with her hands and feet, which does all of the manipulation work on patients with precision, better articulation, and haptic feedback. In addition, the 3D HD endoscope attached to one of the robotic arms gives the surgeon “bionic” vision allowing for better magnification and more precise visualization with the help of fluorescent dyes to identify targeted surgical areas. A new set of augmented reality technologies will take visualization further by layering radiologic images over the endoscopic view to further improve surgical performance. AI will take performance even further, assisting surgeons’ real time operative decisions by incorporating historical kinematic data culled from millions of previous cases.

With a two decade lead in robotic surgical development, over 7 million cumulative procedures conducted, and tens of thousands of surgeons trained and experienced using the DaVinci, Intuitive Surgical is in a unique position in the future of robotically assisted surgery. It is highly profitable, and it has nearly \$6B in cash on the balance sheet with no debt. While the pressure of COVID-19 patient care in the near term will impact the performance of all other elective surgeries, we believe the critical nature of most of these (about half are cancer removals) means they can only be delayed for a few months. When hospitals are able to once again normalize their patient care, Intuitive is likely to see a strong resurgence in growth of its procedures and shipments of new systems to accommodate them.

Arif Karim:



Let's talk about Blackline next.

Blackline supplies cloud-based software that enables the automation, management, and tracking of manual and repetitive accounting procedures, especially related to a process called accounting closing. This relies on collecting sales and expense transaction data from multiple IT systems within mid-size and large enterprises, matching and reconciling those transactions and posting them into a final ledger that is then used to construct the financial statements of a company.

This process has traditionally been manual with excel spreadsheets sent back and forth between multiple individuals and parties, leading to a process that can be error prone or worse. By automating the process, not only do enterprises increase the speed, efficiency, and transparency of their accounting close process, but they also have an auditable system of record and tracking for compliance and management purposes.

All this is to describe just how critical Blackline's software is to customers. Just as an old adage goes that accountants are needed in good times and bad times to tell you which one you're in, so it goes for Blackline's software. In fact, its ability to automate processes means that it also reduces costs in those bad times while allowing companies to act faster in a changing economic environment.

With a 97% customer retention rate and about 110% revenue retention rate, the company's software is clearly very sticky. But this is a young market and Blackline is the leader, so growth is an important value creation goal. As a result, it rationally invests heavily in sales marketing and R&D to both acquire new customers and grow its footprint of products within its customer base.

We expect that with a recently deepened partnership with SAP in its go-to market strategy, when customers are ready again to focus on faster speed, lower cost, and improved efficiency in the virus' aftermath, Blackline will be ready to help them do just that with its software solution.

Sean Stannard-Stockton:

Home Depot is a newer addition to our portfolio. However, we've followed the home improvement space for many years and we're particularly excited about the opportunity ahead for Home Depot. In the years since the housing bust, the company has managed to increase revenue by 60% and earnings by 240% even while only increasing their store count by just 2%. This sort of disciplined execution has led to the company exhibiting returns on invested capital far above most other established retailers, although Starbucks, another holding of ours also generates very high returns on capital.

As discussed during my comments on First American, we do expect housing activity to come to a standstill in the near term. However, Home Depot is deemed an essential business and their stores remain open. With ultra-low interest rates enabling cash out refinancing and with a home owner's deck that needed repairs prior to Coronavirus still needing to be repaired after this is over, we expect an explosion of pent up demand to come back to the home improvement sector when the crisis has passed. Just as housing transactions were growing rapidly in January and February, most leading indicators of home improvement activity were also accelerating going into this period.

As anyone who owns a house knows, it is often easy to overlook cosmetic issues in a house you've lived in a long time or defer maintenance on small items. But after being stuck in their homes for a month or two, it



would not surprise us at all if many homeowners emerge with a long list of items they want to fix. And while Home Depot is the leader in their category and we feel confident they can get through this crisis, the same cannot be said of the large number of local hardware stores which collectively still have a meaningful portion of home improvement market share.

2020 is going to be a highly unusual year. Exactly how it plays out is not knowable. But for those companies that can get through this year, and we think every one of our holdings is among that group, the years ahead will be unique in the degree to which weaker competitors have been swept aside and the opportunity for market share gains for the remaining, undamaged market leaders will be unprecedented.

And with that we'll wrap things up. Thank you all for joining us today. We look forward to speaking with you next quarter. In the meantime, you can follow our writing at IntrinsicInvesting.com and on Twitter by searching for Ensemble Capital.



Disclosures

2020 Q1 Contributors and Detractors to Absolute Return Data

Description	Symbol	Average Weight	Contribution	Description	Symbol	Average Weight	Contribution
Netflix, Inc.	NFLX	7.69%	1.32%	Fastenal Co.	FAST	5.33%	-0.94%
Masimo Corp.	MASI	2.44%	0.22%	NVR, Inc.	NVR	2.44%	-0.96%
TransDigm Group, Inc.	TDG	0.09%	0.05%	Starbucks Corp.	SBUX	3.84%	-1.02%
Blackline, Inc.	BL	1.14%	-0.02%	First American Financial Corp.	FAF	5.65%	-1.55%
Chipotle Mexican Grill, Inc.	CMG	0.39%	-0.07%	Paychex, Inc.	PAYX	5.87%	-1.76%
Intuitive Surgical, Inc.	ISRG	2.05%	-0.37%	Broadridge Financial Solutions, Inc.	BR	6.87%	-1.77%
Ferrari NV	RACE	7.54%	-0.50%	Charles Schwab Corp.	SCHW	7.40%	-2.35%
Home Depot, Inc.	HD	3.11%	-0.53%	First Republic Bank	FRC	6.90%	-2.39%
Alphabet, Inc. Class-A	GOOGL	6.99%	-0.71%	Booking Holdings, Inc.	BKNG	7.47%	-3.01%
Mastercard Inc. Class-A	MA	6.19%	-0.76%	Sensata Technologies Holdings PLC	ST	4.62%	-3.42%
Landstar Systems, Inc.	LSTR	5.53%	-0.82%				

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