"When you improve a little each day, eventually big things occur... Don't look for the quick, big improvement. Seek the small improvement one day at a time. That's the only way it happens- and when it happens, it lasts."—John Wooden

19th of July 2023

Dear Clients and Friends,

Our portfolios performed well in the second quarter, with strong gains across many of our holdings. The combination of competitively advantaged business models, and talented management, shone bright as several of our companies gained market share and posted higher than expected earnings. Despite substantial gains year-to-date, we remain optimistic that many of our stocks have meaningful upside.

In Q2, markets posted solid gains with the S&P 500 returning 16.9%, and the Russell up 8.1%. Improving macroeconomic indicators underpinned investor optimism that inflation is moderating, and the economy is on solid footing. On June 30th, the Personal Consumption Expenditure's price index ("PCE"), a key barometer of inflation, rose 3.8% for the 12 months ended May 2023, the lowest headline PCE index reading since April 2021. The Core PCE Index (which strips out volatile food and energy prices) ticked down to 4.6%, the lowest reading since October 2021. On June 29th, the U.S. Commerce Department revised upward its estimate for Q1 2023 GDP growth to 2% annualized, up from the previous estimate of 1.3%, quelling some concerns about a pending recession in the U.S.

While we keep a watchful eye on shifting macroeconomic tides, we remain steadfast that owning a diversified collection of high-quality businesses with first-class management is the best way to compound our capital over the long-term. Most wealth is not built by timing markets or the direction of the economy. Rather, most wealth is amassed through long-term ownership of great businesses that are purpose-built to deliver ever-increasing value to customers in any economic environment. We believe that our portfolios are lined which such businesses, and we remain on the hunt for more.

PORTFOLIO REVIEW

Across our portfolio, we are encouraged by the level of execution and innovation. By relentlessly focusing on customers, maintaining strong balance sheets, and investing aggressively in new technologies, many of our companies are gaining market share and growing profits:

NETFLIX

Netflix began to execute its plan to reduce password account sharing, allowing Netflix to monetize the over 100m households globally that are using Netflix for free. This market segment represents a substantial revenue opportunity of over $10B. We believe that over time, a large portion of these households will become paying customers given the improving quality of the Netflix subscription and the global growth of streaming entertainment. With a commanding lead in streaming technology, and a content budget that is 2-3x bigger than any competitor, Netflix can profitably grow its customer base for the foreseeable future.

LENNAR

As one of the country's largest homebuilders, Lennar continues to benefit from a housing shortage in the U.S. According to recent estimates form Freddie Mac, the U.S. is short ~3.8m units of housing. With many existing homeowners reluctant to move given that they secured low interest rate mortgages before 2022, new homes must be built to meet demand. With one of the strongest balance sheets in the housing sector, Lennar has the financial strength and experience to capitalize on the pent-up demand for new homes.

META (FACEBOOK)

In 2022, the stock market soured on Meta as investors worried that a slow-down in digital advertising, combined with Meta's expensive investments into the metaverse, would erode profitability for years. Meta stock reached a low of ~$90 in November 2022. We have followed and owned Meta for years, which underpinned our confidence that the value of Meta's two billion daily active users and advertising platform were undervalued. Through the first six months of the year, Meta's advertising business has proved resilient, its daily active user base grew 5%, and Management refocused on profitability.

JP MORGAN

In what has been a challenging year for financials, JP Morgan has proved to be a financial rock of Gibraltar, due its iron-clad balance sheet and best-in-class management. The strength of JP Morgan's brand and balance sheet helped the bank grow tangible book value per share 10% in Q1. Prudent risk management also positioned JP Morgan to go on the offensive this past quarter, purchasing substantially all the assets of failed First Republic Bank, a transaction that is expected to generate more than $500m of incremental net income. After passing the Fed's Stress Test in Q2, JPM announced its plan to raise its quarterly dividend.

SPOTIFY

Spotify continued to widen its lead in the audio streaming market, growing its global user base to 515m monthly active users, with free cash flow growing over 150%. With a large market opportunity and a renewed focus on profitability, we believe Spotify is well-positioned to grow earnings for many years.

ARITIFICIAL INTELLIGENCE ("AI")

Spurred by CHAT GPT, a chatbot developed by a technology startup named Open AI, Artificial Intelligence ("AI") has captured the public imagination. AI is a catch-all term for a computer's capacity to analyze, process and communicate in increasingly advanced and complex ways. Generative AI, an application of CHAT GPT, enables a computer to understand and generate responses to questions with increasingly sophisticated human-like language and reasoning. Some investors believe that Generative AI is just the tip of the spear, and that Artificial Intelligence has the potential to transform every industry, ushering in a period of bountiful innovation and productivity growth.

For some time, we have been analyzing the various ways that Artificial Intelligence may benefit the companies that we own. We see a future where the companies that are best positioned to leverage AI will be the ones with large proprietary datasets, a strong business use case, and bold, forward -thinking management. We believe that we own several of these companies:

Amazon uses artificial intelligence to optimize cost, speed, and accuracy across its vast global logistics network. AI-powered technology predicts where Amazon should store inventory, how the inventory should be packaged, which delivery vehicle should transport it, which route the driver should take, and the precise location (i.e. front step, apartment lobby) where a package should be delivered. By making Amazon's delivery capabilities faster and more accurate, AI can potentially widen Amazon's competitive moat in online retail.

Disney recently an unveiled AI-powered robot that uses motion-capture data to create lifelike character performances in its parks. The technology has the potential to bring Disney's iconic characters to life by accentuating their unique personalities. By integrating advanced AI-supported technology into its theme parks, a Disney vacation can become a more immersive and differentiated experience, buttressing Disney's competitive differentiation in family entertainment.

Alphabet (Google) was an early investor in AI through its investment in 2014 in Deep Mind, a pioneering AI research laboratory. Despite some perceived threats to its search business from Chat GPT, we believe that Google will be a big beneficiary of AI as the technology can improve the targeting, measurement, and relevancy of Google's vast digital advertising business.

Lennar is using sophisticated AI-powered models to more accurately price homes based on its large corpus of real-time market data. Given that a home is the most expensive purchase most people will ever make, any pricing edge that Lennar gains can translate into higher sales volume.

Spotify recently created an AI-powered DJ that personalizes music based on the listener's taste. AI-DJ is one of the most successful product launches in Spotify's history. We believe Spotify will emerge as one of the leaders in marrying AI with music in ways that delight listeners and enhance the value of music for recording artists.

Netflix recently unveiled a new type of AI-powered green screen technology that can produce realistic visual effects for film and television. The technology has the potential to make complex special effects shots more cost effective and life-like.

When AI is thoughtfully married to industry-leading products and services, it becomes a superpower. We are optimistic that the companies above, as well as others that we own, are just scratching the surface of the ways in which AI will deliver more value for customers and for shareholders.

NEW PURCHASE: FRESH DEL MONTE (“FDP”): $25.69

We purchased a new position in Fresh Del Monte in the quarter. Fresh Del Monte sells fresh fruit and vegetables to food retailers. With a global network of farms, ripening warehouses, refrigerated vessels, and distribution centers, FDP has built a vertically integrated fresh produce brand that customers know and trust. The supply chain, distribution and brand name are key assets that make the business difficult to replicate.

We have followed FDP for years and have owned the stock in the past. What attracted us this time was the combination of improving business fundamentals and an attractive valuation. After lapping several years of Covid-induced supply chain challenges and inflation-driven input cost increases, FDP is primed to grow earnings as supply chains stabilize and input cost inflation moderates. We also see margin expansion opportunity in FDP’s recently announced plan to grow its value-added fresh fruit business.

At 11X E2023 P/E, FDP trades at a substantial discount to its 5-year average P/E multiple of 15x and a substantial discount to the S&P multiple of 20x. We believe that this is an attractive valuation for a branded food company in a durable, high barrier to entry category. At .9x Price /Tangible Book, we believe that our downside is protected by valuable owned real estate, and a brand name, with a collective replacement cost that we estimate is worth over $40/share. Lastly, we would not be surprised if the controlling shareholder sought to monetize his interest in the business through a sale of the company. We believe that a buyer could pay in excess of $40/share.

Sincerely,

Ben Weiss, JD
Chief Investment Officer

Tom Eidelman, CFA
President

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