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"All intelligent investing is value investing, acquiring more than you are paying for. You must value the business in order to value the stock." Charlie Munger

10th of January 2024

Dear Clients and Friends,

In 2023, we experienced meaningful stock price gains across our portfolio. We enter 2024 with one of the best collection of businesses in recent memory, diversified across industry, sector, and market capitalization. The common ties that bind our stocks are proven management, talented employees, and shareholder-oriented cultures. We believe that our portfolio offers meaningful long-term upside as growing profitability across our companies translates into continued higher earnings and share prices.

The major indices ended on a strong note, with the S&P 500 and Russell 2000 rising 26.3% and 16.9% for the year respectively as investors grew increasingly confident that inflation was moderating. One of the Federal Reserve's preferred inflation barometers, the Core Personal Consumption Expenditures Price Index ("Core PCE"), fell to 1.9% in November on a six-month annualized basis, below the Fed's stated 2% target. Moderating inflation ignited hopes that the Fed will lower interest rates in 2024 and the economy will avoid a recession. Interest rate sensitive sectors of the market, including financials and consumer discretionary, rallied in Q4 on the data.

While we are mindful of the broader economic backdrop, our focus remains on building diversified portfolios of high-quality companies that can thrive in any economic or market environment. A little thought-experiment helps to reinforce why:

Imagine someone gave you a crystal ball at the beginning of 2020 that allowed you to foresee major economic and geopolitical events over the next three years. Gazing into your crystal ball, you witness a global pandemic, the fastest rise in interest rates in 40 years, a regional banking panic that resulted in the failure of two major financial institutions (Silicon Valley Bank/First Republic), and two horrific wars. If you knew what was coming, you might be inclined to hide your money under the mattress.

Yet despite the procession of challenging events, U.S. equity markets are hovering near-all-time highs, consumer confidence is on the upswing, and corporate profits remain healthy. Looking back on the previous three years, an investors' time was clearly best spent looking for great individual companies to own, rather than perseverating about macroeconomics or geopolitics.

That is not to suggest that macroeconomic events will not impact stock prices, or that the market will not experience rough stretches. But based on history, wonderful businesses adapt and thrive.

In 2024, we are optimistic about the potential for strong execution and earnings growth across several of our holdings including:

DISNEY

2024 should be a transformational year for Disney that could position the Company to generate sustainably higher earnings over the next several years. After a challenging 2023, Disney has committed to $7.5B in cost reductions, profitability in its streaming business, an improved theatrical film strategy, and meaningful free cash flow growth. Over the course of its 100-year history, Disney has faced challenging periods before, and each time the Company has come back stronger. The enduring value of Disney's intellectual property and the timeless allure of a Disney-themed vacation establish a strong foundation for long-term growth.

TYSON

Tyson, one of the largest suppliers of protein-based food products in the U.S., continues to take meaningful steps to improve its business, including closing underperforming plants, better managing costs, and divesting non-core assets. We believe that the protein price commodity cycle that was unfavorable to Tyson in 2023 will eventually move in Tyson's favor, benefiting margins. At 12x our estimate of normalized earnings of $6/share in 2025, we believe that Tyson could be worth $72/share versus $55/share today, ~30% upside potential.

META (FACEBOOK)

Meta finished 2023 with a more efficient cost structure, a growing global user base of three billion people, and an innovative new suite of AI-based advertising products that have the potential to increase profitability. Meta is leveraging its early leadership in artificial intelligence to produce more targeted and relevant advertisements, improving the user experience and the value proposition for advertisers. We see a long runway for Meta to better monetize its massive user base. We believe that Meta's growing profitability and defensible competitive position can result in 15% annualized earnings growth through 2026, which would approximate our annualized estimated return in the stock, assuming it maintains its reasonable 20x P/E multiple.

ALLY

After languishing for most of 2023, we believe that Ally's stock is primed for a strong recovery in 2024 and beyond. Declining interest rates should increase Ally's book value and reduce market-to-market losses on its securities portfolio. The durability and resiliency of Ally's auto lending franchise should become clearer in 2024. At 9x E2024 P/E and 90% of book value, we think Ally is a bargain. By 2025, we estimate that Ally could earn $5/share and trade for $50/share compared to $34 today, 47% upside potential.

CHARLES SCHWAB

With eight trillion in client assets, and a sterling brand name that is trusted around the world, Schwab enjoys several tailwinds heading into 2024. TD Ameritrade has been fully integrated into Schwab's business, giving Schwab access to more brokerage accounts. Lower interest rates should buoy net interest income, and Schwab's tangible book value should recover. At 20x consensus earnings estimates of $4.80 in 2025, Schwab would be worth $96/share compared to $68 today, ~40% upside potential.

AMAZON

Amazon's investments in artificial intelligence are driving fundamental improvements in the speed and accuracy of vast global logistics networks. Machine learning technology is enabling Amazon to better plan where, and how much, inventory to place in its warehouses, hastening delivering times. Prime delivery speeds reached all-time records in 2023, and across the top 60 U.S. metro areas, more than half of Prime orders arrived the same day or next day. Faster and more accurate delivery supercharges Amazon's business by increasing repeat customer orders and reducing the variable cost to ship. We believe that Amazon's retail business will enjoy a multi-year improvement in profitability. By 2025, Amazon could earn $9/share and be valued at $225/share compared to $147/share, 53% upside potential.

FRESH DEL MONTE

Fresh Del Monte is one of the largest suppliers of fresh produce in the United States. We have followed Fresh Del Monte for many years, and are encouraged by several developments at the Company, including increased investment into branded products, divestment of non-core assets, and increased focus on cost control. At 11x E2024 P/E and 83% of our estimate of tangible book value, we feel that Fresh Del Monte is cheap given its strong brand and scale in the U.S. fresh fruit market. We also think that Fresh Del Monte would be an attractive acquisition target and could be worth $45/share, 75% potential upside.

CONSTANT IMPROVEMENT

As company-specific, bottoms-up investors, one of our main jobs is to analyze the business models of our holdings. We never assume that business models are static. Many of the best companies are in a constant state of evolution; they perpetually improve their business model through innovation and investment. Sometimes investors overlook the improvements happening inside a company, especially if the business has been around for a long time, or if the improvements do not produce higher earnings in the short term. Two example of companies that we own that are transforming into better and more profitable businesses before our eyes:

STARBUCKS

Almost everyone knows Starbucks, but few may realize how radically the business has improved over the last several years. Ten years ago, the customer experience at Starbucks consisted of going into a store, waiting in line, ordering, then waiting in a crowded queue for your name to be called. Customers had limited ways to order and pay in advance.

Through years of investment in technology and store format innovation, Starbucks business model has materially changed. Today, in North America, Starbucks has 33m active U.S. loyalty members, a combined 70% of Starbucks orders come through the mobile app or a drive-through, and close to 90% of the new stores opening in North America have a drive-through. Starbucks has evolved to become a convenience-driven, digital-centric business with an industry leading mobile app that makes ordering and paying easier, faster, and more rewarding. The improvements have translated into meaningful sales and profit growth. From 2013-2023, North America sales increased from $11B to $23B, and operating profit increased from $2.3B to $5.4B. Starbucks' Management recently guided to a long-term earnings per share growth target of 15% or better, suggesting Starbucks can build on these improvements to grow its profitability.

NETFLIX

From a standing start in 1997 as a DVD-by-mail-rental companies, Netflix has managed to out-innovate and outmaneuver large legacy media businesses to become the most valuable entertainment company in the world in 2023. Netflix's primacy in streaming was not preordained; it was the result of big, bold, long-term strategic bets on the future. These bets only gestate and manifest under the care of a championship management team and a special culture.

Now, the championship team and culture that steered Netflix to its perch on top of streaming is investing to widen its leadership and increase profitability by investing in advertising. Advertising represents an enormous new profit pool for Netflix given the size of the global television advertising market, Netflix's massive global audience and unrivaled personalized targeting. With time, Netflix can combine the best creative and storytelling aspects of television advertising, with the advantages of digital targeting and measurement. Historically, large media networks generated close to one-half of their revenue from advertising, yet advertising represents less than 5% of Netflix's $35B in revenue. It is just the beginning for Netflix's global advertising business, making us optimistic that Netflix has a large, new source of profitability.

NEW INVESTMENTS

POST HOLDINGS

Post is a diversified consumer packaged foods company with beloved brands, proven shareholder-oriented management, and an attractive valuation. Post owns iconic brands including Raisin Bran, Honey Bunches of Oats, Peter Pan Peanut Butter, Grape-Nuts, Weetabix and Bob Evans. Post is the third largest ready-to-eat cereal company in North America with ~19% market share.

Post's cereal business is highly profitable, given the brand loyalty, consolidated industry structure and the lack of private label competition. Post has taken advantage of the stable profitability of the cereal business by leveraging cereal cash flow to acquire leading food companies in diversified industries, including eggs (Michael Foods), frozen side dishes (Bob Evans), and protein shakes (Premier Protein). Overseeing the acquisition strategy is a phenomenal shareholder-oriented board and management, led by Chairman Bill Stiritz, a legend of the consumer-packaged goods space from his days at Ralston-Purina. Mr. Stiritz owns 4.6m shares of Post's stock and has imbued Posts' entire organization with a shareholder-return mindset.

Consensus estimates forecast that Post will grow earnings per share to $6.56 in 2026. If Post's valuation reverts to its historical 20x P/E, Post could be valued at $130/share in 2026 compared to $91/share today, ~42% upside potential. In an Investor Presentation published December 2023, Post's Management laid out a path for the stock to be worth $165/share by 2028 assuming modest operating earnings growth and consistent debt reduction.

ALASKA AIRLINES

Alaska Airlines is a superbly managed regional airline with a dominant market position in the Northwest United States. By delivering industry-leading customer service, Alaska has established a loyal customer base and a strong geographic niche.

In 2023, investors soured on airlines as worries about a slow-down in consumer spending, higher energy prices and labor disputes damped expectations for airline industry profitability. The negative sentiment caused the entire sector to trade at P/E multiples that approached the lows of 2020 in the throes of the Covid pandemic. We felt that the sell-off was overdone and travel demand would remain robust over the next few years as pent-up demand from Covid continues to unwind. We took advantage of the depressed prices by purchasing Alaska, which we believe has one of the best balance sheets and management teams in the industry, as well as substantial upside potential.

Alaska currently trades at 7x E2024 P/E, a discount to its historical forward multiple of 12x. If Alaska traded at its historical average 12x P/E, the stock could be valued at ~$60/share, compared to $37/share today, 62% upside potential.

Sincerely,

Ben Weiss, JD
Chief Investment Officer

Tom Eidelman, CFA
President

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