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“If you’re long-term oriented, customer interests and shareholder interests are aligned.”-Jeff Bezos

11th of July 2024

Dear Clients and Friends,

Our companies with industry-leading technology, intensely loyal customers, and dominant market share drove our performance in Q2. With consumers and businesses carefully prioritizing their spending, companies such as Apple, Netflix, and Amazon are growing profits by offering customers best-in-class products, unmatched convenience, and value for money. Across our portfolio, we believe that we own companies that will produce many years of profitable growth translating into meaningful stock price appreciation.

In Q2, a small number of stocks drove the S&P 500 and NASDAQ up 4.3%, and 8.1%, respectively. The semi-conductor sector, led by NVIDIA, performed exceptionally well given growing excitement about artificial intelligence. Smaller companies fared less well, with the Russell 2000 Index falling 3.3%. Investors grew less sanguine that the Federal Reserve would reduce interest rates several times during 2024, dampening enthusiasm for rate-sensitive sectors such as banks, industrials, and consumer discretionary.

We enter the second half of 2024 with balanced exposure across size, sector, and industry. Our holdings range from dominant consumer companies, blue-chip health care businesses, category-leading branded food companies, and top financial services firms. Each company possesses a strong business model, talented management team, and an attractive valuation. We remain optimistic that our companies will be resilient in the face of an uncertain economic backdrop and can deliver long-term earnings growth.

PORTFOLIO UPDATE

APPLE (AAPL) - $226

At Apple’s Worldwide Developer Conference on June 10th, Apple announced “Apple Intelligence,” a new suite of AI-based features for iPhone, Mac, and iPad. With over two billion devices in use globally, Apple is uniquely positioned to leverage artificial intelligence to make its product ecosystem more valuable, potentially catalyzing a multi-year product upgrade cycle. With approximately 5% revenue growth, operating margin expansion, and continued share repurchases, we estimate that Apple could grow earnings per share ~10% annualized through 2027, which would approximate our estimated return in the stock.

DISNEY (DIS) - $97

Just 19 days into its release, Disney/Pixar's new film, Inside Out 2, grossed $469.3m in North America and $545.5m internationally, for a total worldwide gross of $1B, reaching the $1b box office milestone faster than any animated film in history. We see Inside Out 2 as the beginning of a major revival of Disney's theatrical business, with eagerly anticipated titles Deadpool & Wolverine, Moana 2, Mufasa: The Lion King, and Captain America: Brave New World all set to be released through 2025. Box office success echoes across Disney's businesses, increasing demand for consumer products and home entertainment, supporting earnings growth. At 25x E2025 earnings of $5.50/share, Disney would be valued at $137.50, ~40% upside.

LENNAR (LEN.B) - $145.50

A persistent undersupply of affordable housing, combined with strong free cash flow, continue to drive Lennar's earnings per share growth. In Q2 2024, new orders increased 19% to 21,293 homes, deliveries increased 15% to 19,690 homes, and net earnings per share increased 15% to $3.45/share. As the cost to finance and build new homes remains elevated, Lennar's strong balance sheet and scale are a competitive advantage. At 10x E2025 earnings of $16/share, Lennar would be valued at $166/share, ~23% upside.

AMAZON (AMZN) - $195

Few companies continue to innovate like Amazon. In the month of June alone, Amazon announced a new partnership with Just Eat Takeaway, the largest food delivery firm in Europe, to offer Amazon Prime members in Germany, Austria, and Spain free delivery of food orders above 15 euros ($16.13); Amazon Pharmacy began offering Prime members in the U.S. on Medicare unlimited access to 60 eligible prescription medications for $5/month with free delivery; and Amazon went live with ROC1, a 2.6-million-square-foot, five-story robotics sortable fulfillment center in Gates, N.Y. The innovations converge to make an Amazon Prime membership more valuable, and Amazon delivery faster and more accurate. We see a multi-year path for Amazon to grow earnings per share between 15-20% per year through 2027, which approximates our estimated return in the stock.

LONG-TERM ALIGNMENT

Companies that think and act in the long-term interests of customers and shareholders often create the most enduring value. Our long-term orientation creates alignment with these companies, a key advantage that we believe allows us to tax-efficiently compound the value of our portfolio. Two of our holdings animate the benefits of thoughtful long-term management and ownership.

SPOTIFY (SPOT) - $299

Spotify is a case-study in the power of long-term thinking. Spotify went public in 2018; at the time, Spotify had 159m monthly active users, 4B Euro in revenue, and operating loss of 378m Euro. Spotify was predominantly a music streaming service facing competition from Apple, Amazon, and a host of regional competitors. Spotify operated on thin gross margins and was losing money. Although consumers loved the product, it was unclear that Spotify could translate consumer affinity into a highly profitable business model.

In 2019, the founder and CEO, Daniel Ek, outlined a vision to evolve Spotify from a pure music streaming service to a broader audio streaming service that delivered a variety of content, including podcasts, audiobooks, and live events. To realize this long-term vision would take years of investment. But in success, we believed that Mr. Ek's plan would transform Spotify into the world's dominant audio streaming company with strong profitability.

Fast forward to today: in 2024, Spotify is projected to have over 630m monthly active users, generate 16B euro in revenue and 1B euro in operating income. Spotify has become the world's most popular podcasting platform, with 35.8% of all podcast listeners (according to Oberlo). Mr. Ek's long-term vision, combined with great execution, has propelled Spotify to the dominant global leadership in audio streaming as measured by users, engagement, and cultural relevancy.

Spotify continues to invest for the long-term. In 2022, Spotify laid out long-term financial targets: by 2032, Spotify is targeting $100B in revenue and a 20% operating margin, which could translate into earnings per share of $80/share. If Spotify can come close to reaching these targets, we believe that the stock will appreciate meaningfully from current levels.

JP MORGAN (JPM) - $207

To build long-term value in the banking sector, a company cannot compromise credit quality to chase loan growth or relax lending standards during economic booms. Avoiding these pitfalls requires a highly disciplined management team that resists the temptation to degrade the quality of the balance sheet in order to chase short-term profits.

JP Morgan, one of our largest financial sector holdings, has been an exemplar of prudent balance sheet management over decades, translating into compound growth in earnings and book value per share. From 2005-2023, JPM has increased diluted earnings per share from $2.35 to $16.23, tangible book value per share increased from $16.45 to $86.08, and the stock price increased from $36.07 to $144.05 (Jan 2023). To achieve these results in an inherently cyclical and economically sensitive industry is a testament to JP Morgan's culture and discipline.

The uncertain path of interest rates, coupled with a dynamic regulatory environment for financial institutions, make JP Morgan's demonstrated ability to navigate complex macroeconomic and political climates a valuable competitive advantage. We continue to own JP Morgan because we feel that it can sustain its long-term track record of compound tangible book value and earnings per share growth.

Sincerely,

Ben Weiss, JD
Chief Investment Officer

Tom Eidelman, CFA
President

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