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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in Wide-Moat Businesses at a Discount to Their Intrinsic Value

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JEFFREY PRESTINE is a Partner at Mar Vista Investment Partners. He has 21 years of investment experience. He is a portfolio manager/analyst and is a member of the investment team. Before joining Mar Vista Investment Partners in January 2009, he was an analyst covering technology and energy stocks at Roxbury Capital Management. Mr. Prestine joined Roxbury from Seneca Capital Management, where he was a technology and energy analyst for more than five years. He began his career in finance at Prudential Securities as an associate analyst covering enterprise software companies. Prior to entering the investment industry in 1999, Mr. Prestine was a senior consultant with Arthur Andersen Business Consulting. Mr. Prestine received an undergraduate degree at the University of Colorado at Boulder and has an MBA from the University of Southern California.

SECTOR — GENERAL INVESTING

TWST: Could you tell me about the firm?

Mr. Prestine: Mar Vista was started in 2007, with the help of our former firm, Roxbury Capital Management. However, our story goes back to 2003 when we were at our prior firm and managing our Focus strategy, which is a 15- to 20-stock concentrated portfolio. In 2004, we began managing the Strategic Growth strategy, which is our more diversified 30- to 50-stock portfolio. And in 2012, we launched the Global strategy, which is a 20- to 30-stock portfolio. Although the firm is only 12 years old, our investment track record goes back almost 17 years.

Regarding our business, the firm currently manages around $5 billion in assets under advisement across our three strategies. The client base is a mix of endowments, foundations, public and private pension funds, and high net worth individuals. We provide our clients a variety of investment vehicles, including separately managed accounts, subadvised portfolios, unified managed accounts — UMA — as well as a global comingled investment trust.

In terms of structure, the four members of our investment team, along with our Chief Operating Officer, own 100% of Mar Vista. As you probably know, a common attribute of successful multigenerational investment firms is equity ownership by the investment team. For us, this incentive structure better aligns our decision-making with the objectives of our investors. Having our entire compensation based on the value we create for our clients is critical to the culture of the firm, the consistency of the team and the long-term alpha generation of our products.

TWST: And when you look at what to include in the portfolio, are there any overarching investment philosophies?

Mr. Prestine: Yes, absolutely. Mar Vista invests exclusively in wide-moat businesses that compound free cash flow, possess the opportunity to produce high returns on invested capital and trade at a discount to our estimate of their intrinsic value. However, there are a few key elements of our investment philosophy that influence our investment process and drive our decision-making.

First, we believe stock prices follow intrinsic value over time. Therefore, we separate the price the market applies to a stock from our estimate of intrinsic value. The objective is to increase the expected return and lower the risk of the investment by purchasing only when an adequate discount occurs.

Second, we believe intrinsic value is created when returns exceed their cost of capital. Although earnings are an important element of the equation, we believe the amount of capital required to grow earnings is equally important. If a business grows earnings rapidly, but the amount of capital required grows at a faster pace, then economic value is potentially eroding.

Third, we believe that sustaining excess returns on capital requires a durable competitive advantage. Businesses grow intrinsic value over the long term only by sustaining durable competitive advantages that allow them to keep competitors at bay. Without that competitive barrier, competition will erode those excess returns.

And fourth, we believe capital preservation is equally important to capital appreciation. History suggests that long-term wealth creation is more about protecting capital on the downside and compounding off a higher base than taking excess risk to outperform in euphoric bull markets.

Mr. Honeycutt: I'd like to add that originally at Mar Vista, we achieved our investment goals by concentrating our clients' capital in predominantly domestic, large-capitalization equities. Over the years, as the companies in our portfolio became more global, naturally our research efforts expanded internationally.

And so as an extension of the investment philosophy and process that Jeff highlighted, we launched a global version of our flagship strategies back in 2012. Managing a global variant of our domestic strategy, we think, leverages our existing investment framework and exposes our clients to international growth opportunities.

Our global portfolio adheres to our firmwide investment philosophy that believes in managing high-conviction portfolios with the premise that capital preservation is equally important to capital appreciation when accumulating wealth. Therefore, we invest in competitively advantaged businesses that possess the ability to compound intrinsic value at above-average rates, but we only invest in these businesses when their stock prices represent discounts to our estimates of intrinsic value.

Our investment process at Mar Vista refines that global investable universe to approximately 170 durable growth franchises. We value each of these companies from an owner's vantage point by discounting their future free cash flows under a wide range of scenarios. And that consistency of our investment process allows us to leverage the firm's existing human capital across all of our portfolio strategies.

Mar Vista's global portfolio is not necessarily designed to generate analytical opinions on every public equity around the world. We are only investing within our circle of competence. The Global strategy supplements 10 to 15 of our highest-conviction domestic ideas with approximately 10 to 15 durable international franchises.

I think it's obvious that the case for global diversification is well-known. From our standpoint, the location of a company's headquarters is less relevant to an investment thesis than the geographic mix of its revenues and profits. While the United States boasts the world's largest stock market, the country's share of the global economy is roughly 25%. Exclusively investing in just domestic companies eliminates three-fourths of the world. Our global clients can benefit from investing in these serial compounders that exist beyond our domestic borders.

Highlights

Joshua Honeycutt and Jeffrey Prestine discuss Mar Vista Investment Partners. They manage high-conviction portfolios and believe that capital preservation is equally important to capital appreciation. With this in mind, they invest in wide-moat businesses that compound free cash flow, have the opportunity to produce high returns on invested capital and trade at a discount. Mr. Honeycutt and Mr. Prestine use their Global strategy to leverage their investment framework and expose clients to international growth opportunities.

Companies discussed: Adidas AG (ADR) (OTCMKTS:ADDYY); Henkel AG & Co. (ADR) (OTCMKTS:HENKY); Nike (NYSE:NKE); Microsoft Corporation (NASDAQ:MSFT) and Alibaba Group Holding Ltd. (ADR) (NYSE:BABA).

TWST: And did you want to highlight a stock that you find interesting now?

Mr. Honeycutt: The first one to talk about is **Adidas** (OTCMKTS:ADDYY). This is a business that owns a 70-year-old global portfolio of branded, innovative athletic products. The company has built its economic moat around their iconic brands and tremendous scale.

As one of only two athletic brands with direct-to-consumer capabilities, referred to as DTC, **Adidas** is well-positioned to increase its competitive advantages in an evolving consumer marketplace. These DTC initiatives really capture an increasing portion of the retail value chain by creating direct connections with consumers. With direct selling, **Adidas** eliminates the middleman from the industry profit pool and earns higher returns on invested capital.

These types of business model transitions require strategic vision and sound execution. We think **Adidas'** CEO, Kasper Rorsted, possesses both of those requirements. **Adidas** was successful in attracting Rorsted away from his successful tenure at **Henkel** (OTCMKTS:HENKY) years ago. Under his leadership, **Adidas'** global supply chain and its underperforming U.S. business has been transformed.

Adidas is roughly one-third the size of **Nike's** (NYSE:NKE) U.S. business. Therefore, there's meaningful market share and profit opportunity in the world's largest consumer market. We think as **Adidas** continues to gain U.S. market share, the company's operating margins and cash flows will converge with those of industry-leader **Nike**.

We expect our investment returns in **Adidas** to shadow the company's long-term business opportunity and 13% to 15% intrinsic value growth. We think the pandemic-related selloff underestimates **Adidas'** ability to deal with the current health crisis and fails to recognize **Adidas'** ability to capitalize on its long-term business opportunities. Our longer-term time horizon allows us to see values that others neglect, and we used the unfortunate circumstances surrounding the coronavirus to increase our **Adidas** investment.

1-Year Daily Chart of Adidas AG (ADR)

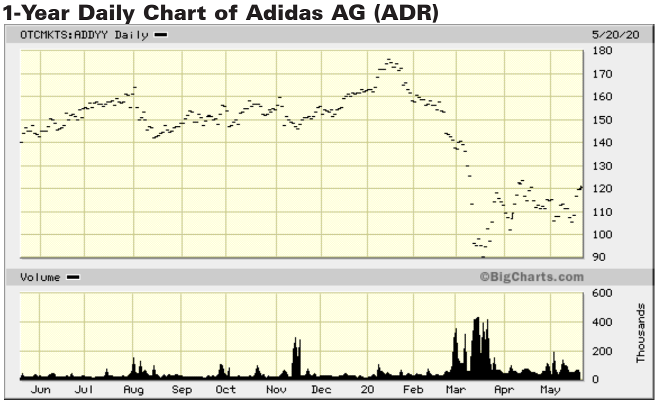

Chart provided by www.BigCharts.com

one of the widest-moat compounding machines in American business, at a significant discount to our estimate of intrinsic value.

We believe **Microsoft** maintains a strong competitive position as businesses adopt next-generation cloud solutions. Its wide moat stems from its diverse set of cloud-enabled products, its seasoned enterprise-focused sales team and its global footprint. Competitive advantages vary by product category, but **Microsoft** enjoys multiple barriers that include scale advantages, network effects, cost advantages and high switching costs.

Of course, **Microsoft** is not immune to macro pressures, as you're seeing from its recent pre-announcement that highlighted a shortfall in its More Personal Computing division. We expect IT budgets to come under pressure in light of the tougher macro environment businesses are currently operating under. With all these factors and potential outcomes included in our scenario analysis and estimate of intrinsic value, we concluded **Microsoft** provided us with a favorable risk/reward, so we initiated the position.

Microsoft is viewed as a strategic partner to CIOs. It offers a broad product portfolio that uniquely addresses the entire IT stack: from data center with Azure, to desktop with its Windows Virtual Desktop solution, to

"The company is well-positioned to grow revenues organically and expand margins as cloud utilization increases, which will result in operating income flowing to free cash flow. Therefore, we initiated the position in the Global portfolio as the margin of safety expanded."

TWST: And I would think too that now with the pandemic, a lot of people might opt to purchase athletic equipment and apparel online. So there's potential for a company like Adidas.

Mr. Honeycutt: Correct. This trend is captured in **Adidas'** direct-to-consumer business. There are very few global brands that have invested significant amounts of capital to reposition the business from a wholesale model to a direct retail model. **Nike** and **Adidas** are two of the largest global brands in the athletic space, and both businesses are equally well-positioned to transition to a direct-selling model.

In an environment where most brick-and-mortar retail outlets are closed due to government mandates, **Adidas** is able to reach its consumer base through its digital ecosystem. **Adidas** is able to generate revenues in an environment where most consumer brands and retail concepts are unable to succeed. For those reasons, we think that as we exit the pandemic, **Adidas** is going to be even better positioned, that its economic moat is going to be even deeper and wider.

When selling directly to the consumer, you're trading wholesale margins for retail margins. This allows **Adidas** to earn an additional 50% to 100% incremental profit on product sales. As the model transitions to more of a direct-to-consumer strategy, the returns on invested capital for **Adidas** and its durable capital advantages will increase for the foreseeable future.

TWST: And did you want to mention a second company?

Mr. Prestine: We can discuss **Microsoft** (NASDAQ:MSFT). **Microsoft** was added to the Global portfolio during the panic selling of the pandemic in March. In our opinion, this highlights that even well-known and highly regarded businesses such as **Microsoft** can see their stock price become disconnected from their underlying intrinsic value. This occurred in March and allowed us to invest in **Microsoft**, which is

1-Year Daily Chart of Microsoft Corporation

Chart provided by www.BigCharts.com

collaboration with its Teams and Office 365 offerings, to security solutions. **Microsoft** provides a comprehensive set of hybrid solutions that allows businesses to operate efficiently in the cloud as well as on-premise.

In stressed environments, incumbent solutions are in advantaged positions, in our opinion. Customers naturally gravitate to vendors they are familiar with during periods of duress, and nearly every global enterprise uses **Microsoft** solutions, thanks to the company's global, enterprise-focused sales force and established customer relationships. **Microsoft's** status as a trusted partner and its low-risk solutions position it to win market share.

We believe **Microsoft** will grow intrinsic value per share at low double digits over our investment horizon as the company is well-positioned to grow revenues organically and expand margins as cloud utilization increases, which will result in operating income flowing to free cash flow. Therefore, we initiated the position in the Global portfolio as the margin of safety expanded during a stressed period in the markets.

TWST: And I would think too that with so many people working from home or remotely right now, offerings like Teams or some of their other products are very popular, and people might even start to use them more frequently long term, even when they're allowed to go back to their offices.

Mr. Prestine: Yes, we agree that the work-from-home initiative clearly is a change in behavior that benefits **Microsoft**. Its Teams solution and its Windows Virtual Desktop initiatives allow people to connect remotely into the data center and to work effectively and productively from home. Longer term, we believe **Microsoft** benefits from enterprises' desire to migrate to the cloud. Its solution is differentiated from the competition due to its complete stack offering that includes the data center solution with Azure, the productivity tools we just discussed with Office 365, as well as Teams and the security solutions, which are often overlooked. CIOs rely on and appreciate an easy road map to disaster recovery and business continuity solutions with a trusted partner.

TWST: Did you want to mention a third company?

Mr. Honeycutt: I can discuss briefly our investment in **Alibaba** (NYSE:BABA). **Alibaba** is a competitively advantaged Chinese e-commerce digital media payments and cloud company. It has over 700 million monthly active users and roughly 30 business units that specialize in enterprise services.

The company's scale and network effects create an ecosystem that benefits both buyers and sellers. It's through these interconnected marketplaces that merchants and global brands can use **Alibaba's** data intelligence to reshape and develop the Chinese e-commerce industry. The integrated platform empowers businesses to succeed in what we believe is a growing digital economy. **Alibaba's** omnichannel platform over the years has delivered well-above-average intrinsic value growth.

We expect the rapid growth for **Alibaba** to continue for the foreseeable future. Once sellers join the **Alibaba** ecosystem, their digital offerings quickly become dependent upon **Alibaba's** marketplaces and payment infrastructure. And management, in our opinion, is smartly expanding **Alibaba's** competitive advantages by successfully investing additional capital in its ecosystem.

While we applaud **Alibaba's** capital allocation decisions, we do frown upon the company's corporate governance. **Alibaba** operates under a variable interest entity, a VIE structure. This legal construct allows **Alibaba** to raise foreign capital without providing direct ownership. Essentially, foreign investors own contractual claims to **Alibaba's** profits without legal claim to the underlying assets. Since the Chinese government never explicitly approved the use of VIE structures, regulators could theoretically revoke **Alibaba's** business licenses.

We do think this is a very unlikely outcome. Any government interference with **Alibaba's** VIE structure would severely limit Chinese companies' ability to raise foreign capital. For that reason, we're willing to underwrite this unusual corporate governance circumstance by limiting our investment exposure.

TWST: Is there any concern that corporations globally might want to scale back from their involvement with China and might move operations or their supply chain to either other nations in Asia or maybe back to their home countries?

Mr. Honeycutt: I think the pandemic and, prior to that, the trade tensions with China highlighted some of the long-term business risks associated with maintaining supply chains in foreign countries. I do expect these global events over the past year will force companies to reevaluate where they're locating their critical assets.

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In the case of **Alibaba**, I think of it more as, if you're trying to reach the Chinese consumer, the best and most efficient way to tap into those demand pools is by partnering with local companies like **Alibaba**. As the largest platform in China's digital economy, **Alibaba** is the main bridge between the physical and digital world. We think global businesses will continue to partner with **Alibaba** for local commerce.

For businesses that don't need to have their supply chains in foreign territories, I think there's going to be some migration of critical assets. Any one country can move offline during black swan events; therefore, the pandemic will force companies to build redundancies into their supply chains. I'd expect broader diversification of supply chain assets across multiple geographies going forward.

TWST: And earlier on, we mentioned that part of who you're targeting are institutional investors. What's been on their minds recently that's unique, especially with the pandemic?

Mr. Honeycutt: I think everyone is well-aware that the coronavirus pandemic has caused an abrupt economic disorder, which has roiled global financial markets. The concern going forward centers around the duration of this global recession, which is essentially unknowable. I do think that navigating this type of uncertainty with well-financed, wide-moat businesses led by proven capital allocators is reassuring to our client base.

Mar Vista's investment process is purposely designed to stimulate rational decision-making in volatile environments. It enables us to maintain investment optimism during excessive pessimism. While we, like our clients, continue to worry about the cyclical headwinds, we believe the pandemic is unlikely to permanently impair the underlying business values of our investments. We think that the impact on investor psychology will likely prove to be greater than the financial reality.

Whenever financial conditions allow us to put capital to work at attractive prices, it's our responsibility to capitalize on those opportunities. I think our clients are confident in Mar Vista knowing that we own a portfolio of exceptional businesses at reasonable valuations. Ultimately, that will lead to above-average returns with less risk. This has been essential to Mar Vista's long-term investment success.

TWST: Is there anything we haven't brought up you care to mention?

Mr. Honeycutt: I think it's worth highlighting that we all come from fairly diverse backgrounds, but we all share the same investment DNA. My career started by learning forensic accounting and mergers and acquisitions before I joined Silas Myers and Brian Massey at Roxbury Capital in 2000.

Silas started his investment career as a value investor at Hotchkis & Wiley after graduating from Harvard Business School. And Brian Massey joined as an analyst in the late 1990s after graduating from UCLA business school. Jeff, a USC MBA, was an analyst covering technology and energy on both the buy and sell side before he joined us in 2006.

I think it's important to highlight that while each of us have sector expertise, we collectively own the responsibility of allocating capital across our portfolio strategies. We think a team-based approach to portfolio management maximizes our analytical potential and optimizes our decision-making. We have built an analytical network effect that is difficult to replicate. Our owner-oriented culture really amplifies that competitive advantage.

TWST: Thank you. (ES)

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