THE ADVISOR

Q1 2019

DARDEN CAPITAL MANAGEMENT

University of Virginia | Darden School of Business

A LETTER FROM THE CEO:

April 19, 2019

Greetings,

Our team at Darden Capital Management is thrilled to bring you the Q1 2019 edition of *The Advisor*. Within the enclosed pages, you will once again find investor letters from each of our five portfolios detailing portfolio activity and reflections on the twelve months that our graduating portfolio teams have spent at the helm of their respective portfolios. As always, select investment ideas are also included following the investor letters—these featured ideas have been nominated by our Senior Portfolio Managers as the best of DCM during the quarter.

Ryan Claxton, DCM CEO

As the Class of 2019 hands off the reins of DCM to the Class of 2020, we find ourselves in a time of reflection here in Charlottesville. In some ways, we wish we could stay for another two or three years and continue to see through our contributions from these past twelve months. In other ways, there is a general sense of closure, a readiness to rejoin the workforce, and a recognition that DCM can only continue to truly grow with a new infusion of energy and dedication that only a new class of management can provide.

When our executive team took over leadership of DCM a year ago, we outlined four areas of focus for the year: institutionalization, training, recruiting, and alumni relations. In terms of institutionalization, we wanted to create an environment that better simulated a professional investment management setting across all five funds, while also enabling better institutional memory to shepherd our annual turnover of portfolio responsibilities to the next class. To those ends, CIO Marnie Lanphier did a sensational job of instituting a standardized one-page stock pitch template across all five funds, formalizing the SPM's quarterly letter process, and rewriting portions of the DCM Operating Agreement to create a more evergreen document that more closely reflects a professional investment mandate.

On the training front, we recognized the inherent disconnect in the Darden curriculum for students pursuing careers in investment management—while our industry-specific electives are only available during the second year, the best opportunities for students to get exposure to recruiters come in the fall of the first year during the second quarter of the core. To address this divide and make careers in investment management more accessible to students without prior industry experience, our Director of Research, Macrae Gould, formalized a first-year training program to guide students through the process of building a stock pitch and prepare them with the necessary skills to compete in stock pitch competitions throughout the fall. The program spanned five sessions, with topics led by a combination of professors, second-year students, and guests from the industry, culminating in our internal first-year team stock pitch competition in October.

The training program paired well with our team's effort to broaden the scope of investment management recruiting opportunities available to our students throughout the year. Coming into the year, we recognized that DCM presents a unique opportunity to get true experience in the field while pursuing an MBA, and yet our top students were still having trouble finding quality roles in the industry—either for internships or after graduation. While some of that difficulty is certainly a function of simply few jobs available across the industry relative to more common MBA recruiting paths, we wanted to increase the flow of investment management opportunities at Darden to ensure that every student seriously pursuing investment management would be able to find an opportunity to best fit their interests and skills. We had two primary approaches to addressing our recruiting goals this year: a closer partnership with the Career Development Center (CDC) and expansion of recruiting opportunities at DVIC. At the CDC, Paul Reeder was instrumental in developing Darden's relationships with top firms in the industry, including BlackRock and MFS (among others), and led a more institutionalized job trek to Boston in the fall for our first-year students. At DVIC, CFO Scott Lusk demonstrated tremendous hustle throughout the fall and was able to secure a record number of judges and sponsors for the event—most of whom integrated some type of recruiting component during their time on Grounds for DVIC and UVIC.

Tying it all together, of course, was our continued focus on alumni relations. DCM hosted 14 guest speakers this year, nearly all of whom are alumni working in the industry, and 2018 CEO Peter Wilson's hard work in sourcing a DCM-specific alumni database was instrumental in enabling us to bring you *The Advisor* throughout the year. Our alumni network is one of the unique elements that makes Darden special, and we have been thrilled to see so many positive responses to this newsletter and the work that DCM has done this year. Thank you to all of you who have engaged with DCM either formally or informally throughout the year!

Of course, as you've seen above, DCM is a team sport—none of the above would have been possible this year without the tremendous dedication of the women and men who make up the DCM leadership team. Our executive team and SPMs alike came into our tenure with tons of ideas, heaps of energy, and a large dose of commitment. One of the most amazing things about this year was seeing how ideas that we initially thought were small could end up having a huge impact. At the simplest level, we started out the year being handed the baton of this already outstanding organization, and I think many of us were simply trying not to trip and fall. Personally, I could not be more impressed at how everyone on this team has grown into their role throughout the year—now as we hand that baton off, I hope we've made you proud to be associated with DCM and that you find that in one small way or another, DCM has moved forward throughout the year.

The baton is now finding itself in the hands of what we are confident will be another excellent DCM team, led by the executive group of CEO Church Waesche, CIO Clarke Ryan, CFO Bevin Landry, and Director of Research Trenton Hegseth. Although it's still a little bittersweet to be handing off all of our sweat equity and leaving Darden, our outgoing team is excited about the depth of the new class and the energy and ideas the new group has brought forward so far—DCM will be in good hands!

In closing, I just want to reiterate once again what an amazing experience this has been for me, personally, this year. At first the role of CEO seemed a bit daunting, and at times it was just as frustrating as it was fun. That said, I would do it one hundred more times if I could do it with the same team. Marnie, Scott, and Macrae were amazing to work with week-to-week, and I am honestly shocked at how much we were able to accomplish this year as an executive team—all thanks to their consistent energy and dedication. Our five SPMs—Miller, Peter, Mike, Sofia, and Kyle—were superstars and exceeded all of my wildest expectations for how the portfolios could be run. I would invest my personal capital with any of them in a heartbeat.

It is truly the people of DCM that make this an incredible experience. I learned from every single one of them throughout the year, and I feel extremely fortunate to have been able to come to Darden and work with this group. My biggest hope for DCM going forward is that every group that comes after us will continue to feel the same way.

Thank you all for your continued support!

All the best,

Ryan H. Claxton, CFA
CEO, Darden Capital Management
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2018–2019 DARDEN CAPITAL MANAGEMENT

EXECUTIVE TEAM

Ryan Claxton	Chief Executive Officer
Marnie Lanphier	Chief Investment Officer
Scott Lusk	Chief Financial Officer
Macrae Gould	Director of Research

JEFFERSON FUND

Michael Kellett	Senior Portfolio Manager
Juan Jaramillo	Portfolio Manager
Annie Madeira	Portfolio Manager
Grant Moraven	Portfolio Manager

CAVALIER FUND

Peter Taylor	Senior Portfolio Manager
Maria Melchor	Portfolio Manager
Itay Ron	Portfolio Manager
Freyan Soonawalla	Portfolio Manager

MONTICELLO FUND

Sofia Scott	Senior Portfolio Manager
Sid Rajagopalan	Portfolio Manager
Wenda Sun	Portfolio Manager
Tris Worth	Portfolio Manager

DARDEN FUND

Miller Jump	Senior Portfolio Manager
Rutvik Karve	Portfolio Manager
Jorge Quinteros	Portfolio Manager
Lex Utt	Portfolio Manager

ROTUNDA FUND

Kyle Rose	Senior Portfolio Manager
Emily Caldwell	Portfolio Manager
Jay Kanakiya	Portfolio Manager
Anne McKenna	Portfolio Manager

PORTFOLIO UPDATES

CAVALIER FUND

"At sea, things appear different."
-Nathaniel Philbrick, *In the Heart of the Sea*

To Our Friends and Partners:

We have had an overwhelmingly positive experience managing our portion of the Darden endowment. Throughout the year, we have learned invaluable lessons in security selection and human capital management. It is fair to say that Darden Capital Management has fortified our MBA education through the trials and tribulations of managing a substantial amount of real capital.

While our first quarter performance lagged the S&P 500, it was an outcome with which we were quite comfortable as we positioned the portfolio defensively. Throughout the quarter, we were positioned approximately 75% net long as we began to witness some tell-tale signs that the economic expansion was winding down (we remain at the same net exposure today). While Federal Reserve policy has remained accommodative (supporting equity valuations), some cues from the bond market support our skeptical view of the recent rally. For one, the yield curve was inverted and just recently self-righted. Second, we've seen the pace of Chapter 11 filings and corporate restructurings increase as some firms have had a more difficult time refinancing debt obligations. Lastly, lower (absolute) government yields in the U.S. portend a slower economic growth profile which seems to be at odds with a higher valuation for stocks as we begin the second quarter earnings season.

	Cavalier	S&P 500
Year to Date	8.98%	13.06%
3/31/18 - 3/31/19	8.92%	8.36%

Recently, we have been hyper-focused on transitioning the portfolio to next year's Cavalier team. The benefit of our positioning is that we are handing over the portfolio with ample "dry powder", lending flexibility to the new team. We have a healthy cash cushion, short-term U.S. treasuries, a few positions worth building out on market pullbacks, and a more diversified short book that can provide ballast in rocky conditions. Instead of continuing to pitch new names as our time runs to a close, we have focused on "re-pitching" legacy positions that may be long-detached from the original thesis. We have provided transition documents that detail our thoughts on each and every position allowing the new portfolio managers to hone their individual coverage. We also hosted a DCM sponsored luncheon out in Keswick to discuss what worked well for us, what did not, and how the Cavalier team can implement ever-improving processes.

Because DCM emphasizes an incentive for learning, I believe Darden students will continue to add market-topping performance for years to come. This is hard work, and we do not accept it idly. The gravity of our responsibility will continue to define our purpose and we are excited to see what unfolds in the future.

Thank you to the mentors, alumni, faculty, and students that take interest in our operation.

Sincerely,

Peter Taylor
434-284-2564
TaylorP19@darden.virginia.edu

DARDEN FUND

To Our Investors:

The first quarter of the year proved to be a major rebound for the US market. The volatility of the last six months was a great learning opportunity for all of us in DCM as we had our will and even belief in our theses tested. I credit everyone on the team for staying on top of their names during this period which resulted in sales of only one of our names (Carriage Services) where we recognized that our thesis was fundamentally broken, despite seeing pullbacks in various stocks throughout the portfolio. Ultimately, we were rewarded for weathering the storm and holding our names rather than selling in panic. The fund bounced back over the first quarter and outperforming the market by roughly two percent.

	Darden Fund	Russell 2000	Alpha
Year-to-Date	16.52%	14.59%	1.93%
1 Year	7.77%	2.04%	5.73%

Within the Darden Fund we saw outperformance due to the strong selection effect of the names that we added to the portfolio over the course of the year. Our top performers over the quarter were Gray Television (GTN), MKS Instruments (MKSI), and Stericycle (SRCL) with each appreciated over 25% since their entry points in the last six months. At the portfolio level, we had a negative allocation effect due to overweighting on energy which was a lesson in and of itself. Therefore, our outperformance was driven by incredibly strong selection on the part of our team. This selection effect was further enhanced by the names that we chose to remove from the portfolio. On an equal-weight basis those names performed -20% relative to the benchmark over the course of the last year from the dates that we removed each from the portfolio.

Though our performance rebounded well over the last quarter, we recognize that much of this was market driven and are careful not to become over enthusiastic pouring money into similar names. We have tried to find ways to further diversify and add names that we think will be resilient should we see another downturn soon. Two of the names that we added over the quarter were TPI Composites (TPIC) and Silgan Holdings (SLGN). We believe that TPI gives us a way to gain exposure to green energy diversifying away from oil dependent companies. Silgan is a container manufacturer that we believe will be more insulated from macro factors due to contracts in a staple business sector.

As we turn over the keys to the next class we wanted to take the opportunity to thank the board for the opportunity to manage this portfolio. Recently, we spent some time reflecting on the lessons that we learned over the course of our time managing the portfolio. The main thing that we all brought up was the difference in the level of care that everyone put into their pitches when there were actual dollars on the line. Not only did this include thinking carefully about the companies and industries that we were investing in but also trying to understand our own personal preconceptions and biases. We couldn't have learned all of this without the opportunities created by DCM. We know that the rising second year team is more than capable of continuing the performance that we achieved over the last year and look forward to watching the fund continue to grow in the future.

Sincerely,

Miller Jump
JumpW19@darden.virginia.edu

JEFFERSON FUND

Dear Jefferson Fund Stakeholders,

Greetings for the last time from the 2018-2019 Jefferson Fund team. It has been our pleasure and honor to serve you over the past year. Time has flown by, and the world of investing certainly looks much different to all of us on the way out of the portfolio than it did on the way in. Unfortunately, due to the nature of the short-term leadership changes on the DCM portfolios, our accumulated wisdom from the past year will only impact the portfolio indirectly – through buy/sell decisions that we have already made and advice that we are passing down to the new Jefferson Fund team. I believe that we have improved upon the Jefferson Fund framework over the past year and left the portfolio in a better place than we found it. We remain actively engaged with the portfolio until our graduation in May, but the decision-making authority has been passed on to the new team, consisting of Senior Portfolio Manager Adrian Moral and Portfolio Managers Anna Mazur, Zac Elkaim, and Andres Campos. All have been actively engaged with DCM during the past year, and I anticipate a smooth transition.

I am happy to present our final quarterly letter below; I hope that you find it useful and informative. Feel free to share your thoughts with me and ask any questions that come to mind – my email remains KellettM19@darden.virginia.edu.

SECTION 1: One for Me

There is an old Hollywood tradition of making "one for them and one for me" – directors and stars accrue capital with the system by making big commercial movies then cash in this capital to make more personal projects that are unlikely to make money for the studio. Consider this letter "one for me" – I hope that I have accrued enough capital through my previous letters outlining my thoughts on value investing, portfolio construction, performance evaluation, and lessons learned from a tumultuous fourth quarter of 2018 that I can stray from the typical commentary around our investment philosophy. Have no fear – the usual discussions on performance and portfolio changes can be found later in this letter.

I hope this section can provide some recommendations on how to consume investing knowledge that might be helpful for your own hunt for alpha and can serve as a starting point for the next generation of DCM in where to turn for information and how to improve investing knowledge.

Reading Recommendations

For a career in investing, independent reading is a must. Most firms are smaller and do not have rigorous training programs, and even for those that do, I would advocate getting a wider array of perspectives. A lot of managers will talk up the classics and base their whole careers on having read Ben Graham's *The Intelligent Investor*. I too have read this, but it is quite honestly very difficult to get through with this many years separating us from the source material. Feel free to read Graham in order to get an understanding of the origins of value investing, but my take is that it is not essential. I hope to instead give a more modern take on investing reading recommendations.

- For an incredibly accessible "how to" guide for beginners and any MBA student interested in a career in investing, I give my highest recommendation to ***Pitch the Perfect Investment: The Essential Guide to Winning on Wall Street*** by Paul D. Sonkin and Paul Johnson. Published in late 2017, this book puts the theoretical underpinnings of the best-known investing books to work and really walks you through how to find – and then pitch – the perfect investment.
- Rounding out my top five investing book recommendations are:
    - ***The Most Important Thing Illuminated*** by Howard Marks – This is a great compendium of memos written by Howard Marks over his illustrious career, and I believe Marks to be one of the best communicators in the investing world today. The "Illuminated" version also includes margin notes from a collection of other great investors.
    - ***Common Stocks and Uncommon Profits*** by Philip Fisher – There are a lot of great value investing books out there, but I believe this is essential reading to get the growth perspective. In contrast to Ben Graham's historical classics, I consider this more of a modern classic.
    - ***The Dhando Investor: The Low-Risk Value Method to High Returns*** by Mohnish Pabrai – This book lays out

value investing frameworks in the most straightforward and accessible manner possible. While it is written with the intelligent individual investor in mind, I think that anyone who reads it will find some important lesson either learned or reinforced.

  - ***Value Investing: From Graham to Buffett and Beyond*** by Bruce Greenwald, Judd Kahn, Paul D. Sonkin, and Michael van Biema – The first half of this book covers the fundamental techniques of traditional value investing, and the second half illustrates various applications of value strategies through vignettes on several high-profile investors, including Warren Buffett, Mario Gabelli, and Glenn Greenberg. Though I advocate for a more modern approach to value investing than the traditional Ben Graham approach, it is essential to stay grounded in what came before, and to see how the great value investors of the past have evolved the profession and laid the groundwork for the great modern value investors.

- I also believe it is incredibly important to understand how you think and how to analyze your own biases and behaviors. To this end, the following books are a great supplement to core investing reading: (1) ***Thinking Fast and Slow*** by Daniel Kahneman, (2) ***Misbehaving*** by Richard Thaler, and (3) ***Fooled by Randomness*** by Nassim Nicholas Taleb.
- One other book that I briefly want to mention is ***Mastering the Market Cycle*** by Howard Marks. Though this is not the same instant classic as his other book, its message about paying attention to cycles and positioning the portfolio to tilt the odds in your favor as market conditions change is a great complement to other investing books that explicitly eschew any discussions on timing.

Other Recommendations

Reading full books takes a lot of time, and it is important to keep up-to-date on the latest news and trends in the investing world. There are a million daily newsletters, Twitter feeds, financial press, and straight-up noise to keep you occupied, and it is easy to get buried under this deluge. Everyone should find the sources that work best for them, but I would advocate simplifying as much as is feasible, so that your entire morning is not drained on reading a myriad of daily newsletters. In that vein, I believe the following recommendations are well worth your time and attention.

- **Robinhood Snacks daily email** – The former MarketSnacks was founded in 2012 with the aim of making financial news digestible, and it was recently re-launched as Robinhood Snacks (following an acquisition by the fintech company Robinhood). I have received a lot of different daily finance and investing emails in the past few years, and none of them hold a candle to this one. Robinhood Snacks is by far the most fun to read, as it is often genuinely funny and makes great analogies that make investing news easy to understand. But more importantly, Robinhood Snacks does the best job of diving deep into news that matters for investors and explaining why it matters. I wholeheartedly recommend subscribing to this daily email, and I think you'll really enjoy it. (Robinhood Snacks also has a daily 15-minute podcast breaking down the top three business stories of the day; I have not yet tried this product, but if it is anything like the daily email, I imagine it is also great.)
- ***Invest Like the Best* podcast** – In contrast to the fast-hitting daily email listed above, the *Invest Like the Best* podcast (hosted by Patrick O'Shaughnessy) consists of 127 episodes (with new weekly releases) of deep-dive discussions with both professional investors and people outside of the investing business with interesting insight and experience. In O'Shaughnessy's own words, he speaks "with the most interesting people I can find, whose stories will help you better invest your time and your money and teach you how to play with boundaries in your own life." This is a great use of your time, and you can cherry-pick the episodes that you are most interested in. For starters, I will recommend episodes with Michael Mauboussin and Connor Leonard on public equity, Brent Beshore on private equity and venture capital, and Eric Maddox on ways to communicate and fight our own biases in listening (from a man who was instrumental in the capture of Saddam Hussein through his unique use of empathy-based listening during Army interrogations).
- **Quarterly Letters** – I think it is also valuable to read a variety of quarterly letters to keep in touch with what other investors are thinking about. Howard Marks's memos should be your first stop here – you can register for email alerts when new memos are posted – but looking at letters from other managers that make them publicly available will also help you stay on top of industry trends.
- **Stratechery** – I have not read enough of this blog/newsletter, but the few times that I have, I have been extremely impressed with the level of detail and analysis on issues relating to technology. I will make a point going forward to cut out some of the extraneous newsletters I currently receive in order to focus more on reading this one.

- **Darden/DCM Resources** – For those of you still at Darden, make the most of Darden's and DCM's resources. I recently attended the HBS Investment Conference at Harvard Business School, and it definitely added to my own investing education. In about a week, I will take a tour of an Amazon fulfillment center. Take every advantage of opportunities to go to conferences or site visits, and do not just sit back and wait for an invitation to come. Make your own opportunities happen.

<u>Other Parting Words of Advice</u>

Be humble. People are streaky, and if you get 54% of your calls right in this industry, people see you as a genius. But it is easy to go from genius to fool overnight, and it is essential to keep a positive attitude and learn from your failures. It is important to keep learning, because the world (and thus the market) is constantly changing.

For the next DCM class – try to have fun with the experience. Darden life can be a lot at times – especially if you have a baby born on the first day of class, like I did this year – but DCM really does merit a higher priority. I believe it is the best learning experience you can have at Darden.

SECTION 2: RECENT PERFORMANCE

The Jefferson Fund returned 12.56% in the three months ended 3/31/2019. For reference, the Russell 1000 Value Index (R1000V) returned 11.94%, and the broad-market Russell 1000 Index (R1000) returned 14.00%. Our best performers were **Constellation Software** (+36.0%), **Facebook** (+27.2%), **American Tower** (+24.6%), **LVMH** (+24.5), **S&P Global** (+24.3%), and the half position in **Electronic Arts** (+28.8%). We continue to believe that these businesses meet our qualitative hurdles, have strong competitive moats in place, and are trading at fair or good prices. That said, we trimmed our allocation to **S&P Global** on concerns that valuation is getting a little ahead of itself.

We should also note that the significant appreciation in **Electronic Arts (EA)** during the quarter was driven solely by the early February release of a new battle royale game with huge potential – Apex Legends. Prior to the release of that game, the stock was down significantly on poor earnings and guidance. While our investment thesis on EA did not explicitly incorporate the release of a new extremely popular game, our analysis of the video game industry led us to the conclusion that a new battle royale release could be incredibly profitable. I personally thought that the new battle royale mode in Call of Duty from **Activision Blizzard (ATVI)** would be that game, but it turned out to be something that EA completely blindsided us with. This game proves that EA does have the ability to innovate – adding upside to cash cow properties like FIFA and Madden – while ATVI has faced execution issues. It appears that the video game thesis with split positions between EA and ATVI is playing out solely within EA, though EA's multiple has run up very quickly (on essentially guesses about the monetization potential of Apex Legends) and ATVI's has come down very quickly in the face of probable near-term weakness (despite positive longer-term trends, especially in mobile and esports). What to do with the EA position (and keeping up to date on the latest guidance and trends with Apex Legends) and the now-tiny ATVI position (<2%) is a task for the new team; we are of course advising them, but the decision is ultimately theirs, and I will not tip their hand here.

Our worst performers were **Realogy** (-21.8%), a half position in new holding **Mylan** (-10.7%), **Markel** (-4.0%), **Berkshire Hathaway** (-1.6%), and the half position in **Activision Blizzard** (-1.4%).

Realogy (RLGY) remains a thorn in our side, as the stock has returned -57.4% since we inherited the position and detracted 325 bps from our full year performance. Our decision to hold the stock on its high upside/downside ratio appears in hindsight to have been the wrong one, though we decided to trim it to a half position right before another poor earnings report and weak guidance sent the stock plummeting. The stock was up for the quarter before we trimmed it, and this decision cushioned the effect of another terrible report; RLGY only detracted 17 bps from performance this quarter. The company continues to struggle with a constraint on supply in the housing market – a macro factor that we have little insight on outside of published predictions on home sales, which have proven to have been too optimistic – and agents negotiating higher commissions. The stock continues to throw off a lot of free cash, the company is buying back a lot of shares, and insiders are buying as well. Though I still think RLGY will do well in the long-term, my confidence interval on what the "long-term" actually means is getting wider and wider. At the same time, I am becoming more and more dubious of the depth of RLGY's competitive moat. The stock is less than 2% of the portfolio today, so it is unlikely to have much of an impact on the portfolio from here. Much like our other tiny position (ATVI, discussed above), the decision of what to do with the

RLGY position lies with the new team, and we are lending our advice.

For the 12-month period in which we managed the portfolio, the Jefferson Fund returned 5.12%, compared to a 5.69% return for the R1000V and a 9.30% return for the R1000. For reference, if we had sold **Realogy** and simply moved that money to cash on the day we took over, the portfolio's return would have been 8.37%, well ahead of its primary value benchmark. As I noted in my first letter, I ask that you not read too much into short-term performance; I believe that the lessons that we have learned over the past year (and the portfolio decisions that we have made) and are passing down through the rest of DCM have left the portfolio in a far better position than we inherited it, especially when it comes to constructing the portfolio better for a potential downturn.

<u>One specific lesson that we have learned from this disappointment with **Realogy** that we are passing onto the new team: over the short-term, do not underestimate the power of momentum and do not overestimate the power of mean reversion. Mean reversion (or traditional "value") tends to work over longer time periods, while momentum works over shorter time periods; if a stock is down 20% in a month, it is more likely to continue down than immediately move back up (all else equal). While the long-term remains our primary focus, the short-term path can cause a lot of distress and distraction, and it should thus be a consideration in any pitch.</u>

Measured by portfolio contribution, our top contributors for the past year have been **O'Reilly Automotive** (+74.5%), **salesforce.com** (+36.2%), **Microsoft** (+31.4%), **Verizon** (+29.4%), and **Constellation Software** (+28.5%). **American Tower** (+38.6%) also performed admirably, though it started the year as a smaller position and thus did not quite crack the top five contributors. Our top detractors were **Realogy** (-57.35%), **United Rentals** (-31.6%), **BlackRock** (-18.9%), **Booking Holdings** (-16.1%), and **Markel** (-14.9%). The half position in **Activision Blizzard** (-32.0%), the since-sold **Polaris Industries** (-22.9%), and the new half position in **Mylan** (-10.7%) also performed poorly, but smaller position sizes or timely exits kept them from being in our top five detractors.

Following the full-year 2018 outperformance of 547 bps, the slight outperformance YTD in 2019 continues the Jefferson Fund's longstanding pattern of outperformance.

SECTION 3: PORTFOLIO CHANGES

During the quarter, we purchased new stakes in **Constellation Brands** (full position), **McDonald's** (half position), and **Mylan** (half position). We did not sell anything, though we did trim **S&P Global Investors**, **BlackRock**, and **Realogy** to half positions. The theme around these portfolio changes was to better diversify the portfolio and to position it better for a potential downturn, moving some of the portfolio into less economically-sensitive stocks and trimming stocks that are more sensitive to economic conditions.

For the sake of keeping this letter to a reasonable length, I have cut the "Investment in Focus" section. If anyone is interested in discussing an investment in greater detail, feel free to reach out to me.

Buy: Constellation Brands (STZ), February 2019

Constellation Brands is a leading producer, marketer, and distributor of beer, wine, and spirits worldwide, and it owns more than 100 brands across these three segments. It owns six of the top 15-selling imported beers in the U.S. (including Corona and Modelo – by far the top two), as well as the largest imported vodka brand (Svedka). Constellation Brands has a much more diversified beverage portfolio than any of its competitors (AB InBev, E&J Gallo Winery, The Wine Group, Diageo, etc.), which enables it to better endure changes in consumer tastes or shifts in industry trends. It has diversified its exposure even further through the acquisition of a 38% stake in Canopy Growth – the largest producer of cannabis in the industry. The stock price came down significantly throughout the back half of 2018, as a $4 billion investment in Canopy distracted from the core thesis for most investors – surrounding positive demographic trends in the U.S. for the company's top beer brands. Does the move into cannabis portend lower growth prospects for the beer segment? We do not think so; we see this instead as a move that adds more diversification to the Constellation Brands portfolio and adds upside optionality to the stock. With the price down from near $230 in October to our purchase price of $173, we thought that the risk associated with overpaying for the Canopy stake was low (and if Darden's winter break fell a month earlier, maybe we could have gotten it at $150). The company has been executing well since we bought it, and the stock is already up 11%. Most of these returns came in April after a strong earnings report and the sale of thirty lower-end wine brands and are thus not reflected in returns discussed in this letter.

Buy: McDonald's (MCD), February 2019

McDonald's is a world-class brand led by an excellent management team, and we believe it is poised to capitalize on the changing fast-food landscape. McDonald's has long been the industry leader in marketing, operational execution, and innovation, and this has enabled it to drive superior financial results for many years. While we believe that McDonald's is a great business that meets our quality hurdles, we also believe that it will prove to be a more defensive stock in a downturn – lowering the cyclical exposure of the portfolio. Due to the nature of its inexpensive menus, McDonald's is poised to thrive during economic downturns when consumers try to spend less money – to this end, McDonald's experienced remarkable growth in 2007-2010, and the stock price did not move down significantly in 2008. We are also big fans of the management team; it would have been easy for McDonald's to simply rest on its laurels as the leader in operational efficiency, but it has continued to make strategic changes that have panned out well (most notably the shift toward franchising a majority of stores in order to improve cash flow and reduce operational risk) and to innovate (just a few weeks after our purchase, McDonald's acquired Dynamic Yield, a company that will allow McDonald's to use decision technology to increase personalization and improve customer experience in its Drive Thrus). Of course, no discussion of McDonald's would be complete without noting the risks posed by consumers becoming more health conscious and the burgeoning "fast casual" segment. Though McDonald's has been expanding the menu to include healthier options (and it is worth noting that these trends are not as strong in international markets), we note that these threats are in fact substantial, and they are the key factor that we are advising the new team to think through. That said, we believe that the share price today adequately accounts for this risk, and we are happy to own McDonalds, especially at this point in the cycle.

Buy: Mylan N.V. (MYL), February 2019

Mylan is one of the largest pharmaceutical companies in the world and engages in the development, licensing, manufacturing, marketing, and distribution of generic, branded generic, and specialty pharmaceutical products throughout the world. It has a durable and diversified platform, with over 7,500 products sold in over 165 countries, no single product generating more than 4% of total revenue, a robust R&D pipeline, and holding a top two position in several categories (usually alongside top competitor Teva Pharmaceutical). Though the stock has languished since mid-2015, we believe there are several positive factors that are poised to turn Mylan's fortunes: (1) the rapidly aging population and pressure from insurance companies to cut healthcare costs should benefit generics; (2) many patents are set to expire over the next several years, and Mylan appears to be positioning themselves as the generic alternative for many of these; (3) there is a significant opportunity to grow in emerging markets; and (4) valuation is at an all-time low of near 6x forward earnings. The key risks are the hard-to-handicap effect of potential government regulation around pricing and a potentially expanding competitive landscape in the generic space. The stock has come down ~13% since we purchased it, on weaker than expected near-term earnings and guidance. We thought that a weak report from Teva had lowered this risk for us, but that turned out not to be the case. Though we were a bit early on this one, we think the stock will benefit from the factors listed above, and the portfolio will benefit from the diversifying characteristics of a health care name – the first we have owned since selling McKesson in September 2018.

Trims: S&P Global Investors (SPGI), BlackRock (BLK), Realogy (RLGY), February 2019

We funded the three purchases listed above solely through trimming large positions that had run up on good performance and by cutting the three positions discussed below to half positions.

We trimmed **S&P Global Investors** on concerns around valuation, and the stock has run up even more since that decision. We continue to really like S&P's business and ability to compound the underlying business value into the future, though its valuation is close to reflecting its present value.

We trimmed **BlackRock** on concerns that the stock could really suffer in a market downturn – as investors flee to safety, they tend to move their investments toward safer (and thus lower-fee) products. We continue to really like BlackRock's position within the asset management industry – as the ETF leader, we think they have the scale and product mix to keep client assets even as investors shift strategies, and we also believe the Aladdin platform has tremendous growth potential in wealth management. However, the market downturn in late 2018 showed us how sensitive this stock is to market conditions, and in what seems like the late stages of a bull market, we decided trimming would help better insulate the portfolio for tougher market conditions.

We trimmed **Realogy** on concerns that the macro environment around home construction and sales would continue to be weak. The ensuing earnings report was even weaker than we thought, and the stock subsequently fell another 20%+ after this decision. As discussed earlier, Realogy has detracted significantly from portfolio performance, and even though the long-term risk/reward tradeoff seems to be skewed significantly toward the upside, our trials and tribulations with this stock has taught us never to look too far past the potential for short-term weakness (especially for companies that are so dependent on macro factors that we are not in a position to forecast).

CLOSING REMARKS

Thank you for this opportunity to serve you over the past year. As my parting words, I want to re-emphasize that I believe we have added long-term value for the Jefferson Fund through our portfolio decisions, our moves to better insulate the portfolio for a potential market downturn, and our education of the new team during this transitionary period. As I noted in my previous two letters: "Though we must report short-term results, I prefer to evaluate our performance internally on processes (and our companies' operational performance), not outcomes. Every great investor has had years of phenomenal performance and years of terrible performance. It takes time for skill to show through in the form of long-term outperformance. We ask that you not focus too much on our short-term results, good or bad."

Thank you very much,

Michael Kellett
KellettM19@darden.virginia.edu

Appendix – Jefferson Fund Portfolio, as of 3/31/2019

Ticker	Jefferson Fund Stocks	Weight
LVMHF	LVMH Moet Hennessy Louis Vuitton SE	6.6%
MSFT	Microsoft Corporation	6.4%
ORLY	O'Reilly Automotive, Inc.	6.2%
CNSWF	Constellation Software Inc.	6.1%
NKE	NIKE, Inc. Class B	6.0%
BRK.B	Berkshire Hathaway Inc. Class B	5.8%
CRM	salesforce.com, inc.	5.8%
FB	Facebook, Inc. Class A	5.7%
AMT	American Tower Corporation	5.7%
VZ	Verizon Communications Inc.	5.6%
MKL	Markel Corporation	5.2%
BKNG	Booking Holdings Inc.	5.0%
URI	United Rentals, Inc.	5.0%
STZ	Constellation Brands, Inc. Class A	5.0%
EA	Electronic Arts Inc.	3.2%
SPGI	S&P Global, Inc.	3.2%
MCD	McDonald's Corporation	3.1%
BLK	BlackRock, Inc.	3.0%
MYL	Mylan N.V.	2.7%
RLGY	Realogy Holdings Corp.	1.9%
ATVI	Activision Blizzard, Inc.	1.9%
CASH_USD	U.S. Dollar	1.2%
		100.0%

MONTICELLO FUND

To Our Friends and Partners,

First let me say, it is bittersweet to be writing my final quarterly fund letter knowing that in six weeks the Class of 2019 will be graduating from Darden. It has been a pleasure managing the assets of the Monticello Fund alongside classmates and friends.

With Q1 2019 concluding as the best quarterly returns for U.S markets over the last decade, the 2018-2019 Monticello Fund ended our tenure managing the portfolio with a strong quarter, pleased with our patience getting through the market volatility of December that didn't lead to any major shifts in allocation. During the quarter we spent time considering where our portfolio may be underexposed from both sector and regional allocation which led to bottoms up analysis and allocation of capital to four strong new ideas.

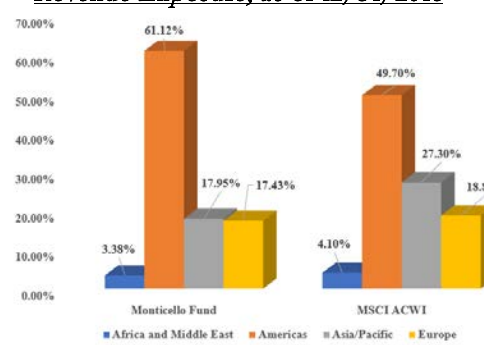
During the first quarter of 2019, the Monticello Fund ended +12.60% and the benchmark MSCI ACWI Index ended +11.61%, therefore over the three-month period we outperformed the benchmark by 100 bps. As mentioned in every quarterly letter, we are long-term oriented managers, focused on the returns over market cycles. Over a three-year period, as of March 31, 2019, the Monticello Fund earned +10.95%, and the benchmark earned +12.51%. The returns were driven by gains in Microsoft Corp., Tractor Supply Co., and Diageo, and offset by losses in Citizens Financial Group, Fortune Brands, and AerCap.

Within this last quarterly letter, I will highlight our parting thoughts on three items: first, where we believe the focus should be moving forward as the Monticello Fund team continues to manage the portfolio as a whole in conjunction with fundamental stock selection (Section 1); second, highlighting the final changes we made in the portfolio through new portfolio additions (Section 2); and lastly, key insights and takeaways from the HBS Investment Conference that we attended and many can benefit from hearing (Section 3).

Considerations for the Future Portfolio Construction

The greatest challenge and joy for the Monticello Fund is considering opportunities in international markets while also positioning our portfolio to capture the opportunities in the U.S. market. Our fund guidelines suggest 65% domestic and 35% international exposure and there are two ways to analyze how we are achieving this guideline: one is geographic exposure by security domicile, and the second is geographic exposure by revenue.

__Exhibit 1 - Regional Aggregate Portfolio Revenue Exposure, as of 12/31/2018__



While we do not want to benchmark hug, we do feel that based on the Exhibit 1 there is significant deviation from the benchmark in exposure by geographic revenue. Key insight here is that the Monticello Fund could be capturing a more aligned risk / reward to the benchmark by obtaining more exposure to Asia / Pacific. We are encouraging the incoming Monticello Fund team to consider ways to get exposure to Asia / Pacific more directly either through individual names through bottoms up research, or through a basket approach of 2-3 names to get a greater diversification of exposure. Other great resources our team chose to utilize included connecting with Darden alumni in those regions to get regional expertise and insight on trends and opportunities within those markets.

The second portfolio recommendation we are sharing with the new Monticello Fund team is consideration of the balance between focusing on value stocks versus growth stocks, as we have tilted towards value historically in the portfolio. This consideration has been brought to our attention lately because in the last 10 years, growth stocks have outperformed value stocks and we have only partially benefitted from this trend in the Monticello Fund, so we believe this focus could be fruitful if applied in a calculated way to the time spent researching ideas moving forward.

New Positions in Growth / Closing Gaps in a Pharmaceutical Staple

The below names were added to the Monticello Fund portfolio in Q1 2019 using the remaining dry powder in the portfolio, bringing our total holdings to 30 names. We believe the companies and investment thesis complement existing names and add new sector beta to the portfolio (SaaS, information technology, and traditional pharmaceutical).

Survey Monkey (SVMK) – *As Pitched by Wenda Sun, Portfolio Manager*

SurveyMonkey has 19-year history of offering users a best-in-class survey platform. Its low-cost and self-serving model has led to 17.5M active users, of which 647K are paying users across more than 345,000 organization, including paying users in 98% of the Fortune 500. More than 80% of SurveyMonkey users leverage the application for business purposes (but are charged with much lower fees vs. enterprise plans), and the company is driving growth in the enterprise space, including new product offerings, an increase in its enterprise sales force, technology investments outside the U.S. and a focus on account sharing reduction. The investment thesis behind this holding is twofold: (1) market leader with competitive moat because of brand awareness and primary preferred platform above Google and Qualtrics which drives recurring revenue, (2) multiple revenue growth drivers coming from ARPU increase, enterprise solution clients and focus, and lastly product and international expansion with large TAM encompassing new uses for data solutions and analysis.

Cloudera (CLDR) – *As Pitched by Sid Rajagopalan, Portfolio Manager*

Cloudera is a leading provider of enterprise data management solutions for machine learning and analytics. The Cloudera Enterprise Data Hub is a secure and flexible software that allows for data engineering, warehousing and provides real-time analytics. Cloudera's platform embeds technology from over two dozen open-source projects (mostly internal projects). The investment thesis is threefold: (1) Merger opportunity with Hortonworks creates clear category winner, (2) Hadoop Evolution leading to fast results, easy management, and cloud-first and cloud-native architectures, (3) Valuation attractive for relative value as indicated by transaction and trading comparables in this space.

Splunk (SPLK) – *As Pitched by Sid Rajagopalan, Portfolio Manager*

Splunk is the current market leader in search and is the Google for log files. Splunk provides an innovative software platform that allows organizations to gain real-time operational intelligence. The operational intelligence allows companies to improve service levels, reduce costs, mitigate security risks, maintain compliance and gain insights. The investment thesis is threefold: (1) Splunk's TAM is approximately $55bn based on the markets and use cases it addresses, as Splunk expects to process tens of trillions of terabytes. Machine-generated data is one of the fastest growing areas of IT and contains records of transactions, customer behavior, machine behavior, security threats, etc. (2) Rising Average Selling Price - Splunk's average selling prices have been growing and the numbers reflect that – it has been beating revenue expectations. Splunk appears to be more challenged in customer acquisition given customer acquisition has been growing at only 500-600 customers per quarter. (3) Growth Story + Opportunity for Margin Expansion – Splunk enterprise is complemented by an app-market which now comprises over 1,000 apps. Most of those apps are available for free, but the growing ecosystem should create a competitive moat and stickiness of the platform. In addition, there is significant runway for Splunk to expand its margins given it has spent more than the other companies in its peer group for advertising.

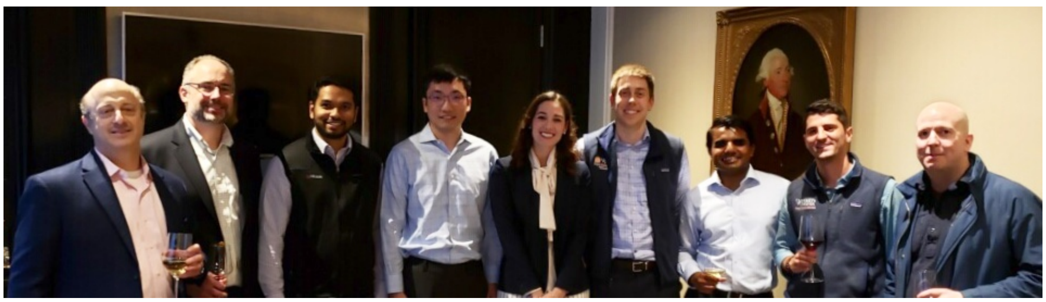
Pfizer (PFE) – *As Pitched by Tristram Worth, Portfolio Manager*

In the best of worlds, large pharma represents a modern-day monopoly in an industry that is growing at 6% or more annually. The value of Pfizer comes from its ability to develop new, profitable medications that it can sell with patent production. These blockbuster drugs can materially affect the share price because the calculation of future cash flows, once in the market, is relatively simple. Conversely, the effect of "Loss of Exclusivity" can also be easily calculated and weigh on the stock. Overall, the ability of Pfizer to reinvest capital into the business via R&D and M&A to produce outsized returns qualifies Pfizer as a classic compounder.

Opportunity for the Monticello Fund to Attend the HBS Investment Conference

In late March, members of the Monticello Fund and the Jefferson Fund flew to Boston to attend the 2019 Harvard Business School Investment Conference. We kicked off our weekend in Boston hosting four Darden alumni for dinner at Mooo…. Restaurant in Beacon Hill (picture below). As always, the Darden alumni imparted great wisdom regarding navigating career decisions and we caught up on what has changed on grounds both at Darden and specifically within the Darden Capital Management Funds that they previously managed during their time at Darden.

The HBS conference had some admirable speakers including Jon Jacobsen (Highfield Capital), Edwin Jager (D.E Shaw), Pam Holding (Fidelity), and Ashraf Haque (Sands Capital). Many of the portfolio construction and name ideas from the conference will be shared with the incoming Monticello Fund team. A specific insight we heard was the contrasting viewpoints of bullish / bearish on international retail which is very relevant to Monticello names JD.com and Walmart. Ultimately, we need our own view and our new Fund managers will have to review and re-underwrite our thesis moving forward.



Left to Right: *Chuck Brown D'97, Greg Faulkner D'06, Mevilton Dsouza D'12, Sofia Scott (SPM Monticello Fund), Mike Kellett (SPM Jefferson Fund), Sid Rajagopalan (PM, Monticello Fund), Juan Jaramillo (PM, Jefferson Fund), Brad Sullivan D'07*

Thank You

It's been a great honor for our team to manage a slice of Darden's endowment. We worked very hard to position the portfolio for generations to come. The opportunities in DCM were unprecedented for graduate students. We thank Pedro Matos, Darden Foundation trustees, and the ex-portfolio managers of the Monticello Fund who gave us this great opportunity. We look forward to seeing how the portfolio continues to evolve under the new team, Katherine Watson SPM, Carson Willoughby PM, Aditya Singh PM, and Yujing Sun PM.

Sincerely,

Sofia B. Scott
858-342-2573
ScottS19@darden.virginia.edu

ROTUNDA FUND

Dear Investors,

I write today to update you on the performance of your holdings with the ESG-oriented Rotunda Fund, which comprises 19.9% of Darden Capital Management's $18.3 million portfolio. Since the beginning of the quarter on January 1, 2019 the fund has returned 15.8% relative to the benchmark S&P 500 return of 13.1% for an outperformance of 2.7%. The fund has averaged three-year rolling returns of 15.1% relative to the benchmark S&P 500 index returns of 13.1% for three-year outperformance of 2.0%. For comparison, and because our initial investor letter indicated our ongoing consideration of the alternative ESG benchmark MSCI KLD 400 Social Index, the three-year KLD 400 return is 13.4%. Cash balance stands at 0.6% of available capital, and the gross/net exposure stands at 100% (cash excluded) with no leverage or short positions currently undertaken.

The top performers in the fund over the past three months have been Cyberark Software Ltd. (NASDAQ: CYBR), Accenture Plc Class A (NYSE: ACN), V.F. Corp. (NYSE: VFC), and Laboratory Corp. of America Holdings (NYSE: LH), which have returned 57.9%, 26.9%, 25.9%, and 25.7%, respectively. Top detractors from performance have been CVS Health Corp. (NYSE: CVS) Johnson & Johnson (NYSE: JNJ), and DowDuPont Inc. (NYSE: DWDP), which have returned (17.4%), 5.5%, and 6.0%, respectively. The largest current holdings are Visa Inc. (NYSE: V), Waste Connections, Inc (NYSE: WCN), and Accenture Plc (NYSE: ACN), which stand at 7.4%, 7.0%, and 6.6% of AUM, respectively. These top positions are unchanged from the previous quarter and reflect our intention for relatively low turnover in our highest-conviction holdings. The fund is overweight in Consumer Discretionary and Utilities relative to the benchmark, and underweight in IT, Financial Services, and Industrials. With a weighted average portfolio beta of 0.9, we are pleased that the fund continues to not only outperform its benchmark on a risk-adjusted basis, but on an absolute basis throughout this long-running bull market as well. Currently at 22 positions, we believe that running a concentrated long-only equity portfolio is the best way to take advantage of our institutional structure and do not anticipate further diluting the portfolio through more diversification.

During our final quarter at the helm of the Rotunda Fund, the team conducted comprehensive portfolio reviews of DWDP, ACN, and Corning Inc. (NYSE: GLW). DWDP was originally added to the portfolio in September 2011 and has performed relatively in line with market expectations over that time. However, with annual returns since purchase at just over 12.0%, the position has shrunk to become our smallest current holding at 2.7%. Combined with the announced spin-off of the combined entity into three distinct businesses, this drove our decision to review and ultimately evaluate whether to upsize the position size to a more meaningful level or look for an opportunity to exit. We believe the combined entity was trading at a conglomerate discount to the relative worth of the parts and will take a more meaningful position in one or more of Dow Inc., DowDuPont Inc., or Corteva Agriscience once the entities are fully distinct. After review, the Rotunda Fund's sizeable position in ACN was also maintained on a continuation of the original investment thesis. Our review of GLW is highlighted in more detail below. In continuance with the price-target rationale explained in last quarter's letter, the remaining stake in Chipotle Mexican Grill, Inc. (NYSE: CMG) was liquidated as well.

The team also evaluated new investments PVH Corp. (NYSE: PVH) and TJX Companies Inc. (NYSE: TJX). With strong investment theses predicated upon industry tailwinds, excellent operational execution, and international growth opportunities in high margin markets, the companies were added to the portfolio at relatively modest stakes of 3.5%. This considers the industry overlap between the two and the already-overweight Consumer Discretionary bucket that has included VFC since 2014. The 4.1% position size in VFC will be reevaluated in April, and the aggregate position of the three companies will ultimately take a holistic portfolio view from a risk management perspective. We are cognizant of the macro risks that these investments entail but believe that they have strong competitive moats that serve to hedge against idiosyncratic risks in the historically volatile sector.

Investment Highlight: Corning, Inc.

While GLW is best known for its Display Technologies business which manufactures the glass that is almost ubiquitous in LCD and OLED displays, it operates six distinct segments: Optical Communications, Display Technologies, Specialty

Materials, Environmental Technologies, Life Sciences, and All Other. At its heart, the company manufactures specialty glass better than anyone else in the world which has a variety of commercial applications including screen displays and fiberoptic cable (essential for next-gen wireless rollouts in the U.S. and China).

Since the initial long position was undertaken in late 2012, GLW has yielded a total annualized return close to 20.0% through a virtuous cycle of product innovation and elevated R&D that have resulted in sustained gross margins well above those of the few competitors that have been able to survive in the concentrated industry. With the lack of alternative industry capacity coming on line in the next few years, there is little worry that lack of continued pricing power will be an issue. CEO Wendell Weeks has a strong track record of operational excellence at the helm and is aided by an experienced executive team with an extended tenure at the company.

MSCI's comprehensive ESG scoring methodology ranks GLW 'AA' which is only achieved by 17% of the current industry participants. The executive leadership previously committed to science-based pollution reduction targets that have been exceeded YOY for the previous ten years through the installation of Global Energy Management teams at each production facility. While far from perfect, we believe the corporate efforts being made to reduce environmental impact, promote socially responsible operations, and establish strong governance are well ahead of competitors.

However, as much of a contributor as GLW has been to the portfolio since position inception, the investment committee voted to liquidate the holding when the opportunity for a replacement investment arises. This is not because we don't believe this is a phenomenal company with high earnings potential in the future, but because we believe the price already more than reflects the economic opportunity set available to each of the segments. Due to the somewhat limited nature of analyst capacity in the DCM fund structure, long-held investments have tended to languish past the shelf life of their original investment thesis and well past original price targets. Remedying this defect (both on the positive and negative end of the return spectrum) has been a point of emphasis by our team in the most recent quarter and will continue to be stressed going forward. We expect that a long position in GLW could be re-undertaken in the future if an attractive entry price were to arise.

Closing Thoughts

As of the writing of this letter the team and I have relinquished our roles as the heads of the Rotunda Fund to an incoming group of portfolio managers that I have every confidence will continue the tradition of learning, professionalism, and outperformance that you have come to expect of each DCM class. While proud of the work that we have accomplished, we are very much aware that the ball was set in motion by many years of exceptional fund managers that came before us. If nothing else, we hope that we have inched that ball a little more in the right direction.

We are grateful for the opportunities afforded to us by your continued trust and remain committed to investing in a socially responsible manner consistent with the mandate of the Rotunda Fund. If you have any questions about our time in charge of the fund, thoughts about any of the investment decisions we have made, or just want to chat about the markets, please don't hesitate to reach out.

Sincerely,

Kyle Rose
RoseK19@darden.virginia.edu

SELECT INVESTMENT IDEAS

Company	*Portfolio Manager*
TPI COMPOSITES (TPIC)	**Miller Jump, Darden Fund**
SURVEYMONKEY (SVMK)	**Wenda Sun, Monticello Fund**
MCDONALD’S (MCD)	**Juan Jaramillo, Jefferson Fund**
MATTEL (MAT)	**Itay Ron, Cavalier Fund**
CORNING (GLW)	**Kyle Rose, Rotunda Fund**

TPI COMPOSITES (TPIC)

TARGET PRICE: $39.00

Miller Jump, Darden Fund

Company Data	
Price	$28.07
Market Cap	$983M
LTM Revenue	$1.001B
EV/EBITDA	7.5x
Shares Outstanding	35.02M
TTM EPS	$1.25

Winds of Change

Over the last year TPI Composites invested back into their business as a result of a major shift in their customer base. A year prior, GE Wind acquired TPI's main competitor in the outsourced wind blade market, LM Wind, and they proceeded to cut their business with TPI, which once comprised 70% of the company's revenue, in half. TPI has responded by broadening both their customer base and product lines over the last year with significant investments that mask an underlying business with strong returns on invested capital. Additionally, TPI has clear visibility into their future, already with a potential $6.8 billion (*minimum* $4 billion) in contracted revenue through 2023 if they stopped all sales right now. The GE Wind acquisition could prove to be a boon to TPI as the OEM market for wind turbines is relatively consolidated, and GE's competitors will be hesitant to share business plans across company lines. Recent comments regarding their (very) short term outlook have given the stock a more attractive valuation, and I believe that this provides significant upside potential for a company with a reputation for quality and execution.

Business Summary

TPI Composites is the largest independent U.S. based manufacturer of composite wind blades with a global footprint. The company operates multiple blade manufacturing plants and tooling facilities spanning five countries (U.S., Mexico, Turkey, India, and China). TPI Composites holds contracts with several of the leading wind OEMs like GE Wind, Vestas, Senvion, Gamesa, Nordex, and Acciona. The company was founded in 1968 in Scottsdale, Arizona as a sail and powerboat manufacturer before transitioning under current CEO, Steve Lockard, to a wind blade manufacturer in 1999 to leverage its expertise in fiberglass manufacturing.

Global Wind Market Trends

The U.S. Energy Information Administration estimates that the world will need to consume over 25% more energy by 2040. This consumption will likely be driven in large part by renewable energy sources as countries collectively focus on decarbonization. Wind currently represents roughly 4% of the global energy production. The result (as projected by Bloomberg New Energy Finance) will be a global investment of over $3 trillion in wind energy infrastructure. Over the course of the next decade, this indicates a CAGR slightly over 8% in developed wind markets and over 25% in emerging wind markets.

Levelized Cost of Energy: Recent improvements in technology have made a critical difference in the LCOE. The main shift over the course of the next five years will be from <60 meter blades (currently almost 70% of the market) to >60 meter blades, with the beginning of this transition occurring now. With taller towers and longer blades, wind energy has achieved standalone profitability for the first time without the necessity of help from tax credits after experiencing a -12% CAGR in LCOE over the last decade. The National Renewable Energy Laboratory estimates that this cost can be halved again by 2030. This is a major key for wind demand, particularly in the United States where the Wind Production Tax Credit (PTC) will begin to wind down this year running through 2023.

Wind Production Tax Credit/Portfolio Standards in the US: The Wind Production tax credit runs through the end of 2019 giving credit per kW/h for any facility that *commences* construction before that time. Logically this will create a pull forward in demand, however given the structure of the credit, its benefits will last through 2023 for OEMs and blade producers alike. Additionally, more than half of the U.S. has portfolio standards at the state level that require from 15-50% of the electricity production to come from renewables at some point between 2020-2030 which will continue to drive domestic demand.

International Wind Demand: Though it does not state hard limits, the Paris Climate Agreement is a step forward in the global effort to reduce dependence on fossil fuels that shows commitment to renewables on a wide scale. Though the United States backed out, there are 170 other countries that have ratified the agreement to date. One of the key nations that people are watching in the agreement is China who is the largest producer and consumer of coal in the world. They have committed to 210 GW of wind capacity by 2020, but to this point have low penetration rates from US wind equipment producers.

Outsourcing: One of the key trends in the industry has been the outsourcing of blades by OEMs. Typically, blades make up 20-30% of the cost of a wind turbine, and due to their size are very difficult to transport (think one 70m blade per truck long-distance). Therefore, having a global presence for the production of blades can drastically reduce the cost to construct the turbine and the overall LCOE. Given that the OEMs typically work on contract jobs, it is cheaper for them to outsource the blade production to a manufacturer with global scale rather than building a line to do it themselves. Outsourced blade providers range in level of sophistication from generic to fully customizable and scale from local to global.

TPI Composites Business

TPI Composites is the largest public wind blade producer in the world. Their operations are globally diversified across the United States, Mexico, Turkey, China, and India. They have established supply chains in each of the geographies that they operate in, so they are not reliant on shipping input materials across borders which might subject them to tariffs. Their business to this point is largely focused on the development of wind blades for onshore wind applications. A key differentiator for them is their level of sophistication and customization that they offer to their clients. That, in combination with their five-year contract structure creates high switching costs for their customers who make up over 45% of all global wind installations. Since 2013 TPI's share of the global wind blade market has increased from 3% to 13%.

Business Model Security: Due to the contracted structure of their business, TPI has significant visibility into top and bottom line for the next few years. This gives additional certainty into their capital investments into new lines. On the plant level, the company generates strong returns on a five-year horizon to match their contracts with a 25% ROIC hurdle rate. Below is an illustration of a typical investment meeting the company's criteria. Over the course of the last year they had a large number of lines in startup and transition for new business that they picked up in the wake of the GE Wind acquisition which diluted their margins and the ROIC on the income statement. While transitions are a future risk to these margins, I believe that the heavy year of startups is not likely to become a recurring pattern and has masked a very attractive underlying business.

Illustrative Plant Financial Results

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Average
Net Sales	$1	$132	$210	$210	$210	$210	$162
COGS (excluding depreciation)	(8)	(108)	(174)	(174)	(174)	(174)	($135)
EBITDA	($7)	$24	$36	$36	$36	$36	$27
Taxes	0	(6)	(9)	(9)	(9)	(9)	(7)
Tax-Effected EBITDA	($7)	$18	$27	$27	$27	$27	$20
Depreciation	(3)	(5)	(5)	(5)	(5)	(5)	(4)
Net Income	($10)	$14	$23	$23	$23	$23	$16
Return on Invested Capital	-17%	23%	38%	38%	38%	38%	26%
Invested Capital	$60	$60	$60	$60	$60	$60	$60

Source: Company Presentation

Contract Structure: TPI's contracts are typically structured on a five-year basis. The contract design is such that they agree to a margin up-front and then share costs with the OEMs for the commodity inputs to the production process. This insulates them from the impact of both tariffs and fluctuating prices of commodity inputs like liquid epoxy resins which spiked in the last year. As of their last conference call they had $4 billion in sales guaranteed under contract through 2023 with potential upside of $6.8 billion total. That would be assuming that they made no more sales as a company in that time. They currently have a pipeline targeting 19 additional lines which, at $40 million per year per line would bring in over $700 million in annual revenue. Initiatives to close their existing pipeline and continue to broaden their customer and product base could offer significant upside to this.

Potential Upside in Offshore, Auto, Aerospace: There are three major avenues that management has called out as pathways to potential growth in the future. The first, and more logical is the offshore wind business. Currently they are heavily concentrated in onshore wind applications. The offshore blades are larger and require more specialized materials which would lead to margin expansion if they grow in the space which they have prioritized in their pipeline. The next major avenue is lightweight components for electric vehicles. The company already has an agreement with Proterra to produce frames for busses that will run electrically. They are in the development phase here, but in the 4-10 year range believe that this could be an expansion that brings in $500 million in revenue per year. Finally, the light weight composites that are used in EV could also be applied to the aerospace industry. The company does not have agreements in the space, but have noted cross-application opportunities here in a market with a 24 billion TAM (per UBS research).

Valuation

TPI's most recent earnings call depressed the valuation of the stock with a pair of announcement's affecting their outlook for the year. First, they noted a labor strike in their Matamoros, Mexico facility fueled by workers demand for higher wages across all businesses in the region. This conflict has already been resolved and poses small threat to their overall costs as a company (20% labor cost increase at 10% of their lines). Additionally, Senvion, which accounts for 1% of their business, has had financial struggles and recently filed for self-administered restructuring. This risk is confined to 2 lines in China, and management has been clear that they are considering all options to limit exposure to risk in this relatively small piece of their business.

Overall, I believe that these two events are both short term and isolated in nature, providing an attractive entry point for a buy. I valued the company with both 10-year-DCF and multiple approaches shown below. Though I believe the company has been unfairly punished in the market lately, I did not apply an upside rerate for the purposes of the valuation. In terms of the likelihood of each outcome, I believe that the base case is highly likely due to the contracted nature of the business, while bull case is also plausible depending on the impact of their post-PTC and EV businesses. The bear case I believe to be the worst-case-scenario given the amount of business that they have under contract and the customer concentration risk, which I find to be the most unlikely.

Base Case: $39

- Company Closes 75% of its existing pipeline over next two years and retains current client base. Grows volumes at industry growth rate thereafter.
- Company realizes half of their targeted $500 MM revenue through alternative lines of business.
- Cost of blades increases at rate of inflation through PTC phase out period.
- Gross Margins stable at 12% (low end of historical range). 1 out of 5 lines in transition per year.

WACC

Growth Rate	8%	9%	10%	11%	12%
2.00%	$ 51.78	$ 43.68	$ 37.62	$ 32.91	$ 29.15
2.25%	$ 53.15	$ 44.59	$ 38.25	$ 33.36	$ 29.49
2.50%	$ 54.65	$ 45.57	$ 38.92	$ 33.84	$ 29.84
2.75%	$ 56.28	$ 46.63	$ 39.64	$ 34.35	$ 30.20
3.00%	$ 58.08	$ 47.77	$ 40.41	$ 34.89	$ 30.59

WACC

EV/ EBITDA	8%	9%	10%	11%	12%
6.5x	$ 43.97	$ 40.67	$ 37.67	$ 34.94	$ 32.44
7.0x	$ 45.79	$ 42.33	$ 39.18	$ 36.31	$ 33.69
7.5x	$ 47.62	$ 43.99	$ 40.69	$ 37.68	$ 34.94
8.0x	$ 49.44	$ 45.65	$ 42.20	$ 39.05	$ 36.19
8.5x	$ 51.27	$ 47.30	$ 43.70	$ 40.43	$ 37.44

Bull Case: $59

- Company Closes 95% of its existing pipeline over next two years and retains current client base. Grows volumes at industry growth rate thereafter.

- Company realizes all of their targeted $500 MM revenue through alternative lines of business.
- Cost of blades increases at 2x rate of inflation through PTC phase out period due to more advanced materials and larger blades.
- Gross margins at 14%, upper end of historical range (12-15%). 1 out of 5 lines in transition per year.

Bear Case: $20

- Company Closes 50% of its existing pipeline over next two years and retains current client base through contracted period. Growth stalls due to end of PTC.
- Company realizes none of targeted $500 MM revenue through alternative lines of business.
- Cost of blades flat reflecting lower demand as PTC phased out.
- Gross margins at 11% at historical lows because lower demand drives down utilization rates which erodes profitability. 1 out of 4 lines in transition per year.
- Multiple rerates lower due to poor execution.

Risks

Customer Concentration: The GE acquisition of LM Wind was a demonstration of this. While outsourcing is a major trend in wind energy, there are still only a few major players in the OEM market. TPI still derives 60% of its revenue from Vestas and GE Wind. For GE specifically, they have the ability to terminate their contract in Iowa with one year's notice and in Mexico with only 15 days' notice subject to a buyout of the guaranteed revenue.

PTC Phaseout: Although they are geographically distributed, the US still makes up a significant amount of their business. Unfavorable regulatory pressure like the removal of the production tax credit could hurt demand. Profitability of the technology after the move to longer blades in the long term is an underlying assumption that would mitigate this.

Competing Alternatives: If other alternative energy sources see more rapid improvements in technology, so as to surpass the economic incentives for wind power this could hurt demand and slow adoption in the long term. Solar comes to mind first.

SURVEYMONKEY (SVMK)

TARGET PRICE: $15.60

Wenda Sun, Monticello Fund

Company Data	
Price	$12.35
Market Cap	$1.54B
Enterprise Value	$1.80B
EV/Sales	6.1x
Float	73.4%

Business Description

Founded in 1999, SurveyMonkey (SVMK) is the leading platform for survey software products that enable organizations to engage with their customers, employees and the markets they serve. SurveyMonkey is based in San Mateo, CA and had ~1,000 employees as of December, 2018. Customers include Bank of New York Mellon, Box, GoPro, HP, Lyft and Progressive. SurveyMonkey went public on September 25, 2018, raising $247M in gross proceeds.

Executive Summary

SurveyMonkey has 19-year history of offering users a best-in-class survey platform. Its low-cost and self-serving model has led to 17.5M active users, of which 647K are paying users across more than 345,000 organization, including paying users in 98% of the Fortune 500. More than 80% of SurveyMonkey users leverage the application for business purposes (but are charged with much lower fees vs. enterprise plans), and the company is driving growth in the enterprise space, including new product offerings, an increase in its enterprise sales force, technology investments outside the U.S. and a focus on account sharing reduction.

Investment Thesis

1. SVMK is the survey platform market leader, which builds itself a competitive moat.
   a) Market leader and brand awareness. According to JP Morgan, a study conducted in 2017 revealed that 45% of business users who leverage online survey software consider SurveyMonkey to be their primary platform, which is nearly double that of Google Forms and 7x the level of Qualtrics. Additionally, SurveyMonkey benefits from 79% brand awareness.
   b) Efficient business model and predictable revenue. SVMK acquires 80% of users for free or very low cost, either by customers visiting the company's website directly or through organic online search, which is very "viral." The efficiency is manifest in strong FCF generation. The company generates 75% of bookings from customers who have been with the company for at least 3 years, and 90% of the revenue was based on subscription.

2. SVMK has multiple growth drivers. Revenue growth continued to accelerate to 19% y/y this quarter (2nd quarter after IPO), up 1% sequentially. The company is also continuing to guide to robust 15-17% y/y growth in the coming fiscal year, alongside ~20% unlevered FCF margins.
   a) ARPU increase. In 2Q17 the company had a price increase to better monetize the value it was providing. However, based on my interviews, it is still highly underpriced compared to its closest competitor Qualtrics in the survey platform space. In the CX solution space, SurveyMonkey CX is significantly cheaper than Qualtrics, Medallia, Maritz CX, Clarabridge, OpinionLab, InMoment, etc. SVMK has significant levers to pull to increase its prices.
   b) Enterprise. SVMK is focusing its effort on expanding the Enterprise solution clients. It uses data to identify users within the same company and on average achieves a 4x increase in ARR when converting companies to team plans (launched in late 2018) and 15x increase in ARR to enterprise plans. SVMK currently only has 1/3 potential targets changed to team plan, 1% changed to enterprise plan and 12% revenue from enterprise plan.
   c) Product and international expansion. Virtually all the companies, including a lot of industries that are thought to be immune from data, will need data from customers and employees which provides SVMK with a large TAM. According to the company's 2018 Q3 report, ~$6B was spent on customer experience management worldwide in 2017, $7B on global talent management software in 2018 and $45B in market research industry in 2016. SVMK estimates the U.S. market opportunity for SVMK's platform to be approximately $25B, and worldwide opportunity to be significantly larger (>$50B). Building on the solid base of survey platform, SVMK

has developed a series of adjacency products in the abovementioned space that it can supplement the self-serve model with paid acquisition, targeted upsell and cross sell.

SVMK operates in an inherited global and growing market and currently has users in 190 countries and is available in 18 languages but only 1/3 of the revenue is generated outside of the US. Also, SVMK is making a push to expand the European market by building an enterprise sales team and data center, as well as investing in S&M.

Valuation

In the base case, SVMK is estimated to generate revenue of $293.7 mm (management guidance $290mm-$295mm), due to increases in the number of paying customers and ARPU. Non-GAAP EBIT is modelled at 2.5% margin (vs 5.9% in 2018) as the company continues to invest in sales forces and global expansions, as well as the impact of lease payment shifting from interest expense to operating expense. I expect EBIT to accelerate once SVMK ramps up these efforts in 2020, which is modelled at 5%. SVMK is expected to decrease its CapEx spending, which is modelled at 5.5% of sales (vs 8.7% in 2018 vs 18.0% in 2017). uFCF is modelled at $50.8 million with 17.3% margin, significantly lower than management's guidance of $55-58 million and 19%-20% margin. Base case CAGR for next 5 years is 13.5% for sales and 12.0% for uFCF.

The Enterprise Value is generated via an average of three multiples: EV/NTM Sales, EV/NTM Adj. EBITDA and EV/NTM uFCF. As SVMK is currently operating in a space that has less growth rate, the multiples in the base case are discounted by 10%. The base case yields equity value of $15.60, with a 26.3% upside. The bull case is $18.50 (49.8% upside) and the bull case is $9.90 (19.8% downside).

Risks

- **Execution of enterprise-focus transition**. SVMK is in the midst of transitioning to selling more directly to enterprises, which entails hiring more sales force, longer deal closing time and uncertain success rate. In the 18Q4 earnings call, the CEO mentioned that SVMK has already hired experienced sales personnel from established companies and SVMK's enterprise customers stand at 3,566 up 11% compared to 18Q3. 18Q4 revenue from enterprise customer stand at 13% total revenue vs 12% in 18Q3.
- **Competition**. The industry SVMK operates in is fragmented with lots of companies trying to win market share. These companies range from big tech companies such as Google and Adobe to research firms such as Forrester, as well as well-known competitors such as Qualtrics and low-cost solutions such as Survey Gizmo. However, the low-cost, powerful and easy to use core survey platform of SVMK should serve as a strong defense for these competitions. And in the market research and CX space, I view SVMK more as a disruptor, as opposed to incumbent.
- **Leverage**. As of 18Q4 SVMK paid down over $100 million of existing debt with proceeds from the IPO and has total debt of $217.4 million (all term loans), net debt of $63.6 million and $62.2 million adj. EBITDA. Although the leverage is well within range, potential acquisition and organic investment as well as economic downturn can potentially decrease the company's cash flow.

MCDONALD'S (MCD)

TARGET PRICE: $207.00

Juan Jaramillo, Jefferson Fund

Company Data	
Price	$183
Market Cap	$142B
Enterprise Value	$172B
EV/EBITDA	19.5x
P/E	24.3x

Business Description

McDonald's Corporation (McDonald's) operates and franchises McDonald's restaurants. The Company's restaurants serve a locally relevant menu of food and drinks sold at various price points in over 100 countries. The Company's segments include U.S., International Lead Markets, High Growth Markets, and Foundational Markets and Corporate. The U.S. segment focuses on offering a platform for authentic ingredients that allows customers to customize their sandwiches. Its High Growth Markets segment includes its operations in markets such as China, Italy, Korea, Poland, Russia, Spain, Switzerland, the Netherlands and related markets. The International Lead markets segment includes the Company's operations in various markets such as Australia, Canada, France, Germany, the United Kingdom and related markets. The Foundational markets and Corporate segment is engaged in operating & franchising restaurants in the rest of the world and increasing convenience to customers, including through drive-thru and delivery.

Executive Summary

McDonald's is a world class brand led by an excellent management and is poised to capitalize on the changing fast food landscape. As the world's most valuable fast food brand by far (more than 10x in brand value than the next largest player, by some estimates), McDonald's is a clear leader in the fast food category. They have been able to achieve this through successful marketing, excellent operational execution, and innovations. The company has one of the highest sales per store ($2.5m / store), while the next comparable peer of Wendy's is $1.6m. This financial superiority is coupled with excellent management skills yielding to industry leading cash-on-cash returns on its real-estate investments (for franchisees to lease). McDonald's leads the market in most industry categories, and it also is poised to perform well during economic downturns, which introduces a compelling "defensive stock" investment opportunity to the Jefferson Fund portfolio.

Investment Thesis

- **Strategically positioned for future growth:** Many countries around the world are an experiencing economic slowdown and many economists believe a mini-recession is likely within 12-18 months. Due to the nature of inexpensive menus and industry leading brand, McDonald's is poised to thrive during economic downturns, when consumers try to spend less money. McDonald's experienced remarkable growth during the 2007-2010 recessionary period.
- **History of returning capital to shareholders:** McDonald's has some of the best free cash flow conversion metrics in the industry and it chooses to invest this capital back into the business through CAPEX and real estate acquisition, as well as through shareholder dividends (~2.5% yield) and share repurchases (current buyback plan still has $7B of authorized repurchases).
- **Evolution of business model:** Under new leadership beginning in 2015, the company has implemented several strategic changes to the business, which have panned out well. The biggest strategic change was the shift towards franchising a majority of stores, in order to improve cash flow and reduce operational risk (commodity prices, labor laws, etc.). Because of this, free cash flow generation and cash-on-cash return (over 25%) exceeds most fast food chains.

Valuation

Scenario Analysis	Price	Upside to Current Price	Key Drivers
Bull	$230	26%	Higher store openings than anticipated, while achieving better than expected same-store-sales growth. In addition, the company successfully achieves their SG&A reduction of $500m/year.
Base	$207	13%	Assumes growth largely from High Growth segments, where McDonald's is relatively untapped and the underlying countries are poised for growth. U.S. and key international countries moderate growth of ~3-4%, as stated by management.
Bear	$170	-7%	Fewer store openings / more store closings coupled with lower same-store-sales and an increased SG&A burden that couldn't be properly implemented. Top line and margin are negatively impacted.

Risks

- **Franchisee growth slows down / reverses:** The company has almost completely shifted towards a franchising business, which opens up operational risks involved with supervising so many different stakeholders to follow a standardized business model.
- **Fast casual segment disruption:** As consumers have become more health conscious, fast casual restaurants like Chopt, Chipotle, SweetGreen, etc. have begun to eat into the fast food market share. McDonald's and other fast food chains are adapting by expanding their offering to more health-conscious options, but the threat is nevertheless substantial.
- **Macro-economic conditions:** The company is facing more competition than ever before and growth is largely dependent on new store openings. Rising interest rates, trade tensions between nations, and possible regulatory issues could become a significant threat to growth.

MATTEL (MAT)

TARGET PRICE: $11.00 (SHORT POSITION)

Itay Ron, Cavalier Fund

Company Data	
Price	$15.23
Market Cap	$4.26B
Enterprise Value	$7.42B
EV/EBITDA	-
P/E	121.45x

Business Description

Mattel, Inc. engages in the design, manufacture, and sale of toys. It operates through the following segments: **North America, International** and **American Girl**. The North America and International segment markets and sells toys in through the Mattel Girls & Boys, Fisher-Price, Construction and Arts & Crafts Brands. The American Girl Brands segment markets and sells historical dolls, books and accessories through Truly Me, Girl of the Year, Bitty Baby, and WellieWishers brands.

The company launched a strategic growth plan based on five pillars. The pillars are: 1) build its power brands into 360-degree play systems and experiences; 2) drive emerging market growth via digital; 3) strengthen its innovation pipeline; 4) seek cost efficiencies through restructuring; and 5) shake up its culture.

Cyclical, holiday-centric business. Holiday season was particularly soft this year.

Brands: **Barbie** and **Polly Pocket** dolls, **Fisher-Price** toys, **Hot Wheels** and **Matchbox** cars, **American Girl** dolls and books, and various **Disney**, **Nickelodeon**, and other licensed brands. Mattel also sells action figures and toys based on Walt Disney and Warner Bros movies, as well as games (**UNO**), arts and crafts (MEGA BLOX, RoseArt), and puzzles.

All of its products, with the exception of the iconic Barbie line, did poorly this past holiday season. Hot Wheels, Fisher Price and American Girl all saw year-over-year declines.

The company recently lost the contract with **DC Comics** (Superman, Batman, Green Lantern, Aquaman, and more). They also lost the partnership with Monster Jam (popular monster truck show), and got sued for infringement, showing a lack of innovation and undermining the company's own strategic statement.

Biggest customers: Mattel sells its products through its own retailers and wholesalers in most of the world and through agents and distributors in those countries where it has no direct presence. American Girl products are sold directly to consumers. **Wal-Mart** Stores ($1.1 billion in sales), **Toys "R" Us** (bankrupt, $600 million), and **Target** ($400 million) are the company's three largest customers, altogether accounting for nearly **40%** of its worldwide sales each year.

Investment Thesis

1. EMs are the name of the game. All metrics point that way – current child population, fertility rates, and economic growth factors. Saturation in the US and European markets. Products marketed by the International segment (some 40% of sales) are generally the same as those developed and marketed by the North America segment, although some are developed or adapted for particular international markets, hampering scale and lowering margins.
2. Growing dependency on 2-3 key customers.
3. Media is changing. With the expected growth in cord-cutting, iconic figures (superheroes, Disney style figures) may switch hands. If Netflix, Hulu, or other original content providers take market share – they are not parties that have agreements with Mattel. Moreover, DTC online is becoming easier and more accessible even in emerging markets, and Mattel's advantage becomes mostly production efficiencies rather than distribution and retail.
4. Lawsuit on behalf of Monster Jam for trademark infringement.
5. Several new AmazonBasics brand private label toys for toddlers and kids.
6. Relatively not crowded @ 19% short interest.

Valuation

Comps: Hasbro

Base Case: Relatively successful turnaround. Sales growth at 6% for several years and then tapers off to 3%. Gross margins improve from 40% to 45%, and SG&A shrinks dramatically from 45% to 35% of sales.

Bear Case: Unsuccessful turnaround. Performance is static from here on out. Bankruptcy.

Bull Case: Successful turnaround. Several years of double-digit sales growth, gross margins return to historic levels at around 50% (despite the shift in EMs), SG&A returns to circa 35% of sales.

Scenario	Perpetuity $/Share	Perpetuity % Up/down	Exit Multiple $/Share	Exit Multiple % Up/down
Base	11.51	-24.43%	9.27	-39.16%
Bear	Bankrupt			
Bull	23.66	55.38%	18.58	22.03%

Risks

1. *Trying to reduce dependency on customers by developing an internet sales platform.*
2. *Long term secular decline – may be ambitious for a short.*
3. *Hasbro may try to acquire Mattel again.*
4. *They just announced a good quarter and the stock jumped from ~$12 to ~$15. Revenue came in at $1.52 billion, which topped analysts' estimates of $1.44 billion. This is either a risk (indication of turnaround) or opportunity (unwarranted market optimism over one quarter).*
5. *New blood in the company (risk/opportunity).*

Other Factors

Mattel And Babytree, the world's largest parenting portal, formed strategic partnership in China. Co-developing a network of physical learning centers across China, that will extend their online partnership from early 2017. With curriculum and activities inspired by Mattel's trusted and globally recognized early childhood development brand, Fisher-Price, the network of learning centers will further solidify Mattel's position in China as a partner of choice for parents in learning and development.

Recent Acquisitions

MEGA Brands Inc. - No. 2 player in the $4-billion construction building sets category with its MEGA BLOKS® brand as well as a competitor in the $2-billion arts & crafts category. [2014]

Sproutling Inc. - wearable "baby monitor." Crashed and burned. Notifications are unreliable and confusing. Urgent roll-over alerts indistinguishable from other messages. May irritate sensitive skin. Basic “baby monitor” features are missing. [2016]

CORNING (GLW)

SELL RECOMMENDATION

Kyle Rose, Rotunda Fund

Company Data	
Price	$33.39
Market Cap	$26.7B
Enterprise Value	$35.8B
EV/EBITDA	11.9x
P/E	31.8x

Business Description

Corning, Inc. develops and manufactures specialty glass and ceramics. The company provides glass for notebook computers, flat panel desktop monitors, LCD televisions, and other information display applications; optical fiber and cable and hardware and equipment products for the telecommunications industry; ceramic substrates for gasoline and diesel engines in automotive and heavy duty vehicle markets; laboratory products for the scientific community and specialized polymer products for biotechnology applications; advanced optical materials for the semiconductor industry and the scientific community; and other technologies. It operates through through the following business segments: Display Technologies, Optical Communications, Environmental Technologies, Specialty Materials and Life Sciences. The Display Technologies segment manufactures glass substrates for active matrix liquid crystal displays which are used primarily in notebook computers, flat panel desktop monitors, and LCD televisions. The Optical Communications segment manufactures optical fiber and cable, and hardware and equipment to being a comprehensive provider of industry-leading optical solutions across the broader communications industry pioneer optical fiber, cable and connectivity solutions. The Environmental Technologies segment manufactures ceramic substrates and filter products for emissions control in mobile and stationary applications around the world. The Specialty Materials segment manufactures products that provide more than 150 material formulations for glass, glass ceramics and fluoride crystals to meet demand for unique customer needs. The Life Sciences segment develops, manufactures and supplies scientific laboratory products. Corning was founded by Amory Houghton Sr. in 1851 and is headquartered in Corning, NY.

Executive Summary

Corning, Inc. is a fantastic business that has been able to translate a core capability in the design and production of high quality glass fiber material into a $30 billion company. The company is well positioned to take advantage of several market opportunities with high quality capital allocation through R&D and CAPEX investments over the past four years in order to increase production capacity. Some of these opportunities are:

- Building out of new-generation wireless networks in U.S. and China requires fiber dense cable.
- Industry does not have significant capacity coming online any time soon, as competitors have higher COGS/unit that does not make the unit economics of additional capacity appealing.
- Industry trend in displays has been toward larger screen devices with more dense screens requiring significantly more glass/unit.

Many of these factors were identified in the hold thesis as of the most recent pitch in 2016. However, unlike in 2016, there has been more clarity provided on guidance and I believe the stock price now currently reflects all prominently available market growth opportunities. Customer concentration is significant and the consumer devices segment, which drives a sizeable portion of aggregate revenue, is highly susceptible to cyclicality. These risks outweigh the successful extraction of value from market opportunities and drive the sell thesis of Corning, Inc.

Valuation

Valuation was assessed through a five year DCF with an abnormal growth period followed by perpetuity growth measured through a 3% LTG assumption and various EV/EBITDA and EV/EBIT multiples which were assumed to revert closer to industry means after the growth period. The company reports on six different operating segments: Optical Communications, Display Technologies, Specialty Materials, Environmental Technologies, Life Sciences, and Other, with the first two comprising 65% of sales. Optical communications is anticipated to experience the most significant growth over the next five years, with Life Sciences sales assumed to have reached a mature sales level already and therefore indexed to industry growth. Management guidance was used for estimates in 2019 and 2020, with an assumed slowdown in growth following as a result of the slowdown in mobile device replacement cycles and diminished pricing power over time as the segment becomes more commoditized with lower industry capacity utilization assumptions. The model also assumes an increase in margins as the benefits from a four year CAPEX elevation result in COGS reduction at the new manufacturing facility.

Display Technologies	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue											
Optical Communications	2,326	2,652	2,980	3,005	3,545	3,956	4789	5171	5481	5810	6158
Display Technologies	2545	3851	3086	3238	2997	3,345	3357	3385	3452	3521	3592
Specialty Materials	1170	1205	1107	1124	1403	1,566	1571	1682	1766	1802	1802
Environmental Technologies	919	1092	1053	1032	1106	1,234	1385	1478	1571	1669	1774
Life Sciences	851	862	821	839	879	981	983	1037	1057	1079	1100
All Other	8	53	64	152	186	208	267	320	374	436	509
Total Revenue	7819	9715	9111	9390	10116	11290	12353	13072	13701	14317	14935
COGS	3,635	4,617	4,465	4,582	5,160	5,630	6094	6362	6577	6872	7169
SG&A	1,739	2,068	2,153	2,165	2,156	2,792	2845	3011	3156	3298	3440
EBITDA	2445	3030	2493	2643	2800	2868	3414	3699	3969	4147	4326
Depreciation & Amortization	1,002	1,200	1,184	1,195	1,158	1,293	1467	1552	1627	1700	1774
EBIT	1443	1830	1309	1448	1642	1575	1947	2147	2342	2447	2553
Unusual expenses	-349	-1,579	590	670	391	0	720	762	798	834	870
Taxes	512	1,096	147	-3	2,154	437	264	298	332	347	362
NOPAT	931	734	1162	1451	-512	1138	1683	1849	2010	2100	2191
add D&A	2445	3030	2493	2643	2800	2868	3414	3699	3969	4147	4326
Less CapEx	-1019	-1076	-1250	-1130	-1804	-2286	-1853	-1699	-1781	-1861	-1942
Less changes in NWC		-695	-293	-116	656	-111	95	85	75	73	73
Free Cash Flow		$ 3,383	$ 2,698	$ 3,080	$ (172)	$ 1,831	$ 3,149	$ 3,763	$ 4,123	$ 4,313	$ 4,502
2021 Steady-State FCF											$ 4,637
Terminal Value											$ 41,966
PV of TV						$ 21,748					
PV of Forecast Period						$ 13,316					
EV						$ 35,064					
Less: Debt						$ 5,998					
Add: Cash						$ 2,355					
Equity Value						$ 31,421					
Price / Share						**$ 35.07**					

ESG Thesis

Environmental: Corning committed to implementing environmental management systems at each of their facilities ten years ago and has met that goal. This has led to quantifiable pollution tracking and science-based targets that they have exceeded regularly. Every facility also has a Global Energy Management (GEM) team which has led to a reported reduction of 35% in energy consumption despite higher output. However, although Corning has been making a concerted effort to reduce its environmental impact, relative to peers, energy consumption and carbon footprint is still worse than industry averages.

Social: Corning conducts significant operations in emerging economies where labor costs are lower. Wendell has made it a stated priority to increase involvement in communities through grants and local partnerships. Average employee tenure is much longer than industry competitors, as evidenced by the extensive average tenure by the executive teams.

Governance: CEO holds the Chairman position. Floating shares are almost 100% of total shares outstanding. The board comprises three women of fourteen total members. Average tenure of the board is over a decade, which does raise questions about the independent nature of members.