Portfolio Activity Q2 2021

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The following discussion mentions stocks that are widely — but not universally — held by clients of Horan Capital Management. Client portfolios are customized, so this commentary may or may not be directly applicable to any given client or account. Our intention is to provide general insight into portfolio holdings and into our overall approach and to highlight situations of interest, both positive and negative. The mention of any stock is neither advice nor a solicitation to buy or sell any particular investment and our opinions regarding securities are subject to change without notice. Investing involves risk of loss. See the legal disclosures at the end of this publication and on our website for more information.

BUYS

Olo, Inc. (OLO)

Third-party marketplace platforms like DoorDash, Uber Eats, and Grubhub have helped shift the dining experience out of the restaurant by providing online ordering and delivery options. The pandemic naturally expedited this shift, forcing consumers to learn a new dining habit through a new distribution channel. The pandemic pulled forward several years of growth in this trend towards online food ordering, but we believe it is now here to stay.

This issue with this model is that these marketplaces take a large percentage of this new revenue while limiting the restaurant's ability to control its digital presence. Olo solves this inefficiency with specialized software designed for the restaurant industry. Think of Olo's software as sitting between the restaurant and marketplace platforms in the food delivery ecosystem. Specifically, Olo offers three modules to its customers:

- Olo's ***Ordering*** module gives restaurants a digital presence, allowing them to do business without the marketplaces. The solution provides a customized, white-labeled platform, which allows customers to order directly from the restaurant's website or mobile app (not through the marketplace platforms).
- The ***Dispatch*** module provides an on-demand delivery fleet for restaurants that lack in-house options. It aggregates third-party delivery alternatives such as DoorDash, Uber, and Lyft. It provides a platform for these couriers to bid on the right to deliver an order in real-time.
- The ***Rails*** module is a channel management system, which aggregates order flow and logistics from multiple third parties into a single ecosystem. This module consolidates information from disparate sources and software systems, allowing the restaurant to maximize accuracy, efficiency, and productivity.

Olo works primarily with enterprise-level clients, meaning restaurant brands with 50 or more locations. Some of its largest clients include household names like Subway, Applebee's, and Denny's.

In our research, we look for superior business models with sustainable competitive advantages and high-quality leadership teams. We become especially interested when we find a company disrupting an industry for the better and we see a large, untapped runway for the company to continue growing. Next, we like to see it operating in an industry benefitting from top-down forces that are helping funnel demand to the business on top of its internal growth efforts. Finally, we prefer to see businesses that have optionality in their offerings and multiple ways to succeed. Olo checked all these boxes for us, which got us excited about its long-term prospects.

From a portfolio perspective, we see great value in allocating a minority percentage of assets to what we consider satellite positions. These satellite positions allow us to go after targeted opportunities that offer asymmetric upside potential at a relatively small scale. Specifically, this strategy allows us to capitalize on unique value opportunities, special situations, or cyclical downturns. In Olo's case, we see an opportunity to gain exposure to a rapidly growing industry with the goal of adding a long-term future compounder at an early stage. The majority of clients' portfolios remain invested in core holdings that anchor overall returns, but we believe this strategy gives the portfolio commensurate asymmetric upside potential. (Matt Holman)

Accenture PLC (ACN)

Accenture is one of the largest consulting and business process outsourcing firms in the world. In its ***consulting*** business, it helps companies integrate new technologies (such as migrating IT infrastructure to the cloud). In its ***outsourcing*** business, the company handles routine processes, often associated with the ongoing maintenance of older, legacy technology systems.

Technology spending took a hit during the pandemic, but it has since returned, and Accenture has more than recovered from the temporary slowdown. Our theory here is that the pandemic expedited many of the trends already in place – most notably, the migration to a fully integrated cloud-based enterprise or "re-platforming" to the cloud. The pandemic forced late cloud adopters to act quickly, or risk being left behind. Conversely, early digital leaders were given a chance to pull away and possibly eliminate these late adopters as competitive threats. Specifically, the impetus to make this shift was driven by competitive pressures to (1) maintain customer engagement, (2) transition staff to work remotely, and (3) find new sources of revenue and growth through new channels in the face of the pandemic. Further, companies faced new operating cost pressures to enhance security and improve efficiency while maintaining resiliency in the changing business environment. Accenture was positioned to help businesses tackle all these issues.

We like this business model and how Accenture is positioned for growth. We like to think of Accenture using the classic "picks and shovels" analogy. Rather than panning for gold, the company has positioned itself to capitalize on others' success by facilitating the proverbial mining (i.e., integrating the new technology rather than developing it). This strategy may limit the near-term upside potential, but we believe it extends the business's runway and limits the risk of disruption due to technological obsolescence. After analyzing how the business navigated the pandemic and positioned itself moving forward, we revalued it and decided to add to our position. (Matt Holman)

Broadridge Financial Solutions (BR)

Broadridge serves as the plumbing of the financial system and plays a vital role in ensuring the ecosystem operates efficiently and meets compliance standards. In the ***Investor Communications*** division, Broadridge helps businesses and other corporate issuers distribute communications to investors, coordinate meetings, and administer the proxy voting process. In its ***Global Technology and Operations*** business, Broadridge provides back-office support for financial firms and automates the entire trade life cycle. The company offers a complete, front-to-back-office solution that allows firms to keep their whole business in one ecosystem.

The past year has brought some new tailwinds and pulled forward some burgeoning growth trends for Broadridge. Notably, the pandemic caused many people to shift their time and attention to the financial markets. This new pool of market participants led to strong equity record growth (i.e., broader ownership among the shareholder base) and thus greater demand for shareholder document distribution. It also increased investor engagement, which led to a greater need for transparency and compliance from the issuers. Lastly, this new class of investors increased the overall trading volume, creating greater demand for trade settlement and communications. Broadridge is able to monetize and profit from all these trends with trickle down benefits in all of its business units.

Further, with more people working and sheltering at home, meetings had to move online, and investor meetings were no exception. Broadridge leveraged its existing client relationships to offer an integrated solution and quickly become the leading host for these meetings. Before the pandemic, these meetings were slowly beginning to replace legacy meetings, but this expedited the trend, and many companies have indicated they have no intention of going back.

We like companies like this because they provide mission-critical services and dominate their industries. These services are essential for a properly functioning financial system, so a sole provider should perform them to ensure continuity and accuracy, giving Broadridge a legal monopoly. Companies like this generate predictably recurring revenues and high returns on capital due to the lack of competition. This business is also relatively insulated from economic gyrations since the SEC legally mandates its existence in all market conditions.

When companies like this can grow on top of this protected stability, we get particularly excited. Broadridge's resiliency during the pandemic provided a cash flow surplus while other businesses were hemorrhaging cash, which management invested aggressively for growth. We found the latest acquisition of European-based Itiviti particularly exciting. With this addition, Broadridge will gain exposure to new asset classes as well as the European and Asian markets. It will also cement relationships with nearly all the top 25 global banks and stands to increase its total addressable market. After re-evaluating its new opportunities, we decided to add to our Broadridge position this quarter. (Matt Holman)

Fair Isaac Corporation (FICO)

FICO is best known for the FICO Score, which summarizes the credit risk of individuals based on their historical credit data. The company licenses its scoring algorithms to the credit bureaus, which generate and sell FICO Scores to lenders. Each time they sell a score, FICO collects a small royalty.

This business unit requires very little tangible capital to run, and operating costs are mostly fixed. As a result, incremental margins and returns on tangible capital are very attractive. The FICO Score is interwoven into the regulatory fabric of the mortgage market and embedded in the decisioning framework of most financial institutions. Further, the company has done an excellent job creating consumer mindshare through *myFICO* and the Open Access program. We think these dynamics contribute to durable pricing power and a runway for score volume growth.

We continue to believe that the earning power of the business is masked by growth investments in the software unit. Management is still focused on building the decision management platform with an external application development environment. We think merging the decisioning assets and application software onto one platform is an intelligent way to entice external developers to build products for other vertical markets. This venture has enormous potential, in our opinion, but it is temporarily concealing the attractiveness of the crown jewel asset (the scores business).

In addition to the investments in the platform, the software unit is undergoing multiple transitions, including: (1) moving products to the cloud, (2) transitioning from upfront license revenue to ratable subscription revenue, and (3) de-emphasizing low-margin professional services. Management also divested a non-core asset during the quarter, demonstrating its commitment to making the business leaner. These initiatives were all in line with management's stated strategic objectives, but they created a lot of accounting noise and temporary uncertainty. This afforded us an opportunity to purchase shares at prices that we deemed reasonable, given FICO's aforementioned business qualities. (Louis Foxwell)

Take-Two Interactive Software, Inc. (TTWO)

Take-Two develops and publishes video games. The company's owned franchises include *Grand Theft Auto (GTA)*, *NBA 2K*, *Red Dead*, *Max Payne*, and *BioShock*. We view these brands as attractive assets in the context of the growing video game industry and its improving economics.

GTA Online is generating record levels of engagement and recurrent consumer spending more than seven years after its initial release. The online experience has become a social platform where friends can engage in *GTA*'s virtual world together. We think there is significant optionality embedded in this intellectual property.

Take-Two has other lucrative properties as well. For example, the *NBA 2K* franchise provides a growing annuity-like revenue stream. The company's relationship with the NBA is symbiotic, and we think it will last for a long time given their co-ownership of the *NBA 2K League,* the rapid growth in live services, and the success of *NBA 2K Online* in China.

During the quarter, Take-Two acquired mobile game developer Nordeus, known for its popular soccer management game *Top Eleven.* We think management paid a fair price for the company, and the acquisition continues a string of shrewd deals that bolster the company's mobile development capabilities. We admire management's M&A discipline. They are willing to acquire key talent and intellectual property through acquisitions, but they are also willing to walk away from deals if the terms are not attractive (as evidenced by their withdrawal from the Codemasters bidding last year).

Investors showed concern during the quarter that player engagement would pull back post-pandemic. While we acknowledge that this will likely happen in the short term, we think habits have permanently changed, and gaming-as-a-service is now ingrained as a social experience. Further, we believe the willingness to purchase virtual goods has increased across the population as society has recognized their role in facilitating social expression. TTWO will be a prime beneficiary of this new social norm in our view.

Lastly, we think the company is investing ahead of revenues – specifically in development talent. As a result, we believe the market is underestimating the true earning power of the business. (Louis Foxwell)

SELLS

(The positions below were reduced or eliminated in most accounts. In some cases, positions were kept in selected client accounts for tax purposes.)

BERKSHIRE HATHAWAY INC.

Berkshire Hathaway Inc. Class B (BRK.B)

We continued trimming positions in Berkshire this quarter with the intention of exiting the position long term. After a few years of underperforming the benchmark, Berkshire is having a strong 2021 as some of its value-driven businesses have come back into favor. Therefore, we are taking advantage of this stronger YTD performance to sell at higher prices. Long term, our strategy to exit the position and re-deploy the capital remains the same. We have concerns about Berkshire's size and its ability to make material investments that will lead to meaningful growth. We are encouraged by the increased rate of share repurchases over the past few quarters. However, we are not encouraged by the rate cash continues to accumulate on Berkshire's balance sheet while the market delivers attractive returns.

Moreover, the operating businesses and investment portfolio are becoming more concentrated in what we feel are inferior industries. Finally, after Buffett and Munger exit, the succession plan leaves us with questions about how Berkshire will be managed in the long run. Please refer to our fourth-quarter portfolio activity report for an in-depth discussion about Berkshire and each of these points. Consequently, we are re-deploying the capital into what we believe are more attractive opportunities with fewer question marks. (Matt Holman)

Hilton Worldwide Holdings, Inc. (HLT)

We trimmed HLT in all accounts with overweight allocations during the quarter. We also swapped the stock into more attractive ideas for select non-taxable accounts.

Accounts that still hold the position either faced tax ramifications from a potential sale or already held the stocks that were swap candidates. We continue to like Hilton's asset-light characteristics and think it is well-positioned for the future. We will hold on to the remaining shares until we see better alternatives for client portfolios. (Louis Foxwell)

Nike Inc. (NKE)

We sold NKE during the quarter and swapped the proceeds into more attractive opportunities. We believe the Nike brand is durable, but the valuation became stretched in our view – to the point where we felt the risk-return tradeoff was less attractive than the opportunities presented in the "Buys" section. (Louis Foxwell)

Starbucks Corporation (SBUX)

We trimmed SBUX during the quarter for non-taxable accounts that held overweight positions. We still view SBUX as a core holding and think it is in an excellent position to take market share post-pandemic. The loyalty membership base is growing, stores are becoming more efficient, and we think consumer mindshare is as strong as ever. (Louis Foxwell)

TJX Companies, Inc. (TJX)

Off-price retail is an attractive business model and has proven to be resilient against the shift to e-commerce. The pandemic complicated matters for TJX, though, as it forced more shoppers online. While TJX navigated the pandemic relatively well, the company felt the pandemic as much as other retailers. The business is returning to its pre-COVID trajectory, and we still like the business long-term. In some client accounts, we swapped TJX for newer names we believed offered more upside potential. (Matt Holman)

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