# University of Washington Finance Association

# 2019-2020 Investor's Letter

UWFA

# UWFA 2019-2020 Initiatives

From UWFA President: Toan Nguyen

*"To improve is to change, and to be perfect is to change often" - Winston Churchill*

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**Member groups**

UWFA was a small club within the University of Washington's Foster community with roughly 20 active members in the academic year 2018-2019. In 2019-2020, UWFA experienced a growth of 900% in our active membership to ~200 paid members, so the officer team needed to find ways to communicate with the club more effectively. To compensate, our team paired members with officers in the club and each officer was responsible for their own individual member groups. Each group consisted of one UWFA officer and roughly ten members. As the year progressed, the officer acted as a communication channel from UWFA to the members. Furthermore, by having small member groups, we were able to make the 200 people club less intimidating.

**Speaker Events**

In addition to our general meetings on Tuesday, UWFA also hosts professionals from the following industries: asset management, investment banking, and corporate finance. Some of our highlights were Goldman Sachs, JP Morgan, Meridian Capital, Blackrock, Microsoft, Amazon, Houlihan Lokey, DA Davidson, Russell Investments, and KeyBank. In total, UWFA hosted 23 different speaker events in 2019-2020 to enrich the experience of our members and allow them to meet industry professionals. In addition to these company events, we hosted Tori Dunlap to speak with our club about personal finance; this event went over well with members and had a high turnout. Because of the Zoom setting for spring quarter meetings, we were able to have speakers from outside of the Seattle area. These sessions were a great experience for our members because they were able to network with a wider range of professionals.

**Foster Undergraduate Investment Group (FUIG)**

We instituted a new program dedicated specifically to pitching stocks and investment-related education. Throughout the winter quarter, we received 55 applications and admitted 24 students as research analysts. These RAs worked under a sector leader to research a specific sector (Technology, Financial Institutions, Consumer Discretionary, and two All-Sector coverage teams). The program included three weeks of educational programming that covered (1) the basics of stock pitching, (2) public comparable company analysis, and (3) discounted cash flow analysis & modeling. Using this education, the RAs submitted three "one-pagers," detailing a basic investment thesis with 3+ arguments related to valuation, secular tailwinds, upcoming growth catalysis, etc. The RAs then chose one of their one-pagers to build into a more robust "Mini-pitch" complete with a slide deck and public comparable analysis. Each of the five coverage teams then chose from one of their RAs mini-pitches to expand into a more robust all-team pitch. These pitches expanded upon the analysis of the mini-pitch, improving the quantitative and qualitative justifications, and adding a complete discounted cash flow analysis to the pitch. These pitches were delivered in weeks 7 and 8 to the entire UWFA general audience of 50+ attendees and were considered by the investment committee to buy into it within the DA Davidson portfolio.

**Professional Development Workshops**

In order to maximize value to our members, especially Freshman and Sophomores, we instituted professional development workshops this year consisting of a Linkedin workshop, resume workshop, and networking workshop. We had large membership turnout at these events and we received positive feedback regarding the presentations.

**Member Social hours**

With the growth our club experienced this year, we wanted to provide the space for members to meet and socialize with one other. In our average club meeting, there is the time for professional and educational interactions, but we wanted to offer time for our members to just get to know each other and build closer relationships. Originally, the officer team wanted to officially introduce more social events at the end of the winter quarter, but when everyone's lives shifted online, we had to find a new way to create this opportunity for our members; this led us to create online social hours, which included socials such as get to know your members, game nights, and a PowerPoint party. These events allowed us to keep a close social relationship with our members even though we could not see them in person.

**Membership fees & Attendance Tracking**

In the past, there were no requirements to join UWFA beyond attending general meetings. We felt that in order to encourage active participation amongst the members, we should begin a membership program with a minimum meeting requirement. We now charge a yearly $25 membership fee. This money will be used for membership workshops, food, and operational expenses. Excess funds will be contributed to our investment portfolio. This year we tracked attendance as well and we counted about 200 members. This number was sustained throughout the year due to the minimum meeting requirement and high-value events.

**UWFA wins Dean's Leadership Award**

Our club was awarded the Foster RSO Dean's Leadership Award at the end of this past year. The award recognized our organization for embodying the Foster's School's mission and values by creating a collaborative learning community through working together to put on excellent events within the school. We are proud to have had a successful year launching new programs, collaborating with other clubs, and hosting our own meetings. This would not have been possible without our members and all our officers.

# DA Davidson 2019-2020 Portfolio

From UWFA President: Toan Nguyen

*"Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard" - Warren Buffet*

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## Portfolio Investment Philosophy

The University of Washington Finance Association employs a unique methodology to actively manage our competition portfolio. Through a mix of private communications in our officer group-chat, and utilizing the research analyst from the Foster Undergraduate Investment Group (FUIG), we bring a bottom-up approach to identifying undervalued positions with growth potential. All opportunities identified are pitched in our weekly club meetings and then voted upon by the investment committee in FUIG. Stock pitches typically include an overview of a company's revenue lines and business model, it's biggest growth opportunities, segment specific market trends, future growth catalysts, and finally a valuation to arrive at a target price along with lower and upper bounds of valuation. Below, we have listed our answers to the DA Davidson prompts, our overall thesis for the competition, and our four positions that we held during the competition that embody this thesis.

Our portfolio had three distinct ideas on which we built it around. The first consisted of companies with a large total addressable market to grow into, the second having a distinct competitive advantage within their sector they could use to achieve sector/market-beating returns, and finally looking for companies that had monopolistic tendencies within different sectors. Within all of these ideas, the idea and importance of scale was something we considered to be crucial to our analysis and valuation, as this reflects the ability of a business to accrue favorable returns on the basis of being able to exploit this factor. Depending on the individual position, we used either a discounted cash flow valuation or a multiple of EBITDA or EPS to determine our valuation.

# Portfolio Positions At The Start of 2019

**AMZN**

Amazon is a company that focuses on e-commerce, cloud computing, and artificial intelligence. Our original investment thesis was betting that AMZN's AWS service would continue to maintain its market dominance as they hold more of the cloud computing market share than Microsoft, Alphabet, and IMB combined. We have decided to continue holding on to AMZN through 2019-2020 as we believe there is still room for our investment thesis to give us more upside given the shift to work from home as a result of COVID.

**FB**

Facebook is a social networking platform with 2.5B users that makes revenue by selling ads based on the metadata and information about its users. Our investment thesis of their ability to continue to increase the monetization of their users has proven to be important during the COVID pandemic as people are forced to social distance. With people socially distancing, that resulted in an increase in usage of Facebook's platform which is why we decided to continue holding FB through 2020.

**ULTA**

Ulta Beauty is a nation-wide chain beauty store that specializes in higher-end cosmetics, fragrance, skin, and hair products. This is a position we held since the start of the year as we believe they continue to take market share from leveraging their third party-branded product mix. With COVID, this pandemic has hurt our thesis since they have had to shut down some of their retail stores. We did sell off some of ULTA to lock in our gains but we believe that ULTA will be able to utilize its size and scale to survive the pandemic and come out of the other side with fewer competitors which will allow them to take more market share in the long term. That is why we have decided to hold on to ULTA for 2019-2020.

**LMT**

Lockheed Martin is the largest defense contractor globally and is famous for its F-35 fighter jet program. We entered this position because we saw that LMT continued to win over contracts at a fast pace and had backorders that were for years to come. Furthermore, we saw that Congress passed a national defense spending bill with another increase in defense spending which would positively impact LMT. We have decided to hold on to this stock throughout 2019-2020 because of the volatility that the current administration brings with their intent to pull out of NATO as well as other unstable regions around the world. This will cause further instability within the world which would result in wealthier countries building up their arsenal in case a war breaks out.

**MSFT**

Microsoft is one of the world's leading technology companies that derive value from its recurring revenues and ability to win large governmental partnership deals. Specifically, the club invested into MSFT for the expected tailwinds of the Joint Enterprise Defense Infrastructure (JEDI) contract with the United States Department of Defense, which signaled that MSFT would not receive criticism in the conversations of breaking up big tech like Amazon or Google.

**GLD**

GLD is the world's largest gold ETF that tracks the performance and the price of gold. The reason we hold this position is because as a portfolio, we tend to hold stocks that are high volatility and high beta. These stocks by nature tend to have high returns in the long run but lots of volatility in the short run. To hedge against market disruptions in the short term where investors are more fearful and the market experience periods of capital flight into safe-haven assets like gold. We decided that GLD would be that hedge for us as well as give us exposure to commodities to diversify our portfolio away from purely equities.

**VRNT**

Verint Systems is an enterprise software company operating in two segments, customer engagement and cyber intelligence solutions. Our investment thesis into this company was to gain exposure to the cybersecurity industry to protect against cyber threats. We noticed a trend of more and more companies within the fortune 500 industry experiencing major hacks that leaked customer information such as credit cards and social security numbers. We wanted to invest in a company to capture the increase in spending by companies to protect their data and believe that VRNT was in a good position to do so and at a fair valuation. We held this stock through 2019-2020 because we continued to see these hacks happen and therefore our investment still had room for upside.

**V**

We bought Visa for the same reason we held it throughout the year: an incredible business model, low risk of disruption, non-negligible dividend yield, and access to profiting on consumer spending at-large regardless of where it occurs. Visa's ubiquitous payment processing network is present across virtually every in-person and online retailer. When consumers spend, Visa profits. We held Visa throughout COVID for two key reasons. First, as consumer spending moves online, Visa is positioned to generate the same revenue as when spending occurs in person. Second, with a beta below 1, we saw a business with a modest dividend and consistent cash flows as a desirable safe haven for our capital. Given the investment committee's long-term bullish thesis on the American and international economy, Visa seems like an indiscriminate bet on future consumption while avoiding the idiosyncratic risks inherent to companies in other industries.

**DIS**

The club traded into Disney for its expansion into Disney+ that would enable the company to generate recurring revenue through a subscription-based streaming platform. With a strong entertainment platform and ability to monetize content through its brand name, Disney appeared as an attractive company in competition with only a handful of other media giants. While Disney+ proved to support the company's 2021 growth plan, COVID immediately stunted Disney's momentum with the closing of amusement parks worldwide for public safety. Therefore, the club will opt to liquidate the entirety of our position in Disney due to the uncertainty around COVID and the possibility of future park closures.

# New Positions Added To Our DA Portfolio 2019-2020

**McDonald's Corporation (NYSE: MCD)**
**Pitch Lead: John Henzler**

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**Company Overview** The McDonald's Corporation is the largest publicly traded fast-food chain in the world, with over 35,000 outlets across 119 different countries. Nearly 68 million customers visit McDonald's on a daily basis. McDonald's serves a variety of menu items that are low cost, appetizing, and delivered quickly to customers. According to Forbes, McDonald's is the 7th most valuable brand in the world with an estimated brand value of ~$130 billion. McDonald's market cap is ~$146 billion.

**Investment Thesis** - John Henzler recommends a BUY in MCD for the following reasons:

1. **Recession Resilience:** The fast food industry has historically performed well during recessions. As the largest fast-food chain, McDonald's follows this same trend. During a recession, consumers are forced to reduce their spending in most areas, including dining. McDonald's offers a low-cost alternative source of food for consumers low on cash. McDonald's was one of the two companies in the Dow Jones Industrial Average to grow its EPS throughout the recession. This is evidence of a recession-resistant corporation. With rising uncertainty about trade development between the US and China, Brexit, and the broader global economic slowdown, there is the danger of a new recession within the coming one or two years. When this recession befalls American markets, McDonald's stock price will most likely continue to rise in value becoming a haven of profit for shareholders.
2. **History of Reinvestment and Innovation:** The McDonald's Corporation has shown itself to be an innovative and proactive company. A strong history of franchising and regular new menu offerings undertaken by McDonald's leadership help to maintain strong growth. McDonald's has undertaken a franchising initiative, franchising over 90% of its global restaurants by the end of 2018 providing a stream of cash flow to the McDonald's Corporation. Furthermore; renovation, new menu items, and system innovation such as the touch screen ordering system, are implemented regularly across McDonald's locations which excite the consumer base and increase visits to McDonald's. This is emblematic of a corporation able to reinvest profit to grow business. McDonald's is currently making a play to refocus on its core American customer basis, where they bring in over 1/3rd of their revenue. Renovating franchises across the country creates a new atmosphere that gives them a competitive advantage over other stagnant competitors. Furthermore, McDonald's has invested in more efficient cooking techniques in their kitchens, and self-service order kiosks in the restaurants, both of which cut down on costs increasing profit.
3. **CEO Shift:** McDonald's has recently named Chris Kempczinski as its new CEO after letting go of former CEO Steve Eastbrook. I believe that this provides investors with an enticing market entry point, as the stock dropped after this news broke. When we look at a fundamentally strong company's stock performance after public issues, we generally see a high short-term drop before a rebound in the stock price. For example, Facebook and Boeing both experienced stock drops after their respective scandals and have now mostly recovered or exceeded their pre-scandal stock price. I expect McDonald's to experience the same phenomenon. Kempczinski has held senior positions in similar industries such as PepsiCo and Kraft before being recruited to McDonald's to focus on innovation, strategy and business development. He wants to refocus on American markets, where McDonald's has more than 1/3rd of its revenue.
4. **Brand Recognition/Foothold in Market:** When consumers think of fast food, the first thing that comes to mind is McDonald's Corporation. McDonald's Corporation has 13,793 locations in the United States, bringing in over 36% of the company's business. McDonald's has the second most locations of any fast-food company in the country, demonstrating a company with a strong foothold in the fast-food market.
5. **Dividend Yield:** The McDonald's corporation has a strong dividend yield that generates substantial value for shareholders. McDonald's is currently paying a yield of 2.6% to its shareholders, which is higher than the average sector yield of 2.22%. McDonald's has historically paid higher dividend yields to its shareholders, generally paying yields about 0.5% higher than the industry average.

6. **Price to Earnings Ratio:** In an age of bloated P/E ratios, McDonald's P/E ratio of 25.38 is a signal of fair valuation in the company. When we consider the high P/E ratios of some other powerful companies in the restaurant industry such as Wingstop Inc. (114.10), Del Taco Restaurants Inc. (259.67), and The Habit Restaurants Inc. (65.15), McDonald's reasonable P/E ratio is a haven of fair valuation with potential for sustainable growth in the future.

**Key Risks and Considerations**

1. **Market Saturation:** The fast-food market is a saturated market. McDonald's faces stark competition from a number of companies offering similar products at competitive prices. The many fast food companies across the country and world offering similar products to McDonald's will require McDonald's to be versatile, flexible, and innovative in their marketing and product offering to stay relevant in the long term. This can be difficult for a company with the size and complexity of McDonald's.
2. **Health Consciousness of Consumers:** We have seen a change in consumer taste and sentiment concerning the health of the food they buy. Consumers have become increasingly concerned with the health effects of their diet and have shown that the average consumer is willing to pay more for healthier options. This may cause a general consumer shift away from low-cost and less healthy options like those offered by the McDonald's Corporation.

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**Decision: PURCHASE**
**Investment Committee Representative: Oscar Avatare**

John Henzler pitched McDonald's Corporation (NYSE: MCD) as a buy in a General Meeting on Tuesday, November 12th, 2019. After review, the Investment Committee decided to purchase MCD. Our reasons are as follows:

- **FIRST:** We agree with the thesis that McDonald's is a strong recession resilient company, with a much lower beta and higher free cash flow yield than many of our current positions. Its position as a substitute to more expensive food during a recession makes sense, and as a staple food and cultural icon in the US, it serves as a strong example of its brand and mindshare amongst fast-food chains. We also feel that its high dividend (basically equal to the US 30 Year Treasury yield in mid-November), and its status as a Dividend Aristocrat, increasing its dividend for the past 42 years, gives us a cushion and strong portfolio diversification within our portfolio. McDonald's was one of only two stocks in the Dow to gain value in 2008, showing its resilience to broad-based equity market downturns. Furthermore, McDonald's is strongly aligned with its shareholders as seen by them returning over $25 billion to shareholders over the past three years through a combination of stock buybacks and dividends.
- **SECOND:** McDonald's is a fundamentally strong company that is taking advantage of its economies of scale and size to allow it to cut costs and improve its efficiency in serving customers. This can be seen in equity research consensus projections around its spending on its capital expenditures, which is expected to reduce in each of the next three years. Additionally, its initiatives in digital order kiosks, efficient cooking techniques, and integration of Big Data and machine learning into its ordering process and drive through are projected to drive significant drops in the cost of running the business. This translates into a 120-basis point increase in the restaurant-level margin between 2019 and 2025, and 670-basis point increase in operating margin between 2019 and 2025. Additionally, outside of its cost-cutting measures, McDonald's runs a highly efficient business when examining its Return on Invested Capital (ROIC), which is around 25% and is very impressive for a fast-food business. Furthermore, McDonald's has grown its Same Store Sales (SSS) by around 5% every quarter during 2019, which is very impressive for a chain the size of McDonald's.
- **THIRD**: We feel that the recent departure of the prior CEO Steve Eastbrook right after a weaker than expected earnings report creates a good opportunity for us to buy into the stock now. There is no indication

that McDonald's and its new CEO Chris Kempczinski would deviate from its strategy of focusing on the US market, and as seen with Facebook, Equifax, and Boeing stock, while scandals hurt the reputation of a business in the short-term, in the long- run they often have little to no impact on the ability of the business to produce free cash flow. In fact, Kempczinski held senior roles at PepsiCo and Kraft before coming to McDonalds to focus on innovation, strategy and business development, showing the breadth of his experience in similar industries. Based on multiple equity research reports from large investment banks such as Credit Suisse and Evercore, we have found a price target of $230 to be reasonable, based on a multiple of 25x on a 2021 EPS estimate of $9.14 or on a multiple of 17.5x next twelve months (NTM) EBITDA. This gives us upside of around ~18.5% based on the closing price of $194 as of 11/14/2019 for MCD. Based on this, and the fundamental strength behind the company, we are long McDonald's

**Twitter Inc. (NYSE: TWTR)**
**Pitch Lead: Cameron Barnett & Ben Barton**

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**Company Overview:** Twitter is a unique social media platform that has a 280-character limit per tweet, making it an easy and quick way for people or companies to express their opinions, strike debate and conversation, spread information, give and receive news, and live stream sports. It is operating one of the largest and most influential social networks in existence, with MAU (monthly active users) exceeding 330 million, and DAU (daily active users) over 145 million. Aside from providing these services, Twitter is in a lucrative industry with high growth potential. Their revenue consists of 85% advertising revenue and 15% data licensing revenue, a far greater percentage of ad revenue than most social media companies. Although the online advertising market is competitive, considering the high ad revenue percentage and the potential growth both internationally and domestically, our team is bullish on the stock.

**Investment Thesis -** Cameron Barnett and Ben Barton recommend a BUY in TWTR for the following reasons:

1. **Unexpected Ad Difficulties Can Be Overcome:** Following the release of Twitter's Q3 earnings, Twitter announced that the company had faced an unexpected bug in the ad revenue algorithms. After the release of this news, the market endured a strong reaction causing the stock price to drop approximately 37% from its 52-week high. We believe that this reaction was irrational and not indicative of the company's value. According to several sources, the issues regarding ad revenue are only short-term problems. In time frames longer than 1 year, we believe that the company will be able to recover from these issues and its stock price will appreciate in value. As Twitter is able to more effectively run advertisements, companies will be more willing to allocate marketing funds to Twitter. This will result in an increase in revenue and market share of advertisement space. Twitter is unique because of its opportunistic positioning for the imminent shift into mobile and native advertising. This shift will provide Twitter with the opportunity to secure a larger portion of the online advertising market share. As Twitter can improve its ad revenue, their room for growth looks promising, especially while it's severely undervalued.
2. **Primed For User Base Growth, Especially Internationally:** Approximately 79% of all Twitter accounts belong to users outside of the United States. However, only 46% of revenue is accumulated from international accounts. This discrepancy provides an opportunity for Twitter to increase the monetization of international users. A capitalization of this would create strong upward growth in Twitter's revenue. To go along with this, Twitter still has room to grow its international user base. The company posted a 17% year over year growth in DAU and mDAU (monetizable daily active users). This metric was considerably higher than the analyst consensus. Japan is the only other country besides the United States with over 30 million users. Growth into new countries can continue to grow daily active users. Because the demographic of Twitter tends to be people under 40, new users will naturally occur as the next generation comes of age. These factors can combine to provide Twitter with immense revenue growth, adding total users and revenue per user.
3. **Upcoming 2020 Election:** During the times of important and newsworthy events, Twitter sees an increase in activity. This upcoming election will be no different. One candidate is very active on Twitter and Twitter may serve as an important platform for election information. Because they have recently banned political advertisements, users can trust that they will not be bombarded with political propaganda while using Twitter. Overall, we see value in the upcoming election and its potential to drive up Twitter's user activity and thus increase revenue. ARPU (average revenue per user) has steadily increased in the past up until the bug so it is safe to assume that it will continue to increase once this issue is resolved. Considering it is inevitable for both MAU and DAU to increase with activity and ARPU will most likely continue to increase, we're confident EBIT will have strong growth going forward.

**Key Risks and Considerations**

1. **Competition for Market Share of Mobile and Online Advertising:** As Facebook, Google and other companies expand, Twitter will face a tougher competition when it comes to selling their ad space. As other companies work towards being more attractive to marketers, Twitter will have to outpace these companies and be a better advertiser. Overall, the nature of the industry provides Twitter with inherent competition.
2. **Continued Problems in Twitter's Advertising Software:** It is apparent that Twitter has been facing troubles when it comes to being an efficient advertiser. Because of their recent bug that resulted in a loss of revenue, we cannot be certain that Twitter will not continue to face these issues. Without an effective advertising algorithm, the demand for advertising space on Twitter will decrease causing a loss in revenue. Until further information is released, we cannot be sure that Twitter will have an easy time fixing their current problems. This uncertainty poses a risk that Twitter will be unable to recover from its recent drop in price.

**Our Price Target:** $41.00 based on an EBITDA multiple of 16x on expected EBITDA of ~$1.7 billion in 2021. The current share price is ~$30.39 as of 12/13/2019, implying ~34% in upside.

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**Decision: PURCHASE**
**Investment Committee Representative: Toan Nguyen**

Cameron Barnett & Ben Barton pitched Twitter (NYSE: TWTR) as a buy in a General Meeting on Tuesday, November 26th, 2019. After review, the Investment Committee decided to purchase TWTR. Our reasons are as follows:

- **FIRST**: Twitter is set on recovering from a cutting selloff in their Q3 earnings miss for revenues and EPS, caused by issues surrounding Mobile Application Promotion (MAP) product bugs. However, Twitter stated in its subsequent Investor’s letter to work on improving upon these glitches as it resulted in a price drop of ~20% on the next trading day. We feel that while Q3 had a negative shock to their share price, Q4 will provide Twitter’s shareholders with accretive effects due to bug improvements, increase in YoY/QoQ MDAU, increase in total revenue (between $940 million and $1.01 billion), and a strong balance sheet with liquidity derived from a large cash holding (~$5.8 billion).
- **SECOND**: Greater than expected advertising seasonality caused Twitter to face headwinds that negatively impacted them and slowed down revenue growth. However, recent data such as the number of jobs added, and consumer sentiment report shows us that the economy in America is still strong and the consumer is still healthy. This data will help Twitter as it will improve CEO confidence and result in businesses to continue to spend money on advertising. With 56% of Twitter’s revenue coming from the United States, this backdrop of a strong economy is a reason we believe Twitter will do well in Q4 of 2019. With the effects of advertising seasonality gone, revenue can continue to grow at a healthy pace which will result in Twitter beating earnings.
- **THIRD**: Twitter currently has roughly 4600 employees and has continued to hire more people all while investing in new R&D. We see that Twitter has been able to increase DAU (daily active users) and more importantly MDAU (monetizable daily active users). As Twitter is continuing to increase the number of people on its platform and create a new product that can better engage these users through the ads that they see, it will result in more and more advertisers marketing using Twitter’s platform. Our perspective is that Twitter will continue to drive these numbers up through creating a better product mix for its users and customers. While this is our outlook for the future of Twitter, we currently see an attractive entry point to buy Twitter stock and our investment horizon is December until February at their next earnings call.

# COVID 19's Impact On UW's DA Portfolio

**Impact:** The first two stocks we bought in 2019-2020 were MCD and TWTR which were all pitched in the Fall quarter of 2019-2020. As we entered the winter quarter UWFA was fortunate to hear two additional pitches which were about Lam Research and Costco. However, as these pitches were at the end of the winter quarter when COVID started the investment committee was forced to weigh the impact of COVID on what it would do to the stocks that were pitched and if these investments theses would continue to hold up during a pandemic. We have laid out decisions on these two stocks below with our reasoning to not purchase the stocks during a pandemic.

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**LRCX**
**Decision - NOT PURCHASE**
**Investment Committee Representative: Ian Klimisch**

- Given the incredible market turbulence experienced in late February and in the following months, the investment committee made the decision to abstain from entering new positions until volatility, as implied by the VIX, fell below the prior 52-week high of 25.
- COVID-19's spread created significant macroeconomic headwinds that the investment committee was not confident would subside within the following two quarters. Given abysmal GDP forecasts, potential credit defaults, and the implications of a prolonged 10%+ unemployment environment, the investment committee made the unanimous decision to veto all stock pitches absent specific and compelling rationale for overperformance in the current market conditions.
- Given the timing of the LRCX pitch occurring before the onset of COVID in North America, therefore lacking the aforementioned rationale, the investment committee has decided NOT to purchase the stock.
- In addition, LRCX has a 5Y beta of 1.34. Without clear reasoning for why LAM is uniquely positioned to excel in current conditions, the investment committee would prefer to avoid unnecessary volatility in our portfolios.

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**COST**
**Decision - NOT PURCHASE**
**Investment Committee Representative: Ian Klimisch**

- Given the incredible market turbulence experienced in late February and in the following months, the investment committee made the decision to abstain from entering new positions until volatility, as implied by the VIX, fell below the prior 52-week high of 25.
- COVID-19's spread created significant macroeconomic headwinds that the investment committee was not confident would subside within the following two quarters. Given abysmal GDP forecasts, potential credit defaults, and the implications of a prolonged 10%+ unemployment environment, the investment committee made the unanimous decision to veto all stock pitches absent specific and compelling rationale for overperformance in the current market conditions.
- Given the timing of the COST pitch occurring before the onset of COVID in North America, therefore lacking the aforementioned rationale, the investment committee has decided NOT to purchase the stock.
- While COST was uniquely positioned to outperform the broader market, the investment committee was not sufficiently convinced in their belief that COST would experience price appreciation from our point of entry, and therefore decided NOT to purchase COST.

# DA Portfolio Summer Management Plan

# Statement About Summer Plans

Scott Elder will continue to actively monitor the DA Davidson investment portfolio during the summer of 2020 to rotate out of positions if the pandemic worsens. Our team has responded during the pandemic by running the Foster Undergraduate Investment Group student investment fund program that onboarded 24 different research analysts to help us find undervalued companies during the Spring quarter. We first trained these analysts to understand how to analyze a company qualitatively with understanding the different catalysts that can drive a company forward. Then we trained these analysts on how to perform a Comparable Company Analysis as well as a Discounted Cash Flow analysis to find the fair intrinsic value of a company. Combining this training with an environment where analysts can learn from each other, these analysts spent 10 weeks researching many different companies within their designated sectors which ultimately resulted in each team pitching a stock at the end of the quarter. We have detailed the investment theses of each stock and the decision from the investment committee on each stock that was pitched throughout the quarter below.

**Lululemon Athletica Inc (NYSE: LULU)**
**Pitch Lead: Elizabeth Bui, Ruolan Du, Mason Liebman, Monserrat Villaseñor**

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**Company Overview:** Lululemon athletica inc. is a Canadian retailer specializing in the sale of athletic apparel and technical clothing for yoga, running, working out, and other physical activities for men and women. They currently operate 491 stores under the lululemon and ivivva brands with 368 in North America, their largest market geographically. The company is quickly expanding across Europe and Asia through a decentralized model to cater to the local communities and consumer preferences. Lululemon channels revenue through two main streams: company-operated stores (63%) and direct-to-consumer sales (29%). Lululemon's market cap is ~$39 billion.

**Investment Thesis -** The Consumer Discretionary Coverage Group recommends a BUY in LULU for the following reasons:

1. **Growth in DTC Sales:** Lululemon is on track to push its direct-to-consumer channel to double in the next three years. Lululemon's DTC sales for the last three years have shown significant growth and in 2019, accounted for 40% of lululemon's total annual growth. The company relies heavily on its brand ambassadors to appeal to the common people via its online Sweatlife platform which boasts over 72 million users since its inception in March 2019. Lululemon's online sales will continue to skyrocket due to the company's strong push for online interaction with their customers. There is also a growing secular trend of maintaining a healthy and mindful lifestyle which attributes to growth in sales.
2. **International Expansion:** Lululemon is driving an international expansion plan which is scheduled to quadruple sales by 2023. In 2019, lululemon's international sales grew 32% from the previous year. The company plans to focus the majority of its expansion efforts in China which would allow it to tap into a $310 billion apparel market. Lululemon has proven consumer interest in mainland China with its 1.28 million users following on a Chinese selling platform, TMall. The company has been able to create its international presence and cult following by utilizing its ambassadors and by hosting health and mindfulness festivals which attracts the attention of thousands of participants.
3. **Strong Balance Sheet and Seasonality:** Historically, lululemon has shown a unique seasonal sales trend in which Q4 is consistently its strongest quarter. This is a huge advantage for the company because it was able to finish off Q4 strong before the COVID-19 pandemic fully gripped the international landscape. Additionally, lululemon possesses a negative net debt and cash reserves of over $1billion which will allow the company to weather any crises that come their way until the pandemic passes.
4. **Strong Management from PIPE:** Lululemon began as a privately owned company, but transitioned into being partially publicly traded in 2007. Advent International is the primary private equity firm that invests in lululemon, holding roughly 14% of the company. In the past, the three main advantages they have provided lululemon include effective cost-cutting strategies, a sophisticated and disciplined management team, and recapitalizing their structure. Their long-term relationship translates into building a long-term strategy and bringing the power of alignment to the company. This relationship will also help control volatility in the stock considering current macroeconomic downturns and future ones due to the sophistication of PIPE.

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**Decision: BUY**
**Investment Committee Representative: Toan Nguyen**

Elizabeth Bui, Ruolan Du, Mason Liebman, Monserrat Villaseñor pitched Lululemon Athletica (NYSE: LULU) as a buy in a General Meeting on Tuesday, May 19th, 2020. After review, the Investment Committee decided to purchase LULU. Our reasons are as follows:

- **FIRST: Lululemon's opportunity set at home in the US and abroad continues to expand despite COVID 19 -** Lululemon continues to demonstrate that they are an industry leader within the athleisure wear industry. We can see that LULU is an industry leader by looking at the company from a financial perspective. Year over year, LULU continues to increase its gross and operating margins and those margins dwarf as compared to Nike and Adidas. These margin increases are a result of LULU's expansion into Europe and China from 2017-2020 as those two regions are the majority of new store openings.

- **SECOND: Efficiently Managed -** After many different transactions with Advent International, we believe that Advent is here to stay for the long term. Advent had invested in LULU many times but with their most recent Private Investment in Public Equity (PIPE), Advent has instituted the Power of Three plan which will take an additional five years to see results. We believe that this partnership between LULU and Advent provides many advantages such as access to capital, discipline for profitability, and strong executives that competitors such as Adidas and Nike simply do not have. As this symbiotic relationship continues to strengthen, the relationship will help LULU capture more market share of this athletic industry.
- **THIRD: Lulu takes the lead -** There are many uncertainties as COVID broke out with different states and countries went under complete lockdowns. The lockdown closed sports, gyms, and many other activities regarding the outside. However, we believe LULU benefited from this shift as home workouts became the norm, and the return of gyms and active sports were nowhere in sight. Our thesis of LULU being a benefactor of COVID is from data we gathered showing LULU's website visit surprising all of their competitors such as Nike, Adidas during the period of January to May. With this data, we saw further evidence that the strategy that LULU has taken to be synonyms with the "sweat life" is paying off.
- Combining the qualitative reasoning and quantitative calculations through our DCF model. we saw that our calculation for LULU's intrinsic value was higher than the market price which is why we decided to buy the stock.

**Broadcom Inc. (NASDAQ: AVGO)**
**Pitch Lead: Hannah Yerex, Zaki Rahman, Roger Chen, Gregorius Hanzel, Nathan Ellisen, Paras Singh**

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**Company Overview:** Broadcom Inc. designs, manufactures, and distributes semiconductors and infrastructure software solutions. Their various products and services include data center networking and storage, software focused on automation, monitoring and security, smartphone components, telecoms, and factory automation. In the wireless sector, Apple and Samsung are two of Broadcom's key customers that utilize the company's chips to add Wi-Fi and connectivity to the world's best-selling smartphones. In the networking sector, Broadcom's market-leading switch chips are used by Cisco Systems, Huawei Technologies, and Amazon in their equipment design. Broadcom's Tomahawk chipsets lead the market for cloud and enterprise switch applications.

**Investment Thesis -** The Technology Coverage Group recommends a BUY in LULU for the following reasons:

1. **Targeted Acquisitions Diversifying Business:** In each of the past 3 years, AVGO has completed an acquisition that has expanded its footprint into the higher-margin software infrastructure business. This segment now represents a third of AVGO's revenues and has reduced AVGO's exposure to the cyclical semiconductor business. All acquired businesses generate positive FCF. CEO Hock Tan is seasoned at buying companies and growing margins by selling off non-core business lines, cutting SG&A, and focusing R&D on core product offerings. Management has stated its desire to move deeper into the infrastructure software market with follow-up acquisitions in the space. The estimated capturable TAM for AVGO has increased from ~$60B in 2016 to ~$200B in 2020.
2. **Irrationally Oversold:** AVGO's spread over the PHLX (semi-conductor) index has narrowed significantly due to worries over its increased debt burden following acquisitions in recent years, especially as the COVID-19 pandemic has hit. AVGO was impacted by the broad market sell-off and is now trading in line with the PHLX index. We view this as mispricing as AVGO has a stronger earnings growth profile in the next 3 years and a better dividend yield than the industry. Fears about AVGO's debt burden are overblown as their interest expense has stayed stable around $1.4B in the past 5 years whereas their FCFE (residual CFs to equity holders after servicing debt) has grown to $9.9B. It seems equity holders believe they are more exposed than they actually are. AVGO also has a strong cash position of around $10B expected at the end of May 2020. AVGO has a rich history of growing its dividend with a 46% 5Y CAGR. AVGO currently pays a $13 annualized dividend. Management has reiterated its intention of keeping the dividend payout ratio at 50% (currently around 48%). Therefore, revenues could decline by 30% and the company could still pay its dividend.
3. **Stability during Market Recession:** The bear case for AVGO during the recession, caused by the global COVID-19 pandemic, outlines revenues down by 20% (with the semiconductor division down 25%). In calculating this down-side estimate, JPMorgan equity research shows that the company would still generate roughly $1.85 billion in FCF each quarter in 2020 after debt and other servicing charges (for comparison, FCF was $2.2 billion for the quarter ending January 31, 2020). This demonstrates that even in the worst-case scenario, Broadcom could still support their debt obligations and would have the option to sustain the quarterly $1.35 billion in dividend payments while maintaining internal reinvestment.
4. **Better Earnings Profile than Peers:** AVGO has a very high forward-looking earnings growth of 36.9% for the next three-year period. This is almost double the expected industry average of 19.0% and significantly greater than its key competitors Intel, Nvidia, and Texas Instruments, which are expected to be -1%, 18.6%, and 2.5% respectively. AVGO also reports a large dividend yield of 4.89%, which is over double the semiconductor industry average of 2.2%. JP Morgan projects AVGO's dividend yield to increase further to 5.1% and 5.6% in FY2020 and FY2021, respectively.
5. **Key Long-Term Relationships:** AVGO extended its deal with Apple Inc. this January to provide components for Apple devices through 2023. This is in addition to another multi-year pact that the two companies reached in early 2019. These combined agreements are reported to return an estimate of $15

billion to AVGO over the next three years. AVGO has been a major Apple supplier in the past, with Apple contributing more than 20% of AVGO's revenues in 2019. These renewed agreements will provide stability for this large portion of the company's future sales revenue.

6. **Increasing Cloud Data Center Spending Trend:** AVGO's cloud/hyper-scale silicon (including networking switching/routing / optical chips, compute acceleration ASICs, network interface cards (NIC), and storage controllers), represents 25-30% of the company's revenues. This revenue segment is growing 10-15% YOY and has a positive future outlook with the key driver being an 18%+ increase in cloud CAPEX spending in 2020 by top Communication Service Providers, including Microsoft, Google, Amazon, and Facebook. These top CSPs rely on AVGO to increase their networking, computing, and storage capabilities, since the company owns ~85% of all cloud data center networking/routing silicon (IP).
7. **5G Demand Increase:** By 2025 5G is expected to account for 2.6 billion subscriptions and generate 45% of international mobile data traffic. AVGO has developed a complete 5G switching portfolio and is the first in the industry to complete an end-to-end 5G mobile networking switch portfolio. Companies that need 5G compatibility will look to AVGO first.

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**Decision: BUY**
**Investment Committee Representative: Toan Nguyen**

Hannah Yerex, Zaki Rahman, Roger Chen, Gregorius Hanzel, Nathan Ellisen, Paras Singh pitched Broadcom Inc. (NASDAQ: AVGO) as a buy in a General Meeting on Tuesday, May 19th, 2020. After review, the Investment Committee decided to purchase LULU. Our reasons are as follows:

- **FIRST: Continuous Improvement & Market Dominance -** Our team utilized a myriad of methods to analyze AVGO and on every metric, they are continually doing well. We looked at the following metrics (Net Revenue, Adjusted EBITDA, Gross Margin, and Free Cash Flow) from 2015-2019 and we noticed a path that was positive on every account. As a portfolio, we wanted to get exposure to the Internet Of Things (IOTs), and given AVGO's performance, we realized they were suitable for investment. The reason that AVGO has been doing so well is a result of its market dominance in infrastructure software and semiconductor solutions. The software and semiconductors have made it so that 99% of all internet traffic flows through one or more of Broadcom's devices.
- **SECOND: Cloud Superiority** - This year we saw the major FANG stocks (Facebook, Amazon, Netflix, Google) and the major MAGA stocks (Microsoft, Apple, Google, Amazon) make huge investments in the cloud data centers as we saw cloud capital expenditures increase by 18% in 2020 so far. The pace of growth in the cloud industry is great for Broadcom because they own 85% of all cloud data center networking/routing silicon (IP). Furthermore, Broadcom's Tomahawk4 Ethernet Switch Chip has double the bandwidth of any other offering. Their market dominance should result in Broadcom's ability to capture the majority of market share in this cloud space.
- **THIRD: 5G Technology Coupled With Apple's Contract -** When Apple signed the contract to allow Broadcom to supply their parts until 2023, we saw that move as two titans in the market joining forces to continue innovating the smart devices industry. As 5G becomes the norm and demand grows exponentially, we see that Broadcom's partnership with Apply will allow Broadcom technology to be in every new iPhone sold on the market. The relationship between these two companies is symbiotic and gives our portfolio exposure to the smartphone industry as well as the diversified portfolio within Broadcom.

**Illumina, Inc. (NASDAQ: ILMN)**
**Pitch Lead: Blake Musburger, John Henzler, Nathan Destouches, Cameron Barnett**

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**Company Overview:** Incorporated in 1998, Illumina is the world's leading developer, manufacturer, and marketer of integrated systems for the analysis of genetic variation and biological function in 115 countries and has helped scientists generate over 90% of the world's sequencing data. This American company provides a diverse line of products and services that support a wide range of genetic analysis to help researchers identify and understand genetic variations. Examples of these research applications include whole-genome sequencing (analyzing entire genomes), genotyping (studying variation in genetic sequences), gene expression (analyzing which genes and transcripts are expressed in a given sample), and epigenetics (studying heritable changes in gene regulation that occur without a change in the DNA sequence).

**Investment Thesis -** The DA Gold Team recommends a BUY in ILMN for the following reasons:

1. **Growth in Genome Sequencing Market:** The DNA Sequencing market is expected to experience an 18% CAGR over the next 5 years. This largely benefits Illumina, as it operates with over a 70% share in the global sequencing market with 73% of its revenue coming from sequencing tools and dedicated consumables. Increasing applications of DNA sequencing such as the development of effective gene therapy for the treatment of various diseases and the use of gene sequencing to aid in choosing optimal therapies and screening for hereditary disposition for certain cancers are likely to drive the market growth. Lowering the costs of sequencing over time is expected to further contribute to the boost in market demand. CEO Francis deSouza stated that "this is the decade that genomics becomes available to cancer and genetic disease patients on a mass scale and integrates into the standard of care." The remaining revenue is broken down as follows: 10% microarrays (a glass slide that tests large amounts of biological material used in drug discovery) and 17% services (basic maintenance, clinical lab applications).
2. **R&D Drives Innovation:** With its strong commitment to internal innovation, which includes spending more than 20% of sales on R&D in the past 5 years, Illumina's technology will continue to lead the industry in sequencing price, cost structure, and accuracy for years to come. These investments come with excellent returns relative to its peers with an ROIC of 16.03%, compared to an industry median of 7.96%. Illumina has the resources to continue heavy R&D in the future, with a Current Ratio of 6.69 and $2 BN in cash/cash equivalents, much more liquid than the industry's median Current Ratio of 1.54. Furthermore, the addition of Scott Gottlieb, former commissioner of the FDA, to their board of directors is expected to aid in their ability to release new products requiring FDA approval.

**Key Risks and Considerations**

1. **Inability to Acquire Competitors:** Due to Illumina's global domination in the sequencing market, it will have difficulty acquiring competition. In 2019 it attempted to acquire Pacific Biosciences, a biotech company that develops systems for gene sequencing. However, the FTC blocked the transaction stating that Illumina was "seeking to unlawfully maintain its monopoly in the U.S. market for next-generation DNA sequencing systems" due to its over 90% share in the U.S. sequencing market, opening the door for new competitors to begin a business and take market share.
2. **Lack of Expertise in Long-Read Sequencing:** Due to the failed acquisition of Pacific Biosciences, Illumina does not have expertise in long-read sequencing, a newer technology that is less accurate than short-read genetic sequencing (where Illumina's strength lies). However, these newer technologies could make advances in the coming years and become a pressing threat. Illumina is currently investing in its own long-read sequencing technology.
3. **Plummeting Revenue from Consumables:** Demand for consumer genetic services (products like Ancestry.com and 23andMe) will continue to steeply decline in 2020 due to privacy concerns and the

exhaustion of the pool of early consumers who were curious about genealogy. Direct-to-consumer sequencing made up 13% of 2019 revenue.

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**Decision: BUY**
**Investment Committee Representative: Scott Elder**

Blake Musburger, John Henzler, Nathan Destouches, Cameron Barnett pitched Illumina, Inc. (NASDAQ: ILMN) as a buy in a General Meeting on Tuesday, May 12th, 2020. After review, the Investment Committee decided to purchase ILMN. Our reasons are as follows:

- **FIRST: Monopoly in a Niche Market -** Illumina's 90% share of the DNA Sequencing market signifies the company's potential to continue its dominance and consistency for the foreseeable future. From a product angle, ILMN provides consumables at a competitive price to undercut the market due to its size. Additionally, ILMN provides sequencers to research professionals that rely on its products once used and we expect an increase in purchases because of the COVID outbreak.
- **SECOND: Emphasis on Organic Growth -** Without the ability to complete more acquisitions, ILMN has found ways to create growth through developing new versions of products by effectively leveraging R&D. ILMM's ROIC of ~16% outpaces the market average of 7% and indicates its success in turning investment into economic gain. Specifically, the NextSeq1000 and NextSeq2000 will advance the company forward by increasing sales for the upcoming year, while serving a market need of mid-range sequencers.

**DocuSign Inc. (NYSE: DOCU)**
**Pitch Lead: Dil Thiagarajan, Daniel Chen, Jailyn Fonseca, and Alicia Chok**

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**Company Overview:** DocuSign is an American company based out of San Francisco that allows companies to manage electronic agreements. DocuSign helps organizations do business faster with less risk, lower costs, and better experiences for customers and employees. A vital service they offer as part of their DocuSign Agreement Cloud is a way to sign electronically across devices. DocuSign went public on the NASDAQ on April 27, 2018.

**Investment Thesis -** The DA Purple Team recommends a BUY in DOCU for the following reasons:

1. **Growing Customer Base:** Docusign is a major player in the e-signature industry with a market cap of about $18.3 billion, and hundreds of millions of users worldwide. In 2019 DocuSign brought in revenue of about $700.9 million which was an increase from their 2018 revenue of $518.5 million. Roughly 94% of their revenue came from subscriptions displaying their strong customer base and loyalty. Since the majority of their revenue stems from their subscriptions, the company is less likely to be negatively affected by a recession, and its remote signing technology promotes efficiency which is crucial during times of economic uncertainty. The company has experienced a customer base that has risen 24% to 589,000.
2. **Market Opportunity:** DocuSign competes in a high growth industry that is rapidly expanding. They estimated the total market available in the e-signature business at $25 million, and say that market penetration currently sits at only 5%. There has been a sharp decrease in interest rates in 2020, leading to a boost in home loans and refinancing agreements that have increased the demand for electronic signatures. We can expect low interest rates in the near future to help stimulate the economy. DocuSign's gross profit was $508.5 million in 2019, up from the previous year's $400.2 million. The company's 2020 profit projections are $730.7 million and are expecting a decrease in costs. DocuSign has an EBITDA margin of 13% and is projecting a 2% increase in the coming year. They have a strong margin considering they are a growing company in the big technology industry. A lot of the companies that had higher margins were similar to Microsoft or Adobe who have other major sectors in their business. DocuSign appears to have dominance in the specific e-signature domain.
3. **Innovation and Growth:** DocuSign made a strategic investment last year through the acquisition of Seal Software, an artificial intelligence company specializing in contracts and legal software, for $188 million. Seal is known as one of the pioneers in AI-driven contract analytics. It has the ability to search large collections of agreements by legal concepts. DocuSign also acquired SpringCM in 2019 for $220 million to expand its product line into contract life cycle management. DocuSign is looking to further its dominance in the industry by implementing artificial intelligence into their technologies through these acquisitions.

**Key Risks and Considerations**

1. **Reliance on e-signatures.** DocuSign derives a significant majority of its revenue from its e-signature solutions. If there is a declining adoption of their e-signature solutions, without a corresponding increase in the use of their other products and solutions, they could suffer.
2. **The entrance of Adobe.** DocuSign has experienced a competitive environment due to being the first mover in the industry. Adobe is entering the market and is looking for a bigger share, and already has a strong customer base.
3. **Young Business.** The market for their products and solutions is relatively new and evolving. If the market does not develop further, develops more slowly, or in a way that they do not expect, they will experience struggles. It is difficult to predict customer demand for their products and solutions, customer retention and expansion rates, the size and growth rate of the market for agreement automation, the entry of competitive products or the success of existing competitive products.

**Decision: BUY**
**Investment Committee Representative: Scott Elder**

Dil Thiagarajan, Daniel Chen, Jailyn Fonseca, and Alicia Chok pitched Docusign Inc. (NASDAQ: DOCU) as a buy in a General Meeting on Tuesday, May 12th, 2020. After review, the Investment Committee decided to purchase DOCU. Our reasons are as follows:

- **FIRST: Future of profitability -** Docusign is currently unprofitable and therefore our club has contrarian conviction that the stock is mispriced in the market. The company spends the most amount of resources on marketing its e-signature solutions product and we expect the business to reach profitability as more subscriptions/customers are acquired, which will provide DOCU with stable cash flows to grow. Moreover, DOCU has a large TAM with only a 5% market penetration rate, meaning that DOCU is nowhere near maxing out on potential customers.
- **SECOND: Growth through acquisitions and innovation -** While DOCU mainly focuses on the e-signature space, the company has expanded into contract life management, or CLM, to provide users with a more comprehensive experience. DOCU has already disincentivized MSFT from continuing with developing its e-signature products and the company aims to include CLM to prevent Adobe from taking market share. By acquiring SpringCM, DOCU is primed for creating a more holistic brand to take advantage of the COVID era with its paperless agenda.

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**PayPal Holdings (NASDAQ: PYPL)**
**Pitch Lead: Joaquin Leija, Tyler Norby, Aidan Gray, Ben Barton**

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**Company Overview:** PayPal is a leading technology platform and digital payments company that enables digital and mobile payments on behalf of consumers and merchants. Its revenue streams are divided into transaction revenues based on the volume of activity or total payments volume (91%) and value-added services (9%), such as interest and fees earned on loans and interest receivable. Sales within the US are 2.9% + $0.30 per transaction, international sales are 4.4% transaction fee plus a fixed fee based on currency received, PayPal Here card transactions are 2.7% when you swipe a card or 3.5% plus $0.15 for manually entered transactions, and instant transfer with eligible linked debit card or bank account is 1% of amount transferred, with a maximum fee of $10.00. In 2019 PayPal processed over $700B in TPV up 23% YoY. PYPL took in $17.8B in revenues, up 15% YoY and increased earnings 28% YoY, ending the year with a record 305 million active accounts, including 24 million merchant accounts.

**Investment Thesis -** The Financials Institutions Team recommends a BUY in PYPL for the following reasons:

1. Future-focused Acquisitions:
    a. Venmo: When PayPal purchased Braintree in 2012, they acquired mobile payment service, Venmo. Venmo has been a catalyst for PayPal's impressive member growth of 17% in 2018 with a member transaction rate increase of 10%. Additionally, in 2018, over 41% of PayPal's total payment volume was coming from mobile devices. Venmo is growing popular fast, of the 65% of 20 to 30-year-olds who use payment apps, more than 68% of them use Venmo, compared to the 22% using their own bank's mobile app. Also, Venmo is in the early stages of becoming monetizable through its "instant-transfer" function and is now a payment method for several retailers, like Target, Walmart, Uber Eats, J, Crew, Footlocker, and Lululemon, to name a few. PayPal is looking to monetize Venmo through its new Venmo debit card, which is on currently on limited release, and was noted to be one of the main drivers of revenue increase when it was being tested from 2017 to 2018.
    b. GoPay: PayPal has become the only online foreign payment processing platform that's allowed to operate in China through its 2019 acquisition of GoPay. Online payment transactions in China doubled between 2013 and 2018, reaching $200 trillion in 2018. This is especially crucial because about 35% of all retail sales in China occur online, compared to just 11% in the U.S.. Digital payments in China are set to grow at an 18.5% annual growth rate over the next four years, from $1.57 trillion in 2019 to $3.1 trillion by 2023. And, between 2017 and 2023, the number of Chinese citizens using mobile payments is set to nearly double, from 562 million to 956 million
    PayPal which is already the dominant online payment provider in the U.S., by acquiring GoPay makes it significantly harder for its competition to expand globally. Even though Alibaba's Alipay, is the dominant force in China's online payment market, PayPal CEO Dan Shulman addressed during a conference call that rather than going toe-to-toe with the Chinese giants, would focus on cross-border payments, linking China's payments ecosystem to PayPal's vast international payments networks. PayPal would be looking to allow Chinese consumers to buy from PayPal merchants outside the country, and to enable Chinese merchants to sell to PayPal-linked consumers outside of China as well.
    c. Honey: In late 2019, PayPal acquired e-commerce tool, Honey Science. Honey is a browser extension with a smart shopping assistant that automatically applies every discount to a consumers online shopping cart. Honey earns revenue through commissions from merchant partners when a consumer uses their service. Honey has saved shoppers more than $1 billion and has 17 million daily active users since its launch 7 years ago, increasing from 2018's 10 million members saving over $800 million. PayPal is particularly interested in using Honey to create more engagement and increase user growth through Honey's shopping assistant along with their mobile app that allows customers to add items from different retailers into their cart, smoothing the customer experience.
2. Dominant Player in a Growing market: The E-retail sales measured just over $2.9 trillion globally in 2018 and is projected to grow at a 17% compounded annual growth rate into 2023. PayPal accounted for roughly 20% share of the $2.9 trillion in 2018. PayPal is the major growth-driver for online payments ranking as the

most popular mobile billing and leading payment options for online transactions in the United States. As of December 2018, 36 % of American retailers were already accepting customer payments via PayPal and 34 percent were intending to do so within the next two years. PayPal's dominance in its growing market can be shown through a Comparative Company Analysis, where PayPal trades at a slight premium with a 57.53 P/E ratio and an EV/EBITDA ratio of 39.02 compared to means of 46.86 and 35.41.

**Key Risks and Considerations**

1. **Fraud vulnerability:** PayPal's popularity makes it a prime target for online scams and fraud. As of October 2018, PayPal was impersonated in 6% of phishing attacks worldwide. The average price of a stolen PayPal account login on the dark web was approximately $42 USD. However, in comparison, stolen bank details were worth $259.56. Additionally, PayPal has robust fraud protection programs for customers and merchants and constantly publishes articles on their website about avoiding scams and fraud, keeping their users aware and updated new ways they can be taken advantage of.

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**Decision: BUY**

**Investment Committee Representative: Ian Klimisch**

Joaquin Leija, Tyler Norby, Aidan Gray, Ben Barton pitched Paypal Holdings (NASDAQ: PYPL) as a buy in a General Meeting on Tuesday, May 19th, 2020. After review, the Investment Committee decided to purchase PYPL. Our reasons are as follows:

- **FIRST: E-commerce is positioned to grow in current market conditions.** Data across the e-commerce space over the prior several months have shown consumer behaviors shifting their purchasing activity online (obviously). In a sense, COVID accelerated the long-run secular tailwinds pushing the tremendous growth e-commerce has experienced over the past decade. This incremental growth caused by COVID will be in part temporary, subsiding after in-person retail reopens in the coming quarters, but part of the growth will remain as a permanent addition to e-commerce's TAM.
- **SECOND: PYPL is positioned to grow in lock-step with e-commerce.** The investment committee was most convinced by the fourth argument in the financial team's investment thesis (added retroactively to the pitch deck): Braintree's integrated payment system. The financial institutions team was able to successfully argue that PYPL's services are nearly ubiquitous in most small business e-commerce and have a considerable stake in major e-commerce players (AirBnB, Uber, Stubhub, UnderArmor, etc.). The pitch successfully positioned PYPL as nearly equivalent to an e-commerce ETF minus the expense ratio, and successfully convinced the investment committee that e-commerce itself was perhaps the best-positioned industry to invest in given current market conditions.
- Combined with a compelling comparison of the team's intrinsic DCF valuation against market valuation, the investment committee has decided to BUY PYPL stock.

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**Closing Statement**

Navigating the market turmoil this year has not been easy given the amount of volatility arising from the worldwide pandemic. However, as a student investment club, we remain focused on our core investment philosophy to identify undervalued companies using a bottom-up approach. We believe the asset allocation of our portfolio represents our investment portfolio in action and while our returns have not beaten the market, we know that our investments will pay off in the long term. As we are halfway through 2020, we have seen the worst day in the stock market history as well as the best week since the 1908s. This amount of volatility has presented value investors like our fund many challenges but we will continue to keep a quote by Warren Buffet at the top of our mind when managing our portfolio "Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard;" This quote offers us some wise words to not capitulate when the market faces unprecedented levels of uncertainty but rather remaining focused on the long term which is how we will make money.