To our Partners-

As we turn the calendar to 2018 and approach the completion of our sixth year in operation, a review of the recent past and a discussion of what to expect from us in the future is in order. We closed 2017 with returns of 3.3% in the fourth quarter which was sufficient to push our full year figures above 21%. The average annual rate of compound "interest" we've earned since starting Ironvine's Concentrated Equity strategy now exceeds 11%, and the cumulative amount gained on our original capital stands at 83%. These figures, along with the data in the following table, are presented on a total return basis, and shown net of all fees and expenses.

Cumulative Returns	Since Inception[1]	5 Year	3 Year	2017
IVCP Concentrated Equity (net)	82.52%	75.19%	15.03%	21.37%
S&P 500	114.46%	108.14%	38.29%	21.83%

Average Annual Returns	Since Inception[1]	5 Year	3 Year
IVCP Concentrated Equity (net)	11.03%	11.87%	4.78%
S&P 500	14.19%	15.79%	11.41%

Note: Ironvine Capital Partners performance data is presented net of all fees and expenses.
[1] Composite inception 04/01/2012. Please refer to the Important Disclaimers at the end of this document.

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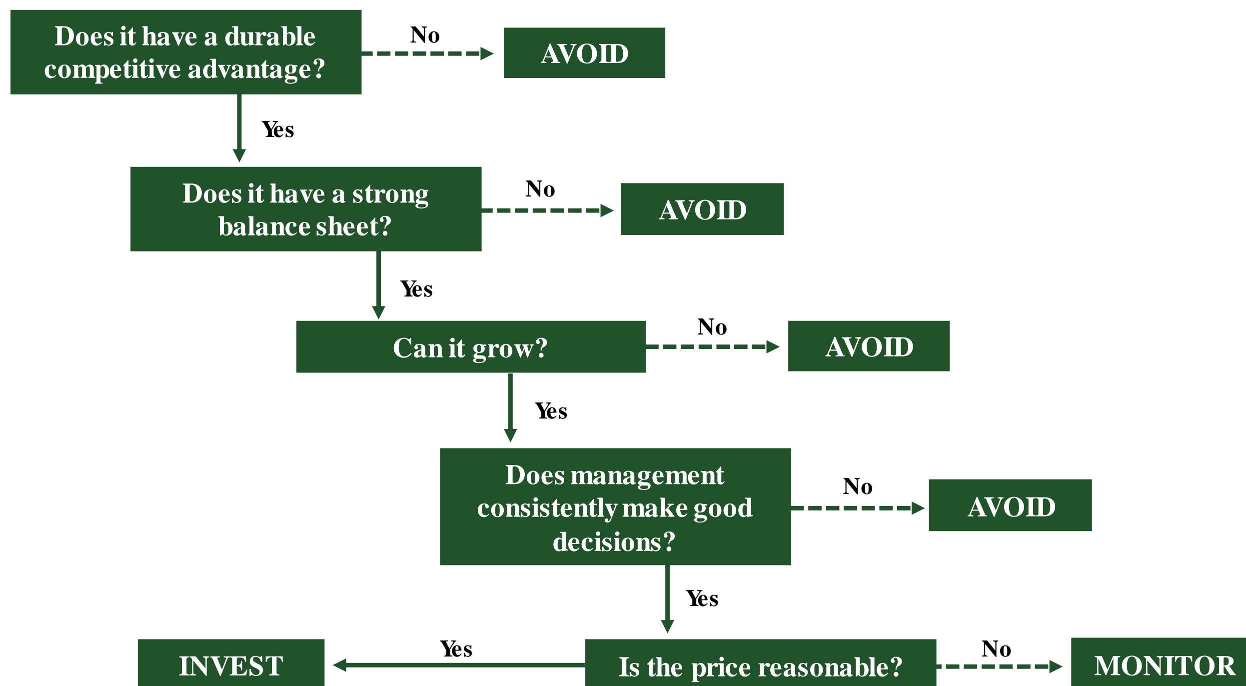
It's been a year-and-a-half since we implemented the changes discussed in our 2nd quarter letter in 2016. In that letter, we wrote *"Recoveries rarely happen quickly and they're never linear. Our own recovery will likely appear pedestrian until the disappointments of the last twelve months are in the distant past. And it could be interrupted at any point by a bear market (we have no opinion of what the market will do). However, it's imperative that we remain focused on the power of compound interest and what can be accomplished over long periods of time with modest sums of capital."*

Since we penned those words, our portfolios have grown by 34%[1]. And although 18 months is far too short of a time period to make an appropriate judgment as to whether the recovery we predicted then has taken full form, we are confident that this is more than just circumstantial. If Ironvine was a holding company that accounted for its ownership stakes in the businesses we hold today on a "look through" basis, you would own a partial interest in something that's more dominant, earning higher returns on capital, is growing faster, and is more conservatively financed than at any time in our past. You would also own something with qualities that exceed those of the average U.S. business. We intend to do more of this—

[1] Net of fees, 6/30/2016 through 12/31/2017

our task is to increase the quality of this metaphorical holding company with investments that improve on these characteristics without unduly increasing the aggregate earnings multiple of our portfolio. Visually speaking, the course we navigate when a business comes into our purview looks something like this:



This is an oversimplification of how we go about our craft—but not terribly so. We prefer a simple set of filters that allow us to quickly discard businesses we deem inferior or insufficient. What remains is a rich but manageable pipeline of outstanding businesses run by good people that we can spend our time getting to know better. We've discussed a number of these methods in the past, but it's been some time since we wrote about them in any comprehensive manner. And we've evolved in recent years—we've grown more process oriented and have developed a particularly strong distaste for the aggressive use of debt, for example. As such, it may be useful to review how we think and what we look for as a business works its way through our process.

Does the Business have a Durable, or Lasting, Competitive Advantage?

The laws of capitalism all but guarantee that high profits in relation to capital employed will be competed away over time as new entrants attack. To prosper, a business needs a fortress. And it needs a wide (and widening) moat around that fortress to fend off today's armies of competition while having the foresight to adapt to what new armies might use to attack it in the future. We are moat investors. We are looking for those select few companies that can defy the gravities of capitalism by earning above average returns on capital for extended periods of time. These are unusual creatures, they are not static (that is, their economic defenses are usually shrinking or expanding), and identifying their durability requires significant judgement. There are four broad categories of advantages that permit companies to betray economic decay—each have their own strengths relative to one-another, and on occasion the presence of one helps create a second.

- Cost advantages—processes that are done more efficiently than competitors or produced at such scale that per unit costs are lower than competitors

- Intangible assets—perception-based or legal barriers such as patents, brand names, or licenses that endow a company with the privilege of selling a product or service at a higher price than potential or existing competitors
- Switching costs—when actual or perceived costs (time, money, mental anguish) of switching from an incumbent product or service creates customer lock-in
- Network effects—a product or service that increases in value as more customers use it

Understanding the economic strengths and weaknesses of a business (and thinking about what the future holds for those economics) is the most important aspect of our process. Without a sound understanding of today, and some insights as to what tomorrow looks like, we simply can't move on.

Does it have a Strong Balance Sheet?

It's hard to go broke if you don't have any debt. This doesn't imply that companies should completely avoid borrowing money. Employing modest sums of leverage is entirely acceptable—particularly when it's used to accelerate attractive growth investments or to make a strategic acquisition (beware: many of the acquisitions we've studied have proven to lack industrial logic). And different businesses can operate appropriately with different levels of debt. All else equal, however, debt should be used wisely and treated with caution…doing so will keep businesses (and consumers) out of trouble when credit markets grow less accommodating. The signposts we look for in a conservatively-financed balance business include the following:

- Net cash position or low levels of debt
- Strong free cash flow capacity in relation to debt
- Capacity to finance growth from internally-generated cash flow
- Consumer deposits…liabilities, but with low/no interest costs, covenants, or maturity dates
- "Float"…liabilities, but without interest costs, covenants, or maturity dates
- Strong lending and underwriting cultures in the case of a bank or insurance company

Can it grow?

We like a little growth. The right types of growth can create tremendous value over time. Growth can also help insulate an investment operation from a lot of mistakes. For instance, by favoring companies in stable to growing end markets, it becomes easier for us to eliminate something appearing statistically cheap that might be highly cyclical or in structural decline. And though it doesn't entirely preclude a business from graduating through our process, a lack of growth requires a depressed valuation, a well-timed purchase, and a management superb in allocating excess capital for the investor to earn a good return. Getting all three of those right with any consistency is a tall task.

Growth comes in three flavors—two that we seek out, and one that we actively avoid.

Our preferred method of growth resembles a royalty requiring little or no capital to maintain and increase the stream of cash flows a company spins off over time (Moody's, Visa). To illustrate, imagine investing $100 in a savings account at what we'll call Benevolent Bank that pays 10% interest. This bank is generous and has agreed to increase your rate of interest by one percentage point annually under one condition…you can't reinvest your earnings back into the account. That is, this account will earn $10 in its first year, and $11 in year two, but you will need to find an alternative investment vehicle for those monies. After 10 years, you will have accumulated $145 in interest payments and will remain eligible to earn a growing

stream of coupons each year. Moreover, if you were successful in finding attractive uses of the interest the bank distributed to you over 10 years, the total value of your capital will have grown to something far more than $245.

The second type of growth we look for resembles that of a traditional savings account where interest earned can be reinvested at similar rates (Costco, Amazon). Take Compound Bank, for example, who offers you 10% interest on $100 and on all subsequent earnings as long as you keep your deposits at the bank. Unlike at Benevolent Bank, where you were required to take earnings elsewhere, at Compound, a $100 investment will earn $10 of interest in year one, and after reinvesting those earnings, $11 in year two ($110 x 10% = $11), etc. Therefore, after 10 years, this investment will have grown to $259. It's worth noting that though your return from this type of investment appears inferior to that described above, it removes the risk of making poor choices with the distributions you received from Benevolent Bank.

The imperative ingredient in all of this is *capital efficiency*. The savings accounts illustrated above offer decent returns on capital (and in the second case, decent returns on *incremental capital*). Profitable growth—a term we see used with gross negligence—is simply not enough. Growth must be measured in relation to the capital required to achieve it. This brings us to the third type of growth—the type that you should fear. Continuing with our story of make-believe institutions, we introduce Miserly Bank. Savings accounts here offer paltry rates of interest on capital while requiring savers to reinvest all their earnings at equally inferior rates (despite better rates being offered elsewhere in the market). In the most dreaded cases, Miserly asks you to add still more capital to your original principal even while promising nothing in the form of a reasonable return on it. Miserly is a shrewd marketer and quick to point out that their investors are experiencing "growth". But as you can see, not all growth earns its keep.

Businesses aren't all that much different than savings accounts. They have a quantifiable amount of capital invested that can be ascertained from the balance sheet, and we can determine the "coupon" they pay from looking at the income and cash flow statements. With some judgement, we can assess if that coupon can grow, and how much capital will be required to grow it. In practice, most businesses require large sums of capital to grow and inevitably run out of good reinvestment opportunities. It's unusual to find a business on one of the extremes—those that can a) capture growth without the need of incremental investment or b) consistently reinvest all their earnings at attractive rates of return. If you find one, bet big (and then call us).

Does Management Consistently Make Good Decisions?

Whether a business builds planes or sells opinions, management's uppermost task is to build a culture obsessed with deepening the company's competitive advantage by improving the customer experience in a way that makes life tough on the competition. A CEO must then turn his or her attention to allocating excess capital in a way that builds additional, or per-share, value. In many instances, capital allocation is the deciding factor as to whether shareholder value follows business value. Said differently, you can own a good business and get an exceptional result. You could also own an exceptional business, and get a mediocre result. How the cash gets spent is important.

We grade management by assessing how well they deploy capital in each of the following categories:

- Reinvesting in the business: This is job number one. Assuming the business is earning a reasonable return on its capital—say, 15%—management should direct dollars here to maintain and enhance the productivity of the assets producing that return. If there are opportunities to grow by investing incremental capital at similar rates, management should do so.

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- Debt reduction: Once investments have been satiated, management becomes responsible for the thoughtful allocation of excess dollars. A strong balance sheet is sacred—it protects shareholders from the unknown and provides a source of cash should something highly strategic come along. If a business is carrying too much debt in relation to its "through the cycle" cash flows, it should use excess cash to reduce it.

- Returning capital: Only after its investments have been made and its balance sheet is in order should management contemplate distributing excess capital to shareholders. Returning capital comes in two forms—paying dividends to *all* shareholders, and buying back stock from *selling* shareholders. Here, management must develop a conservative estimate of what the business is worth before they can appropriately decide which course of action to take. Dividends are value neutral as long as they aren't funded with debt or paid out in favor of a better use. Share repurchases, however, are only value neutral if stock prices approximate intrinsic value. When share repurchases are conducted at prices below intrinsic value, they create value for continuing shareholders at the expense of those selling. If executed above intrinsic value, buybacks destroy value for continuing shareholders by paying sellers more than they deserve. Don't ever let management tell you it's not their job to value the company—if they're buying back stock, they better have a rough idea of what the business is worth. Otherwise, how do they determine if they're getting a good deal or not?

- M&A: Using shareholder capital to make acquisitions is something we approach with a healthy dose of skepticism. The price paid by the buyer is usually full, the fees are high, the synergies are difficult to realize, and properly integrating the target consumes enormous resources. There are exceptions to the rule, of course. Horizontal acquisitions wherein two more or less identical firms combine have a more identifiable path to realizing synergies. If a business employs price discipline, consolidating a fragmented market can create steady value. And then there are the infrequent cases where entities have demonstrated that M&A is a core competency. Berkshire and Liberty come to mind here, but their success is unusual.

- Selling assets: Contrary to popular belief (at least in board rooms), dispositions are often times a *good* thing. We call this addition by subtraction. Selling non-core businesses that might be worth more in the hands of another company increases focus and frees up valuable capital.

Is the Price Reasonable?

Determining what qualifies as a reasonable price is multi-dimensional. Put simply, a business with dominant competitive and financial positions containing excellent growth prospects that's guided by a skilled management team is worth more than a business with lesser qualities. Because so, we would pay more for a dollar of earnings (meaning a higher multiple, or P/E) for the former. In practice, it's more complex than this, but here again we find that simplicity is more desirable than attempts at getting scientific.

Let's consider some simple figures. Equity returns are driven in large part by dividend yields, per-share earnings growth, and the multiple investors assign to those earnings. Working in concert, the three have contributed to long-term returns of about 9% for the S&P 500 leave the index selling for about 17 times expected earnings. We estimate the average company earns 10%-12% on capital and will grow earnings at a rate of 3%-5% from here. With these bookends, we now have the makings of a useful tool kit for practical

comparison. Suppose a business we understand well earning 15% on capital and growing 5% annually was selling for 12 times earnings. If we had some insights as to the durability of the business, its balance sheet strength, and liked the management, we would likely conclude that this price is quite reasonable—the company earns more in relation to capital than the average business, is growing just as quickly, yet is available to us at a multiple of earnings far less than the broad market. If we were to invert these figures into an "expected return" construct, an earnings yield of 8.3% (1/12 = 8.3%) plus growth of 5% could presumably drive a 13% return on our investment. Should the multiple of earnings expand to that of the average business (something we never count on), our return would exceed 13%. The same conclusion could be reached for a business earning 40% on capital growing 20% annually that's selling for 25 times earnings. Despite what appears to be a high multiple, when considering that an owner's yield of 4% will be enhanced by growth of 20% when the average stock expected to earn 9%-10%, the price appears downright cheap.

When you buy a home, you consider the design, the build, the yard, and the neighborhood in addition to the price per square foot. Businesses are no different—it's necessary to analyze the strength of the franchise and balance sheet, the growth prospects, and the management team before you can conclude if the price you're paying is reasonable or not. In fact, we would argue that you'll be better suited making these assessments *before* looking at the price.

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We are in the decision-making business. With fewer decisions come fewer mistakes. A process is useful in eliminating unforced errors. A process gets you to "no" quicker and focuses your attention on things that might result in "yes". We will continue to make our share of mistakes—and we'll continue telling you about them. We'll also continue refining our craft and working at getting a little less dumb each day. Avoiding stupidity is easier than achieving brilliance. We like easy.

Thank you for your continued support.

February 9th, 2018

Important Disclaimers

Reported performance figures represent an average, or composite, of our progress. Individual returns will vary based on the timing of your investment with us, fee differentials, or other account-specific circumstances. Client reporting, including positioning and performance, will be sent under separate cover.

Past performance is not a guarantee or a reliable indicator of future results. All investments contain risk and may lose value. This material contains the current opinions of the authors such opinions are subject to change without notice. This material is distributed for informational purposes only. Forecasts, estimates, and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed.

Ironvine Capital Partners (IVCP) is an investment adviser registered with the SEC that commenced managing client assets in November of 2013 as the successor firm to the strategy that its co-founder—Matt Barnes—employed since March of 2012 for assets in which he had full discretion over at McAdams Wright Ragen. The Firm definition includes all assets that are managed by Ironvine.

Ironvine Capital Partners claims compliance with the Global Investment Performance Standards (GIPS®). To receive a description of Ironvine Capital Partners' composite and a presentation that adheres to the GIPS standards, please contact Ryan Mendlik, rmendlik@ironvinecapital.com, 402.715.5224, or write Ironvine Capital Partners; 9290 W. Dodge Rd, Ste 203; Omaha, NE 68114.

The Ironvine Concentrated Equity Composite *includes all accounts over which Ironvine deems to have discretion and that follow the composite strategy. Ironvine seeks to earn above average returns by investing primarily in a concentrated portfolio of global issuers in all facets of capital structures, including but not limited to common and preferred stocks, debt instruments, & convertible securities.*

The Ironvine Concentrated Equity Composite was created on December 1, 2013, with an inception date of April 1, 2012. Prior to October 2017 the composite was named "The Ironvine Composite." For comparison purposes the composite is compared against the S&P 500. The benchmark includes 500 stocks representing all major industries of the economy. Ironvine employs a total return strategy and the S&P 500 is provided for illustrative purposes only, as it is the most widely-recognized alternative to any actively managed mandate amongst global investors. Past performance is not indicative of future results.

The composite benchmark is the S&P 500 which is an index of 500 stocks selected based on market size, liquidity, and sector and is designed to provide a broad snapshot of the overall U.S. equity market. New accounts that fit the composite definition are added at the beginning of the first full calendar month for which the account is under management. Closed account data is included in the composite as mandated by the standards in order to eliminate a survivorship bias. Portfolios that are deemed too small to receive the Ironvine Composite allocation are considered to be non-discretionary and are not included in the composite. All returns are expressed in US dollars. All performance data reported in this document is net of all fees and commission.

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