IRONVINE
CAPITAL PARTNERS, LLC

"It gets back to that old story… when the tide goes out you learn who's been swimming naked. Well, we ran into a nudist colony here."
-Warren Buffett on recent banking executive behavior, April 12th, 2023

Investors & Friends of Ironvine-

Banking is a fine business if you don't do dumb things with the money. The business model is simple. Executing it with discipline over a prolonged period of time has proven to be anything but. Banks take in customer deposits and make loans. To illustrate, a bank might pay consumers 1.5% on deposits and earn 5% on its loans. For every $100 million in loans a bank makes, its owners put up $10 million of equity and fund the rest with deposits and debt resulting in a blended cost of funding of, say, 2%. The resulting 3% net interest margin on $100 million in loans generates $3 million in revenue. After operating costs and taxes, the owners of a bank might earn $1.5 million or 15% on equity. Grow deposits, make more loans, and run operations efficiently. It's a license to print money.

Earning 1.5% on assets but 15% on equity has a luring effect. At last count, there were 4,844 banks in the United States, a number that far exceeds the number of individuals commanding both the intellect and character to run a bank responsibly. We don't necessarily find this mismatch of quantity over quality inconsistent with the rest of the executive ranks across corporate America. We're often discouraged to learn who is running some of the country's largest companies and the misaligned incentives under which they operate. But banking is a different breed of business. When mistakes get made at a bank, leverage, at first your friend, can have a vaporizing effect. There are multiple ways to run a bank into the ground, but we suggest one of the following two routes if you're in a hurry.

The first and most obvious path—making bad loans—remains clear and present in our minds a full 15 years after the Global Financial Crisis brought capitalism to its knees. How can we forget the prevalence of undocumented mortgage loans being made to home buyers with slivers of a down payment during the mid-2000s? "Home prices only go up, and borrowers will grow into appropriate loan-to-values quickly as a result" was the logic. Narrator: home prices went down. Or the magnitude of leverage banks were extending private equity firms to buy companies? Near the peak in lunacy, it wasn't unusual for deals to be funded with debt/EBITDA ratios of 8x-9x[1]. Need we remind you that the I, T, and DA in this metric stand for interest, taxes, and depreciation & amortization, which are very real expenses last we checked. We were effectively dismissed in 2007 when we asked Harrah's management what they thought about putting eight turns of leverage on arguably peak profits before Apollo and TPG took them private. One analyst told us that Las Vegas Strip revenues never go down. Narrator: they went down, the equity was worthless, and the debt—much of which remained on bank balance sheets—was impaired.

[1] Debt to EBITDA, or earnings before interest taxes and depreciation and amortization is a measure of a company's debt burden relative to cash flow and is industry shorthand for making comparisons of creditworthiness across companies. With few exceptions, we consider companies carrying more than 3x debt/EBITDA to be aggressively financed.

In July 2007, Chuck Prince, then the CEO of Citigroup infamously told the Financial Times, *"…when the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance… and we're still dancing."* Prince quit three months later, Citigroup imploded, and its shares lost 98% of their value. While testifying to the Financial Crisis Inquiry Commission in Congress years later, Prince defended his actions as a race to keep up with competitors who were loosening lending standards, and that *"Citi couldn't afford to drop out."* Citi couldn't afford *not* to drop out, and it was Prince's job to do exactly that.

The second path to destruction is a bit more nuanced. When deposit growth begins to outstrip loan demand, bankers have a choice of what to do with excess liquidity. They can hold those deposits in cash, or they can invest them—typically in highly liquid Treasuries or other government-backed paper to generate yield. The question then becomes what *duration* of securities to buy. Properly done, a bank matches the duration of its assets (securities it buys) to the duration of its liabilities (in this case, deposits). But banks have enormous leeway in estimating the stickiness of their deposit base, and the flexibility—or should we say temptation—to borrow short and invest long is always just one modeling adjustment away.

Here's what M&T Bank Chairman and CEO René Jones had to say a year ago on the matter of reaching for yield with the tidal wave of deposits his bank absorbed during the pandemic:

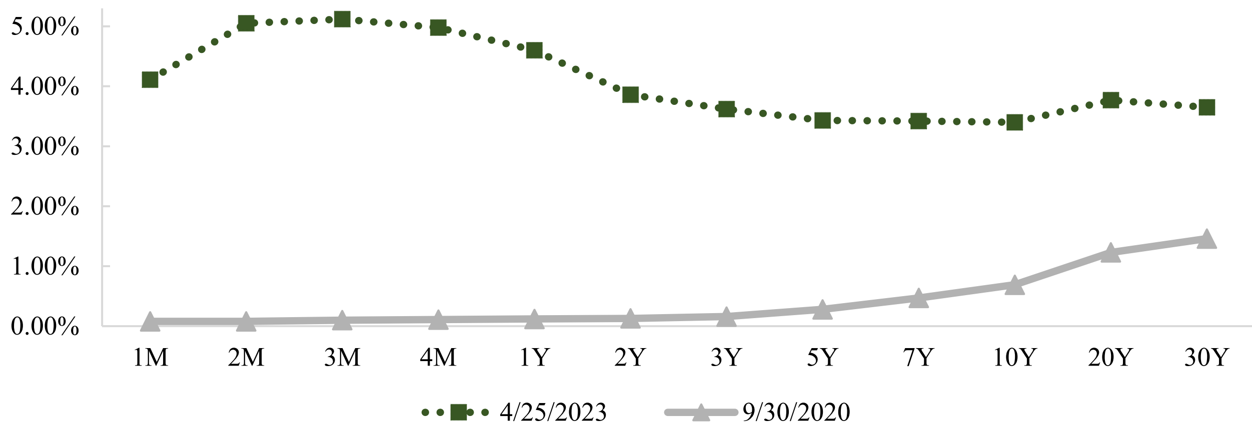
"A core operating tenet at M&T has always been to avoid reaching beyond our purpose and taking on too much risk, which can be in the form of credit risk from aggressive growth in loans or from fluctuations in interest rates. With a lack of loan demand during the year, many peers chose to invest a greater proportion of their excess cash into investment securities. It is notable that during the year, we chose to avoid following suit given the historically low rates of interest that did not seem to compensate us for the risk that rates might rise in the future. In essence, we decided it was better to hold our fire."

On the other side of the country, there was a bank taking an entirely different approach:

"Our treasurer and his team go home tired every day. They've been working hard to put that money to work, and you saw in the quarter that we put close to $10 billion worth of money to work in investment securities. The bucket continues to be refilled with additional liquidity and we plan on continuing to deploy it."

This particular bank saw its deposits swell from $61 billion in 2019 to $189 billion at yearend 2021. Through hubris, ignorance, or some combination of the two, its management seemingly grew convinced this cash would be stickier than the deposits on hand prior to the great stimulus of 2020-2021. Accordingly, it invested an astonishing $85 billion into mostly government-guaranteed mortgage-backed securities (MBS) **with an average life of over 10 years at a weighted average yield of 1.6%**. Just like other bonds, MBS decline in value as interest rates rise (duration). But when interest rates rise sharply, mortgage refinancings grind to a halt, and the duration of the security *extends* (a phenomena known as convexity) as prepayments are less likely to materialize. Said differently, this bank's bond portfolio was going to lose significant sums if interest rates rose.

And did they ever. By mid-2021, inflation was running at 5%, the Fed was earnestly shifting to a hawkish tone, and the long end of the yield curve began to march precipitously higher. Bond prices got smoked, and the institution known at the time as Silicon Valley Bank (SVB) was in trouble.



Or was it? Banks have two types of securities portfolios. Available-for-sale (AFS) and held-to-maturity (HTM) securities. AFS securities are typically marked to market daily. But GAAP accounting allows banks to mark HTM securities at cost regardless of their true value. We'll let you guess which portfolio SVB management put these bonds in. No losses, no problems… *as long as you don't need to sell the bonds*.

The damage done to SVB's HTM portfolio was shocking in its magnitude and abruptness. At the end of 2021, Silicon Valley Bank had a modest $1.3 billion loss in a portfolio valued at $97 billion. By September 30th, just nine months later, those losses had swollen to $16 billion and exceeded the bank's equity.

Silicon Valley Bank HTM Portfolio	12/30/2020	12/31/2021	9/30/2022
Cost	16,592	98,202	93,292
Fair Value	17,216	97,227	77,370
Unrealized Gains	627	368	-
Unrealized Losses	(3)	(1,343)	(15,922)
Tangible Common Equity	7,675	12,055	11,346
Unrealized Losses % of TCE	NA	8%	140%

Realized or not, Silicon Valley Bank's financial position stood on shaky ground. Its funding costs were increasing to uncomfortable levels in conjunction with the Fed's aggressive actions to tame inflation, and it was losing deposits at an alarming pace. It held just $21 billion in available-for-sale securities, and it couldn't source cash from its $77 billion held-to-maturity portfolio without first realizing losses and admitting it was insolvent. SVB was running out of cash.

Silicon Valley Bank came clean on the night of Wednesday March 8th, telling investors higher funding costs were going to dampen its profitability materially, its deposits were fleeing, and that it needed to raise capital to fill the hole caused by losses taken in its securities portfolio. Its stock collapsed 60% on Thursday before being halted, and the bank was seized by California regulators on Friday and put under FDIC control to protect depositors. Silicon Valley Bank did dumb things with the money.

Silicon Valley Bank Stock Price

****

"There are others, you know. There were eight of us."
-Shoeless Joe Jackson in Field of Dreams

Monitoring the behavior of executives is a favorite past time of ours. The nod above to Shoeless Joe's conversation with Ray Kinsella was in reference to an internal Ironvine email dated November 2nd 2022 that began with Ray Liotta's movie line. That was the day we learned Silicon Valley Bank was effectively insolvent and added it to our short list of poorly behaving banks. "$15.8B in equity - $0.4 billion in goodwill - $3.6 billion in preferred = $11.8 billion in tangible common equity against $15.9 billion in unrealized, held-to-maturity losses = negative $4.1 billion in tangible common equity."

Unrealized losses in held-to-maturity portfolios have since gone mainstream, becoming a cornerstone metric in every banking analyst's report. The media has caught on too, publishing graphics that assess what bank capital levels would look like if unrealized losses were treated with economic reality (see right pane). It's not entirely inspiring. Of course, no one knows how this is going to play out. But we don't believe what drove Silicon Valley Bank into bankruptcy is behind us. There are others, you know, and it's easy enough to see how stubbornly high long-term rates could require the nudists in the group to raise additional capital.

****

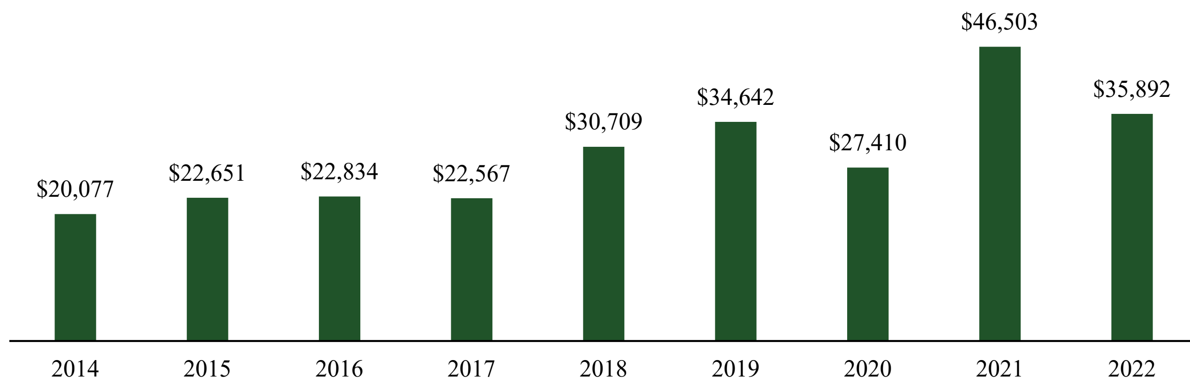
After considerable thought and deliberation regarding the economics of the banking industry, we sold our investment in JPMorgan Chase (JPM) during the first quarter. The business has been a significant holding

for nearly nine years and our sale creates a natural opportunity for reflection. We made our first investment in JPM in early 2014 and added to it on three separate occasions over the subsequent seven quarters. At the time, the bank was facing backlash from the London Whale trading incident while still trying to emerge from the regulatory quagmire resulting from its rescue of Bear Stearns and Washington Mutual. The company's earnings power was weighed down by billions of dollars in fines, legal fees, and investments in compliance controls. JPMorgan was regarded as an inferior operator to Wells Fargo, the long-time industry darling, and traded at a significant discount as a result. Contrary to the widely held narrative pressuring the share price, however, we believed the firm was comprised of several advantaged franchises likely to grow earnings well into the future. From our Q2 2014 letter:

…this particular investment is highly consistent with the businesses that dominate Ironvine's portfolio—competitively entrenched pieces of "plumbing" that have built recurring revenue business models run by owner-operators. JPMorgan consists of four such pieces of plumbing—leading franchises in essential roles within consumer banking, middle market business lending, asset management, and global capital markets.

The value of JPMorgan will manifest from its four franchises' capacity to compound equity capital at rates of return between 15% and 25% long into the future. The likelihood of this outcome is high, rendering today's share price—based on an arbitrary multiple of temporarily depressed earnings—significantly undervalued… Cyclical pressures, investments in controls and compliance, and other growth initiatives could very likely keep JPM's reported earnings anchored around the $20 billion figure for the next 2-3 years. However, we believe… at some point over the next 5-10 years, JPMorgan could earn $30 billion after tax, and could be valued not at the 9x multiple it sells for today, but at a more commensurate multiple of 12x -15x earnings that comparable banks earning 15% returns on tangible equity command.

While we certainly would not have been able to predict many of the ups and downs over the ensuing nine years, the high-level story has played out largely as we expected. JPMorgan emerged from the ire of the US government, and its methodical investments across its franchises have driven significant growth in earnings, as shown below. The firm's return on tangible equity has improved from 13% to 20% over the life of our investment as it has taken share from competitors across most of its lines of business. Management reduced the share count by more than 20% over our holding period despite being handcuffed by regulators at some of the most opportune times, and the company's dividend yield at exit was roughly 7% of our original cost.



There are few CEOs we hold in higher esteem than Jamie Dimon, and we think he's doing an exceptional job managing one of the country's most important institutions. JPMorgan has effectively zero risk of suffering a "run on the bank" akin to what imperiled Silicon Valley Bank. Indeed, it's likely to see deposit *growth* as a result of the recent crisis of confidence across community and regional banks. Nonetheless, when the actions of a few bad actors subject an entire industry to collateral damage, we find ourselves losing sleep and losing patience. We see little way how the systemically important banks in the United States emerge from the current malaise with *less* regulation—restrictions on share repurchases, higher capital requirements, higher FDIC surcharges, and higher liquidity requirements are all within the range of possible outcomes. Taken as a whole, these considerations increase our concern that JPMorgan will have even less control over its own destiny—that returns which *should* accrue to it will be regulated away—and we've therefore chosen to move on.

We concluded our JPMorgan commentary in the second quarter of 2014 with the following:

Asymmetric investment opportunities in iconic businesses with entrenched competitive positions and strong global growth prospects are rarely found at reasonable prices. We believe JPMorgan to be one of those.

All told, our investment in JPM ended up being just that, yielding a 17% IRR for clients invested from beginning to end. We reinvested the proceeds from these sales into businesses that are equally as dominant in their respective industries, earn far higher returns on equity without the need of leverage to do so, are less cyclical, and in most instances growing faster. We paid more from a multiple perspective for these businesses, and we lost a great manager in Jamie Dimon. But we believe these investments in aggregate improve the sum product of our portfolios, which we will no doubt share with you in subsequent letters.

****

In closing, Ironvine had the opportunity to speak with Value Investor Insight during the quarter about one of our largest investments, Thermo Fisher Scientific. We've attached the summary of our conversation to this letter for those interested in our latest thinking on the company.

Thank you for your continued trust and confidence.

The Ironvine Team

April 28, 2023

IRONVINE CAPITAL PARTNERS, LLC

CONCENTRATED EQUITY

			Annualized Returns as of 03/31/23			Cumulative
	YTD 03/31/23	1 Year	3 Year	5 Year	Inception 04/01/12	Inception 04/01/12
Ironvine Concentrated (net)	7.74%	(7.59%)	15.85%	10.43%	10.91%	212.40%
S&P 500	7.50%	(7.73%)	18.60%	11.19%	12.40%	261.67%

Performance reflects the results of the Ironvine Concentrated Equity Composite. See the Important Disclaimers at the end of this document for additional pertinent information.

IRONVINE
CAPITAL PARTNERS, LLC

CORE EQUITY

			Annualized Returns as of 03/31/23			Cumulative
	YTD 03/31/23	1 Year	3 Year	5 Year	Inception 01/01/16	Inception 01/01/16
Ironvine Core (net)	6.19%	(9.12%)	17.37%	11.99%	12.76%	138.84%
S&P 500	7.50%	(7.73%)	18.60%	11.19%	12.18%	130.04%

Performance reflects the results of the Ironvine Core Equity Composite. See the Important Disclaimers at the end of this document for additional pertinent information.

March 31, 2023

ValueInvestor INSIGHT

The Leading Authority on Value Investing

Right Down the Fairway

The roll off of Covid-related impacts can make life difficult for analysts and shareholders contemplating a firm's long-term future. David Perkins explains why that dynamic may be creating opportunity in Thermo Fisher Scientific's stock.

When value investors talk about capital allocation, it's often in a negative context. A company is overpaying for an acquisition. Its capital-spending priorities are unclear or inconsistent. It should pay down debt rather than buy back stock. While management's capital-allocation skill is considered important, it isn't often lauded.

That's not the case when David Perkins of Ironvine Capital talks about Thermo Fisher Scientific. He certainly appreciates the company's leading positions in providing instruments, chemicals, lab supplies and value-added services to research organizations of all stripes. He values its highly recurring revenue streams, which account for over 80% of total sales. Its bias toward secular-growth markets like biopharma and life sciences is a clear benefit.

But what distinguishes the company in Perkins' eyes is the capital-allocation prowess of its management, led since 2009 by now 55-year-old CEO Marc Casper. Through a deft combination of organic growth and acquisition, Thermo Fisher has consistently under Casper expanded the products and services it offers, deepened its relationships with customers, and strengthened its competitive positions in attractive end markets. The proof is in the pudding. Organic revenue growth when Casper took over, says Perkins, was in the 3-5% annual range, while the company today expects that to be 7-9% over the next three to five years. By next year, he says, free cash flow per share is likely to have tripled over the past decade, from $7 to around $24 per share. Since Casper took over, the stock has been a 13-bagger.

While that doesn't seem like a fact pattern resulting in investor neglect, Perkins argues that the market is giving Thermo Fisher's stock short shrift. The culprit, he says, is worry about growth as Covid-related testing and treatment revenues roll off. Such revenues peaked in 2021 at $9.2 billion (out of $39 billion), but this year are expected to come in around $900 million (out of at least $45 billion). While short-term optics may suffer, he believes the company's long-term earnings power is intact – by 2024 he expects per-share growth in free cash flow to return to its historical low to mid-teens annual rate.

INVESTMENT SNAPSHOT

Thermo Fisher Scientific
(NYSE: TMO)

Business: Provides research instrumentation, equipment, consumables and services used in a wide variety of healthcare, life sciences and other enterprise applications.

Share Information (@3/30/23):

Price	**562.97**
52-Week Range	475.77 – 618.35
Dividend Yield	0.2%
Market Cap	$216.98 billion

Financials (TTM)

Revenue	$44.91 billion
Operating Profit Margin	19.1%
Net Profit Margin	15.5%

Valuation Metrics
(@3/30/23):

	TMO	S&P 500
P/E (TTM)	31.9	17.7
Forward P/E (Est.)	23.7	17.7

Largest Institutional Owners
(@12/31/22 or latest filing):

Company	% Owned
Vanguard Group	8.4%
BlackRock	8.0%
Capital Research & Mgmt	5.4%

Short Interest (as of 3/15/23):

Shares Short/Float	0.7%

TMO PRICE HISTORY

THE BOTTOM LINE

Management's uniquely impressive long-term record of creating value isn't adequately reflected in the company's current stock price, says David Perkins, who believes shareholder returns from today's level could compound at a mid-teens rate for many years to come.

Sources: Company reports, other publicly available information

One new component of that earnings power he highlights is the company's acquisition in December 2021 of pharmaceutical contract research organization PPD, Inc.: "They essentially took the windfall profits from Covid to make a $20 billion acquisition of a highly relevant and attractive business, turning something with a finite life into an enduring asset," he says. "That's a great example of the capital-allocation acumen here."

The stock at today's price of around $563 trades at a 4.3% free-cash-flow yield on Perkins' 2024 estimates. With that free cash flow growing at a 10% annual clip and with more than $25 billion in balance-sheet firepower, he believes shareholder returns could be in the mid-teens over the next several years. "This is right down the fairway of what we want to own and let compound," he says. VII

Ironvine Capital Partners, LLC (Ironvine) is an independent registered investment adviser registered with the United States Securities and Exchange Commission. ***Please visit our website at https://ironvinecapital.com for copies of our Form ADV, Customer Relationship Statement, and Privacy Policy.***

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 interviewee, and 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.

Important Disclaimers

We recently updated our Form ADV, Customer Relationship Statement, and Privacy Policy. There were no material changes to these documents, but if you would like to review a copy of them, please visit our website at https://ironvinecapital.com or contact us at 402-715-5224.

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, is 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. Holdings mentioned, including the Ironvine Core Equity Top Ten Holdings, are subject to change and are not recommendations to buy or sell any security.

Ironvine Capital Partners, LLC (Ironvine) is an independent registered investment adviser registered with the United States Securities and Exchange Commission. The firm definition includes all assets that are managed by Ironvine.

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

The Ironvine Concentrated Equity Composite was created on December 1, 2013, with an inception date of April 1, 2012. The strategy does not seek to directly track or compare itself to any particular equity benchmark, but the composite is compared against the total return of the S&P 500. The benchmark includes 500 stocks representing all major industries of the economy. Ironvine Concentrated Equity employs a total return strategy and the S&P 500 is provided as it is the most widely recognized alternative to any actively managed mandate amongst global investors. Past performance is not indicative of future results. All results are calculated in US Dollars and include reinvestment of dividends and other earnings.

Performance presented prior December 1, 2013 occurred while the Portfolio Management Team was affiliated with a prior firm and the Portfolio Management Team members were the only individual(s) responsible for selecting the securities to buy and sell. A review of the performance record for compliance with the portability requirements of the GIPS standards was completed by an independent accounting firm. The verification and performance examination report are available upon request.

Prior to October 2017 the composite was named "The Ironvine Composite."

The Ironvine Core Equity Composite *includes all accounts over which Ironvine deems to have discretion and that follow the composite strategy. Ironvine Core Equity seeks to earn above average long-term returns by investing primarily in a portfolio of common equity securities with a particular focus on companies that have the ability to generate high and sustainable returns on invested capital.*

The Ironvine Core Equity Composite was created on 12/29/2017, with an inception date of January 1, 2016. The strategy does not seek to directly track or compare itself to any particular equity benchmark, but the composite is compared against the total return of the S&P 500. The benchmark includes 500 stocks representing all major industries of the economy. Ironvine Core Equity employs a total return strategy and the S&P 500 is provided as it is the most widely recognized alternative to any actively managed mandate amongst global investors. Past performance is not indicative of future results. All results are calculated in US Dollars and include reinvestment of dividends and other earnings.

Performance presented prior January 1, 2017 occurred while the Portfolio Manager, Richard L. Jarvis, was affiliated with a prior firm. Mr. Jarvis was the only individual responsible for selecting the securities to buy and sell at the predecessor firm and was a primary decision maker in that capacity at Ironvine until his retirement on 12/31/20. This performance record was incorporated into the Ironvine Core Equity Composite in compliance with the portability requirements of the GIPS standards. A copy of the Portability report is available upon request.

Ironvine Capital Partners ("Ironvine") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Ironvine has been independently verified for the periods 12/1/13– 12/31/21. A firm that claims compliance with the GIPS® standards must establish policies and procedures for complying with all the applicable requirements of the GIPS® standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS® standards and have been implemented on a firm-wide basis. The Ironvine Concentrated Equity Composite has had a performance examination for the periods 12/1/13– 12/31/21. The Ironvine Core Equity Composite has had a performance examination for the periods 1/1/17– 12/31/21. The verification and performance examination reports are available upon request.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. To be included in the composite an account must have a minimum value of $25,000 at the beginning of a month. The U.S. Dollar is the currency used to express performance. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Returns are presented net of management fees and commissions and include the reinvestment of all income. Net of fee and commission performance was calculated using actual management fees and commissions. The investment management fee schedule for the composite is tiered, at 1.0% for relationships less than $10 million, 0.90% for relationships between $10 million - $25 million, 0.80% for relationships between $25 million - $50 million, 0.70% for relationships between $50 million - $100 million, and 0.60% for relationships above $100 million (each tier indicated as an annual percentage charged quarterly). Actual investment advisory fees incurred by clients may vary. The collection of fees produces a compounding effect on the total return net of fees. For example, a portfolio that earned 8% annually for ten years would result in a cumulative return of 115.9% before investment management fees and 96.7% net of such fees, assuming a 1.00% fee per year.

The firm's list of composite descriptions is available upon request. Effective 1/1/2017 Ironvine merged with Saddle Road Partners, LLC (Saddle Road). The surviving entity is Ironvine Capital Partners, LLC. For more information about any of the above contact Paul Penke at 402.916.1702 or ppenke@ironvinecapital.com. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission.