ACADEMY
CAPITAL MANAGEMENT

July 31, 2020

Enclosed is your statement for the second quarter of 2020.

We use the second quarter's letter to highlight our focus on earnings. We look for long-term aggregate EPS growth of 6-8% per year in the companies that we hold in our portfolios. This growth is what ultimately drives market value growth. In line with our expectiations, the prior five-year EPS growth of our portfolio companies was 11.3% per year, while their prior five-year price return (excluding dividends) was 8.3% per year. As discussed last year, what continues to be striking is the differences in performance of the companies falling within the three categories outlined below.

As a firm, we continue to evolve. In our earliest period, we focused on "deep value" opportunities in which the book value was greater than the market value. Book value is an accounting measure, while market value is derived from public opinion. A significant divergence sometimes indicated an opportunity to buy accounting measured dollars for mere quarters in real currency. The accounting measures indicated enduring values that were likely to be realized when temporary adversities subsided. But over the past decades, these divergences have been increasingly narrowed by a write down of book value. The forces driving this trend are like those causing consumers to replace home appliances rather than to repair them. Improvements in manufacturing, increased competition and 0% interest rates are accelerating the tendency to disregard historic investments, which less frequently indicate enduring values, in favor of "out with the old and in with the new."

Seeking higher returns, we have reduced exposure to "deep value" stocks. At the end of 2019, we held roughly 8% of our portfolios in this category and are targeting 0%. In this category, prior five-year EPS declines averaged 44% and prior five-year price declines averaged 33%. We are not only reducing ownership of these companies, but we are also reducing research of such companies, so they will "lead us not into temptation."

*It is important to reiterate that because we manage individual portfolios but write a general letter, your portfolio may vary from the stocks assumed in our discussions.

Over time, we have increasingly focused on more durable business franchises, building the core of our portfolios around what we term "equity bonds." These are companies whose earnings are so predictable as to appear bond-like. Their predictable earnings are mostly driven by brand characteristics, like those of Hershey, Pepsi, and Philip Morris. Further, their competitive advantages are so stable and durable that they are easily held for a decade or longer. However, two factors continue to reduce their attractiveness. First, their prices have become elevated. Second, their market share gains have been stalled by a combination of

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declining opportunities for mass advertising and increasing competition in product diversity and price. We currently own roughly 65% in this category – a comfortable percentage. However, the headwinds we have identified have caused prior five-year EPS increases to be 36% while prior five-year price increases are 24% (with a sizeable premium for companies with tech exposure like Apple). Our future investment in this area is likely to be more limited.

The final category of stocks and our highest preference is a group we term "compounders." We use this designation to identify companies with multiple factors likely to drive earnings growth. We can use a simple example here with Mastercard. Mastercard has the likelihood of issuing more cards as one factor for growth and the likelihood of encouraging increased per card spending as another growth factor. These "compounders" are attractive to us because they have multiple tailwinds driving EPS growth. Unfortunately, these companies have been attractive to others, too, and their stock price has been high. Paying "nosebleed" P/E ratios has been hard, but nonetheless we have done so, and we're glad we did. We currently have roughly 25% of our portfolios invested in this category. Over the past five years, EPS increases have averaged over 200% while price increases have averaged 150%. It's important to note that there is no free lunch, and the downward volatility of these holdings in a rising interest rate environment is likely to be much greater than that of holdings in the other categories.

We hope that this brief discussion illustrates why we have been selectively trimming in our "deep value" and "equity bonds," while continuing to build positions in our "compounders." We want you to stay informed and feel comfortable about our investing discipline. In communicating, we try to "do unto others as we would want done unto us." If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or from our office. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio. We have enclosed a copy of the new ADV Part 3 Relationship summary. This summary is a brief overview of the long standing ADV Part 2A Disclosure Brochure. If you would like a copy of Academy's Form ADV Part 2A Disclosure Brochure, the more detailed information report about Academy that we file with the SEC each year, please contact clientsupport@academycapitalmgmt.com.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management

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