Portfolio Activity Q2 2018

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

BUYS

Facebook, Inc. (FB)

Facebook, Inc. owns multiple social networking platforms – most notably Facebook, Instagram, WhatsApp, and Facebook Messenger. Facebook generates revenue by selling advertising space on these platforms to businesses around the world. After the *Cambridge Analytica* scandal, which drove the stock price down considerably, we purchased an overweight position for client portfolios. We continued to build on this position during Q2, as we believe that this company remains a core long-term holding.

In our opinion, Facebook's economic moat is incredibly wide due to a lack of competition and a strong network-effect. This moat allows it to generate significant cash flow with very little incremental investment. Its capital-light business model and strong financial standing are exactly what we look for in a high-quality business. Therefore, we were pleased with the opportunity to purchase shares at a discount to our estimated intrinsic value.

McKesson Corporation (MCK)

McKesson's primary line of business is drug distribution, which constitutes more than 95% of its revenue. Its high volume of business and operational efficiency combine to produce high returns on invested capital – a characteristic that we prioritize when seeking investment opportunities. This, in junction with scale (it sells to over 40,000 pharmacies throughout the US), supports McKesson's economic moat and gives us confidence in the long-term earning power of the business.

The company's stock price declined during the quarter as a result of two main factors. First, there was speculation that drug prices would come down in the future, which would potentially hurt McKesson's bottom line. Secondly, Amazon made an acquisition and entered the space. When we initiated our position in McKesson, we believed that these factors were appropriately priced into the stock. Furthermore, we have conviction that McKesson will remain a high-quality company in the face of these external threats. The company serves as a necessary cog in the healthcare system. Drug companies do not have the means or the desire to distribute drugs to pharmacies. McKesson's distribution infrastructure and customer relationships make the process more efficient for the end user, drug manufacturers, PBMs, and pharmacies. The drug distribution business is an oligopoly and highly regulated, which creates natural barriers to entry on a wide scale. While Amazon could gain a piece of the market, we still believe that McKesson will remain the market leader. This stock is a new position for clients, and we purchased a large amount of it during the quarter once it met our valuation criteria.

BUYS (Cont'd)

Starbucks Corporation (SBUX)

Starbucks retails specialty coffee around the world. It primarily operates retail locations but sells whole bean coffees and bottled drinks outside of its retail locations as well. We added shares of Starbucks to client portfolios because it checked all of our boxes for a high-quality business selling at what we believed to be a fair price. In our opinion, the company's greatest asset is its brand. We see tremendous value in the fact that it has captured significant mind share among millions of global consumers and has become a staple in many people's daily routines. We believe that this gives the company excellent pricing power and limits its customer acquisition costs.

The market recently penalized the company for lowered same-store sales, executive management turnover, and a public relations issue. These concerns are certainly valid; however, we view them as short-term in nature. We see a long runway for Starbucks to extract value from its strong brand, and in our opinion Starbucks will continue to act as a steward for the growth of coffee's popularity on a global scale.

Apple Inc. (AAPL)

Apple designs, manufactures, and sells consumer electronics, software, and online services. Its primary product – the iPhone – accounted for 62% of revenue in Q2. We added to our existing position during the quarter, as we believed the market was failing to account for the company's post-tax reform financial standing and the company's strong moat. Apple is an excellent cash generator and a staple in our clients' portfolios. We continue to be a net buyer of the stock and seek to add shares when the market and our calculation of intrinsic value are materially disjointed.

Berkshire Hathaway Inc. Class B (BRK.B)

Berkshire Hathaway is a holding company that owns subsidiaries in a diverse range of industries – from railroads and insurance to batteries and candy. It is run by legendary investor and businessman Warren Buffett. We added shares of Berkshire Hathaway throughout the quarter as prices fell below our estimation of intrinsic value.

Cerner Corporation (CERN)

Cerner creates, sells, and services electronic health record (EHR) software for healthcare organizations. The company has a strong economic moat as it enjoys excellent scale and customer relationships. Its products and services are used in 70 of the 100 largest national health systems and the company is the #1 or #2 share leader in 10 of 11 global regions. Due to consolidation in the healthcare sector – specifically within hospital systems – we believe Cerner can experience more rapid organic growth and lower customer acquisition costs without significantly ramping up capital expenditures. Share prices dropped considerably in the early parts of the quarter, and we took the opportunity to purchase shares for clients. However, shares quickly appreciated beyond our entry price after this initial purchase.

Alphabet, Inc. Cl. C (GOOG)

Alphabet (formerly known as "Google") continues to dominate and grow through its wide economic moat. Alphabet is highly profitable, has minimal debt, and holds a stockpile of cash on its balance sheet. These attributes, coupled with an underappreciation of the company's network effect, an opportunity to significantly monetize YouTube, and an over-penalization of Google Ventures' negative profitability, continuously incentivize us to add to our long-term position when given the opportunity. We also believe that shares of Alphabet were punished during the quarter as a result of the Facebook scandal, which gave rise to concern surrounding personal data handling. As a result, we were able to acquire more shares of this high quality company at prices which we believed compensated us for any inherent risks.

BUYS (Cont'd)

Wells Fargo & Company (WFC)

Wells Fargo is the third largest bank, by assets, in the United States. We purchased shares during the quarter as the company continued to recover from its account fraud scandal. We believe that Wells Fargo will fix its internal incentive structures and come out of this situation a better company. At the end of the quarter, the company passed the Federal Reserve's stress test and increased its dividend. This further reaffirmed our long-term confidence in the business' financial standing and economic moat.

SELLS

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

Biogen Inc. (BIIB)

We sold shares of Biogen in all accounts except those that had short-term taxable gains. We believe that Biogen has reached its fair value range, and we saw better opportunities in the companies listed in the "Buys" section.

Cisco Systems, Inc. (CSCO)

We sold shares of Cisco during the quarter in all non-taxable accounts and in some taxable accounts in which sales were tax-efficient. Shares of Cisco surpassed our estimate of intrinsic value, and we used proceeds for more attractive opportunities.

Pfizer Inc. (PFE)

We sold out of the position as shares surpassed our estimate of intrinsic value. We took this as an opportunity to consolidate our pharmaceutical holdings and reposition funds into other sectors.