THE MONOPOLY PORTFOLIO

The Monopoly Portfolio has power to perform
High Performing Stocks often have little or no competition

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September 2018

Over the years, there have always been some companies that manage to get to the market first with new technology or they leverage their way into a number one position and cannot easily be displaced. Two great historical examples are AT&T (before their breakup) and Microsoft Corp. Both these companies were positioned so well and dominated their market sector that the U.S. government took direct regulatory action to bring more competition into the markets with the thought that too much monopoly power would not be good for "the people". As investors, we should be aware that companies with strong market position that lead in their sectors often make excellent long-term wealth generators.

How do these companies gain this monopoly status? There are usually three ways:

01 *Governments often create monopolies*:

AT&T was a great example in the U.S. Another case, this time in China, is Baidu (BIDU). The government has given a clear advantage to Baidu in its regulations. They have kept Google out of China and restrained some local competitors in the way they compete.

02 *Innovation and patent power*:

Some companies create new technologies that allow them to dominate their sector for 17 years (the life of their patents). Microsoft's DOS operating system was the only operating system allowed on IBM PCs due to an agreement with IBM in the early days of the companies. This solidified Microsoft's position as they dominated with 90% market share for decades.

03 *Marketing power and better execution*:

A good example here is IDEXX Laboratories (IDXX,) in Portland, Maine, that dominates in the pet diagnostics test market. IDEXX has 40% (or more) market share and spends 4 times more in R&D per year than the next closest competitor. They are not a pure monopoly, but they dominate via better products and services.

As investors we are continually searching out companies that have innovated and developed into a strong market position. We are continually seeking out these situations, since they often allow long-term shareholders significant wealth creation opportunities. In today's marketplace, companies like Alphabet (Google's parent company,) Amazon, and Facebook all dominate in the sectors they operate. In the case of Google and Facebook, they certainly have monopoly-like power. Having 80-95% market share is a clear indication that you are far superior in some way to any other company in the sector. For example, Google is indisputably dominant in the search business – they have more than 90% of the search market and it is highly likely they will maintain this position since they are clearly a powerhouse with more computing power (and highly valued data indexed) than any other company.

Along with the power in the marketplace, monopoly-like businesses often come with superior business models. This includes high margin, low recurring capital requirements, and just an easier business to operate and maintain. Having low or no competition seems to make life easy for these companies. You, as the shareholder, could potentially have a wonderful benefit derived from these high profits and superior business model – you are able to create wealth at a faster, more reliable manner. Having managed portfolios over the last 35 years, we have often invested in these types of companies. We highly recommend that you work to develop as many of these companies as possible into your investment portfolio. Higher profit returns will be your reward.

Many monopolies or quasi-monopoly businesses have surged not because the markets were doing something right, but, in fact, because the markets were doing something wrong. In other words, as it is often the case, when a business creates robust and durable competitive advantages, the explanation lies in that the business unraveled the strands of market inefficiencies.

Warren Buffet and his partner, Charlie Munger, have repeatedly emphasized that a good investment must have "durable competitive advantage." That advantage should result in profit sustainability. Many others have used terms such as economic moat, competitive edge, and so on. The idea remains, a company with a strong differentiator, usually given by its first-to-market position, geographically unique position, lowest cost of production, efficient scale, brand loyalty, etc., should, in most cases, predict a company's success.

In constructing Cabot's aggressive growth portfolio, we have aimed to identify the companies that, with compelling risk-adjusted returns, are poised to capitalize secular and structural trends by having introduced a large change into the market, are in the process of introducing large breakthroughs, appeal to a very large target market, and are led by extraordinary leaders. Some positions are:

Alphabet (GOOGL/GOOG) (Google's parent company) – This company is, without a doubt, the best example of a highly monopolistic business. Not convinced? Guess what has been one of the most searched words on Bing? Google! So, that gives us a clear idea that Google predominates in the search-engine market in America and other countries. EU regulators definitely think Google is a monopoly and have imposed some big fines on them. Nevertheless, Google has shown robust growth both on top-line revenue and earnings fueled by ad sales. Mobile ads are becoming increasingly a key revenue driver for the company. Cloud services, hardware, and YouTube are also driving growth, but still representing only ~14% of total revenue. New stock catalysts? Google is developing AI chips in-house. Google's TPU features a new architecture "systolic array", which reuses the same input several times, without repeatedly having to store it back in a separate memory or register, claiming to be the world's fastest AI chip[1]. Another one is Waymo, Alphabet's subsidiary, which leads in the Autonomous Driving race.

Market Share:
>90% of search in the U.S.[2] & >35% share of digital ad revenue[3]
Key Driver of value:
Make information universally accessible and AI advances
Size of Target Market:
>3 Billion internet users globally (excluding China)
Stemwinders:
Co-Founders, Larry Page, CEO & Sergey Brin, President

[1] Bloomberg New Energy Finance. (2018). *Bloomberg NEF Technology Radar: The AI edition.*
[2] Retrieved from: http://gs.statcounter.com/search-engine-market-share
[3] Retrieved from: https://www.recode.net/2018/3/19/17139184/google-facebooks-share-digital-advertising-ad-market-could-decline-amazon-snapchat

IDEXX LABORATORIES

Idexx Laboratories (IDXX) – The king of diagnostic and test applications for pets. Set to capitalize on the increasing "humanization" of pets, Idexx Labs is the global market leader in the companion animal diagnostics and veterinary diagnostic and testing market with >40% of the total addressable market. Our research has concluded that their competitors' position is weakening against very strong efforts by Idexx to lead and innovate. They have been doing this by investing more than 4 times the next closest competitor in R&D.

Market Share: >40% of total revenue
Key Driver of value: Increasing pet ownership and humanization drives total pet spending
Size of Target Market: $2.6B U.S. Veterinary Diagnosis and Software Market Revenue (170mm dogs & cats) + potential Developed Markets Revenue $6.1B[4] (400mm dogs & cats)
Stemwinder: Jonathan Ayers, Chairman, President, CEO

The market Idexx serves is still nascent, although diagnostic spending on pets is more than four times the level of 2000. Diagnostic testing utilization is expected to keep growing as millennials tend to spend more on their pets than older generations.

Adobe®

Adobe Systems, Inc. (ADBE) – In the digital content space, Adobe has become a "must-have" software for multimedia, design, and creative professionals and individuals alike. Adobe is pretty much ubiquitous and offers the largest suite of products out there, whereas its competition, if some, offer one-point solutions. We recently attended a conference and had the opportunity to listen to Adobe's recently appointed CFO, John Murphy, who expressed his enthusiasm and mentioned that he joined Adobe in 2017 because Adobe does not act like a 36-year old company. Indeed, this year Adobe is expected to display a staggering 56% EPS growth along with pristine financial statements- no net debt, strong growth in sales and earnings, above average margins, positive FCF, and high ROIC.

Market Share: De-facto standard in digital documents and creative software
Key Driver of value: Enterprises are becoming digital
Size of Target Market: >$80B total addressable market by 2020[5]
Stemwinder: Shantanu Narayen, Chairman, President, CEO

GUIDEWIRE
Adapt and succeed™

Guidewire (GWRE) – This company is the #1 software provider to the property and casualty (P&C) industry. Its closest pure competitor is said to be four times smaller, and its growth rate has always been outpaced by Guidewire. In 2013, Guidewire had 158 customers and that number has been increasing steadily to 328 customers as of Q4-2017. Looking forward, Guidewire still has a large opportunity to grow, with approximately 80% of the industry's premiums still transacted in legacy systems. Guidewire's customer retention is as good as it can get with almost 100%, demonstrating the critical nature of the software in the P&C industry. Guidewire is currently transitioning to the

[4] IDEXX estimate of 2017 sales of veterinary diagnostics products, software and services to pet care providers compared to IDEXX estimate of the number of pets in developed markets as of the end of 2017. Potential International companion animal diagnostic market size estimated assuming the same diagnostic spending per pet as in the U.S. in 2017.
[5] Source: Adobe's Investor Presentation July 2018

cloud, shifting the revenue model from license fee to a recurring type of revenue model of monthly subscriptions, increasing the sustainability of their business, in our view.

Market Share:
Est. 70-80% share of new digital cloud-based software solutions
Key Driver of value:
Requirement for operational efficiencies increasing
Size of Target Market:
>$5.8B Global Market Estimated Wallet[6]
Stemwinder:
Marcus Ryu, President, CEO and Co-Founder

CoStar Group

CoStar Group (CSTR) - CoStar is by far the predominant provider of commercial real estate data – management claims to have a decade of competitive advantage over the competition with more than $1B spent in research and 10,000-man years building the database. Real estate professionals have claimed that CoStar is the gold standard information provider and has increased exponentially the efficiencies of their jobs, from data collection to a building-relationships-type of business. The company is in the middle of a transition from one of its brands, LoopNet, to their core CoStar offering, driving incremental recurring revenue at almost no additional cost, causing margins to improve significantly towards management's goal of 40% EBITDA margin by year end.

Market Share: 94% of U.S. brokers already list with CoStar. 83% of all commercial real estate transactions in the U.S. in 2016 involved CoStar at some point[7]
Key Driver of value:
Data is the new asset class
Size of Target Market: CoStar total worldwide addressable market at $10.1B[8]
Stemwinder: Andrew Florance, President, CEO

It is impossible to own a portfolio of only monopoly-like companies. One cannot find that many companies that dominate their sectors. However, one must recognize that these monopoly characteristics along with high margins and strong management teams are a powerful ally to the investor's goal of building wealth. Some of these companies will continue to create a great deal of value. We are fully aware that some of these companies will endure the same fate as AT&T or Microsoft when the U.S. government came down on them with new limiting regulations. When this does occur, it may limit but not end growth opportunities. We believe the new digital world has given some of these companies a bit of extra time as the world works to digitalize nearly all industries over the coming years.

For more information about our services, visit:

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[6] Source: Guidewire's Analyst Day Presentation 2017
[7] Retrieved from: http://www.costargroup.com/costar-news/details/Forbes-names-CoStar-Group-one-of-the-worlds-most-innovative-growth-companies-2017
[8] Source: J.P. Morgan estimates