Second Quarter 2024

The performance of securities mentioned within this letter refers to how the security performed in the market and does not reflect the performance attributed to the core equity portfolio. Please see the chart at the end of letter, which reflects the full list of contributors and detractors based on each security's weighting within the core equity portfolio.

For a copy of Ensemble Capital's equity strategy performance track record, please email a request to info@ensemblecapital.com.

Returns as of June 30, 2024	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SINCE INCEPTION*
ENSEMBLE EQUITY COMPOSITE	8.02%	18.23%	2.48%	11.25%	11.33%	10.08%
S&P 500 TOTAL RETURN	15.29%	24.56%	10.01%	15.05%	12.86%	10.21%

Past performance is not an indication of future returns.
Please see disclosures on final page. Performance figures with the Ensemble Equity Composite are shown net of fees. The composite's inception date is December 31, 2003

In the first half of 2024, our investment strategy was up 8.02% while the S&P 500 was up 15.29%. Incredibly, the S&P 500 was up over 15% even as the average stock within the S&P 500 is only up 5.07% so far this year. Given this massive disconnect between how the market is doing and how the average stock is doing, our comments in this letter are going to focus mostly on stocks we don't own in our portfolio, rather than our more typical discussion of what we do own.

Investors generally think about the S&P 500 as a broadly diversified benchmark that represents the returns an investor would generate by simply buying all the stocks in the index. The stocks within the S&P 500 index are weighted based on their market capitalization with the largest companies making up a larger percentage of the index than smaller companies. But for most of stock market history, the performance of larger stocks within the S&P 500 were highly similar to the performance of smaller stocks within the S&P 500.

For instance, from our 2003 inception through the end of first quarter of 2023, the market cap weighted S&P 500 generated annual returns of 9.16% per year while the average stock within the S&P 500 generated slightly better returns of 9.35% per year. We can also extend this analysis back to the end of 1989, the earliest data available on Bloomberg, to show how the returns of the market cap weighted S&P 500 are always nearly identical to the returns of the average stock within the S&P 500, with the S&P 500 returning 9.89% per year vs the average stock return of 9.64%.

There have been periods during which the market cap weighted S&P 500 deviated from the average stock returns, such as from 1995 to early 2000 during the Dot Com Bubble, but historically periods like these have always reversed over time.

Over the last five quarters the market cap weighted S&P 500 has generated a blistering 35.43% return even while the average stock within the S&P 500 is only up 16.23%. But it's not all of the larger companies that are outperforming smaller ones, rather it is just a handful of the largest companies.

Most people by now have heard of the so called Magnificent Seven, or Tesla, Amazon, Apple, Google, Nvidia, Microsoft, and Facebook. Those stocks as a group are up a shocking 94.90% over the same time period, compared to a total gain of just 16.23% for the average stock.

But even within the Magnificent Seven, it is only a handful of stocks driving the big gains. Microsoft is only up 57%, trailing the Magnificent Seven average return by nearly 40%. Apple is only up 29% and Tesla is actually down 5%. Google has generated returns nearly as good as the Magnificent Seven average, while Facebook has outperformed significantly. But to really understand what's going on, you primarily just need to focus on Nvidia.

Nvidia is up a shocking 345% while the average stock in the S&P 500 is up just 16%. It is only during the Dot Com Bubble, the one other time in at least the past 35 years that the market cap weighted S&P 500 has sharply outperformed the average stock, that the largest stocks in the index have put up such dramatic returns.

In the late 1990s, the market cap weighted S&P 500 outperformed the average stock dramatically due to what was then called The Four Horseman of Technology: Cisco, Intel, Microsoft and Dell. These stocks rocketed higher on the back of a mania over the promise of the internet. Each of these stocks were indeed big beneficiaries of the internet. But their stock prices did not just bake in the idea that the internet was a big deal, but rather that these specific companies would capture a massively outsized portion of the total internet driven profit pool.

And at ground zero was Cisco. The company literally built the very technology over which the global internet flowed. Without Cisco, there would be no internet. And so in the five years leading up to the peak of the Dot Com bubble, Cisco rallied 3,550% vs the S&P 500 up 227%, while the average stock was up just 111%.

Not dissimilarly, we are in the midst of a massive wave of enthusiasm for artificial intelligence. The fact is, the enthusiasm for the internet in the late 1990s was not misplaced. In fact, we would argue that the internet turned out to be an even bigger deal that most investors appreciated it would become. Rather the mistake of the Dot Com era was investors thought that it was the incumbent market leaders that would capture all of the profits of the internet age. While in fact, the big winners of the internet were smaller, newer businesses or even businesses that were founded well after the Dot Com bubble had crashed.

And yet once again, we believe investors are correctly recognizing the massive potential of artificial intelligence even as they incorrectly assume that all of the AI profits will accrue to the incumbent market leaders. And so, we get Nvidia behaving just like Cisco did during the Dot Com bubble, up 2,926% over the past five years vs the S&500 up 101%, while the average stock is up just 68%.

Today, the five largest companies in the S&P 500 make up nearly a quarter of the entire index, the most intense performance concentration in at least half a century and significantly more concentrated than at the top of the Dot Com bubble.

Now to be clear, there is no particular level of concentration that is "fair" or "appropriate". In some countries, particularly emerging markets, only a small number of companies capture the bulk of corporate profits and thus justifiably make up a very large portion of the index. But what we can say is that the largest companies within the S&P 500 currently make up a far larger weight than the earnings they contribute, and investors appear to be betting that the incumbent market leaders will capture nearly a quarter of all corporate profits generated by the S&P 500 in the future.

Is this plausible? Sure. Is it likely? We strongly think not.

The fact is we've all been hearing about the strong returns of a small number of large stocks for quite some time. We used to talk about FANG, for Facebook, Apple, Netflix and Google before we talked about the Magnificent Seven. But for much of the past decade, the strong performance of a set of large companies was driven by those companies' strong earnings growth. From 2010 until late 2022, the PE ratio of the S&P 500 was nearly identical to the PE ratio of the average stock within the S&P 500. But in the year and half since, the average stock's PE ratio has trended at a very reasonable 17x-18x, while the market cap weighted S&P 500 has seen its PE ratio soar to 24x, or essentially the highest valuation ever afforded the S&P 500 outside of recessions or the Dot Com bubble.

But as we've seen earlier in this letter, it is really just a couple of the largest stocks driving all of the elevated valuation. Nvida trades at a PE of 70, Amazon has a PE of 54, Microsoft trades at 40 times, Apple at a PE of 34. Despite being down by more than half since its all-time high, Tesla still trades at a PE of 100.

In most years, about half of all stocks outperform the S&P 500 and half underperform. This makes good sense. The market is pretty efficient. It is not uncommon for only 40% of stocks to outperform in a given year or as many as 60% to beat the index. These are normal variations. But last year less than 30% of stocks in the S&P 500 outperformed the index and so far this year only 25% of stocks have outperformed.

We are witnessing the most dramatic deviation of at least the half century with fewer stocks beating the market today than even the peak years of the Dot Com bubble.

In the years ahead, one of two things will happen. Either the largest companies in the world will gobble up a larger share of profits than has ever occurred in the US, or the average stock will perform much better than the S&P 500 in the years ahead as the excessive outperformance of mega cap stocks reverts as it has in every past instance. Either this time is different or it's not. And we believe strongly that it's not.

Our goal is unequivocally to outperform the S&P 500 net of fees over the long term. Most of the time when we generate returns above or below the S&P 500 it is due to particularly strong results or weak results within our portfolio. But recently, the primary explanation for our underperformance has been stocks that we have

chosen not to own in our portfolio. This is a rare phenomenon because, as I've laid out, it is unusual for such a small number of stocks not in our portfolio to so heavily influence our relative returns.

From the inception of our performance track record at the end of 2003 through just before COVID, our strategy returned 9.97% per year. Over the four and a half years since COVID, our strategy has returned an almost identical 9.77% per year. In other words, the investment returns we've generated for our clients since COVID have been completely consistent with the returns we generated over the 16 years prior to COVID.

However, since COVID began, there has been much, much higher volatility in the US economy, financial markets, and our investment strategy. And there has been much higher dispersion, meaning that the difference between strong performing stocks and weak performing stocks has expanded dramatically.

So while we've had a handful of stocks perform very poorly and drag down our returns since COVID began, we've also had a group of super strong performing stocks. Google is up 172%, Ferrari is up 155%, Netflix is up 109%. NVR has doubled, Booking is up 94%, Fastenal is up 92%. And Chipotle, which we bought during the initial COVID market crash and sold in June, was up 371%.

While our absolute return since COVID began is highly similar to our returns over the 16 years pre-COVID, it is true that our strategy did better than the average stock in the S&P 500 during the first 16 years but has slightly trailed the average stock return since COVID began. But this difference only adds up to a cumulative return shortfall of just 2.7%. This isn't an outcome we are satisfied with, but we only need a good quarter or two to get back to beating this benchmark.

However, while the pre and post COVID returns for our investment strategy and the average stock in the S&P 500 have been very similar, the market cap weighted S&P 500 has outperformed the equal weight index by 4% per year. This huge gap is historically unprecedented and is due to the very small number of mega cap stocks trading up to all time high valuations.

	2003-2019	2019-2Q24
Ensemble Capital	9.97%	9.77%
Equal Weight S&P 500	9.37%	10.21%
Market Cap Weight S&P 500	9.10%	14.19%

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So how does this unwind? Plenty of people worry that if Nvidia and the Magnificent Seven stop posting strong returns, the overall market will suffer. But this is not actually what happened the last time mega cap valuations unwound in the wake of the Dot Com bubble.

In the year and a half after the Dot Com bubble burst up until the day before 9/11, Cisco fell 81% and the S&P 500 declined 26%. But the average stock in the S&P 500 generated slightly positive returns.

For more than two decades we've generated just below 10% annual returns net of fees for our clients. This return has been higher than the average stock performance over that time period. But due to extreme performance from a very small set of the biggest companies in the S&P 500, driven by their valuations expanding to record levels, the market cap weighted S&P 500 has generated returns superior to our own since COVID began.

Our plan is to stick with what has worked for over two decades. We don't know when the relative performance of a small number of very large stocks will revert to be more in line with the average stock, but we do know that this has indeed happened in every historical instance.

Over the very long run, the stock market has returned about 9% a year. This return comes from about 5% growth in the economy and corporate earnings, as well as 4% from dividends and buybacks. We buy stocks with a goal to beat this long run hurdle and we've done just that for over two decades now. In the years ahead we expect the average stock to outperform the S&P 500 as valuations normalize as they have done so many times in the past. Our goal will be to keep putting up performance, net of fees, that exceeds the long term rate of return of the stock market and in doing so, we expect we will outperform over most long term time frames.

Company Focus: Analog Devices (ADI), Chipotle (CMG), Illumina (ILMN), Veeva Systems (VEEV)

We initiated a position in Analog Devices (ADI) in May 2023 and then further increased our position in September 2023 as our conviction grew.

Since May 2023, the stock is up about 25% despite quarterly revenue declining by 33% in the most recently reported quarter. As surprising as it might sound, this discrepancy wasn't entirely unexpected. Semiconductor stocks often sell off in anticipation of a slowdown or decline in revenue and rise in anticipation of a bottom and future improvement.

At the time we started buying, the analog semiconductor market was at the front end of cyclical weakening coming off of the post-pandemic inventory corrections. Customers and distributors built up inventories to support the surge in sales of products and corresponding shortages they experienced in 2020 and 2021. As supplier production caught up just in time to meet end demand shifting from products to services in mid-2022, the result was a drop off in end-demand and the realization that there was too much inventory of components built.

While ADI was late to see this cyclical weakening, its stock price had already anticipated it because other industry players like Texas Instruments were already a couple quarters into the down cycle and there was a broad consensus that the US was headed into a recession due to the fastest interest rate hikes in modern history. The stock therefore bottomed in October 2022 ahead of its revenue peaking in early 2023.

The analog semiconductor industry has experienced multiple cyclical declines in the past only to resume making new highs as the secular demand for products continues to grow over time with new applications. Recently, both ADI and TI reported that they are seeing improvements in net new order bookings across most segments and geographies, which gave the management teams the confidence to offer an improving outlook for the next quarter.

With inventory for their products depleting at their customers and distributors and end demand resilient, ADI stock price has seen new record highs in anticipation of a resumption in revenue growth rates and profitability. If we are indeed at the bottom of the cycle, then we anticipate the next few quarters should see improving revenue and earnings growth.

Next, we'd like to discuss our position in Illumina. Despite its poor stock performance over the past two years, we believe it's an important competitively advantaged company and has become very undervalued for two reasons.

First, its acquisition of GRAIL - the first multi-cancer early detection screening technology, one that has required huge amounts of investment and meaningfully diluted earnings while coming under fire from regulators for being anti-competitive.

Second, a slowdown in its core genetic sequencing business due a slowdown after the COVID pandemic subsided, tighter capital markets for customers during 2022 and 2023, exacerbated by an important product cycle transition that ultimately improves its competitive positioning and business outlook.

Illumina is the leader in genomic sequencing, with 80-90% of all sequencing volumes globally performed on its instruments. Its innovations across biology, chemistry, optics, and computation has helped drive down the cost of sequencing an entire human genome from over $100,000 in 2009 to just $600 in 2021 with its NovaSeq 6000 high throughput instrument. Despite the 99% reduction in cost, Illumina's revenue increased from $666 million to $4.5 billion because applications and volumes of gene sequencing exploded higher, enabled by greater affordability.

As the cost of sequencing comes down, it makes new research and clinical applications more affordable to develop and adopt. As a result, the volumes of genes sequenced tends to increase even faster across not just humans, but all organisms of interest, including food and pathogens.

Thus far, our best estimate is that fewer than 10 million human genomes have been sequenced cumulatively. But as prices come down to just a couple hundred dollars with the adoption of the newest NovaSeq X+ instrument launched in 2023, it makes it feasible to create and adopt applications that will leverage an even lower cost of $200 per genome to potentially drive tens of millions of genomes annually.

AI is an important complimentary technology towards driving sequencing applications because it can automate sifting through billions of bits of DNA, RNA, and protein data to extract clinically useful information around people's health while accelerating new discoveries. Years or even decades of human labor can be automated by AI into weeks or months, while its scale will enable new types of discoveries beyond past human capabilities.

It is why Jensen Huang, CEO of Nvidia has repeatedly said that he believes digital biology is the area where the next amazing revolution is going to come from, enabled by AI. Illumina's sequencing instruments are the gateway between the chemical/biological world and the digital computing where information can create useful discoveries, tests, and therapies.

One application is the multi-cancer early detection screening (or MCED) that GRAIL has developed and is commercializing. Currently there are only standardized tests for five types of cancer – breast, prostate, colon, cervical and lung. However, about 80% of cancer deaths occur from cancers without recommended screening and cancers are the second largest killer after cardiovascular disease. Catching cancer early, before symptoms are present is a key factor in driving up survival rates. Grail brought together Illumina's tools for genomic sequencing and AI to create a test that could detect 50 different types of cancers from a single blood draw across a market that could be as large as hundreds of millions of adults globally. The large market, commercial viability, and ability to accelerate this huge sequencing application's time to market were the rationale for Illumina's acquisition of the company in 2021.

However, regulators came out against the deal because of the advantage Illumina brings to GRAIL's MCED testing application disadvantages other potential GRAIL competitors since everyone needs to use Illumina's sequencing instruments and reagents to power the application. Illumina's de facto monopoly on sequencing technology had regulators worried in the EU and in the US.

Also, by requiring over $600 million of investment per year since the acquisition, GRAIL also had Illumina's traditional investor base upset at the hole it created in Illumina's earnings especially as Illumina's core business suffered a slowdown.

That slowdown was the result of multiple factors that hit simultaneously – a post COVID pandemic reduction in demand for disease surveillance across governments and research labs around the world, a capital markets contraction that led to lower investment in the biopharma industry reducing demand, and a significant product cycle disruption as Illumina introduced its newest higher end instrument, the NovaSeq X/X+ which uses all new consumables vs the instrument it replaces, the NovaSeq 6000. The 60% reduction in cost per sequence the NovaSeq X+ brings vs the NovaSeq 6000 also disrupts current revenue ahead of the volumes increases it will drive in the longer term.

The combination of these issues have driven down the price of Illumina stock to a level we believe offers a very compelling valuation, while our research points to Illumina's competitive position and relevance only strengthening.

We believe the stock is set up to be a compelling investment from current levels. The new CEO Jacob Thaysen committed to divesting GRAIL, which was effectuated on June 24th, so that it will no longer be a drag on Illumina's GAAP earnings. Second, Thaysen was mandated with improving profits at Illumina, which had operating margins at 30% as recently as 2019 compared to its most recent report of an adjusted 21% (excluding GRAIL). And third, there is evidence that the pressure on revenue from the product cycle transition to the new NovaSeq X will start to abate as inventory adjustments and volumes start to provide a tailwind to consumables revenue growth driven by clinical applications.

Finally, we'd like to discuss Chipotle, a nice long term success story in our client portfolios that we recently sold out of due to its high valuation after holding for over 4 years. This was an exit that was driven by the strong performance of the stock, increasing about 370% over the past 4 years from March 2020 to June 2024.

Chipotle has been a very successful stock as a result of the strong business performance of the company. Under Brian Niccol, its CEO since 2018, it has accelerated its growth, improved operations and efficiency, and set its sights on higher goals in bringing its casual healthy Mexican cuisine to all of North America and increasingly, the world.

We first bought the stock in client portfolios in March 2020 on the thesis that there was substantial growth runway and margin leverage in the business as it scaled. The initial reaction of the COVID pandemic shutdowns on the stock was severe, with a nearly 50% drawdown, which provided the opportunity to start buying at prices that we believed offered good future returns. As it turned out, underlying acceleration in demand for Chipotle and its pricing power proved the strengths of its offering and business model shortly after.

Adding a loyalty program, digital ordering, and Chipotlane drive-thrus further accelerated trends while its better corporate policies towards employee experience and benefits helped it navigate labor shortages pervasive throughout the industry.

We had an aggressive view of how fast the company could grow, how large its market could be, and how high margins could get as the company scaled restaurants across the US and same store sales it could drive. Those targets were increased as the company proved it could meet and then exceed them, while the stock performance followed.

However, the stock price has now gotten to a point where it more than reflects all those targets, meaning that even more aggressive targets need to be incorporated in order to rationally pay the premium valuation it now commands.

While this could come to pass, the stock price now materially exceeds the value of the business under aggressive assumptions for the US while incorporating substantial international growth as well, where Chipotle is only really beginning to scale and build the necessary fresh food infrastructure needed to support the growth.

As a result of the stock price meaningfully exceeding what we believe to be relatively aggressive assumptions for the value of the business, we exited the stock.

Lastly, Ensemble has recently taken a position in Veeva Systems, which we believe is expanding its lead in the life sciences software market. As pharma, biotech, medtech and contract research organization (CRO) companies buy more of Veeva's applications that tie together on its cloud-based Vault platform, the more efficient and stickier those customers become. We expect this to fuel above-average growth in revenue and profits for Veeva over the next decade.

Founded in 2007, Veeva started by selling customer relationship management (CRM) software designed to meet the complex processes and regulatory requirements of pharma companies like Pfizer and Merck.

Veeva's CRM was built on the Salesforce cloud-based platform -- Veeva's CEO was previously the SVP of Tech at Salesforce -- and Veeva's CRM was quickly adopted when the iPad was released in the 2010s. Pharma sales reps could use Veeva's CRM on tablets to track and facilitate their interactions at doctors' offices. By 2012, Veeva had over 80% share for its CRM.

Although Veeva's CRM has the most market share in life sciences, its CRM suite is now only about one-quarter of Veeva's total revenue as it has successfully upsold other applications. CRM is within Veeva's Commercial Solutions segment (50% of fiscal 2024 revenue) that is growing single digits annually. Aiding growth is software like PromoMats to create and distribute marketing content, and its datasets like Compass transaction data on patients and prescribers and national projection data, which companies use to target customers like doctors.

In 2012, Veeva launched its own Vault platform on which its software in the R&D Solutions segment (50% of fiscal 2024 revenue) is built. R&D Solutions target the development side of life sciences firms, and its subscription software sales are growing at a double-digit pace while replacing legacy and fragmented solutions that don't "talk well" to each other, and even paper. Switching to one of Veeva's modern applications can result in a 30%-40% cheaper total cost of ownership versus a legacy solution. An executive of a large pharma company described Veeva as having the potential to become the Microsoft Office of clinical operations, replacing outdated software the equivalent of WordPad – not even Word!

Top selling R&D Solutions applications include Vault QualityDocs for document management related to quality and manufacturing records, Vault Submissions for regulatory documents, and Vault eTMF (electronic trial master file) software that stores essential documents for clinical trials. Veeva is also pushing further into clinical trial management system (CTMS) software that manages the logistics of a trial, and electronic data capture (EDC) software that collects data from a trial. There is a lot of opportunity for growth as Veeva goes deeper into clinical trials. Clinical trials are becoming more digital and decentralized, which increases their efficiency and the number of eligible participants since it can lessen the need to be near a physical site.

Life sciences companies face an imperative to boost efficiency. Eroom's Law shows that since 1950 there has been a long-term decline in the number of FDA-approved drugs per billions of R&D dollars spent. Eroom is the clever backward spelling of the much more productive Moore's Law in the semiconductor industry. And while software alone can't reverse life sciences' fall in productivity, it can help.

The broad adoption of Veeva's software reflects customers' need to be more efficient. Veeva has over 1,400 customers and its software has been used by 47 of the top 50 biopharma companies like Ely Lilly, emerging biotechs like Replimune, medical device firms like Boston Scientific, and CROs like ICON that run outsourced clinical trials. Its revenue has become more diversified as a result, with the top 10 customers accounting for 28% of revenue in fiscal 2024, down from 61% in fiscal 2012. It has also expanded internationally with 59% of revenue from North America, 28% Europe and Other, 11% Asia Pacific, and 3% the Rest of World in fiscal 2024.

The majority, 94%, of Veeva's revenue comes from biopharma customers, 4% medtech and 2% consumer products as of fiscal 2q24. Of its biopharma revenue, 66% comes from large enterprises, 25% small medium businesses (SMBs), 4% emerging biotechs and 5% CROs. While Veeva counts most large biopharma companies as its customers, it has many more products left to sell them, and further to penetrate SMBs and

emerging biotechs. Veeva recently launched Vault Basics, a low-cost, easy-to-deploy software package that offers smaller companies a chance to expand.

Contributing to Veeva's success is its distinct corporate culture reflected in its decision to convert to a public benefit corporation (PBC) -- the first public company to do so in 2021. Being a PBC gives Veeva legal runway to consider the interests of customers, employees, and communities, alongside the financial interests of shareholders. Veeva says, "As a Public Benefit Corporation, we are guided by our core values — do the right thing, customer success, employee success, and speed — to help the life sciences industry improve health and extend life and to create high-quality jobs that benefit our employees and communities."

Caring about doing the right thing does not mean Veeva doesn't care about profits or shareholder returns. In fact, Veeva ranks near the top of public global application software companies by their 3-year average GAAP operating margin, per Bloomberg data, with room to grow. Veeva's CEO and founder Peter Gassner is also the second largest shareholder – behind only Vanguard, with almost 8% of the shares outstanding worth over $2 billion. We like that he has that amount of skin in the game, alongside us shareholders.

Being a PBC is a competitive edge for Veeva as well, as it signals to customers that they are a priority. This is important in life sciences where customers put sensitive information into Veeva's software and may use it for decades.

Another edge for Veeva is that its key competitors are not focused on life sciences software. Top rival Medidata was acquired in 2019 by the French company Dassault Systèmes, more known for its engineering software for manufacturers of products like airplanes and cars. Oracle is gigantic and sells software to many different industries. IQVIA is focused on the life sciences industry but is not known as a software developer. IQVIA was formed in 2016 by the merger of Quintiles, a CRO, and IMS Health – the largest provider of US physician prescription data.

IQVIA sells CRM software that is built on the Salesforce platform, like Veeva's original CRM. In April 2024, Salesforce and IQVIA announced a deeper partnership to co-market a new CRM and other life sciences software based on Salesforce's platform and IQVIA's expertise and data. This was preceded by Veeva announcing in 2022 that it would move its CRM off Salesforce onto Veeva's own Vault platform. Veeva launched its Vault CRM for general availability in April 2024 and will convert existing CRM customers to Vault through 2030. Having its CRM on the Vault platform will enable more innovation and better data flow between Veeva's Commercial and R&D Solutions software.

We believe Salesforce is seeking to replace the royalty revenue it will lose from Veeva in launching its Pharma CRM with IQVIA -- right after Veeva's exclusive 10-year contract with Salesforce ends in September 2025. Salesforce also announced general availability of its Life Sciences Cloud including applications for clinical operations in June 2024. We are skeptical of Salesforce's success in life sciences given their lack of focus on the industry. IQVIA doesn't have much to lose since its existing CRM with Salesforce, released in 2017, has already failed to significantly dent Veeva's dominant market share.

In addition to key competitors Medidata/Dassault, Oracle, IQVIA and potentially Salesforce, there are many other point solution vendors far behind Veeva in developing a suite of integrated software. And the greater

the number of products Veeva's customers adopt over time, the wider its moat grows. The more needs that can be met by one vendor with multiple applications, the more effective the solution is to a customer.

Veeva's platform strategy has been unfolding for more than a decade since it launched Vault in 2012. As it progresses, a successful platform strategy reduces the incremental effort and cost to upsell. Although Veeva aims to sell best-of-breed software, at some point the customer purchasing decision becomes as much about easy integration and not having to deal with too many vendors. This becomes a barrier to entry for competition. Evidence of Veeva's success at upselling software can be seen in the fact that customers of Veeva's Commercial Solutions own a rising 4 products on average, and in its R&D segment, 3 products on average. Veeva has over 40 products to upsell.

There is often concern with vertical software companies like Veeva that focus on one industry or end-market, that they don't have as big a total addressable market (TAM) as horizontal software. Horizontal software firms like Microsoft can sell Office to almost every industry that exists. And while a vertical focus does limit Veeva's total market size, we are satisfied it has a long runway for growth. Veeva has already increased its total addressable market (TAM) from $5 Billion when it IPO'd in 2013 to $20 billion.

Veeva calculates its TAM at $20 billion -- 1% of the $2 trillion in life sciences revenue that's growing at a 6% compound annual growth rate (CAGR.) At $2.4 billion in revenue in fiscal 2024, Veeva has penetrated only 12% of its TAM. The 1% of life sciences revenue used to calculate TAM could also go higher, as the industry adopts more technology.

Despite the above positives, Veeva faces some headwinds that have created opportunity in the stock. Among them is weaker spending by biopharma companies. In the last couple years, spending has been impacted by uncertainty related to the US Inflation Reduction Act (IRA)'s changes to Medicare pricing and a slowdown in clinical study starts after the initial wave of Covid-19, along with other issues. The headwinds have primarily hurt Veeva's professional services revenue that is 20% of total and that is more discretionary but have also delayed some deals for Veeva's subscription software (80% of revenue.)

In its most recent quarter, Veeva also talked about the effect of artificial intelligence. Customers are evaluating how pricey new AI services might impact their IT budgets. The AI impact is not exclusive to Veeva as many enterprise software stocks were also at least partly hit on this issue around the same time. A pullback in spending due to customers' reconfiguring their budgets for AI, however, is likely temporary for Veeva given its software is mission critical. And Veeva should be an outsized beneficiary of AI longer-term. Given the importance of accuracy, Veeva has positioned itself as the source of truth for life sciences data that customers and partners can leverage. This is a valuable spot to be in. And with the launch of its DirectDataAPI in April 2024 for its Vault platform Veeva says customers and partners can access its data 100x faster than normal. In fact, advances in AI are likely to make the data stored in Veeva's systems even more valuable.

Despite the various pressures on its customers' spending, they still need to increase their productivity and to drive revenue. Exciting areas in medicine like gene therapies, RNA drugs and complex biologics are set to unleash a new wave of treatments for cancer, and rare and infectious diseases. And with the cost of a successful clinical trial often in the hundreds of millions of dollars, getting such innovations faster to approval and more effectively to market can translate into tens of millions of dollars to the customer.

The adoption of integrated, cloud-native software is also still early in life sciences. As a manager at Becton, Dickinson & Co. (BD), a maker of medical devices like syringes and stents, and a customer of Veeva said: "We are working towards unifying our R&D systems. We are not quite there yet. Its definitely an end goal that really goes into our BD 2025 strategy to simplify, right, and to reduce complexity. . . A key piece to running clinical trials right is the ability to reduce time to market, and to really get the products and solutions to patients as quickly as possible. Being able to unify our clinical systems, all of our R&D technologies, is really going to help be a focal point in being able to advance our products and get them to market a bit quicker."

In conclusion, while life sciences companies face various near term headwinds, this may only create pent-up demand for Veeva's software that helps customers be more efficient, reduce costs, and bring their therapies and medical devices faster and more effectively to market, necessary to fuel sales. And while Veeva faces existing and new competitors, its moat expands each day its customers adopt more of its software on the Vault platform.

Disclosures

2024 Q2 Contributors and Detractors to Absolute Return Data

Description	Symbol	Average Weight	Contribution (Gross)	Contribution (Net)	Description	Symbol	Average Weight	Contribution (Gross)	Contribution (Net)
Alphabet, Inc.	GOOGL	6.87%	1.29%	1.27%	Broadridge Financial Solutions	BR	6.65%	-0.26%	-0.27%
Netflix, Inc.	NFLX	7.10%	0.74%	0.72%	Ferrari	RACE	4.07%	-0.27%	-0.28%
Analog Devices, Inc.	ADI	5.27%	0.72%	0.71%	NVR, Inc.	NVR	5.83%	-0.31%	-0.32%
Booking Holdings, Inc.	BKNG	7.46%	0.65%	0.63%	Veeva Systems, Inc.	VEEV	2.73%	-0.42%	-0.43%
Servicenow, Inc.	NOW	4.32%	0.21%	0.20%	First American Financial Corp	FAF	4.41%	-0.55%	-0.56%
Chipotle Mexican Grill, Inc.	CMG	1.27%	0.19%	0.18%	Mastercard, Inc.	MA	7.01%	-0.60%	-0.61%
Perimeter Solutions	PRM	2.42%	0.13%	0.12%	Idex Corp	IEX	3.46%	-0.64%	-0.65%
Grail, Inc.	GRAL	0.06%	0.06%	0.06%	Home Depot, Inc.	HD	7.06%	-0.64%	-0.66%
Nintendo Co	NTDOY	4.07%	-0.09%	-0.10%	Masimo Corp	MASI	4.24%	-0.65%	-0.66%
Paychex, Inc.	PAYX	4.67%	-0.16%	-0.17%	Nike, Inc.	NKE	3.60%	-0.69%	-0.69%
Landstar System, Inc.	LSTR	3.67%	-0.17%	-0.17%	Illumina, Inc.	ILMN	2.77%	-0.77%	-0.77%
Fastenal Co	FAST	1.24%	-0.22%	-0.23%					

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities listed above. The performance information shown above has been calculated using a representative client account managed by the firm in our core equity strategy and represents the securities held for the quarter ended 06/30/2024. The individual quarterly net contribution to returns are calculated by reducing the gross contribution to return by 1/4 of the weighted average of the firm's highest management fee, which is 1.00% per year. Information on the methodology used to calculate the performance information is available upon request. The performance shown in this chart will not equal Ensemble's composite performance due to, among other things, the timing of transactions in Ensemble's clients' accounts.

ADDITIONAL IMPORTANT DISCLOSURES

Ensemble Capital is an SEC registered investment adviser; however, this does not imply any level of skill or training and no inference of such should be made. The opinions expressed herein are as of the date of publication and are provided for informational purposes only. Content will not be updated after publication and should not be considered current after the publication date. We provide historical content for transparency purposes only. All opinions are subject to change without notice and due to changes in the market or economic conditions may not necessarily come to pass. Nothing contained herein should be construed as a comprehensive statement of the matters discussed, considered investment, financial, legal, or tax advice, or a recommendation to buy or sell any securities, and no investment decision should be made based solely on any information provided herein. Ensemble Capital does not become a fiduciary to any reader or other person or entity by the person's use of or access to the material. The reader assumes the responsibility of evaluating the merits and risks associated with the use of any information or other content and for any decisions based on such content.

Ensemble's Equity strategy is intended to maximize the long-term value of the underlying accounts. The strategy generally invests in U.S. common stocks, but from time to time the underlying accounts may hold cash and/or fixed-income investments in an attempt to maximize capital gains. The strategy holds mostly large and medium-capitalization stocks, although accounts may also hold small-capitalization stocks.

Performance results for the Ensemble Equity composite since the composite's inception on December 31, 2003, are unaudited and are subject to change. The Ensemble Equity composite includes realized and unrealized gains and losses,

the reinvestment of dividends and other earnings, and is net of management fees, brokerage transaction costs and other expenses. Taxes have not been deducted. Net of fee performance was calculated using actual management fees. Management fees for an Ensemble Equity account range from 1.00% to 0.50% on an annual basis and are typically deducted quarterly. Fees are negotiable, and not all accounts included in the composite are charged the same rate. Results are based on fee paying, fully discretionary, unconstrained accounts managed with an Ensemble Equity objective and include those Ensemble Equity accounts no longer with the firm. Accounts must exceed $500,000 to be included in the composite. Accounts with assets below $500,000 and accounts with objectives other than Ensemble Equity are excluded.

Unless otherwise stated, returns for periods exceeding 1 year are annualized.

The comparative benchmark is the Standard and Poor's Total Return Index of 500 Stocks ("S&P 500"), an index of 500 large capitalization equities, generally considered a comprehensive indicator of market performance. The S&P 500 Total Return Index includes realized and unrealized gains and losses, the reinvestment of dividends and other earnings and is not subject to fees and expenses. It is not possible to invest directly in an index. The holdings in the Ensemble Equity strategy may differ significantly from the securities that comprise the benchmark.

All investments in securities carry risks, including the risk of losing one's entire investment. Investing in stocks, bonds, exchange traded funds, mutual funds, and money market funds involve risk of loss. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable or suitable for a particular investor's financial situation or risk tolerance. Some securities rely on leverage which accentuates gains & losses. Foreign investing involves greater volatility and political, economic and currency risks and differences in accounting methods. Future investments will be made under different economic and market conditions than those that prevailed during past periods. Past performance of an individual security is no guarantee of future results. Past performance of Ensemble Capital client investment accounts is no guarantee of future results. In addition, there is no guarantee that the investment objectives of Ensemble Capital's equity strategy will be met. Asset allocation and portfolio diversification cannot ensure or guarantee better performance and cannot eliminate the risk of investment losses.

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