AMERICAN MONEY MANAGEMENT, LLC

SEC Registered Investment Advisor

Broadridge Financial: An Unknown Monopoly

You're playing basketball and you try out a new move. You know immediately if it worked or not. You also immediately know how to tweak it, to improve it, and then test it again. You keep fine tuning your move with immediate and constant feedback until you've perfected it.

Basketball is also defined by a standard set of rules. The rules are the same all around the world. A player in the U.S. could fly to Spain without knowing how to speak Spanish and could jump into the middle of any game.

This is **a kind learning environment**. The rules are well known and do not change. You receive immediate feedback, both positive and negative, on everything you do. You improve by engaging in the activity.

The opposite of this is a wicked learning environment.

> "In wicked domains, the rules of the game are often unclear or incomplete, there may or may not be repetitive patterns

> and they may not be obvious, and feedback is often delayed, inaccurate, or both."

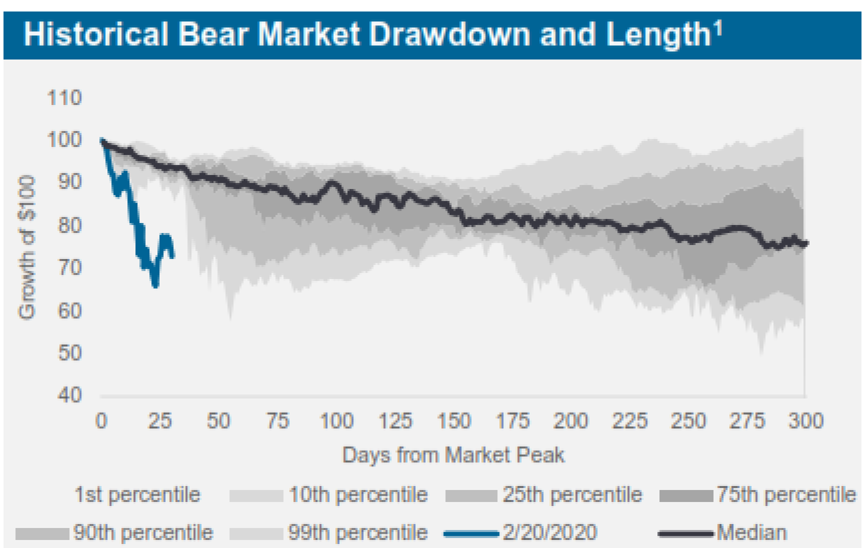
From David Epstein's book Range: Why Generalists Triumph in a Specialized World

Psychologist Robin Hogarth describes wicked learning environments as Martian Tennis.

> "You can see the players on a court with balls and rackets, but nobody has shared the rules. It is up to you to derive them, and they are subject to change without notice."

Investing is a wicked learning environment. Once you think you've developed some form of mastery and that you "know" the rules of the game, the rules change.

In our Q2 letter to clients we highlighted the 4 stages of a bear market: Duration, Frustration, Capitulation, and Recovery.



These rules were based on an accumulation of knowledge from investing over many decades. But the knowledge was built on old rules and the rules changed.

The bear market did not last long. It took less than a month from the all-time high on February 19, 2020 to the bear market low on March 23, 2020. By April 8, 2020 the S&P 500 recovered over 20% and hit a new all-time high on September 2, 2020.

In past bear markets the Federal Reserve did not move as fast or as aggressive as it did during the coronavirus panic. The only corollary is the Great Financial Crisis of 2008. But even then, Ben Bernanke moved slow, testing out each new Federal Reserve policy. This time around Jerome Powell did everything Bernanke did and more. Instead of over 1.5 years, Jerome Powell did it all within two months.

This is not a rant against the Federal Reserve, easy money, or how they've "made it impossible to be an investor" like some famous investors have. It's just an observation that there are other major players in capital markets and their actions affect other investors. Some players, like the Federal Reserve, can even change the rules.

It's Martian Tennis but even in Martian Tennis there are constants. A racket, a ball, an opponent, and a court. We need to find our investing constants.

No One Can Predict the Future

If the rules are always changing, then there is no reliable system or signal to tell us the right time to buy or sell stocks. We do know the odds favor positive returns for the stock market. Time is our ally, but our returns will not be linear. The longer the time frame we can stay invested the higher the odds for a positive outcome.

S&P 500: 1926-2015

Time Frame	Positive	Negative
Daily	54%	46%
Quarterly	68%	32%
One Year	74%	26%
5 Years	86%	14%
10 Years	94%	6%
20 Years	100%	0%

Source: Returns 2.0

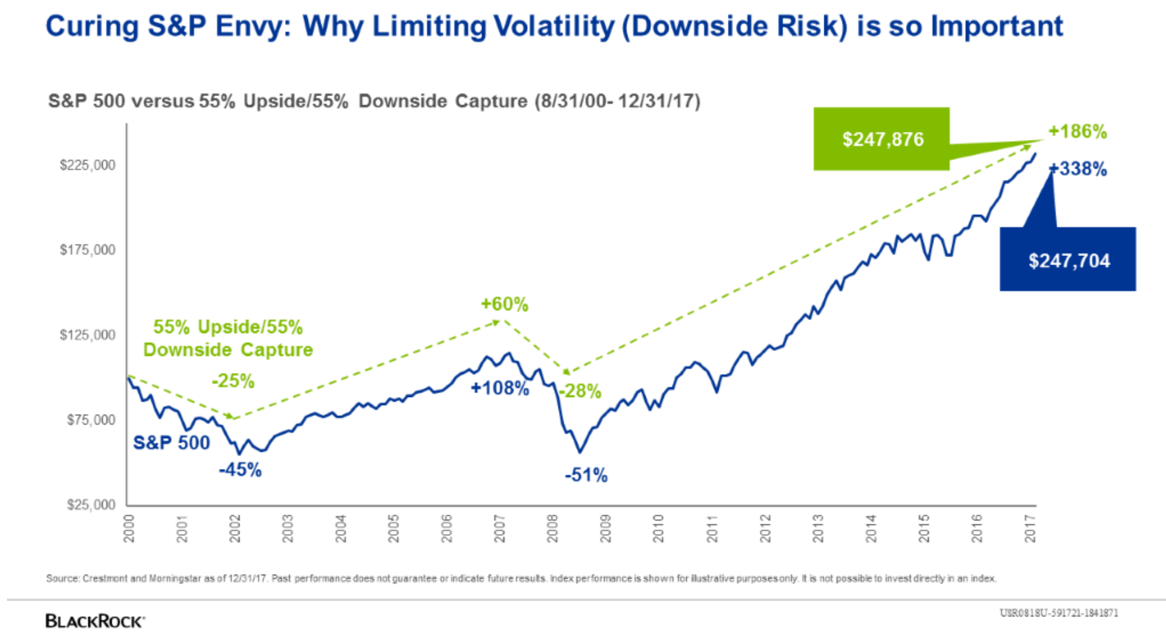
Chart from [A Wealth of Common Sense]

High Quality Companies

We want to own companies that survived or can survive different economic scenarios. Companies that generate high returns on invested capital and have done so for many years.

We're more focused on protecting capital and reducing our downside risk. If we can reduce our downside risk and participate in most of the upside of the stock market, then our portfolio should produce good long-term returns.

The chart below is a portfolio that only captures 55% of the total S&P 500 when it declines in price and captures 55% of the S&P 500 when it rises. This is over the time frame from 8/31/00-12/31/17 and includes two major bear markets. While the optimal up/down capture % will vary over different time periods and market cycles, this illustrates the importance of risk management in the investment process.



Companies that generate high returns on invested capital tend to be less volatile than the overall stock market.

Don't Overpay

No matter how high quality the company is, we don't want to overpay for its stock. All else being equal, paying too high a price can make any investment a poor one.

Valuation is both an art and a science. Two different analysts can come up with two widely different estimates of fair values given the same variables. But we have a process that we're comfortable with and it's a process that isn't complicated. Too much complexity adds too many ways to make a big mistake.

It was tough but staying focused on our constants and our process allowed us to add to existing names and to buy new names during the peak of the Coronavirus panic. The subject of this letter, Broadridge Financial, is one of those new positions.

Sincerely,

Your Portfolio Management Team

Dividend Stock in Focus

Broadridge Financial (BR): $130.40*

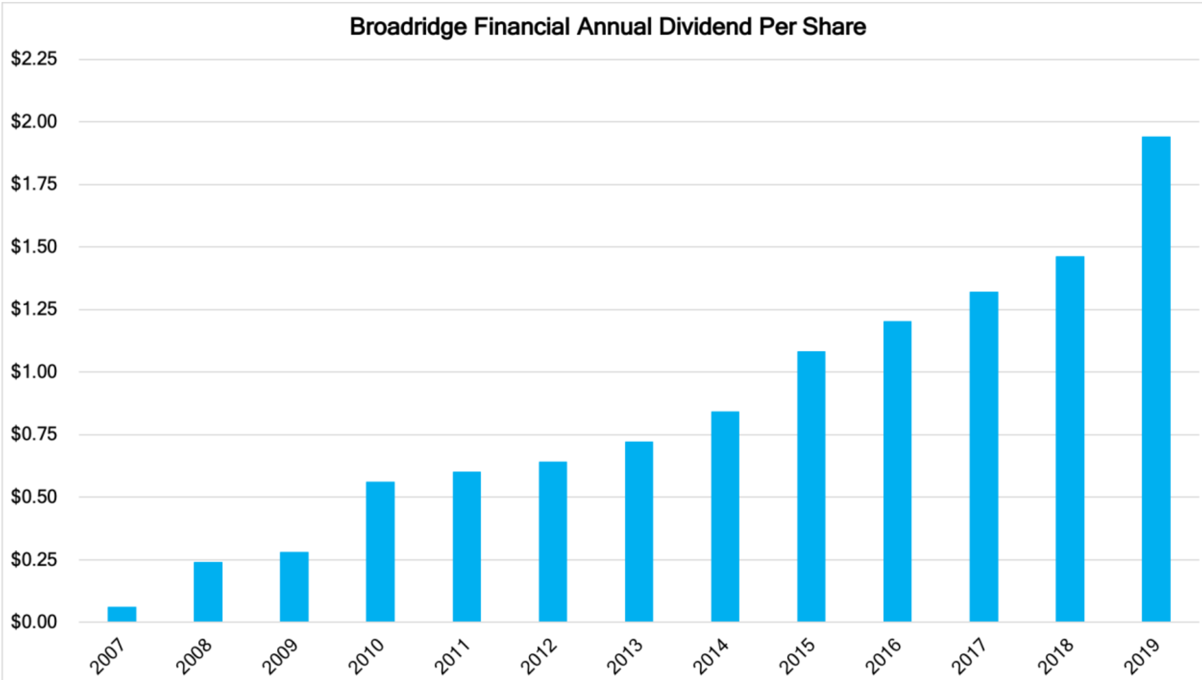
Price as of the close September 25, 2020

Odds are you’ve never heard of Broadridge Financial. But it is a very important company for the successful operation of the financial markets.

Whether voting as a shareholder, moving money between financial institutions, or executing trades, Broadridge offers services that can help investors and financial market participants.

As we’ll discuss below, Broadridge is a high-quality company focused on returning excess capital back to shareholders. The company has been on our watch list for a couple of years. Then during the coronavirus market panic, the company traded at a price we were willing to pay.

Dividend History



Broadridge Financial started paying a dividend in 2007. Since then, Broadridge grew its dividend at a **20% compound annual growth rate**.

During the height of the coronavirus market panic, Broadridge increased its quarterly dividend another 11%.

Dividend Safety

Dividend Payout Ratio < 60%?	60.85%	✗
Cash Dividend Payout Ratio < 60%?	51.65%	✓
FCFE Coverage Ratio > 100%?	258.03%	✓
Debt to Equity < 1.00?	1.14	✗
Interest Coverage > 2.00?	20.34	✓

Broadridge's payout ratio and its debt to equity ratio are just slightly above our cutoff. Broadridge's high Free Cash Flow to Equity coverage ratio and high interest coverage ratio make us more than comfortable with these two "misses".

Catalysts Price Appreciation & Dividend Growth

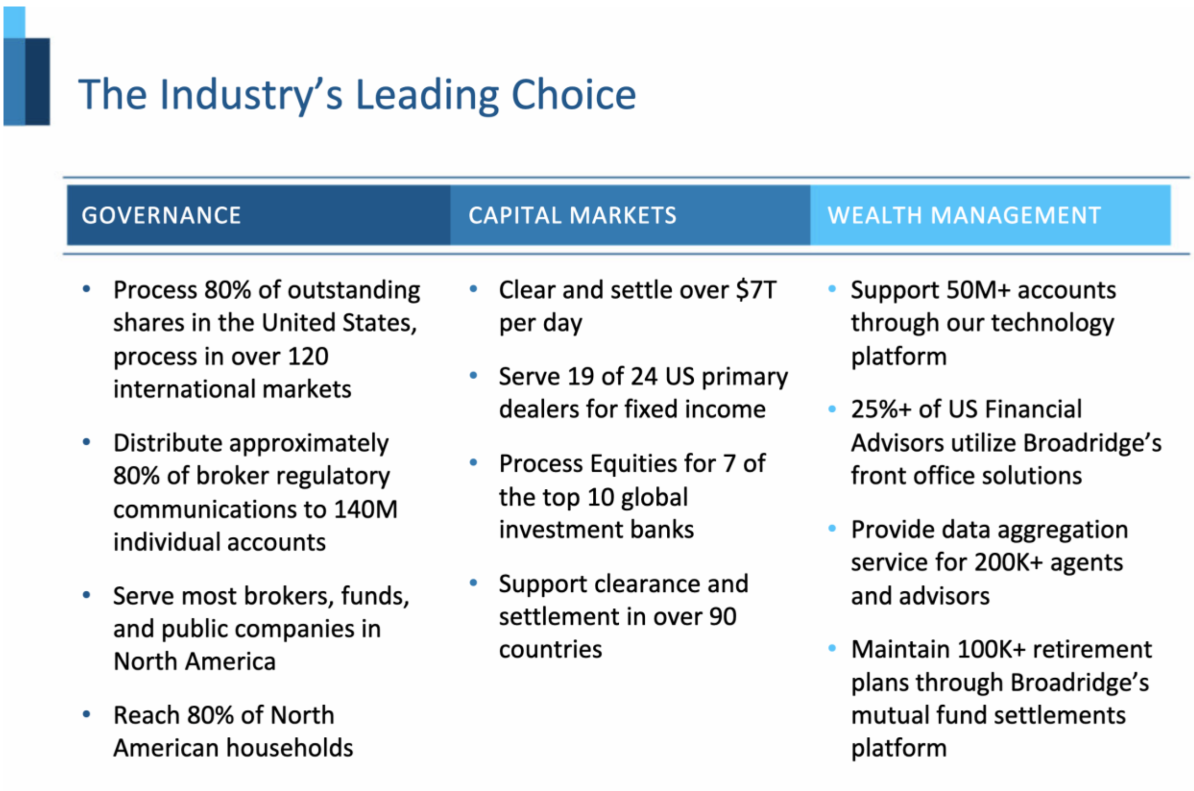
Switching Costs

Broadridge Financial rules the financial back office. The stars of the financial world are the bigger than life hedge fund managers, activist investors, and a 90-year-old man in Omaha. They make the headlines. But it is the people working behind the scenes, the people you never hear about, that make the financial world work.

Broadridge Financial powers the back office. They are the main firm that facilitates proxy distribution and voting services in 120+ international markets.

Broadridge also handles the bulk of regulatory communications delivering around 80% of the broker regulatory communications, both print and digital. These are the transaction reports, bills, and statements that retail and institutional investors receive.

Broadridge is also one of the largest global post trade processors. It clears and settles over $7 trillion across multiple asset classes per day.



From Broadridge Financials Q4 2020 Investor Presentation

A company this ingrained in the financial and capital markets comes with high switching costs. Do you switch your entire back-office systems to save money knowing that the slightest disruption to your operations carries large financial risks?

No.

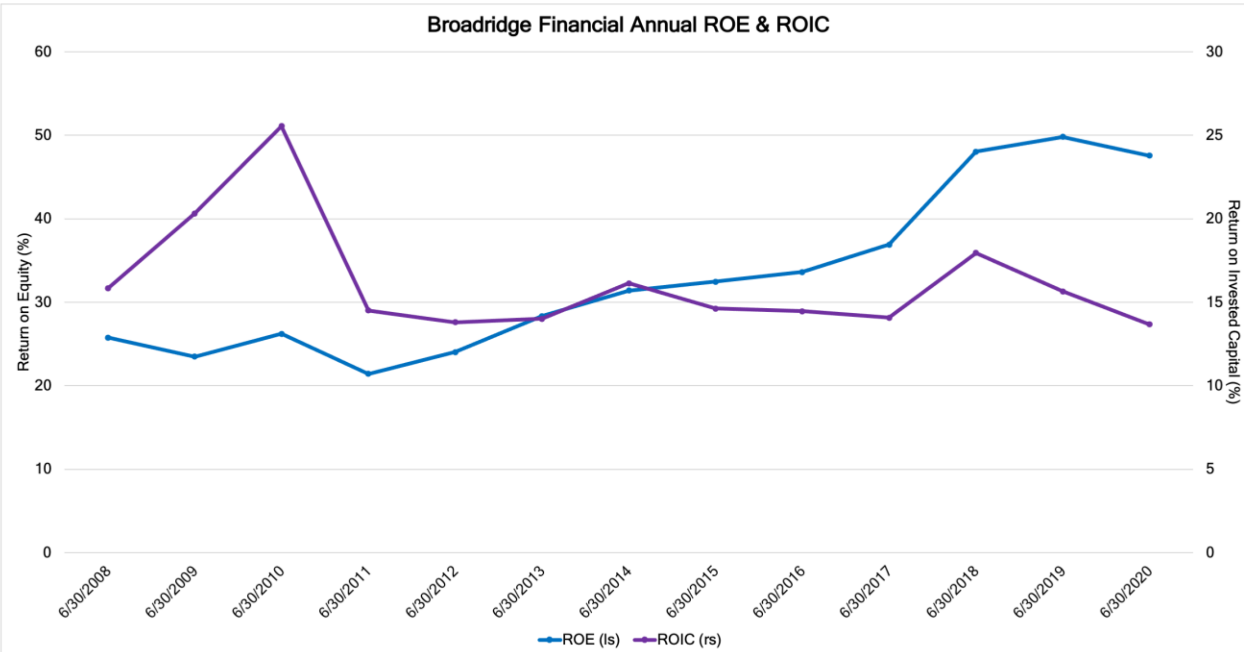
This is why Broadridge's revenue is **68% recurring with a retention rate of 98%**. Recurring revenue reached $3 billion in fiscal year 2020.

High Barriers to Entry

Broadridge Financial has deep industry knowledge and a proven record of executing mission critical services and because of this it has built strong relationships with the major financial institutions.

Broadridge's deep integration with the major financial institutions makes them a formidable competitor. Do you compete on price? How big of a discount do you have to offer for a major financial institution — many of them "systemically important financial institutions" — for them to risk disruption to their key systems?

Competitors have a high entry barrier to effectively compete with Broadridge. The high hurdle combined with switching costs leads to low competition. It also gives Broadridge the opportunity to cross sell its other services to its client network. This leads to high returns for Broadridge.



Mutualization & Digitization

Two ongoing trends in the financial services industry are mutualization and digitization.

Mutualization is the process of large financial companies offloading workflows to a third party. The workflows are costly to each individual company and distract the firm from their primary function. A common third party can onboard these workflows and leverage their size and scope to turn these undifferentiated workflows into a profit center. This is what Broadridge has done.

Digitization is exactly what it sounds like. It’s the shift from paper and physical based systems to digital and internet/cloud-based systems.

The shift to digital is an opportunity for Broadridge to extend its market share in investor communications and global trade technology while increasing margins.

Broadridge may not be able to charge as much for its digital investor communications but digital is cheaper to operate than paper-based systems. While ICS revenue will likely not grow like it has in the past, Broadridge’s operating margins should expand.

Wealth Management

The fastest growing segment within the financial services industry is wealth management.

The technology that serves this industry is highly fragmented. A wealth management firm must use multiple vendors to source the technology and tools they need to run their business. This increases operational risk and operational costs. What wealth management firms want is an all-in-one solution. Broadridge Financial wants to be that trusted one-stop shop for the wealth management industry.

Creating a one-stop shop for wealth management technology is complex. Broadridge has the deep industry knowledge to handle the complexity. Broadridge also has the size and the capital to buy the leading or promising software providers and integrate them into their all-in-one offering.

UBS is a top 5 U.S. wealth manager. They recently entered a deal with Broadridge for their core advisor product and their end-to-end financial advisor solution.

> "Broadridge is the right partner and the only Fintech leader with the proven technology, scale, and experience, to deliver such a transformational solution."
>
> Tom Naratil, Co-President UBS Global Wealth Management & President UBS Americas.

The UBS deal give Broadridge **access to 6,000 US based advisors**. Broadridge can also leverage its existing relationship with the other major financial services companies to cross sell its end-to-end financial advisor solution. It is estimated that **the top 15 wealth management firms employ over 200,000 advisors**.

Wealth management technology is a higher growth opportunity and a higher margin business for Broadridge. An end-to-end solution also has high switching costs. If Broadridge can successfully capitalize on the wealth management trend it will have another highly recurring revenue stream and another high return business line.

Risks

Investor Communications Monopoly

Activists and large fund companies like Vanguard hate paying Broadridge's fees for proxy campaigns and investor communications. They think Broadridge's fees are too high. But their best option is to use and pay for Broadridge Financial's services. Broadridge has an under the radar monopoly.

If a large customer like Vanguard successfully shifts their back-office operations to a Broadridge competitor to lower their costs than Broadridge's switching costs and barrier to entries are not as high as we thought.

One of the newer companies coming after Broadridge Financial's monopoly in Investor Communications (ICS) is Say Technologies.

Mergers & Acquisitions

22% of Broadridge's revenue comes from its top 5 customers and 5% of its total revenue comes from its top 15 customers.

Further consolidation in the finance industry could cause Broadridge to lose business. Especially, if one of its top customer's merges or is acquired by a company that doesn't use Broadridge. Broadridge lost its Ameritrade business when Ameritrade bought TD Water House and integrated with their systems.

Consolidation also presents an opportunity. Charles Schwab is now buying TD Ameritrade. Schwab uses Broadridge Financial and is expected to keep using Broadridge after the acquisition is complete. The Ameritrade business that Broadridge lost years ago looks to be coming back.

Valuation

Broadridge is a good candidate for an economic profit model because of its recurring revenue business model and stable capital structure. An economic profit model allows us to estimate a company's fair value by tying ROIC and cash flows together.

Our best-case scenario grows cash flows at 8% over the next 5 years, 5% the next 5, and then a 3% terminal growth rate. We'll also grow ROIC from 15-20%.

Our best-case scenario generates **a value per share of $168 per share.**

Broadridge Economic Profit Model (Best Case)						
Year	Invested Capital $ million	ROIC %	WACC %	Economic Profit $ million	Discount @ 10%	PV of Economic Profit $ million
2022	$ 3,634	15.00%	7.50%	$272.57	10.00%	$247.79
2023	$ 3,959	16.00%	7.50%	$336.54	10.00%	$278.13
2024	$ 4,313	17.00%	7.50%	$409.77	10.00%	$307.87
2025	$ 4,699	18.00%	7.50%	$493.41	10.00%	$337.00
2026	$ 5,119	19.00%	7.50%	$588.72	10.00%	$365.55
2024	$ 5,577	20.00%	7.50%	$697.14	10.00%	$393.52
2025	$ 6,076	20.00%	7.50%	$759.48	10.00%	$389.73
2026	$ 6,619	20.00%	7.50%	$827.40	10.00%	$385.99
2027	$ 7,211	20.00%	7.50%	$901.39	10.00%	$382.28
2028	$ 7,856	20.00%	7.50%	$981.99	10.00%	$378.60
Continuing Value						$ 14,005.23
Present Value of Economic profit						$17,471.68
Iinvested Capital Current Year						$ 3,134
Invested Capital & Economic Profit Value						$20,605.68
Value of Cash						$477.00
Value of Investments						$0.00
Total Value						$21,082.68
Less: Value of Debt						$1,788.00
Less: Value of Unfunded Retirement Obligations						$0.00
Equity Value						$19,294.68
Total Shares Outstanding						115.00
Equity Value Per Share						$167.78

Our base case grows revenue at 5% over the next 10 years and 3% is still our terminal value growth rate. We'll keep ROIC at 15% with no growth.

In this scenario our estimate of fair value equals **$151 per share**.

Broadridge Economic Profit Model (Base Case)						
Year	**Invested Capital**	**ROIC**	**WACC**	**Economic Profit**	**Discount @ 10%**	**PV of Economic Profit**
	$ million	*%*	*%*	*$ million*		*$ million*
2022	$ 3,634	15.00%	7.50%	$272.57	*10.00%*	$247.79
2023	$ 3,959	15.00%	7.50%	$296.95	*10.00%*	$245.41
2024	$ 4,313	15.00%	7.50%	$323.50	*10.00%*	$243.05
2025	$ 4,699	15.00%	7.50%	$352.43	*10.00%*	$240.72
2026	$ 5,119	15.00%	7.50%	$383.95	*10.00%*	$238.40
2024	$ 5,577	15.00%	7.50%	$418.28	*10.00%*	$236.11
2025	$ 6,076	15.00%	7.50%	$455.69	*10.00%*	$233.84
2026	$ 6,619	15.00%	7.50%	$496.44	*10.00%*	$231.59
2027	$ 7,211	15.00%	7.50%	$540.83	*10.00%*	$229.37
2028	$ 7,856	15.00%	7.50%	$589.20	*10.00%*	$227.16
Continuing Value						$ 13,158.19
Present Value of Economic profit						$15,531.63
Iinvested Capital Current Year						$ 3,134
Invested Capital & Economic Profit Value						$18,665.63
Value of Cash						$477.00
Value of Investments						$0.00
Total Value						$19,142.63
Less: Value of Debt						$1,788.00
Less: Value of Unfunded Retirement Obligations						$0.00
Equity Value						$17,354.63
Total Shares Outstanding						115.00
Equity Value Per Share						$150.91

We first bought Broadridge at a large discount to our estimate of fair value during the peak of the coronavirus sell-off. Even at today’s prices, we are getting a fair price for Broadridge Financial if our expected base-case scenario plays out and a great price if our best-case scenario happens.