

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Finding Opportunities in Companies That Are Changing Our Lives



THOMAS PLUMB, CFA, is President/CEO/Chairman of Plumb Funds, a proprietary mutual fund company where he is also the Lead Portfolio Manager for the Plumb Equity Fund and Plumb Balanced Fund, a role he's had since the funds' inception in May 2007. He is also the founding Principal of Wisconsin Capital Management, LLC since January 2004, a firm that traces its origins back to 1984 — formerly Thompson Plumb & Associates. With more than three decades of experience as an investment professional, his career includes 30 years as the lead manager of two balanced mutual funds, the Thompson Plumb Balanced Fund and the Dreyfus Premier Balanced Opportunity Fund. He received a business degree from the University of Wisconsin-Madison.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Plumb: Plumb Funds was started in 2007 after I finished my term with what originally was the Thompson Plumb Balanced Fund, which then we sold to Dreyfus. At that time, we felt that our local clients in Wisconsin still needed us to have a pooled fund available for them, so we launched the Plumb Funds.

TWST: Could you tell me about the funds that you work on?

Mr. Plumb: We manage two funds. The Plumb Equity Fund is an all-stock fund. It's primarily focused on what we believe are secular growth trends. The fund participates in those trends, especially with companies that are involved in some of the disruptive technological changes occurring in data processing, financial transaction processing and health care innovation. We focus on those types of companies because that's where we see a real secular growth trends and where these companies have essentially developed into software as a service, allowing them to have recurring revenue streams. We believe that those are good quality companies to own in a growth portfolio.

The Plumb Balanced Fund owns many of the same stocks. Because of how our philosophy works in the Balanced Fund, we typically have about two-thirds in stocks. Then, we attempt to moderate the volatility of the stock market with fixed-income investments, primarily investment-grade corporate bonds.

TWST: Did you want to talk about the philosophy of the funds?

Mr. Plumb: We believe that equity investing depends on participating in growth characteristics. When I was in college in 1975 — through probably 1980 — for example, the 10 top companies in the S&P were dominated by six of them being energy or oil-related. Markets reflect world change. Now we look at companies who've been benefitting or have the potential to benefit from current significant secular trends.

We believe that once you can identify and see something happening, you need to then determine what types of companies are either driving these changes, enabling these changes or benefiting from those changes. Our view is that we're not necessarily looking only for those companies that are on what we call the bleeding edge of technology, but we're looking at companies that are changing our lives daily and how that's structured into the potential for good investment opportunities.

TWST: And did you want to highlight a company that you find interesting now?

Mr. Plumb: Our largest holding for many years has been **Visa** (NYSE: V). We also like **Mastercard** (NYSE:MA), and **PayPal** (NASDAQ: PYPL). When you look at **Visa**, the profit margins after tax have been running 60%, while the top line has been growing at the mid-high teens. And, nearly every one of us is touched by that company every single day.

When you and I go into a retailer and make a face-to-face transaction, historically, about \$0.10 to \$0.15 on every dollar purchased uses a **Visa** card. But when we create transactions electronically, either with our mobile device or on the internet at home, over 40% of those use a **Visa** card. So here we have an opportunity to participate in a major secular trend around the world with a company that's a leader and who has a high profit margin. It also has recurring revenue because every day there're almost a billion clicks on **Visa** cards. In that environment, we think you have a good investment opportunity. So that's our largest holding.

We participate in other companies as well, always looking for where there is a major secular trend because we believe that it's easier to swim with the stream than try to swim against the stream. Look at energy companies: for the last 50 years they've had a challenging environment. You may have the best-managed oil company in the world, but they're still fighting against the stream. We say, "Why make it hard on ourselves?" We look for companies that are participating in major economic trends, have a business model that looks like it's sound and defensible, and then have developed a recurring revenue stream model.

TWST: And is there something interesting going on with the company that investors might want to know about, something that's coming up in the next couple of years?

Mr. Plumb: Visa acquired Visa Europe a few years ago. Visa Europe did not have the same profit margins as Visa around the rest of the world. That's given them an opportunity to continuously improve margins since they acquired it about two years ago.

Another interesting aspect revolves around blockchain technology. As we often we hear on the news, many people are looking for ways to invest in this newer blockchain technology. Often, people focus on companies like bitcoin. From our perspective, we're not sure that we understand the recurring revenue stream that bitcoin might offer investors. It's a commodity, and we typically stay away from commodities. But blockchain technology is something that financial transaction processors are developing and using; it will continue to make these types of companies part of our everyday purchases with increasing security.

"We look for companies that are participating in major economic trends, have a business model that looks like it's sound and defensible, and then have developed a recurring revenue stream model."

TWST: And do you think that this entire financial sector is going in a positive direction when it comes to things like credit cards and the kinds of things that Visa does?

Mr. Plumb: We think it's an enabler for even companies like PayPal. People often use their Visa cards as the underlying financial transaction to make the purchases on PayPal. But Visa is not the sole player. If you think about a company like Discover (NYSE: DFS), they are who owns the Pulse network for interbank electronic funds transfer, they serve more than 4,400 U.S. financial institutions and have partnerships around the world. In the case of Discover, they actually own loans. They have a 10%-plus net interest margin on assets and continue to show topline organic growth. So, it's not just Visa, but many companies are participating in this expanding universe of digital financial transaction processing.

Other companies that we also own are WEX (NYSE: WEX) and FleetCor Technologies (NYSE: FLT), which provide payment processing plus other services to the trucking fleet industry. We look at these companies as participating, enabling, reducing costs, increasing security for their clients and providing some real pathways for financial success.

The big market is, of course, credit cards. We are all familiar with how they're used between businesses and consumers. They often call that the C2B market, where a consumer goes to a business and uses their credit card. PayPal is developing the C2C

market, people-to-people transactions, through Venmo. It is likely that a market that is much bigger than either of those is the business-to-business market. What we're finding is that these companies are using some of that technology, some of that expertise to allow businesses around the world to process transactions.

We at the Plumb Funds believe that this innovation in financial transaction processing has been a bigger factor to world economic growth than any of the headlines we've been seeing about tariffs and business or political relationships between countries. It expands marketplaces.

In Madison, Wisconsin, we have a thing called the "Art Fair on the Square" every summer. Hot days usually, where a lot of artists come and present, and a lot of pedestrians walk in this hot weather and visit the offerings from these various artists. One of them, a friend of mine, has a very nice leather art business. They pulled out their Square (NYSE: SQ) system to process a transaction almost instantaneously. The artist mentioned that when she started using Square, it doubled her business.

Opportunities didn't have to walk away because it was hot and customers didn't want to sit in a hot tent. They were able to process a payment quickly and move to the next one. They didn't have to handle checks. They didn't have to figure out cash. And, they were able to process transactions so smoothly, so easily with reduced bookkeeping. Most importantly, it gave them the opportunity to expand their business. That's a phenomenon we're seeing nearly everywhere around the world.

TWST: Did you want to mention another company?

Mr. Plumb: Financial transaction processing is something where we've all seen some significant secular trends. One of the other areas has been in the defense sector. The tensions that we all read about daily are creating funding of defense programs with higher priorities from governments around the world.

One of the biggest participants in that is Lockheed Martin (NYSE: LMT), which produces the F-35 fighter plane. In Madison, Wisconsin, where the Plumb Funds are based, we have an Air National Guard unit that's been devoted to the F-16 for at least the last 20-some years. We recently were awarded the F-35 plane, and that ensures the Air National Guard being part of the Madison economy for the next 25 to 35 years. Companies like Lockheed Martin then have an incredibly sticky and long backlog.

Typically, as production rates move up, the marginal cost of production moves down, so they become more profitable.

Highlights

Thomas Plumb discusses the Plumb Equity Fund and the Plumb Balanced Fund. The Plumb Equity Fund is an all-stock fund that focuses on secular growth trends. Mr. Plumb especially sees secular growth opportunities in disruptive technologies in data processing, financial transactions and health care innovation. According to Mr. Plumb, he's not just looking at bleeding-edge technology but at companies that are changing our daily lives. The Plumb Balanced Fund invests in many of the same stocks, but then the volatility is moderated with fixed income. Despite many investors' anxieties, Mr. Plumb still thinks the market is in a secular bull market.

Companies discussed: Visa (NYSE:V); Mastercard (NYSE:MA); PayPal Holdings (NASDAQ:PYPL); Discover Financial Services (NYSE:DFS); WEX (NYSE:WEX); FleetCor Technologies (NYSE:FLT); Square (NYSE:SQ); Lockheed Martin Corporation (NYSE:LMT); Dassault Systems SE (OTCMKTS:DASTY); Ansys (NASDAQ:ANSS) and Intuitive Surgical (NASDAQ:ISRG).

*Holdings are subject to change at any time.
Plumb Equity Fund Holdings <https://plumbfunds.com/images/pdf/holdings-equity.pdf>
Plumb Balanced Fund Holdings <https://plumbfunds.com/images/pdf/holdings-balanced.pdf>*

So again, we look for companies that give us a reason to believe they'll have a high recurring revenue stream. It's sometimes looking at different types of investments from different perspectives. But a company like **Lockheed Martin**, we believe, has the potential to maintain high-single-digit revenue growth with increasing margins for multiple years in the future.

TWST: And do you think the defense contractors have benefited from the commitment that the Trump Administration has to boost defense spending?

Mr. Plumb: We believe that the administration and our allies are committed to increasing their expenditures on high-level defense systems. Right now, the F-35 is one of the highest-level defense systems being used by NATO, by Saudi Arabia, and by a number of our allies. We think that that commitment goes well beyond any one administration.

TWST: And it sounds like beyond one country?

Mr. Plumb: Yes, definitely.

“Financial transaction processing is something where we’ve seen some significant secular trends. But another area has been the defense sector. The tensions that we all read about are actually causing funding of defense programs with a higher priority from governments around the world.”

TWST: Did you want to mention another company?

Mr. Plumb: The incredible technology available at what is called the “internet of things” [the interconnection via the Internet of computing devices embedded in everyday objects, enabling them to send and receive data] is likely to have an impact on a variety of industries, including engineering with simulation programs. We look at a company like **Dassault** (OTCMKTS: DASTY) or **Ansys** (NASDAQ: ANSS), which provide engineering software that specializes in simulations that reduce the cost of developing products and getting them to market, by reducing both cost and time.

1-Year Daily Chart of Visa



Chart provided by www.BigCharts.com

In the health care area, one of our favorites is a company called **Intuitive Surgical** (NASDAQ: ISRG). **Intuitive Surgical** makes a device called the da Vinci, which is basically the robotic surgery system used in many soft tissue surgeries. If you're a male over 50 years old and you're facing potential prostate surgery, one of the things you hope for is that you will be eligible for robotic surgery. It's less invasive, and hence, the recovery over the next few years may not be much different than other surgeries, but the discomfort in the first six months after surgery is significantly improved.

Companies like **Intuitive Surgical**, which has built up an incredible installed base, is now seeing their revenue from software,

service and disposables grow like Gillette saw razorblades become recurring revenue once they developed the installed base of razors decades ago. A hospital with one of these devices wants it to be used, and they will use the approved parts and disposables from **Intuitive Surgical** because they can't risk that the machine will fail. The economics are that you don't get anything for the use of the machine if you're not using it. We see **Intuitive Surgical** as the type of company that has defined a new industry and built up an installed base. Now are starting to see the benefits of recurring revenue as the disposable part of that business, the razor-blade side of the business, becomes much more important to their business model.

TWST: And how would 5G help something like the da Vinci technology?

Mr. Plumb: We believe there's potential when people talk about 5G and what it might mean for the cellular telephone industry. We think 5G may have some real ramifications, for example, in the operating suite.

We haven't seen it yet, but just speculating a little bit. Robotic surgery allows a doctor, a surgeon, to conduct surgery without physically having their hands involved in the patient. 5G could conceivably allow that surgeon to not even be in the room because of the instantaneous movement. If you and I need some type of a surgery, we may want the best surgeon available, even if he's not locally available. And that's something that we will see if it develops, and it's something that could be really significant. Three, five years from now, we may be talking about it not as a pipe dream but as a reality.

1-Year Daily Chart of Lockheed Martin Corporation



Chart provided by www.BigCharts.com

TWST: And when you talk with your clients about what's going on with the market now and what they're looking at in terms of next year, what are some of their concerns?

Mr. Plumb: There's an old, old cliché that bull markets climb walls of worry. What we've seen is significant anxiety. We've read that the hedge funds are as negative on the market as they've ever been. Meanwhile, the market keeps moving up.

We think that we're still in a secular bull market, that the price/earnings ratio of the average company is not that outrageous. In fact, they're within a P/E multiple or two of where the average has been for the last 50 years. We see still worldwide economic growth and a very low

bar as interest rates remain so low. The question facing investors is “do you buy a company that has a 2% dividend yield that’s growing or a U.S. Treasury 10-year bond at under 2%, where about the most you can expect is to get your money back and hope to stay flat given whatever the inflation rate might be for the next 10 years?”

We think the stock market still provides some real opportunities. We do think that the volatility that we’ve seen historically, but less so over 2014 to 2017, will probably return to historical levels. This means we think there could easily be a 5% to 10% drop in the market based on headlines that come across. Barring some major catastrophe in the Middle East, some accidental hitting of boats that are threatening or intimidating each other in the China Sea or a conflict with the Russians, we just don’t see an environment where investors should be so anxious about the stock market. Again, we use bonds in the Plumb Balanced Fund to moderate that volatility, but we still think that people should look at the long term and not be afraid at this point.

TWST: Is there anything we haven’t talked about you care to bring up, either about the firm or some trends out there?

Mr. Plumb: The Plumb Funds have been around for quite a while, last 12 years. Our focus is to make sure that we continue to manage those with the best of our ability, and we’re very focused, and we think that we have a strategy that we will continue to pay dividends to our shareholders.

TWST: Thank you. (ES)

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