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MONEY MANAGER INTERVIEW

JEFF FISCHER

The Motley Fool

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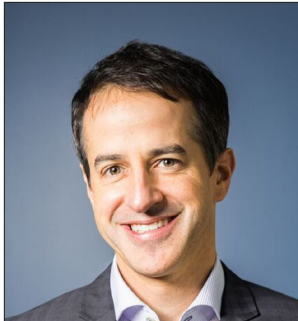
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Seeking Long-Term Investments with Recurring Revenue

J E F F F I S C H E R , T H E M O T L E Y F O O L



JEFF FISCHER, Portfolio Manager of Motley Fool Pro and Adviser on Motley Fool Options, started his career at The Motley Fool in 1996. For 20 years online, he's been making fully accountable investment recommendations and managing long/short portfolios. All five of the portfolios Mr. Fischer has managed or co-managed since 1996 have beaten the S&P 500. Mr. Fischer is the editor or author on several of the Motley Fool's best-selling investment books.

SECTOR — GENERAL INVESTING

(AHD505) **TWST:** Could you tell me a little bit about the firm?

Mr. Fischer: The Motley Fool was founded in 1993 to help individual investors invest better. And since that time, through multiple services, investment services, and now financial wealth advisors and mutual funds, the company is fulfilling its mission.

TWST: And is there a unique philosophy that you have at the firm?

Mr. Fischer: We're very long-term-oriented. We look for growing businesses that we should be happy to own for at least three to five years, and ideally longer than that, 10 years, even 20 years is not out of the question. Some examples are investments made in **Amazon** (NASDAQ:AMZN) in 1997 and **Starbucks** (NASDAQ:SBUX) in 1998 that are still current at the firm.

TWST: And what conditions exist now in the market and the economy that makes that approach meaningful?

Mr. Fischer: I think the approach has always been meaningful, but especially, it's meaningful when you have businesses that are allowed to grow. And our economy and our system in the United States is one of the best ones for entrepreneurs and for young companies to grow value not

only quickly in some cases but especially over a long period of time. So as long as capitalism is working in this country and entrepreneurs are allowed to begin companies that can grow earnings over time, we think long-term investing is the best way for most investors to grow

real wealth. It takes years to compound money, so it's only by owning great companies for years that you can really compound your wealth.

TWST: And do you think enough investors realize that, or do some of them have more interest in those short-term gains?

Mr. Fischer: I certainly don't think enough realize that, and many of us realize it later in life, and thankfully, the market is generous enough that you can still make up for lost ground in the market by owning great companies from midlife on for the next 10, 20, 30 years. But no, I think most young investors think the way to make money — and for some people it is a way to make money — is to trade in and out rapidly. But for most of us, that's a losing game. Studies have shown that time and again.

And that's especially true these days where you're up against rapid frequent-trading programs that you really have no advantage over whatsoever. And anyway, if you're trying to scalp small amounts, it's really hard

Highlights

Jeff Fischer discusses The Motley Fool and its philosophy. Mr. Fischer is a long-term-oriented investor and, as such, looks for growing companies that he can own for at least three to five years. He believes this approach is always meaningful within the U.S. because capitalism provides the opportunity for entrepreneurs and young companies to grow earnings over time. Generally, when it comes to selecting stocks, Mr. Fischer looks for companies with recurring revenue and high retention. In addition, when investing in tech companies specifically, Mr. Fischer thinks it is important to find a company with a product advantage and high switching costs so that customers can't easily leave. In both tech and nontech companies, he also wants to see a management team that embraces new ways of doing business or smartly uses technology to improve the business. Companies discussed: Amazon.com (NASDAQ:AMZN); Starbucks Corporation (NASDAQ:SBUX); Apple (NASDAQ:AAPL); Verisk Analytics (NASDAQ:VRSK); MasterCard (NYSE:MA); Visa (NYSE:V); Skyworks Solutions (NASDAQ:SWKS); Medtronic plc (NYSE:MDT); General Electric Company (NYSE:GE); O'Reilly Automotive (NASDAQ:ORLY) and OpenText Corporation (NASDAQ:OTEX).

to build that into a real nest egg, whereas a winner like an **Amazon** can grow 15 times in value the last 10 years, or **Apple** (NASDAQ:AAPL) grew 10 times in value the last 10 years too. Companies that everyone knows can actually build real wealth, and you just have to buy them and hold them, but most people, it takes time for them to realize that because those gains only come over time.

“It has about 75% of its revenues on a renewal basis. It just keeps getting renewed again and again, with retention rates topping 98%. So that’s the type of company we like to look for, a company with naturally recurring revenue or subscription revenue and high retention.”

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

Mr. Fischer: Certainly, there are several companies in the portfolio that I manage that are interesting. And one is **Verisk Analytics** (NASDAQ:VRSK). And the company has been public since 2009; it’s a data and analytics provider. It was actually founded by its customers, much like **MasterCard** (NYSE:MA) and **Visa** (NYSE:V). In 1971, all the large insurance companies got together to found this company. And therefore, it has data on insurance risk and policy underwriting success, data going all the way back to 1971 that it now sells to its customers, which are almost all of the insurance providers and many financial institutions.

Verisk has four pillars to its success: its proprietary data that we just talked about; deep domain expertise in whatever industry it serves, whether it’s insurance or energy or health care, where it also operates; first-mover advantage, developing new analytical methods and being the first to perfect them; and then, it’s deeply embedded in its customer workflow so that it becomes an integral part of how a customer analyzes its risk. The company has been able to grow smartly since it went public. And even in 2008 and 2009, it was able to put through price increases, and that shows it’s really a key to how its customers operate. It has about 75% of its revenues on a renewal basis. It just keeps getting renewed again and again, with retention rates topping 98%. So that’s the type of company we like to look for, a company with naturally recurring revenue or subscription revenue and high retention.

TWST: And did you want to mention a second company?

Mr. Fischer: Sure. Another company that we own and like is **Skyworks Solutions** (NASDAQ:SWKS). The company makes analog semiconductor products, mainly integrated modules for smartphones but also for Internet of Things devices, so it’s things like power modulators and antenna amplifiers and Wi-Fi connectivity. So anything that’s getting connected to the Internet is now a possible candidate for a **Skyworks Solutions** module or product. They sell to all the smartphone makers in the world, and they have other giant customers like **Medtronic** (NYSE:MDT) and **General Electric** (NYSE:GE) for Internet of Things devices, medical devices, smart homes, things like that.

The company has about \$3.3 billion in annual revenue, \$14 billion in market value. It’s expected to grow earnings per share more than 20% annualized the next five years. What’s really great about its solutions are they’re becoming more and more complex to the point that competitors can’t match them, and product lead times are becoming longer and longer, getting **Skyworks** much more revenue visibility looking forward.

And the company’s margins are going higher. That’s something you certainly don’t hear in a semiconductor-related business most of the time, but **Skyworks** has enjoyed steadily increasing operating margins and expects that to continue. The stock is about \$10 below our fair-value estimate of \$85, and we think it could grow about 15% annualized the next five years.

TWST: Did you want to mention a third company?

Mr. Fischer: Sure. Moving a little bit away from technology, in The Motley Fool portfolio I run, we have owned and still recommend **O’Reilly Automotive** (NASDAQ:ORLY), which sounds boring. They operate 4,500 auto part stores, and they’re adding about 200 stores per year. They expect to add 210 this year. And the company is just exceptionally well-run and has a lot of demographics working in its favor: more cars on the road, record number of cars are being sold. Unemployment is going down, which of course means more people are driving. A lower price of gas leads to more miles being driven as well.

1-Year Daily Chart of Verisk Analytics



Chart provided by www.BigCharts.com

The company has just been really about phenomenal operation by management. For seven straight years, earnings per share have grown 20% or higher per year with 28 straight quarters of earnings per share growth above 20%. Same-store sales grew more than 7% every quarter last year in 2015. So what’s happening is customer loyalty is very strong, and the company still has a lot of room to expand in the Northeast as well as other parts of the country, so they continue to look at acquisition targets as well. They grew earnings per share 25% last year, and they should grow earnings per share 16% to 20% this year. The stock trades in kind of a mid-20s value multiple on most metrics, but I think that premium is worth it.

TWST: And did you want to mention a fourth company?

Mr. Fischer: Sure. Another company we own and still recommend is **OpenText** (NASDAQ:OTEX). **OpenText** sells

enterprise information management, or EIM, software to organizations, whether it's a corporation or a government or a school, just to help the customer manage its increasing pile of digital information from start to finish. It's another company that has a lot of recurring revenue; about 82% of its revenue every year is recurring. Customers are renewing the contracts or just paying on a yearly basis. We like to see that sort of revenue stability because it makes it much easier for the company to grow on top of that, even during slow economic times.

“In general, when you're investing in technology, the keys for us are to look for a strong recurring-revenue base and a competitive position that protects the company's profits. If you have rising profit margins, that's another good indicator that they're doing something that somebody else can't. Pricing power is key too.”

The company has historically grown free cash flow by strong double digits, 15% annualized the last five years. The industry is growing around 10% annualized. I think **OpenText**, which is slowly taking market share, can grow along those same lines. The stock is below our fair-value estimate of \$55, and we're looking for about 11% to 12% annualized returns from it the next three to five years.

TWST: You've mentioned some tech companies. What advice can you give investors if they are looking to invest in the tech sector, and particularly, what precautions should they take? I mean, there's an awful lot of companies out there involved in the area.

Mr. Fischer: In technology, it's so easy to get attracted by something that's new and sounds exciting, and there's a lot of risk in that because if a company hasn't proven that it can steadily generate free cash flow, it may never reach that point. And of course, even with established technology providers, they can be displaced fairly quickly by new technologies, new competitors. So what we look for are companies that have product advantages, that have strong recurring revenue and that have high switching costs so that customers can't easily leave them.

Verisk is a great example. The data that **Verisk** sells goes back to 1971, and nobody else has it. Insurance companies, in particular, have a hard time operating without paying for **Verisk's** data. With **OpenText**, the company offers a full suite of enterprise information management software that helps the customer manage its data from the minute it receives it to how it processes it and then to how it outsources it to the rest of the world. So it becomes deeply embedded in how the company works, and **OpenText** has been around a long enough time for us to see that it keeps the customers that it gets.

We also want to see a management team that moves forward into new ways of doing business, and **OpenText** is doing that by embracing the cloud. Its cloud revenue is growing sharply. In general, when you're investing in technology, the keys for us are to look for a strong recurring-revenue base and a competitive

position that protects the company's profits. If you have rising profit margins, that's another good indicator that they're doing something that somebody else can't. Pricing power is key too.

TWST: And what about those companies that are not traditionally in the technology sector but technology plays a key role in their company? Are those sorts of companies those that you also look at carefully?

Mr. Fischer: We don't per se, but these days, as you know, all companies depend on technology to a growing degree. **O'Reilly Automotive** is one good example. One of the reasons they're so profitable and growing so strongly is they invested early in data and information, and that helps them have the right auto part at the right time at the right place for people, and that's a big convenience. When your car breaks down and you need a part, you're going to get it from whoever can get it to you quickest. So companies that know how to harness the power of technology and use it to their advantage are certainly something that we look for. Even in our nontech companies, we want to see management that is smartly using technology to do business better.

TWST: We were talking earlier about the approach that investors use and whether they want to look for the long-term or maybe some short-term gains. Do you think there's anything unique about the Millennial generation with their investing style and what they're learning as the market improves?

Mr. Fischer: That's another great question. I'm 46 years old, and with the Millennials that I do see, they surprise me because the ones I talk to are beginning with more of a long-term mindset than I did in my early 20s, and I think part of that may be due to technology. More Millennials are willing to invest directly through kind of a robot type of format online, whether it's an app or just a Web page that automatically puts their money into index funds. I find this is appealing to a lot of them, and dollar cost averaging, just putting in some money twice a month with each paycheck. So my guess is that it's the messaging that you see online now from new bot-based investment companies oriented toward building for the long-term when you're just beginning investing, that this tech-based approach is resonating with Millennials.

1-Year Daily Chart of O'Reilly Automotive



Chart provided by www.BigCharts.com

I'm sure there are plenty of Millennials out there who are the

opposite of that and think that the money to be made is by rapid trading. But the vast majority of them will find, typically within a few years, that that doesn't work. So I'm hopeful that the collective wisdom about how to use the stock market to the greatest advantage is slowly spreading and making its way down to the younger generations too. And of course, if you've had parents who have invested through the 1960s, 1970s, 1980s and 1990s, and seen the results of long-term investing, they can hopefully teach that to their children as well.

TWST: And do you think that the Baby Boomers that might be looking at retiring in a few years still realize the importance of equities as part of their portfolios?

Mr. Fischer: I think so, and I read a recent study how Baby Boomers are still one of the largest investors as far as assets go, as you would expect, in the stock market. And the reality is, I think, they need to be there to grow their money. The S&P 500 now yields more than the 10-year Treasury, which whenever that happens, typically, the S&P 500 does well the ensuing years, and that would make sense.

Of course, many Baby Boomers are nearer or at retirement. About 10,000 Baby Boomers retire every day now. That number is hard to even fathom. Most need to invest in stocks to keep up because you don't get yield elsewhere, but some of those investors, they're looking for ways to tamp down volatility or take out some risk. The main portfolio I manage, called Motley Fool Pro, we average about 72% net long, or about 72% net invested in stocks. That appeals to our Baby Boomer clients. We have some shorts and cash and hedges as a way to take advantage of downturns and not swing as much as the market may.

TWST: And any overall advice for investors in 2016? It started with a kind of bumpy road.

Mr. Fischer: This year has been a bumpy road, and I expect that to continue. There are a lot of concerns out there from China to how quickly interest rates will rise here to how much earnings can even grow this year and next. But I think those concerns are very likely setting us up for a slow grind upward in fits and starts.

You have stocks at kind of right around the average of their historical valuation; you have earnings still that are pretty modest the past 12 months and this year so far. So any uptick in the

economy in the next year or two, both stateside and around the world, would really help drive earnings higher and perhaps more than people expect. But overall, when you have the stock market, the S&P 500 trading around its historical valuation, but you have interest rates much lower than historically they've been at, stocks are the most attractive place for you to go still, and anyone with a three-year outlook or longer should be rewarded by owning today's leading companies over those next three years and longer.

TWST: And do you think the fact it's a presidential election year is going to impact the markets at all? We've heard from some of the presidential candidates when it comes to issues on the economy, some have made some kind of strong statements about it. Do you think any of that might have an impact as the year continues?

Mr. Fischer: The stock market definitely dislikes uncertainty, and not knowing which way economic policies may go will likely cause some increased volatility in the market, which will hopefully bring about some opportunities. We look at falling prices on businesses that we really know well and like as an opportunity to invest more funds. But certainly this year, there seems to be some extreme views from candidates on what they would like to do if they were to get into office. And so the more those views are shared and the closer someone seems to be getting to reaching the office of the White House, the more volatile the market may become up or down depending on how investors view that candidate's agenda. I think, historically, election years are volatile, and this one probably will not be an exception.

TWST: Thank you. (ES)

JEFF FISCHER
Portfolio Manager & Adviser
The Motley Fool
2000 Duke St.
Fourth Floor
Alexandria, VA 22314
(703) 838-3665
(703) 254-1999 — FAX
www.fool.com