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BARRON'S ROUNDTABLE

Henry Ellenbogen: The Case for a Credit Bureau, a Ski Resort, and More

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PHOTO: JEREMY LIEBMAN FOR BARRON'S

Barron's: Ready to join this party, Henry?

Ellenbogen: I am ready. I look to buy small companies that can become much larger. Consistent with that, we believe you can take advantage of today's significant technological changes by buying durable companies that use technology to make themselves better, gain

significant advantages over industry competitors, and consolidate share. Today, I will discuss a turnaround, two companies undergoing fundamental transformation, and two potential platform companies in industries with significant growth.

The first is Equifax [EFX]. In 2017, Equifax faced tremendously negative headlines after a cybersecurity breach. Ironically, the issues around Equifax should have increased the multiple on the company's stock. That isn't what happened. We believe you never know how good a company is until its business model is tested under the greatest duress. For a credit bureau, potentially the worst thing that could happen would be to have 145 million credit files exposed to hackers. These credit files are one of the reasons that credit flows so freely in this country. And that is why this company, despite its missteps, has proved how strong its business is.

To rewind the clock, the credit files were hacked out of Equifax's consumer website. During a one-month period afterward, the CEO was replaced, there were congressional investigations, and there were warnings on social media telling people to lock their credit reports. And yet, what was the net long-term impact on the company? It was quite marginal. One million Americans used to lock their credit reports. Now estimates are three million to four million. It went from a negligible number to a negligible number.

If you talk to the company's bank partners who contribute valuable data to these collaborative databases, each basically said, "While we might be upset with Equifax, we can't stop contributing data to this company or the other two parties in the business, because they are critical to how we operate as businesses." That is what I call a testing of the economic moat. The core U.S. credit business contributes 35% of Equifax's sales and about half its Ebitda. On a sum-of-the-parts basis, you are getting that business at a 50% discount to where it should trade because of the noise around the company.

What are the company's other businesses?

Henry Ellenbogen

Portfolio manager,
New Horizons fund

Chief investment officer,
U.S. Equity Growth

T. Rowe Price

Baltimore

Ellenbogen: I'm not suggesting that Equifax will be broken up, but it is helpful to consider for this conversation. Internationally, the company has market-leading assets in Canada, Australia, and the United Kingdom, among other countries. This is a bit of a transition year for the company, but its international business hasn't really been affected. It will generate about $330 million of Ebitda [earnings before interest, taxes, depreciation, and amortization] as we enter 2019, and we think that's worth 13 to 15 times, where historically these things have traded. There are multiple potential buyers for them.

Second, the workforce solution business is probably Equifax's best business. The company has income and employment data on all Americans. If you want to get a job, your employer or anyone looking at you will pull from this database. Even new platforms such as Uber and Lyft and Airbnb will do it to credentialize you. This is a unique data set. There is no competition. That is why the business has close to 50% Ebitda margins. It is a lower-double digit growth business, and worth 15 to 18 times Ebitda, which gets you to $7 billion to $9 billion. Even if you assume the company is going to have a $1 billion potential liability for the credit-file break, or $7 per file, and even if it has to spend

another $50 million on cybersecurity on an ongoing basis, the U.S. business is essentially trading somewhere at about eight times what should be 2019 Ebitda, which is basically a 35% to 50% discount to fair value.

Another way to think about Equifax is, it could earn close to $8 a share in 2020 as we move through the noise of 2018 and into 2019. If it gets a 20 to 22 multiple, consistent with where it has traded, that would get you to $160 to $172 a share, compared with a recent $120. The industry's strength should argue that multiples should go up over time.

What are the caveats?

Ellenbogen: There are a couple. Fintech and banking companies are pooling more data every day as these companies start to use algorithms and machine learning to look at credit in new and novel ways. Proprietary data sets are being used increasingly across the economy, and since a credit file is the core building block of any decision made on credit, you are seeing faster and more differentiated growth.

Abby Joseph Cohen: What other steps did Equifax take after the hacking episode, in addition to removing the CEO?

Ellenbogen: They are spending more than one hundred million dollars on breach costs in the third and fourth quarters, and will spend additional millions to improve ongoing security. The issue was poor hygiene under the CIO. They didn't update a security patch that had been released. While the former CEO made good business deals and ran a tight ship, he didn't understand what needed to be done, and in hindsight didn't have the right people working for him. This is a short way of saying this wasn't a structural issue. The company doesn't need a technology refresh. It was bad process and bad people.

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Scott Black: What is the company's secular growth rate?

Ellenbogen: This is a cyclical business with less than 20% of revenue tied to basic credit reports, so in a normal economic downturn, business would be down. But through a business cycle, Equifax can achieve double-digit annual earnings growth. Recently in the core business of providing credit files to banks, we're seeing better volume growth and more consistent pricing because people increasingly are pooling proprietary credit files. Equifax is a way to play some of the trends we are seeing in machine learning that make proprietary data more valuable in our economy.

When did you buy the stock?

Ellenbogen: T. Rowe Price is the largest investor. We have held it through this downcycle. In the New Horizons fund, I own Transunion [TRU] because it is a small-cap. I first bought on the initial public offering in 2015, and more on the announcement of the Equifax breach. TransUnion trades at about a 20% premium to Equifax because it is viewed as a share gainer due to Equifax's issues. Experian [EXPN.UK], the third player in the industry, is a good business, but hasn't invested as much in its platforms to allow partners to pull the data.

It's such a cold day in New York that I'll talk next about Vail Resorts [MTN], the ski-resort operator. Vail created a subscription business and a network of mountains, combined with a world-class database-marketing business to transform an industry that had been in and out of private-equity hands. It was a transaction-based business with a lot of seasonality around weather, and cyclicality around the company. Rob Katz bought this business in 2006 and undertook this transformation.

Walk us through the process, please.

Ellenbogen: First, Katz introduced a low-cost season pass. Previously, if you wanted to go and have an all-you-can-eat skiing experience, you would pay $1,200 to $2,000 to go to a premium mountain. It was a price point only for people with second homes or who lived in the locale. He lowered the price to $800, which not only allowed him to gain market share in Colorado and then Utah, but to start marketing the subscription business to destination skiers. Now, the break-even is four days. If you go to Vail, Park City, Whistler, Stowe, or any of Vail's resorts and ski more than four days, you should buy a season pass. It has become so popular that before Thanksgiving ended, Vail Resorts had sold 740,000 season passes, more than half to destination skiers outside the geographic area, locking in over $500 million and transferring the weather risk from the company to the individual in exchange for a very good deal.

Oscar Schafer: Imagine taking your kids to Vail from New York for Christmas vacation. It's fogged in, you land in Denver, the kids are screaming, it's late at night, you get to Vail, and there's no snow. But they have that $500 million backload.

Ellenbogen: It is snowing today in Vail, but because of how bad the snow has been this winter, the stock is down 13%, which is another reason I really like it. Because this is a fixed-cost business, Katz has been able to invest aggressively in better, higher ski lifts. And, he recently bought Whistler, in Canada. When he bought it, Whistler had a fine infrastructure for a $90 million Ebitda company. He has announced that he plans to invest $50 million just in higher-speed lifts, allowing more people to get up the mountain. We believe Whistler, purchased by Vail for 11 times Ebitda, is going to do $180 million to $190 million of Ebitda three years after the purchase. Katz has brought a network to Whistler. Now, if you live in San

Francisco or Seattle and you don't want to ski only in Utah or Colorado, you can fly to Vancouver, drive an hour and a half, and ski at Whistler.

Do other ski companies now offer similar passes?

Ellenbogen: Everyone else sells their passes locally or regionally. Only Katz has been able to create a national business. He has done it by lowering the price, putting together a network of resorts, and investing in a 300-person database marketing organization that is best-in-class. He took a small team out of Caesars Entertainment [CZR]—Harrah's invented the Total Rewards system—and under the leadership of executives from PepsiCo [PEP], they built what is as good as anything we've seen in database marketing, including at companies as sophisticated as Amazon.com [AMZN] and Priceline Group [PCLN].

Because you are gaining share, you can fold new assets into your network, and your network becomes more valuable. Had someone else paid the same price for Whistler, at best they would have earned a 10% return. Vail is going to earn a 20% return on capital. You end up with a company that is growing faster than the industry because it can market nationally and offer better value. And it can buy assets that are uniquely valuable to it because they get pulled into the network. As bad as the weather has been out West this season, we believe Vail will hit its numbers this year.

Which are?

Ellenbogen: He has committed to doing $640 million to $660 million of Ebitda. if the weather gets better, I actually think he would have beat those numbers because the snow this year is probably going to cost him $30 million-$40 million, which probably is his upside cushion. We think he does $10.50 in free cash flow this year and close to $12.50 next year in free cash flow.

This is clearly a company that is going to see a big advantage from the new tax law. His competition is highly levered or doesn't actually make any money, and so they are not going to get the same benefits.

Black: Tell us what the price of the stock is.

Ellenbogen: Around $205, down from $225 because of the weather concerns out West.

Black: What is the balance sheet like?

Ellenbogen: It is 1.2 times debt to Ebitda, with significant free cash flow. It is a growth cyclical, and even though people focus on the weather, actually demand tends to focus more

on the S&P 500. So if the S&P 500 were to enter a bear market, you would probably see your estimates go down by 20%-25%.

Schafer: Does Vail still make money by selling real estate?

Ellenbogen: No. He exited that business. He moved them completely out of the real estate business.

Black: Is a season pass good at all the operations?

Ellenbogen: It is. There's multiple versions, but with the $800 one, you get all the mountains all the time.

What's to stop competitors from offering the same thing?

Ellenbogen: Well there's two things. One is you have to put together a compelling network because just having one asset or a couple of assets doesn't work. Second, you've got to do data capture. He convinced customers to give him their email addresses—and that was a multiyear process—and then set up a very sophisticated direct marketing organization.

Because of the success that Rob has had, the Crown family, which owns Aspen, has partnered with KSL Capital to go buy Mammoth in Los Angeles and buy Deer Valley and some assets in Vermont. There is some talk about them putting together a pass program. There are several issues they have with that, and I won't get into it, but Rob's assets are better; he has more of them; he actually has already done the hard work of capturing the data, and he has transitioned to the $800 pass. In Deer Valley, the pass is close to $1,800.

The other company I'll mention that is a business transformation is Bright Horizons Family Solutions [BFAM], the premium provider of preschool education in the U.S. Started in Massachusetts, it has 1,037 full-service child-care centers. They are the market leader in both the U.S. and the U.K. From scratch, they basically also had a backup-care business. The initial business model was not to sell to individuals, but to sell to corporations. And they have continued to do that. At T. Rowe Price, we offer employees backup care. If my son's nanny is sick, I can, for a small co-pay, put him into a Bright Horizons Center or get someone to fill in for the day. This is a very good business because they are the premium provider. They have a world-class service culture. So their employee retention is three times anyone else's in this industry, and it has led to 97% customer retention.

But the reason we are particularly excited about Bright Horizons is if you were to interact with Bright Horizons like I have, it would have been like using an analog taxicab or black-car service. You would have to call them; they would have to find availability, and they'd have to

call you back once they found it. Now, by investing in technology, it's going to be more like an Uber experience. They are using their scale, which no one else has—they are 10 times bigger in the backup-care business than anyone else—to invest in systems that will give instant availability.

And in their full day-care centers, they've introduced a service called My Bright Day, which gives you a daily account of what's going on with your child. This is successful because they've already layered in the cost to do this, but we believe that we are just on the cusp of seeing the revenue grow, in two ways. One, you will see utilization go up, and two,more companies will want to sign up because it is more on target with what millennial employees need. Obviously, millennials don't want to interact with their backup-care provider on the phone.

It is now basically going to accelerate from what historically has been 12%-15% growth to 20% growth, and the company will be able to hold on to the tax advantages it gets. So when we look out to 2019, we think the company earns around $4.04. Historically, it has traded at a premium because it is a modest cyclical with subscription characteristics and it is so dominant. We think that it will maintain a 28 times multiple. It's slightly cheaper on free cash flow, which gets you to $110 to $120 a share. The stock's in the mid-$90s today.

How much do they charge for day care?

They are positioned in the premium side of the market. They are traditionally not a low-cost provider. Their average tuition is around $18,000. So they do very well. Massachusetts is one of their biggest and most successful markets. The company is headquartered in Watertown. Also—and this is not a big part of our thesis—in the tax bill there was a child-care credit that was doubled, and also the income qualification went from $75,000 for single earners and $115,000 for couples to $200,000 and $400,000, respectively. And so, basically, more of their customers or potential customers will be able to get 10% to 15% back.

Do you have another pick?

Ellenbogen: The next company I want to talk about, ServiceMaster Global Holdings [SERV], is going to see a spinoff in the back half of the year. One of the things that led us to this was our success in investing in the national pizza companies. Until the iPhone was created, there was literally no market share growth among the national providers of pizza delivery, and it was a modest- growth business. After it was introduced, Domino's Pizza [DPZ], followed by Papa John's International [PZZA], significantly invested in technology—which, in pizza delivery, is all about quality, convenience, and price; improving the app was all about convenience. National providers gained significant market share over regional providers,

which lost share. The mom-and-pops, who actually make the best pizza and are the most nimble, stayed flat.

The same thing is happening today in pest control, a terrific, terrific industry. Even in the housing crisis, residential pest service was flat. It is now growing at 5% to 6% annually, half in units, half in price. The unit growth is driven by people wanting to move to warmer climates and by global warming. Some people at this table might even say the tax bill is going to drive the migration to the South. There are only two national providers: Orkin, half-owned by the Rollins family, and Terminix. I would point to Terminix, which actually will be the remaining company of ServiceMaster Global Holdings as a stock after American Home Shield is spun out.

ServiceMaster Global Holdings was an LBO brought to the market several years ago, and, to be frank, it was not ready for prime time. They had a CEO who fundamentally didn't understand the pest-control business, and, instead of investing in the service, they consolidated branches, which lowered the quality of their service.

Schafer: Did you know that Orkin was the first LBO?

Ellenbogen: Believe it or not, I have visited the Rollins Corp. museum in Atlanta. Before I bought Rollins stock, I actually went to the training center and to the house where they teach the local reps how to basically do the service.

Cohen: They give everyone a big shoe [laughter].

Mario Gabelli: I was at the sales center, where the salesmen go into a house and drop a mouse on the floor, and then knock on the bell and say, "Look, you got mice." Don't bite on that one.

Ellenbogen: Back to ServiceMaster. Terminix is growing at zero to just 2% because of the mistakes that were done under prior management. But the company started to head in the right direction in 2017. It did two very important things. One, it announced that it was splitting into two pieces: American Home Shield, the market-leading home-warranty company, which is an above-average business with leading scale, and the Terminix and Franchise Services Group.

I'm really focused on Terminix and what they call the brands, primarily ServiceMaster Restored and ServiceMaster Clean [which provide cleaning and other services]. Our belief is that you have an $8.2 billion pest industry with two players that each have 20% share and will grow faster than the industry, because they are going to invest in technology.

The path has been shown to everyone by Rollins. Rollins set down this path of investing in iPhone technology to do virtual route planning and eliminate the need for technicians to go to their headquarters every day to pick up their routes. And since they've done that, you've seen 300 basis points of margin expansion. More importantly, the technicians now earn more money because they get paid by the route, and they can do one or two more routes a day. That is leading to better retention of technicians, which leads to better organic growth.

ROUNDTABLE PART 2

- Henry Ellenbogen: The Case for a Credit Bureau, a Ski Resort, and More
- Mario Gabelli: Bullish on Media and Entertainment
- Jeffrey Gundlach: Bullish on Commodities and Bank Loans
- Abby Joseph Cohen: Drilling for Oil and Making Gadgets
- William Priest: Bullish on Screen Technology and Chip Gear
- Scott Black: Making Chips and Crushing Sand
- Meryl Witmer: Used Cars and Carbon Black
- Oscar Schafer: Loading Up on Auto Parts, Off to the Movies
- Paul Wick: How to Play the Big Trends in Tech

Rollins' organic growth has now picked up toward 6%, and we think it is going to grow faster. We own Rollins; we like it. It trades at 35 times 2019 estimated earnings and 20 times Ebitda. ServiceMaster we believe will be created at 14 times Ebitda and more like 20 times earnings. You are getting something that has zero organic growth, but we believe with the proper investment under the new CEO, they will at least move to industry norms. In fact, as they invest in technology and service, we think that is going to pick up.

Schafer: The name ServiceMaster was from the old CEO. He was very religious and he was doing it in service of a master.

Gabelli: Nothing wrong with that. I thought it was bed bugs that were the big driver of incremental growth.

Schafer: Believe it or not, Mario, there is an argument that actually mosquito control could be a big deal.

Ellenbogen: We think American Home Shield, as a market-leading business, is worth 12 to 13 times Ebitda. That would make AHS worth $3.6 billion to $4.2 billion. They have the market-leading restoring clean brand in ServiceMaster, which is a cyclical business and tends to

benefit a little bit from storms. That is a 15 to 18 times multiple business because it is a fee business with mid-single digit cyclical growth. We think that's worth $1.2 billion to $1.7 billion. You are going to get that in the Terminix spinoff. And then you can buy Terminix today at around 13 to 14 times Ebitda, which we think is a very low price. And so, if you do that against $2.3 billion of debt, 133 million shares outstanding gets you to low $60s to high $60s per share.

Black: What's the price now?

Ellenbogen: It is in the low $50s. I think it is $52 today.

Finally, part of what we do is invest in early-stage growth companies. On a short-term basis, these may look expensive. But we have found that, if you own a company that is not only on the right side of change but is actually driving it, you will make a lot of money.

The first I want to talk about is Shopify [SHOP]. U.S. e-commerce is a $500 billion business that is growing at 15% to 16%. Amazon is $200 billion of it, and is actually gaining share. The midplayers are losing share, although they're growing close to 4%. These are legacy companies that have legacy cost structures, legacy workforces, legacy systems. The only other area of the market that is growing in line or faster than the end market are the small-to-medium-size businesses, particularly those that sell less than $10 million and are very nimble. They are able to leverage their nimbleness, and they don't have legacy cost structures. They also can leverage the front-end platforms of Facebook and Google to reach the consumer. The back-end platform that they all use and increasingly is gaining share—we think it's 40% share going to 80% share—is Shopify.

Shopify was started by a very well-known engineer named Toby Lütke, who was one of the fathers of Ruby On Rails and has created the predominant and pre-eminent technology company in Canada.

Paul Wick: The only thing is it is a Canadian technology company, and Canada has a long and proud tradition of Canadian tech companies that implode. Nortel, Research in Motion. And then the other thing is the CEO wears a beret.

Cohen: Is he French-Canadian?

Wick: He reminds you of the CEO of JDS Uniphase, who wore a beret, and the stock went from 130 to three by the time he left. So those are the caveats.

Ellenbogen: Well, first off he is German; he is not Canadian.

Wick: Well, it is a Canadian company.

Ellenbogen: I would argue it is a global company that happens to be based in Canada, because it has increasingly global end-markets. The second thing is, if you visit Ottawa you probably want to wear a lot more than a beret when you are outside. With the exception of about two months a year, it is really cold; people ice skate to work in Ottawa. Anyway, back to Shopify. It represents $27 billion, or about 10%, of U.S. e-commerce, excluding Amazon, and its platform is growing at about 70% a year. We think the market is missing a couple of things.

One, it is by far the best and least expensive technology, and it is gaining market share. A lot of competitors have moved up to the mid-market because they simply cannot compete with Shopify.

The second thing is that they are essentially becoming the front-end system of record. If you meet with companies that are initially built on Shopify, they basically run their businesses off it and then use it for other services. They attach payments. They attach capital. Shopify has a deal with UPS where they get a commission to make shipping integration easier.

The margins associated with this are very high. The way we look at Shopify is very simple. It has $27 billion of gross merchandise value, going to $80 billion over the next three years. In the short term, the market thinks that the company will do $943 million in revenue in 2018 and $1.25 billion in 2019. We think these numbers are wrong. What is wrong is the gross margin is going to be much, much higher, because they attach very high ancillary services to it. When we look out to 2020, we think you are going to have $2.4 billion of revenue, $1.4 billion of gross profits. It is the type of business that we think, long term, is a 45% to 50% margin business. That will mean it will trade between 13 to 18 times gross profit, or $150 to $180 a share. Today, it is $110.

Anything else?

Ellenbogen: We invested privately in Grubhub [GRUB] before they bought Seamless at $500 million of private market value. The company has grown now to a $6 billion company, and we still like it.

Delivery is going to generate 100% of all the restaurant industry growth in 2018. Basically, only two platforms are powering delivery—UberEATS and Grubhub. These are business models where scale matters. Customers want to go where there is more selection. Increasingly, chains like McDonald’s, which has a successful relationship with UberEATS, want to be in places that can give them national coverage and also bring in customers.

So you are basically buying one of the two platforms in an industry where we believe that delivery is going to grow 25% to 30% for the sustainable future, and this company has become one of the consolidators. The stock is trading at 28 times next year’s earning, in an

industry that has sustainable 25% to 30% EPS growth, and it is a profitable business. It currently makes about a $1.50 of Ebitda per order, and the number of orders is going to continue to go up.

Cohen: Are these companies only in the largest metropolitan areas? What percentage of population do you think could be covered?

Ellenbogen: Good question. UberEATS and Grubhub are essentially nationwide now. UberEATS is also international, while Grubhub is not. What is very interesting about these platforms is that, in terms of growth and percent penetration, they actually tend to be more successful outside major markets, because in those markets you have less selection. So, they actually do really well with the tails, as well as the heads.

Thanks, Henry.

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