Economic Moats Can Help Your SSG!

2025 SF Bay Area Chapter Investor Education Day

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Agenda

- Why worry about quality and economic moats?
- What are economic moats (Moats)?
- Stock Selection Guide (SSG) Sections 1+ 2 (Quality) = business models = potential economic moats.
- Moat details, concepts and ideas.
- Summary

Warren Buffett on Quality and Moats

- "When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever." Source: Letter to shareholders, 1988.

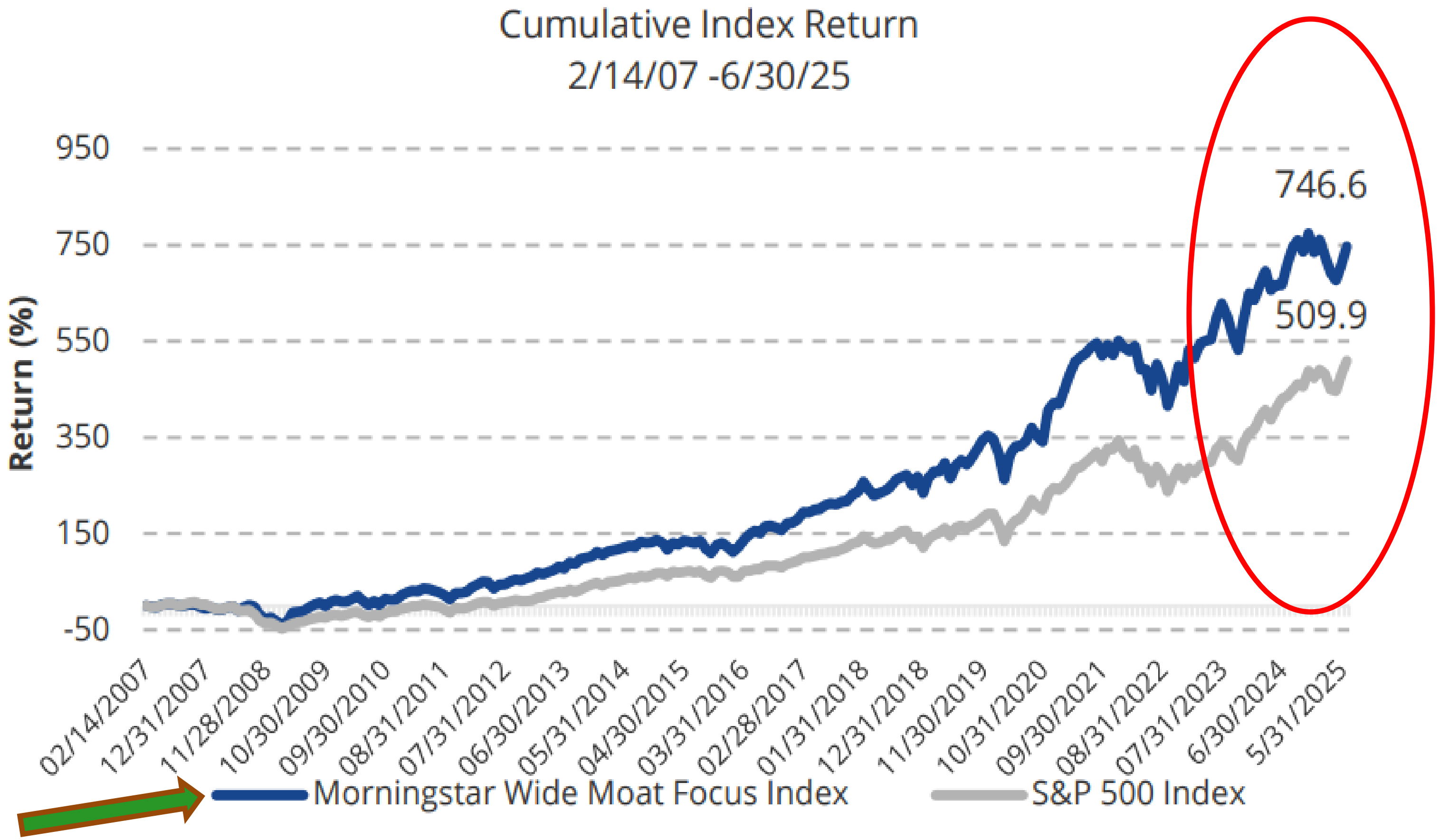
- "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."
  Source: Letter to shareholders, 1989.

- "Long ago, Ben Graham taught me that "Price is what you pay; value is what you get." Whether we are buying socks or stocks, I like buying quality merchandise when it is marked down."
  Source: Letter to shareholders, 2008.

Source: Berkshire Hathaway Annual Reports

Performance of the Concept Over Time

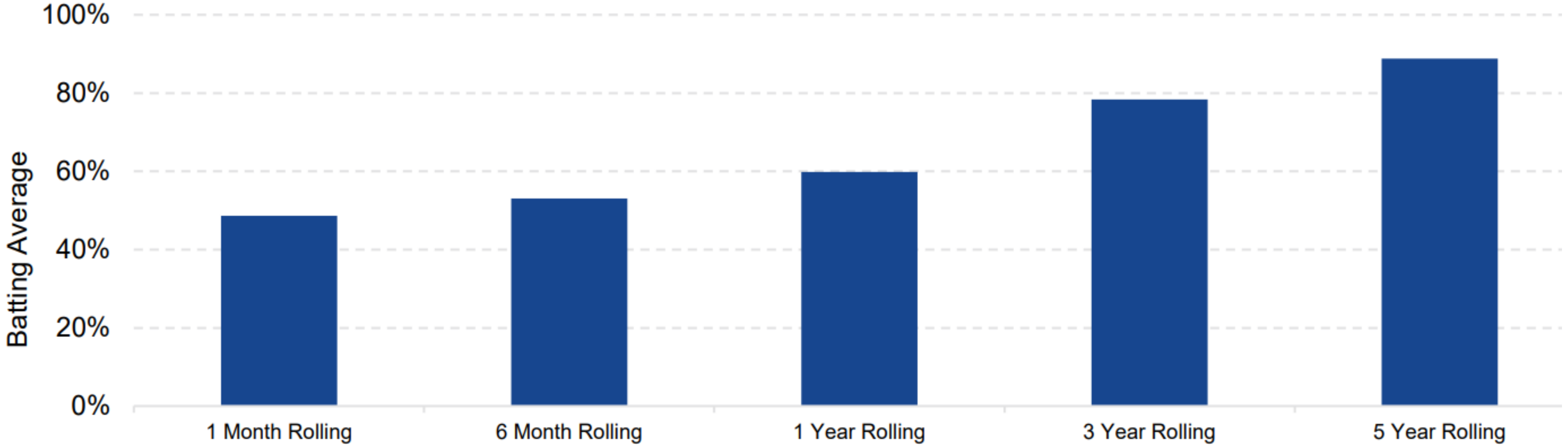
Morningstar Wide Moat Focus Index has Outperformed the S&P 500 Index



Source: Van Eck. Morningstar, June 2025.

Batting Average of Wide Moat Focus Success vs S&P 500 Index

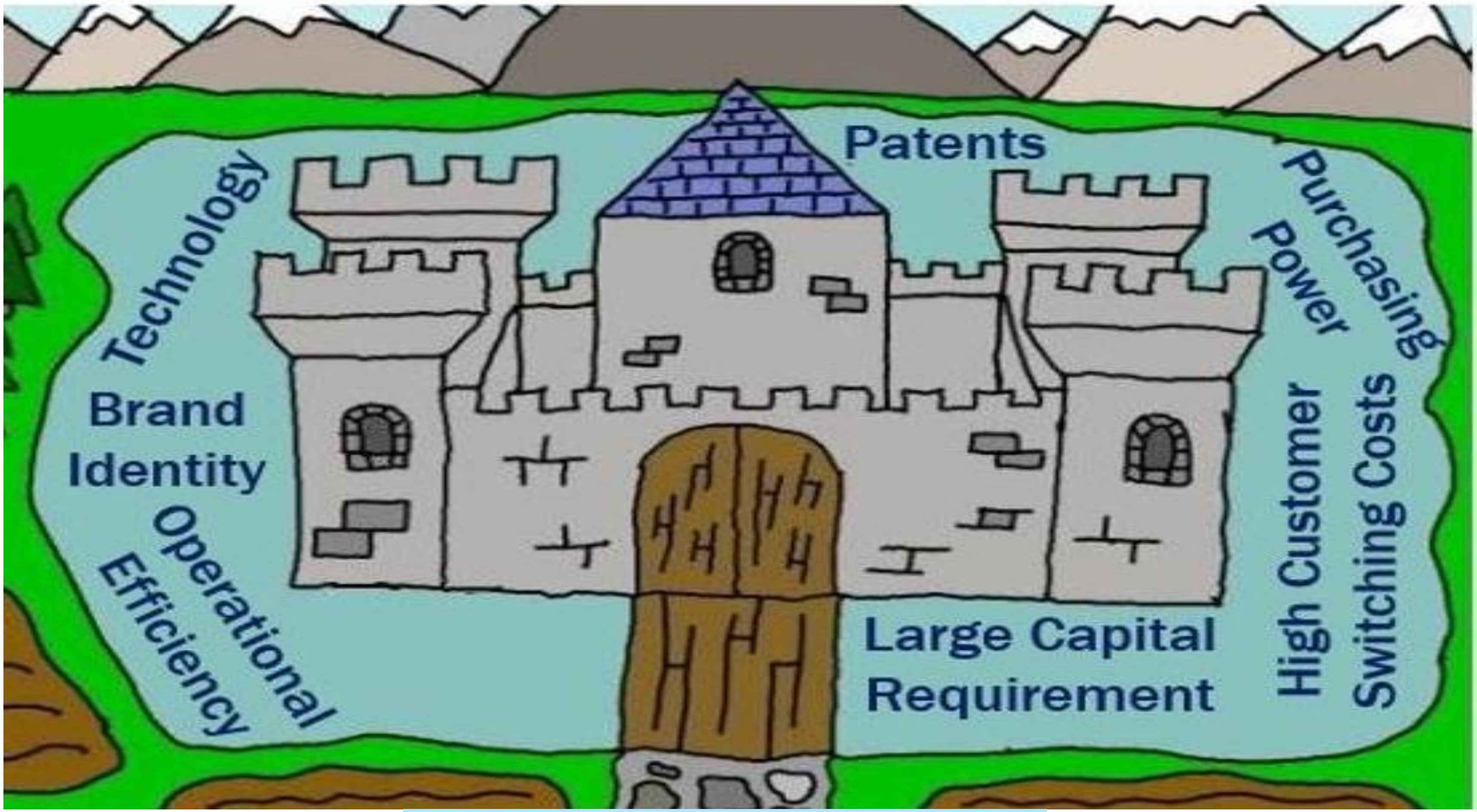
Batting Average is measured by dividing the number of periods a portfolio or investment strategy outperforms a benchmark by the total number of periods.



	1 Month Rolling	6 Month Rolling	1 Year Rolling	3 Year Rolling	5 Year Rolling
Total Periods	220	215	209	185	161
Total Outperformed	107	114	125	145	143
Batting Average (%)	49%	53%	60%	78%	89%

Source: Source: Morningstar, VanEck. As of 6/30/2025. Past performance is no guarantee of future results. Batting Average is measured by dividing the number of periods a portfolio or investment strategy outperforms a benchmark by the total number of periods.
Batting Average: Morningstar Wide Moat Focus Index vs S&P 500 Index Monthly Frequency: 2/2007 - 6/2025.

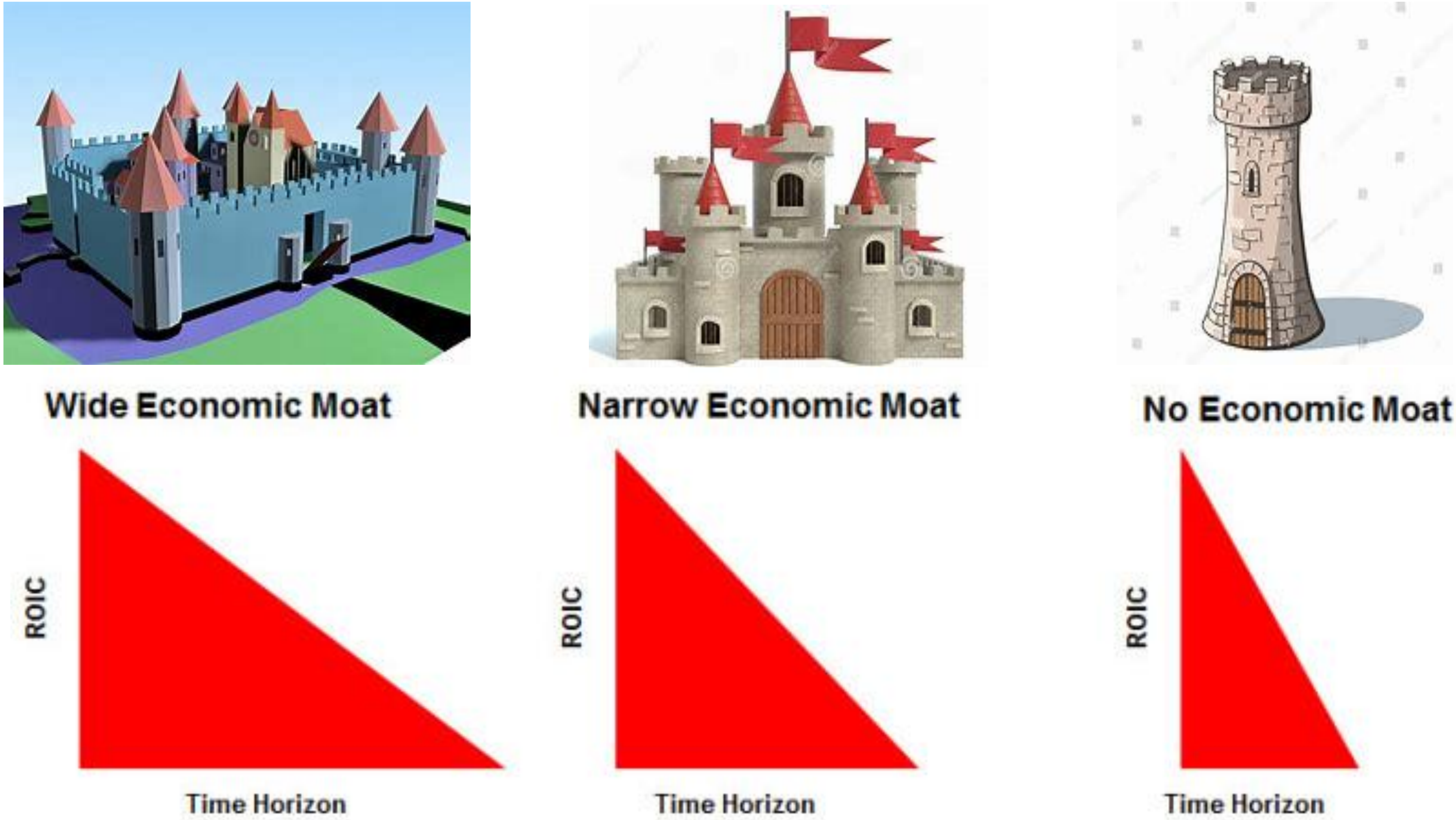
Wide Economic Moats – Sustainable and Competitive



- **An Economic Moat protects a company's profits from being attacked by business forces**

  Traditional management theory terms: "Sustainable Competitive Advantage" or "Entry Barriers"

Economic Moat Thought Process



Source: Pat Dorsey, Morningstar.

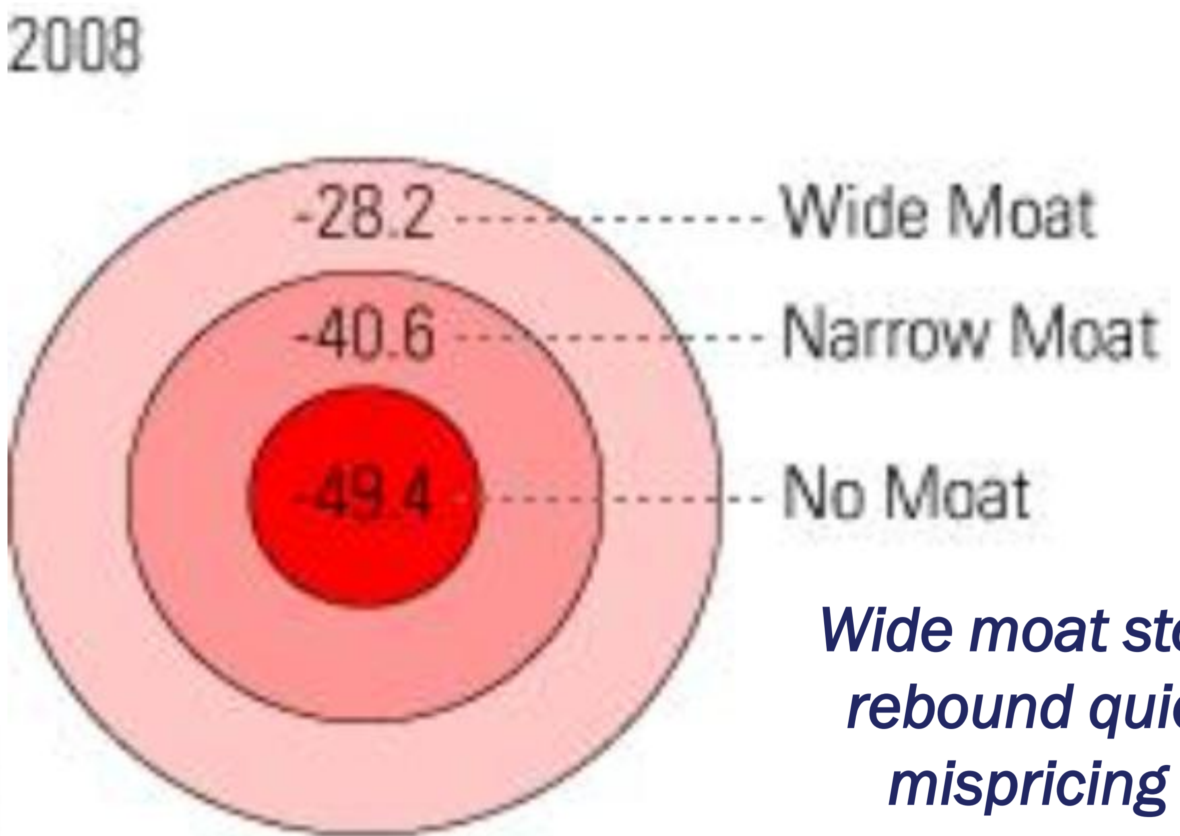
Moat Performance – No Moats Lose

Market Performance by Moat Rating and Moat Source ■ Top Performer ■ Bottom Performer

	Number of Companies	Median Annlzd 5 Yr TR (%)	Mean Annlzd 5 Yr TR (%)	Median Annlzd 10 Yr TR (%)	Mean Annlzd 10 Yr TR (%)
Morningstar Coverage Universe	1,503	13.7	13.2	7.3	6.8
Moat Rating					
Wide-Moat Companies	209	15.7	15.6	10.6	11.0
Narrow-Moat Companies	643	15.5	16.0	8.6	9.0
No-Moat Companies	651	10.5	9.6	3.3	2.9

Source: Morningstar Magazine, August / September 2017.

In Tough Times Wider Moats Help



Wide moat stocks tend to rebound quicker due to mispricing of quality companies during sell-off.

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Source: Morningstar

Wide Moats = Sustainable Competitive Advantage = Quality Stocks

- An economic moat (competitive advantage) allows a company to fend off competitors and earn sustainable excess economic profits. (Wide and Narrow)
- My belief: wide / narrow moats = higher margins, those leading to good quality stocks, but they must be purchased at a reasonable price.
- Section 2 of the Stock Selection Guide (SSG) is our **Quality Section**. Spend time here to:
  - Improve your returns.
  - Retain good stocks over time.
  - Determine when a company is past its prime.

Moat and Margins

- The potential of wide moat stocks are intriguing.
- Wide moat stocks should have higher margins over a longer time period.

Moat Rating	Number of Companies	ROIC TTM (%)	ROIC Trailing 3 Yr (%)	ROIC Trailing 10 Yr (%)	Operating Margin Trailing 10 Yr (%)	Net Margin Trailing 10 Yr (%)
Wide	209	12.5	13.5	19.0	21.1	14.1
Narrow	643	9.0	9.7	14.8	14.7	9.0
None	651	5.1	4.8	8.6	7.6	4.4

Source: Morningstar Magazine, August / September 2017.

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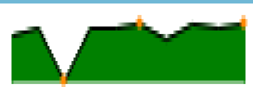
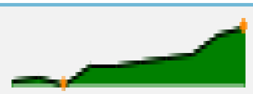
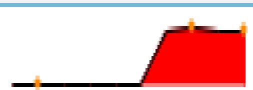
Quality Analysis - SSG Style – Narrow vs Wide Economic Moat

Evaluate Management	Narrow Moat										
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	8.1%	11.0%	12.6%	12.3%	12.7%	12.9%	13.5%	13.4%	12.8%	12.2%	13.0%	
% Return on Equity	8.7%	10.1%	12.1%	10.9%	10.8%	11.5%	14.0%	16.9%	17.7%	18.8%	15.8%	
% Debt To Capital	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	50.5%	10.1%	

Evaluate Management	Wide Moat											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	57.5%	61.6%	21.2%	61.6%	60.8%	64.8%	53.1%	63.7%	62.1%	64.8%	61.7%	
% Return on Equity	11.1%	13.0%	8.0%	17.8%	19.5%	21.9%	22.0%	24.8%	35.1%	40.1%	28.8%	
% Debt To Capital	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	32.5%	35.9%	32.8%	32.5%	26.7%	

Use the SSG to Find Excellent Management or Quality

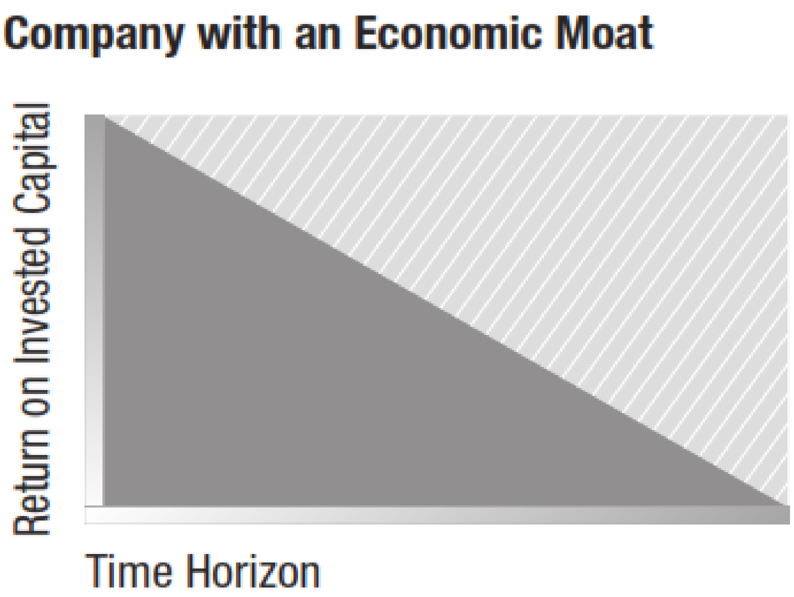
- Use Section 2 of the SSG to determine quality.
- Two profitability measures –
  - Pre-tax profit margins
  - Return on Equity (ROE)

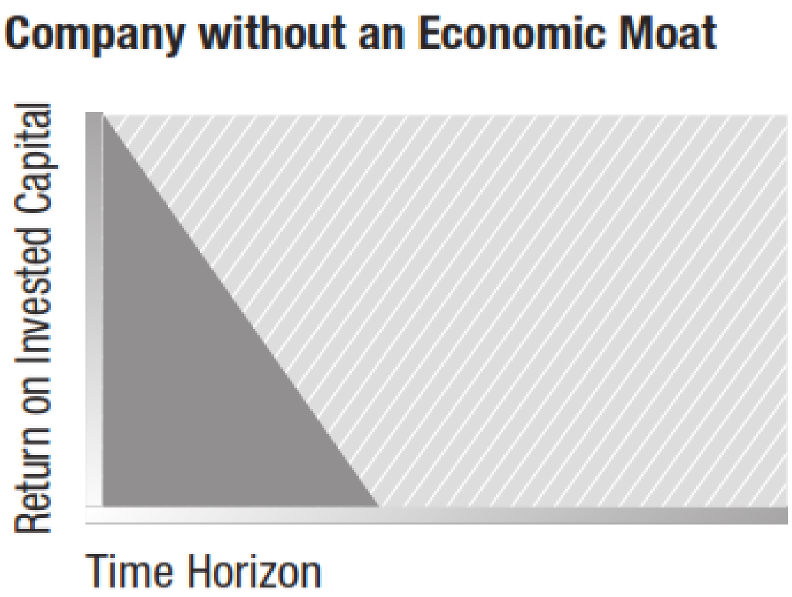
- One balance sheet analysis - Debt-to-Capital.

Evaluate Management

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	39.5%	38.3%	37.6%	40.5%	40.4%	41.0%	38.4%	25.8%	31.8%	36.3%	34.7%	UP
% Return on Equity	16.0%	15.8%	14.8%	18.1%	20.4%	17.9%	19.6%	13.2%	14.1%	13.1%	15.6%	DOWN
% Debt To Capital	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	DOWN

The Financial Risk of Moats



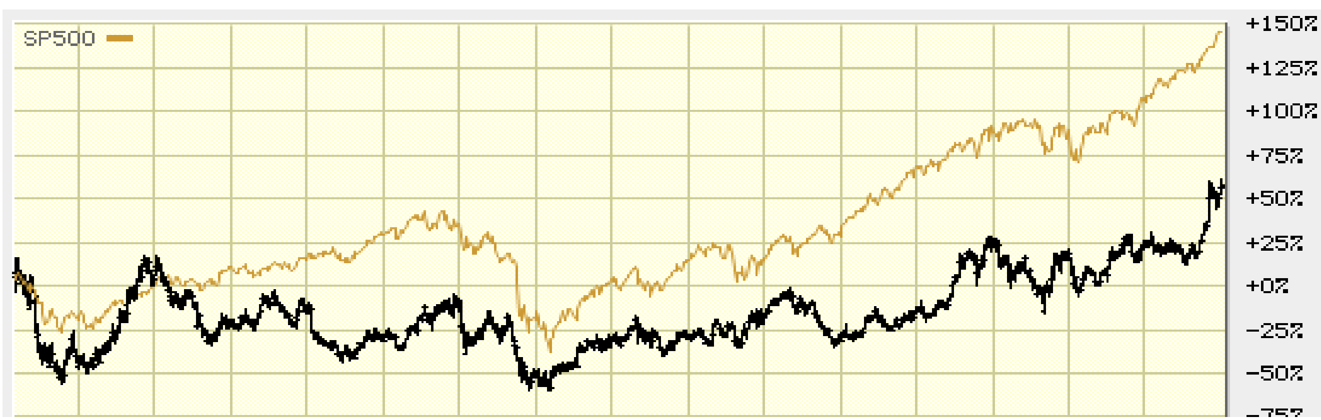


- A weakening moat, margins or "Quality" can show in the stock price over time.
- No moat stocks can do well in the short run due to growth.
- Wide moat stock valuations can be too high and this is the concern of the quality stock investor.

Example of Losing an Advantage

Evaluate Management	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	20.0%	23.9%	20.4%	16.2%	36.8%	32.9%	27.9%	23.9%	28.3%	25.7%	27.7%	DOWN
% Earned on Equity	14.2%	16.0%	13.1%	10.2%	22.4%	25.9%	20.6%	16.9%	19.6%	19.3%	20.5%	DOWN
% Debt To Capital	5.2%	4.7%	4.8%	5.1%	4.1%	13.8%	20.8%	18.8%	19.7%	27.1%	20.0%	UP

- Intel is a leader in their industry, but the industry changed. The chart is from 2003-17.



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A Wide Moat Is Similar to a Strong SSG

- Moats help identify sustainable competitive advantages.
- By doing this work it can help:
  - Support holding good quality stocks longer.
  - Helps to understand your SSG numbers.
  - Provides items to think about regarding whether your stock is losing their advantage.

Sections 1 & 2 of the SSG are how we analyze a company's business model or moat.

Solid Moat - What Do You Think?

Evaluate Management												
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	32.2%	39.5%	38.3%	37.6%	40.5%	40.4%	41.0%	38.4%	25.8%	31.8%	35.5%	DOWN

- The last 5 years are down. Interesting?
- The last year has recovery.
- High pre-tax margin business model.

Knowing your company by understanding their business by doing additional analysis can help with winning stocks like ISRG and long term issues.

Wall Street Worries over Margins and Earnings Growth = Opportunity

Evaluate Management	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	32.2%	39.5%	38.3%	37.6%	40.5%	40.4%	41.0%	38.4%	25.8%	31.8%	35.5%	DOWN

Opportunity - Know your company. ISRG dropped from $198 to $115 over two years.

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Solid Moat - What Do You Think?

Evaluate Management												
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	20.9%	21.2%	28.1%	28.4%	31.6%	35.6%	29.3%	29.3%	31.0%	28.5%	30.7%	DOWN
% Earned on Equity	25.6%	22.6%	25.8%	29.0%	33.6%	37.1%	29.0%	31.3%	40.9%	35.0%	34.7%	EVEN
% Debt To Capital	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	12.1%	24.0%	35.1%	40.4%	22.3%	UP

- Margins peaked in 2012. Recovering in 2021.
- Debt is rising. Cash is held off-shore.
- High absolute profit margins and ROE.
- I'm a leading consumer products company.
- I'm widely held in BetterInvesting – I'm Apple.

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Is This Additional Analysis To Your SSG Useful?

- It forces you to think about a company's business - positives and negatives.
- Moats fall into 3 buckets: Wide -Narrow -None.
- By figuring out why there is a high margin or wide moat, and whether it is sustainable, this could be important to your stock.
- Competitive advantages identified by this research can protect high profit margins.

Question Time

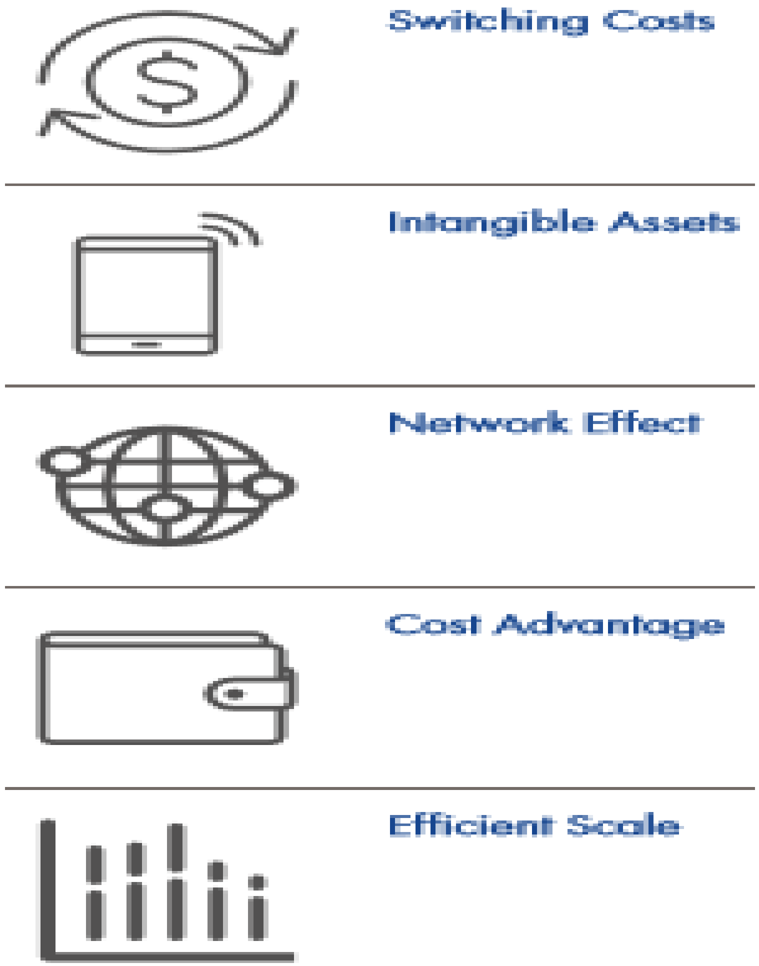
Morningstar Moat Categories

- There are 5 categories.
- The three moat system should help you think about as they classify long term business models.
- Morningstar identifies wide moat stocks.

By learning more I can understand the stock's long term business model and if it has a sustainable competitive advantage.

<u>I like the potential advantage of wide moat stocks and their performance.</u>

Morningstar's 5 Sources of Sustainable Competitive Advantage



Source: Van Eck

Moat Analysis – Network Effects Has Strong Performance

Market Performance by Moat Rating and Moat Source ■ Top Performer ■ Bottom Performer

	Number of Companies	Median Annlzd 5 Yr TR (%)	Mean Annlzd 5 Yr TR (%)	Median Annlzd 10 Yr TR (%)	Mean Annlzd 10 Yr TR (%)
Morningstar Coverage Universe	1,503	13.7	13.2	7.3	6.8
Moat Source					
Switching Cost	314	16.4	16.5	9.3	8.9
Network Effect	112	17.1	18.0	10.0	11.7
Intangible Assets	491	15.9	15.7	8.9	8.9
Cost Advantage	358	15.9	15.7	8.9	8.9
Efficient Scale	200	13.2	13.3	9.0	8.5

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Source: Morningstar Magazine, August / September 2017.

Definitions of Competitive Forces

Economic moat is a sustainable competitive barrier against competition.

- **<u>Network Effect</u>** – When the value of a product or service grows as its user base expands. Each additional customer increases the product's or service's value exponentially. *<u>It is perhaps the strongest type of economic moat.</u>*

- **<u>Switching Costs</u>** – When a company has pricing power by locking customers into its unique ecosystem, they have high switching costs. Payroll processing is an example.

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Source: Investopedia, Morningstar.

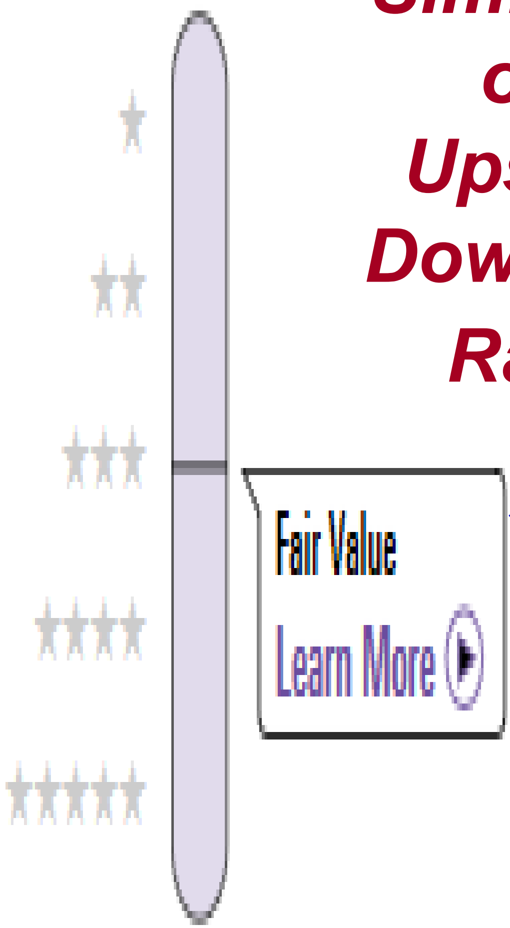
Definitions of Competitive Forces

The key of an economic moat is how long a company will keep competitors at bay.

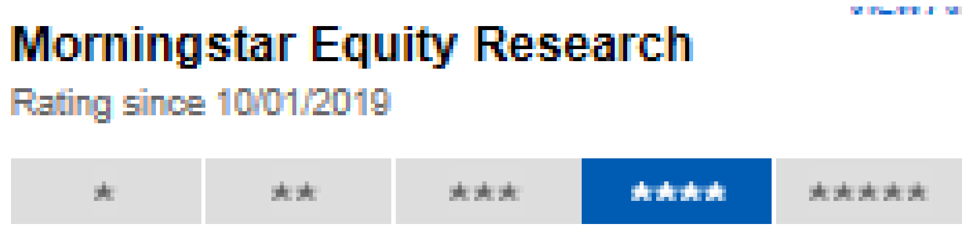
- **Intangible Assets** - A broad category that includes brands, patents, and regulatory licenses.
- **Low Cost Advantage** – Ability to offer lower prices than your competitors for the same product or services.
- **Economies of Scale** – Lower cost advantage typically comes from size or scale or "The Largest Player" in a smaller sector. Spread the costs over your size.

Source: Investopedia, Morningstar.

Morningstar's Star and Moat Analysis



Similar to our Upside-Downside Ratio



You get more stars when the current price is below Morningstar's Fair Value. Also if a stock price is way above Fair Value, you get fewer stars.

You can get the economic moat analysis in their 10-12 page report. Nice summary about the company's economic moat.

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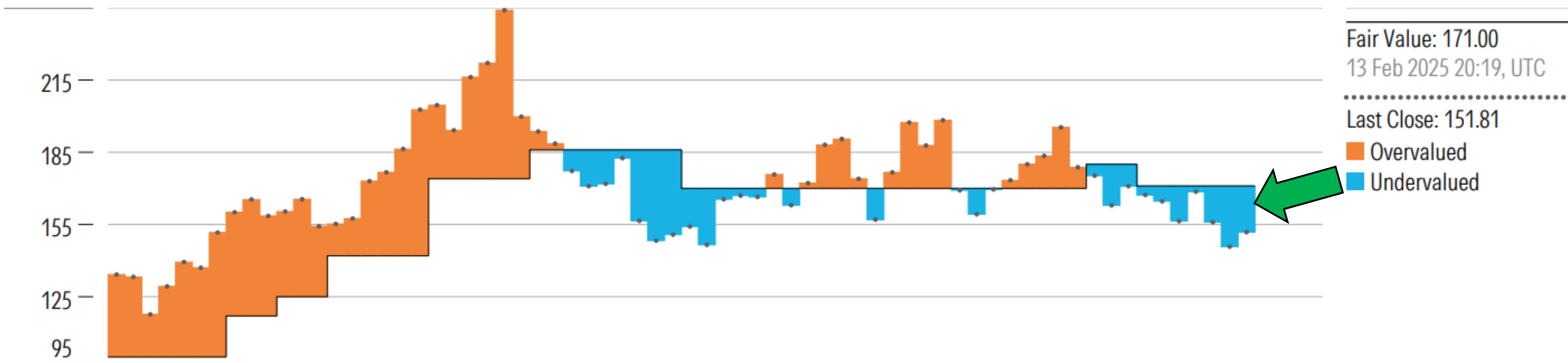
Source: Morningstar

Morningstar's Price vs Fair Value

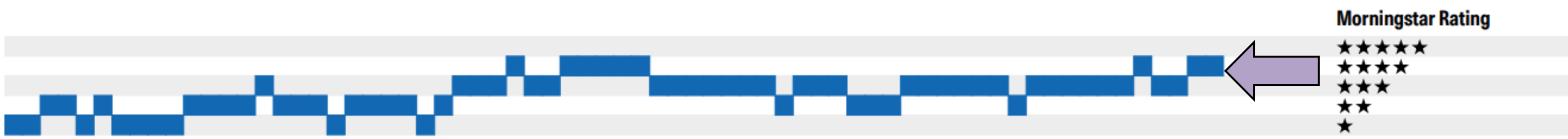
Zoetis Inc Class A ZTS ★★★★ 4 Aug 2025 21:49, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
151.81 USD 4 Aug 2025	171.00 USD 13 Feb 2025 20:19, UTC	0.89	65.00 USD Bil 5 Aug 2025	Wide	Mid Blend	Medium	Exemplary	4 Jun 2025 05:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD	
	1.32	1.40	0.86	1.16	0.91	0.89	Price/Fair Value
	25.65	48.05	-39.41	35.70	-16.57	-5.90	Total Return %



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Source: Morningstar

Economic Moats = Business Models

As an investor, I'm trying to find information that confirms or denies my beliefs about a company's Moat by doing more research.

How Do You Look a Bit Deeper?

- Go online to company's websites.
- Review their home page to understand their message they are communicating.
- **Finally, go to the Investor page.**
  - Typically titled "Investor Information" or "Investor."
- Look for an Investor Presentation.
- Review other documents.

Zoetis – ZTS – Moat Confirmation

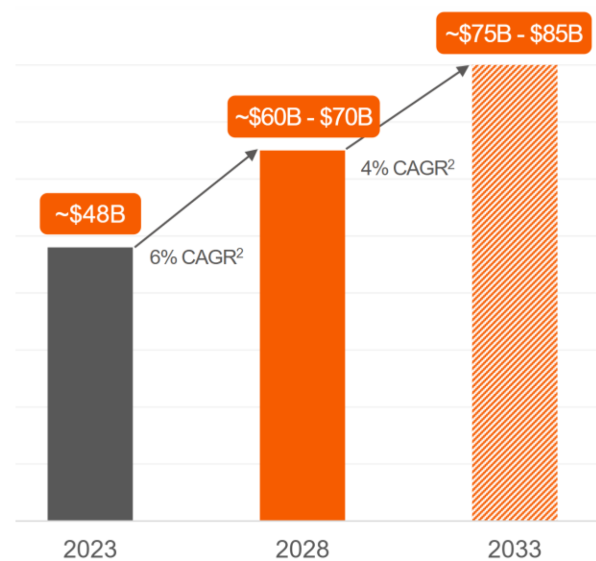
*World's leading animal health company advancing care for animals.
*70 years of experience innovating a leading portfolio and pipeline of medicines, vaccines, diagnostics, and technologies.

World Leader in Animal Health[1]

By Species	By Product Category	By Geography	High Growth Franchise Areas[3]
Companion Animal #1	Other Pharma[2] #1	North America #1	Dermatology #1
Cattle #1	Anti-Infectives #1	Latin America #1	Pet Pain #1
Fish[3] #1	Vaccines (Biologicals) #2	Asia #1	Pet Parasiticides #2
Market Leader in Species Representing ~90% of Our Portfolio by Revenue[3]	Diagnostics[3] #3	Eastern Europe #2	
Swine #3	Parasiticides #2	Western Europe #2	
Poultry #6			

[1] Vetnosis Management Report 2024 Q3 YTD. Rankings are based on revenues.
[2] Includes pain, sedation, internal medicine, dermatology, etc.
[3] Zoetis internal estimates

Expected Market Growth ($B)[1]



Did you know that this information is available on their website?

Source: Company website 2025..

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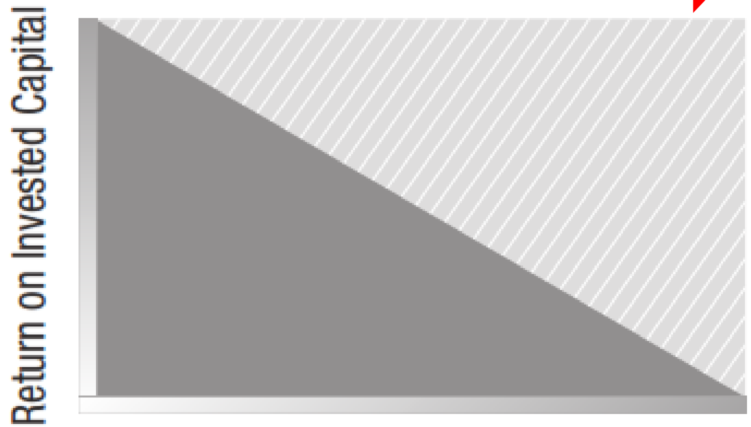
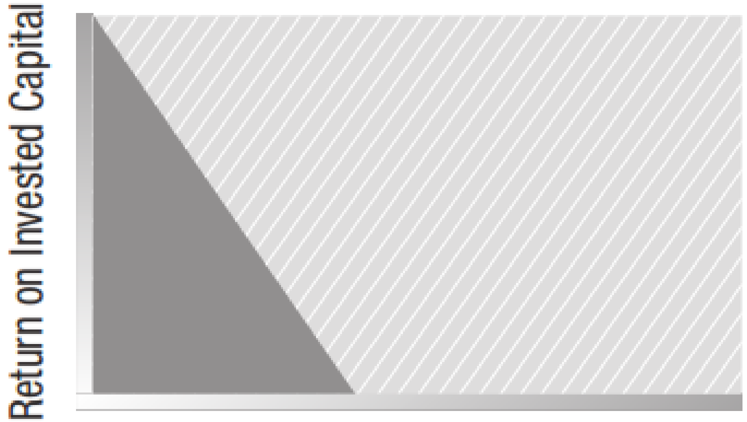
The Main Concern as an Investor





Evaluate Management

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	20.0%	23.9%	20.4%	16.2%	36.8%	32.9%	27.9%	23.9%	28.3%	25.7%	27.7%	DOWN
% Earned on Equity	14.2%	16.0%	13.1%	10.2%	22.4%	25.9%	20.6%	16.9%	19.6%	19.3%	20.5%	DOWN
% Debt To Capital	5.2%	4.7%	4.8%	5.1%	4.1%	13.8%	20.8%	18.8%	19.7%	27.1%	20.0%	UP

Source: Morningstar.

Stock ideas - MOAT – Van Eck Vectors Morningstar Wide Moat Index

Ticker ↓↑	Holding Name ↓↑
GOOGL US	Alphabet Inc
MPWR US	Monolithic Power Systems Inc
TER US	Teradyne Inc
ALLE US	Allegion Plc
HII US	Huntington Ingalls Industries Inc
EL US	Estee Lauder Cos Inc/The
AMAT US	Applied Materials Inc
USB US	Us Bancorp
BA US	Boeing Co/The

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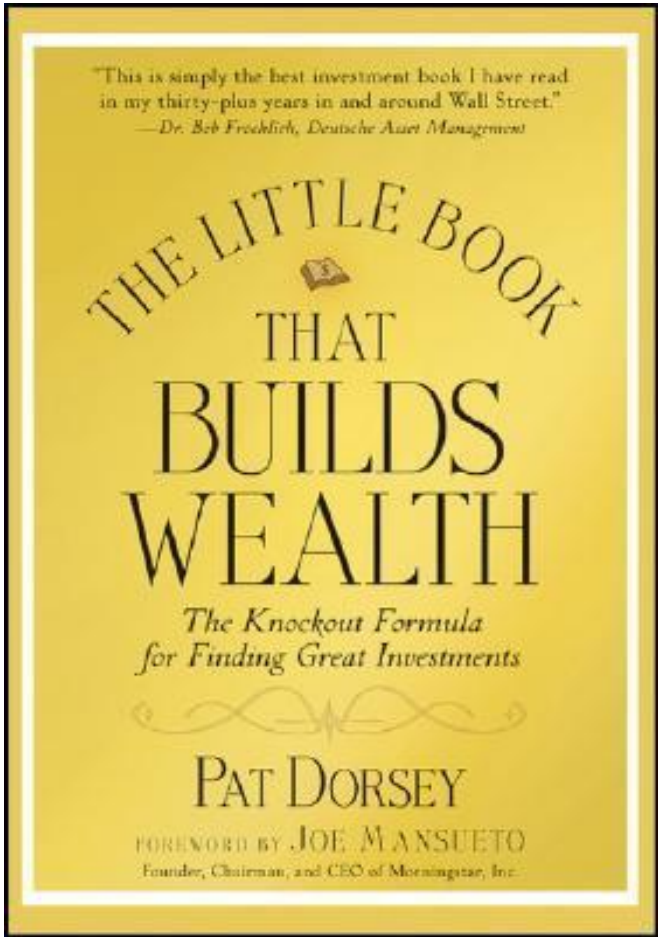
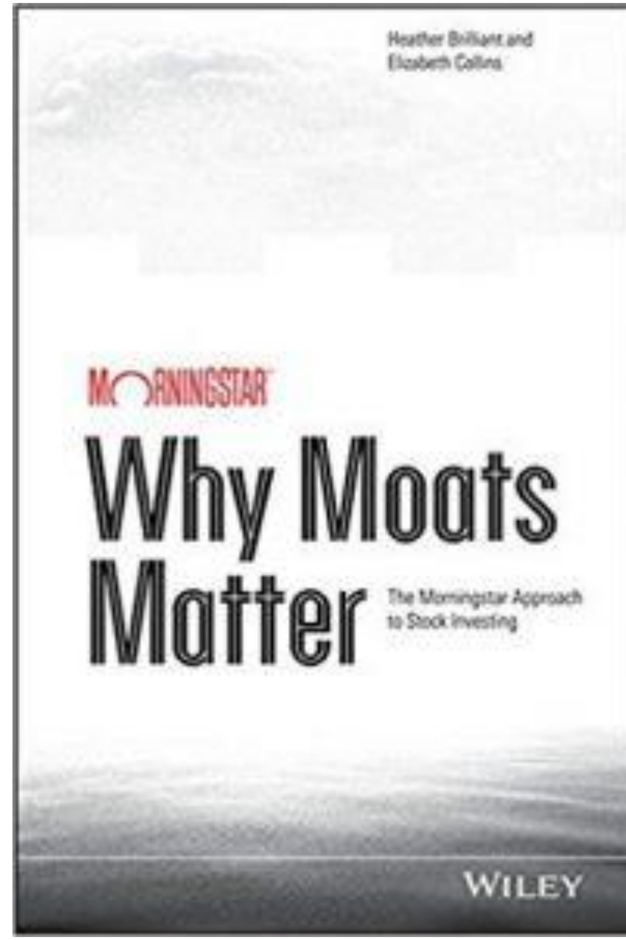
Source: Van Eck.com. 9/18/2025

If You Want to Learn More?





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Summary

- Strong Moats = Strong business models = "Quality" stocks = Sustainable Competitive Advantage.
- To obtain this information – online libraries that subscribe to Morningstar and Schwab.
- Moat analysis is a good way to help support owning a stock and wide/narrow moat stocks can fend off competitors to earn excess profits.
- Morningstar has found that <u>cheap wide moat stocks </u>is a good ownership process.

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Economic Moats Can Help your SSG!

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