

Finding The 1% of Stocks That Matter | Henry Ellenbogen Interview

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SUMMARY

Henry Ellenbogen discusses his investment philosophy centered on building durable, long-term growth companies through a balanced approach that emphasizes growth, innovation, and profitability. He reflects on his journey from politics to investing, highlighting the importance of understanding ecosystems in both biology and business. Ellenbogen emphasizes the value of investing in small-cap companies, the significance of strong management teams, and the necessity of adapting to technological changes, particularly with AI and robotics.

- *Successful companies must balance growth, innovation, and profitability to thrive in the long term.*
- *Ellenbogen's investment philosophy is influenced by his background in science and politics, focusing on sustainable growth.*
- *He believes that 80% of great companies start as small-cap firms and emphasizes the importance of investing in them early.*
- *The role of management teams is critical; "act two" entrepreneurs who have previously succeeded are often more likely to succeed again.*
- *Ellenbogen advocates for a culture of humility and continuous learning within investment teams, emphasizing the importance of collaboration and shared insights.*
- *He highlights the transformative potential of AI and robotics, suggesting that companies leveraging these technologies can gain significant competitive advantages.*
- *The public markets provide valuable feedback through daily marks, which can help companies realign their strategies and foster accountability.*
- *Ellenbogen stresses the importance of being transparent with investors about the long-term vision and the potential for volatility in performance.*

To run a company well, you have to be in the and business, not the or business. You have to drive growth measured by market share in the short term. You have to drive innovation or allocate capital well to position yourself better for the future. And you have to drive profitability. But I believe the path to building a compounder or even a what some people would say a generational company through the public markets is proven. >> >> I thought a interesting place to begin would be with you telling us the origin story of your investment philosophy.

We're going to talk deep specifics about a lot of things in the world today so that people understand where you're coming from and how you came to your philosophy. I just love to begin there like the key ingredients of the recipe that's become how you attack and think about markets. Where did it come from? Where did it start? >> There's probably a couple places that come from so one was frankly my own personal background. So I came

into investment not you know directly out of school. It's not like I went a finance pass. I went into politics. I didn't I wasn't an economics major. I was actually an organic chemistry and a history and technology major and you know I worked in politics for many years and as I started to like try to figure out what I wanted to do professionally and eventually I started to think more about investing and I get got involved in it.

I started to think about investing based on a lot of the same principles that I learned in science, right? In particularly biology that in order to have organizations or organisms that sustain over a long period of time and kind of persist much like human beings, they kind of have to be in balance with their ecosystem, right? So, you know, you see it today. I'm I'm a father of two boys and you see it today, right? When when when children develop, right, they they got to basically go through certain, you know, curves like child, adolescence, teenager, adult, and they have to basically be in balance. And if they are, they can kind of thrive and kind of do incredible things. And we as human beings, if we do that, like look at look at all the success humans have had, you know, relative to every other species. I started to think about why shouldn't investing follow the same rules we see in science right so why shouldn't investing mean that there should be a healthy balance between companies that invest in their customers their employees their shareholders and actually support their greater communities and that that really kind of resonated with me and in many ways I was lucky too that I ended up at Euro price early in my career. And really the guy who became my mentor, Jack Leaport, this is what he believed, right? He believed you invested in small companies, run by people who thought like owners. They woke up every day to make themselves better. They were they gave their employees a good deal. They had good cultures. They allocated capital. Well, this is what created companies that could grow and sustain. And and that was how he had been so successful over the 25 years he did what he did. That resonated with me. You know what happened to me though was a a bit of good luck, right? I was asked halfway through my career at Hero Price to basically go manage the New Horizon fund and I started reading all the shareholder letters. at that point it was turning 50. So I actually went into the archives and basically read the shareholder letters and tried to understand what was what drove the success of this fund over 50 years. At the time it was the oldest but also most people would say it was the most successful from a performance fund small cap growth fund in the country. And in doing it I started to realize wow it's really it was really only 20 stocks over 50 years that drove the performance.

And then coincidentally Jack or maybe purposely Jack decided to have a 50th you know birthday party for the fund and all the fund managers came except for Troll Price himself who managed the fund but was passed away. And in doing that I I talked to one of the managers who told the story of meeting Sam Walton on the IPO road show when Walmart first came public. And for those of you who don't know Walmart came as a super small company. It only had 50 stores and obviously Walmart, you know, became Walmart. And I went back and I looked and I was like, "Wow, this is definitely one of the 20 stocks that mattered."

But actually, unfortunately, it was sold. >> They sold it. >> And the math at the time was the retail fund, I think I was managing about \$8 billion, which was the largest pool of small cap growth money in the country. And had the stake in Walmart not been sold, the stake in Walmart would have been greater than the sum total of everything that I was managing. And I'm not saying people had made bad decisions before, but actually the math was one bad decision or maybe you had to make that decision every day because the public markets are open every day actually wiped out all these other good decisions mathematically than had done.

And so what that caused me to do was at that point start to really study the history of the US public market. You know, since then I think a lot of people talked about the Benheimer study that came out of Chicago. >> Yeah. The 4% thing, >> right? And that's true. But at the time when I did this, no one had actually asked the simple question in the history of the US equity market, which is to me like representative of capitalism.

If there's 4,000 average public stocks, how many of them truly are great? The philosophy we have today is predicated that over a rolling 10-year period, you have about 40 stocks that compound wealth at 20% a year or go up a little bit over 6x. So about 1% of the stock market is the are the validatorans. And that's what we want to go do. And so, you know, since then, right, you you like a lot of things in life, you get through looking at lateral examples, biology, and then you look at anecdotes, and then if you like to double click or you're you're maybe a geek on data, you start to really study it. And then obviously since then, we've tried to create an investment philosophy that maximizes the probability of investing in those 40 companies. And the other thing about 80% of those companies actually start their compounding journey as small cap companies. And so I always people always say Henry why do why why do you love small cap companies? I was like well I love them because I love the people side of the job but I also love them because 80% of them of these great companies actually start as small cavs.

That's what we're trying to maximize because we think that's what creates, you know, long-term wealth and economic growth. Basically, what we have done is basically purpose-built an investment philosophy and just as importantly tried to purposely build an investment organization that can go do that. >> I want to ask about each your firm is literally named as an ode to this concept durable durable long-term compounding growth for the companies that you back. give us one more click of detail on after that original insight.

So you've identified that you want to be in this group of 40 companies as best you can possibly approximate. What are the common elements that you've discovered that fit your personal and your team style that are indicators that you might have one on your hands? And I know you do latestage private investing as well. So you're you're looking at these companies and when they're, you know, at or near their IPO. we'll talk about going public later on and and why that's valuable, but what have you, what have you refined to be the most important signposts of a company that might be one of these 1% validictorians?

If you've been one before, you have a higher probability of being one again, right? Which just sounds so simple, but is actually really interesting. We look at who who has actually done it. And if we don't really know the company and we haven't studied before, we'll go double click and go essentially study it, see if there's an opportunity, but if not, go do a case study on it, right? So, we want to go learn it. One of my partners, Anukate, basically you know teaches a class at Colombia Business School, the value analysis program. And partially this is our way of kind of going back to school as an organization and partially it's our way of giving back to our community. But you know the class is based on this and the students literally do about six case studies a year but over time you kind of build out a library of them. You just start by basically studying the ones who've done it and then obviously trying to study the patterns of those who've done it.

Right? So that that that's that's number one on how we do it. Second of all, they're diversified across the

economy. So, you know, look, we're in a period of time where what's going on is and AI is so impactful. My view on the impact of this is probably no different than a lot of the other speakers you've had. I would say what I think about when I think about the power of AI and really studying it, I don't only think about the companies that are the first or second derivatives or maybe people were categorized as technology companies. I also think about the existing diversified companies outside of the technology space that could be huge companies here. So as an example when you go back and you look at the era of cloud and mobile you know for sure you wanted to go own Amazon in that period of time but actually if you look at retail once Walmart and Costco really understood what Amazon was doing but still had relative scale they leveraged their advantages and since they basically you know got on the same curve 62% of all retail has gone to those three. So for sure one might have been better than the other, but actually all three were good. What What was the best Russell 2000 growth or for your investors who don't know benchmarks small cap company over that 10-year period in the 2010s? Well, actually it was Domino's Pizza, >> which you know is is was a modest growth company. It didn't have didn't average 10% growth over the period of time. Why was Domino's so good? Well, it turned out, having gone back and studied Domino's from the beginning, but obviously owned the stock for some period of time, the pizza market in the United States, when Domino's basically started its run, you basically had a third of the market that was like local.

So, probably like a lot of listeners, I have my favorite local pizza place and I like it because the pizza's great. And then the the other third we know, right? There's the Nationals, Domino's, Papa John's, Little Caesars, others. And then the middle third, there used to be in DC this place called Arman's that had had about 30 places and they had, you know, local or geographic scale, but they didn't have the scale of Domino's and they didn't have great pizza. And what happened was when Domino's started its run, well, first of all, it started by basically making the product a little bit better. But if you talk to Patrick Doyle, you know, who was CEO at the time and you really study it, what they started doing was if there's three value equations in pizza, it's quality, value, and convenience. And what they realized is if we really really invest in technology, we can make convenience a lot better.

And so they really invested in their app, built a direct relationship with their customer very early on. and they could then target that customer more efficiently with couponing, what have you, drive scale through that box. And then when you basically do something well, right, you improve the product, probably was slightly above average, you really iterate on convenience and now you have a direct relationship with those customers. All of a sudden, actually the brand halo started getting a little bit better, right? Because you put all that together against a wonderful business model of a franchise business model which is you know ROI light you end up with a great stock. And so one of the things we think a lot about at durable is which of the companies that are in distribution trucking who are already good and maybe investing on a different curve have the ability to use AI to either substantially lower their their relative cost advantage versus their competition, gain more revenue scale, and then reinvest that in a way where you create something that's permanent over the companies that maybe get to this late if they ever get to it. And often those are the best stocks when you go study the markets because you're already in a in a physical world business where the technology advantage transitions into a physical mode advantage or distribution or scale advantage. That's one of the patterns we've ser we've observed. We call that you know the good to great thesis internally.

>> And then the second way is people. If I think about the investments we have today, we tend to be in business with certain people we've known for 20 years now and maybe they're doing the same thing or maybe doing they're doing the next thing but we think these are the type of people who build great organizations and then obviously we have to meet new people too. So one of our largest holdings is Duolingo right? So we first spent real time with the CEO Luis Vonwin during COVID you know and you know during the COVID era as the markets reopened you know they went to highs and the private markets were white hot you know in the zero interest rate environment and you know people were meeting people on Zoom and I remember meeting Louise you know with my colleague Julio I called Julio up and I was like what do you think and he was like well it's a super impressive business and they're they're leading their market, you know, they're they're on the right side of their consumer and the product's great. And I said, "Yeah." I said, "Louis reminds me of Toby from Shopify, >> right? The last time I spent time with someone that technologically strong, right, Louise had been head of AI and ML at Carnegie Mellon, but also has that much business clarity and is so crystal clear at communicating that he can make complex topics simple that even I can understand them was when I spent time with Toby when Shopify was private and I said, "We're going to basically clear our schedule and whenever Luis will spend time with us as in Pittsburgh, we're going to go spend time with him.

And so I think the understanding of the patterns and having studied them, the understanding of what creates the environment, Sakori is famous for saying why now and what could lead that not only on the technology side but across the economy. But I think the clarity you have when you've spent time with you know at this point thousands of executives and you have seen the ones who've done it you want to do more with them and then you have seen the ones who are trying to do it but remind you so clearly of the ones who have done it. Can you say a little bit more about this notion of act two teams and management teams and why that is an interesting concept to you when you're thinking about the relationship between an act 2 team and a potentially very durable compounding company? This is something that is so dear to me because one, it's something we invest in, but two, it's actually at the heart of durable itself, right? And it's one of the reasons that I think durable is just different than other investment firms because we ourselves were an act 2 team, >> right?

>> At my prior prior firm, I invested in workday when they were about at hundred million of revenue scale. The two co-founders of workday Anneil Bushri and Dave Duffield had basically been the people who had pioneered HR systems of record in the previous client server world. So they were they were literally the people who built peopleoft scale peopleoft and then a lot of history there but there was there was basically a very aggressive takeover by Oracle and so in many ways they had felt they had frankly completed their vision and so they came together but what really also lit up the vision was cloud. Now this sounds so obvious today.

>> Yeah. >> But you know in 2012 when we invested in workday I think a lot of the understanding of the cloud was not as obvious by investors and frankly I'm not sure I fully understood it either. But what I did understand was this was an act 2 team. There's a bunch of the stuff you have to build into the product that for lack of a better word is exception management. And if you don't understand that exception management because you have done it before, you're you're going to not properly be able to do it. And because this was an actu team, they actually knew how to leverage the modern technology but also build the system of record in the way it dealt with the edge cases at super scale. Obviously, they also understood what segment of the market to go after and then how to serve it.

And I, you know, that to me is the image we have at durable when we look at an entrepreneur who has solved and successfully won a product product, you know, in a product area or an area of business, but now wants to go do it again. And there's you know huge advantage when you go do it again right you are essentially solving the same problem with you know total clarity at the beginning. The other thing is if you've been successful, it allows you to align all parts of the organization, the people, the organizational structure, the investors exactly how you want to go do it. You know, Max Levkin, right? So, a lot of people know Max obviously. He's one of the co-founders of PayPal and know we we first invested in Max actually. It's one of my first private investments in my whole career. We invested in Sly, right? And for many years until recently, we're now investors in a firm. I used to joke Max I'm I'm like the only investor in Max who hasn't made a lot of money, right? But with all jokes aside, Max to me represents, you know, the best of an act two entrepreneur, right? For those of you who don't have the benefit of knowing Max, first of all, he truly understands technology and he really understands how it can be used in very complex systems to solve problems. He can recruit exceptional people because he speaks their language. He's also a very good leader and people believe in him. He's also exceptionally resilient, right? And so Max is a perfect example of like an act two entrepreneur >> that we had we had already been in business with. And when you look at the you know if if durable does anywhere from 5 to 10 new investments a year right with a lot of times it actually is with act two entrepreneurs >> and then if we're lucky and this happens because of compounding relationship for having done this for 20 years a lot of times it's with people that actually we were investors in their previous act and I think that's also great right because they know us and we know them. We know each other's strengths and we know exactly how we can help each other and you know look this is this is like the maxes of the world and the anals of the world get to do business who with who they want but I think what it allows them to do is with a clean sheet of paper decide who we want they want to be in business with but obviously from our standpoint we we don't do a lot of new things and it allows us to basically really align our resources to support them. What changed the most in your own act two? So, as you structured durable itself to be have the same features of the companies that you're looking at investing in, last a long time, do really well, be tightly aligned, like all these things that you're referencing, what were the biggest learnings that you took with you and that you jettisoned coming from your first first act to your second act?

>> Actually, I almost named Durable Act 2 Capital by the way. >> Oh, wow. >> It was such a prominent view >> in what I was trying to do. We talked a little bit about the investment philosophy. I mean, the investment philosophy is really simple. Let's invest in small companies that can compound over time and become, you know, large companies. And what's our advantage that we bring over other investors? I think we think we're great at people and understanding change. So basically everything we do at Durable because we're an investment driven firm is in support of that investment mission. Essentially with a clean sheet of paper said if we were going to go purpose build an investment vehicle to allow us to do this, how would it actually be structured? So you know essentially the percent of capital that we put in the public markets in the private markets is aligned against that and then organizationally how are we going to go align against this right so the way we think about people is very purposeful we really believe that very few people actually operate the way we do we think durable is just different my partner Katherine who when we first underwrote Figma in 2020 and also when we led the investment round in 21, you know, is the same person who basically was at the all hands meeting with Figma when Dylan announced to the company that they were going public and is still the person that basically looks at the company when they announced their public earnings and what have you. I mean, that's just different, right? So you have to have people who can, you know, work with companies that are valued

at two billion and they're private and have 30 million of run rate revenue. And now, you know, Figma is a billion two companies, a public company, and can continue to work on that. And investment firms aren't structured that way. So if you want to have people who can do that, you got to develop them internally. Second of all, it's time allocation, right? So in general at any point in time we probably have 10 15% of our capital in the private markets and the rest in the public markets and then we have to be willing to spend the appropriate time on new ideas right so when we look at Duolingo and the right decision for Duolingo and maybe the right decision for us is only to invest you know \$20 million we don't look at it as a \$20 million investment on a \$15 billion vehicle And you know, we don't look at it as 10 basis points or 12 basis points. We actually look at it as our future compounder, right? Our investment memos are just fundamentally written different than other investment firms, right? So when we look at an early stage growth company that is not already competitively advantaged, we write the memo that says if Duolingo does what we think it can do over the next three years, not only do we make a fair return for the risk of the company, but at that point in time, we would want to buy more at these higher prices. And if we can't write the memo that we want to buy more at higher prices, we can't buy the shares and our thesis can't be it gets bought. That has to be aligned. And then the investors we're in business with, we have incredible investors. We have to be transparent with them that in order to pursue this philosophy, we're going to have what people would say is monthly or quarterly volatility in our performance, right? when they look at our performance. And that sounds so obvious, but you know, increasingly the market has changed where capital is short cycle, right?

Like so many people are on one month basically incentive models, not even yearly, one month. And so we have to have been very transparent with our investors and told them what we're trying to do, deliver on those promises, but deliver on those promises over the right period of time. I'm so intrigued by this like dollar cost averaging up concept that you're not willing to invest in the first place if you're not excited to if it goes well invest more at higher prices and is that the right way to think about it that the way you build a position over time is investing more as the price goes up to build your full position.

>> Yes and no. There's really two parts of our portfolio, right? So when we're looking at what we call early stage growth companies and it could be Duolingo as a private company or it could be Duolingo after it goes public but it's still not competitively advantaged at that point in time it didn't have cash flow it didn't have PE ratios we still in our view view that as an early stage growth company where we're saying in the future could be competitively advantage the operating culture could be clearly established where we could look back and see the excellence of it and the adaptability of it and then we could look at the growth formula and really understand it and obviously along the way we've really believe this these are our kind of people who can scale organizations when we look at the 3 plus three we're underwriting it on a three-year basis in general not always if it does what we think it can we would then want to buy more as it in our lexicon gets bigger but also derisks and then proves to be a competitively advantaged business and then shows more resilience and and shows the ability to you know financially balance growth, profitability, innovation basically prove its ability in the case of Duolingo to become more of a just a power app teaching you know speakers a foreign language for more self-improvement that it starts to do it for learning that basically increases educational ability to participate in the economic world. Right? they're obviously going to different subject with chess. So as you progress as a business more towards you know what we view as a competitively advantaged business that's for lack of a better word baked but still has growth. We underwrite those with the view that if it does that scenario we would want

to buy more and if not we just can't get involved. Now, in my career, I've invested in over a hundred private companies and I think I've been involved in over 50 IPOs.

And then how many of them do we still own? Well, we probably still own more than anyone else in the markets, right? Like even if I look at durable, among our largest positions in the public markets are Door Dash, Affirm, Toast. We led those last private rounds, right? And so yeah, they persisted and we kind of bought more >> right at different points on the curve. I would say on a durable growth company because of market volatility and you know this kind of agency principle that I think about that's forcing people to have you know short cycle view of the public markets actually probably you're buying more of them when they're down right so you know one of our favorite entrepreneurs is a guy named Jay Henik essentially CEO of Collars but he was also the founder of first service and we own both of them we're actually involved in a private investment with him. Also, in the case of Collars, I think it's a very misunderstood company. I think for sure the brand suggests it's a commercial real estate broker and commercial real estate brokers don't do well in general when interest rates are high. But I think what's misunderstood about Jay and he's done this time and time again is because of his understanding of he was really a disciple and his mentor was Peter Ducker. his understanding of local incentives and his sharpness of capital allocation and the way he sets up the partnership model when he buys people.

What people haven't realized is he's built a much an incredible business both in asset management on the real estate side in Harrison Street and also he's building a terrific consulting platform. And so I think our insight there is starts with Jay but it starts with understanding actually the asset quality of callers is not the quality of a commercial real estate firm that's cyclical. It's actually a really good real estate asset manager and a emerging really strong consulting firm. And so last year when people were worried about, you know, the weak commercial real estate market and interest rates, we bought a lot more of that company when it was it sold off based on short-term, you know, macro concerns.

Yeah. So in that part of the portfolio probably we're buying more of the companies when they go down. >> You said something really important and interesting that I'd love to dive into which is the principal agent problem. And my question is a market structure question. We've talked before about some crazy percentage of just marginal volume that happens inside of the platforms the you know citadels millenniums balasnese 72s of the world. How are how do you feel that? And I'm curious just for your thoughts on changes to market structure in general since you've been doing this. how it contributes to that volatility, what opportunities it creates, what dangers it creates.

>> It's something I thought a lot about. I started thinking a lot about it two years ago and in hindsight I probably started should have started thinking hard about it you know you know three years ago but but you know you don't you don't get everything right. There was a period in my career where the quant funds really started to do great. the two, you know, the two sigas of the world. And, you know, one of the things I've I we really stress at durable is humility, right? So, we never look at a problem and assume we're right and the other person's wrong. And we never assume we're good and the other person's bad.

We actually look at things and assume the other person's really smart and what can we go learn from them. And

so this this relates back to for you know I found it durable but I went and I studied the quants and what I concluded was the short-term alpha game is probably going to be won by the machines paired with the humans and at the time it was when for the first time computers paired with machines could beat the best human chess player. Mhm.

>> And this is obviously when I went went to spend time, you know, with the principal at Two Sigma, I learned he was doing exceptionally well. But anyway, I got to know him and we talked a lot and I realized actually there were very there were real limitations to what the quants could do. And so I started realizing if it's a repeat actor problem based on known data actually the quants are pretty good. So what does that mean at the time? Well, it means if if you're just a person who buys an industrial company because the PMI is down and historically when the PMI rerates and gets better and you make money, that's not going to work.

>> The machines are just going to be better at that than you. But if you're like what we were at the time, people who are really good at understanding people and really good at understanding change, that was really advantaged. And I basically at my old firm, you know, I did a internal kind of teaching on man versus machine. And I said, as a result, what what the New Horizon fund is going to go do is we're going to go double down on these two things >> and we're going to get better at them.

>> We're going to get more focused on what we do on the people's side of our business, both in the public and private market. And we're going to get more focused on where change impacts both our early stage growth companies and our durable growth companies and where we're basically investing where we're not advantaged versus these machines. Probably shouldn't have done it anyway, but we're going to stop doing it. But we did it, of course, all within our investment philosophy. And that's basically what we've done at Durable as we've gone and studied Millennial and Citadels. First, let me be very clear, deeply respect those organizations. I think they're great at what they do. And I actually believe the people who work there are very talented and we start from the view that these are exceptionally talented people who are actually very good at what they do and are high quality people. But what we have said is what do they do and what is the limitation? And one of the limitations is if you work at a firm that deeply measures your risk every day and then if you have a bad period of time measured by a month, but certainly three months you get your capital cut back and you there's a good chance you get let go. It probably means you can't have a time horizon longer than your career horizon.

And what we also have noticed because we we not only understand things anecdotally, we also study them. If you look at the last public market earning season, which was companies reporting Q2 this past year, if you study earnings volatility, it was more volatile than any earning season since the financial crisis. Even though during the financial crisis as we all know the fundamental banking system in the US was under question which meant the economy and the markets as we know it really had a wide dispersion of opportunity and the markets tend to be a lot more volatile when they're making lows and making highs and yet this was the most volatile earning season. I think the reason for that is just basically the fact that you know we estimate somewhere between 80 and 90% of the institutional flow is basically driven either by the firms that have one month and three month agency or the quants that have to take these price signals into account and then their models are optimized for this. And so what we have said at durable is really simple. Let's go do less so we can do more.

Because if we're going to accept volatility in stocks, we have to really understand the business and the people like we do at Collars such that if Collars is down because people are worried about commercial brokerage because of interest rates, actually the markets are probably right. >> They're probably right 90% of the time. But if we understand what's unique about that culture, how they allocate capital, we understand deeply how the quality of that Harrison Street is because we've studied it for 20 years and we we know the people who run it. Well, that's that's a reason why we're willing to basically lean into that stress. You know, the same thing when I look at our early stage growth portfolio, you know, we I spoke about Dualingo earlier. you know, they they came public, you know, the last time the capital markets were really open to companies, which was 2021.

And there's been a lot written about the 2021 IPO class, right? How they came public in a zero interest rate environment and how many so many of these companies actually were going to have a tough time getting to profitability and as as interest rates went up in 22, I think correctly, a lot of people said actually just throw them all out, right? the the average loss making company in 2022 in the Russell 2000 growth went down over 70%.

>> You know, our view was makes sense. The market's probably right, but not all of these, you know, can't adapt. You know, not all these don't have businesses that are good enough to make real economic returns. Our view is not all of these companies didn't have the discipline and the organizational fortitude to transition and become successful companies in a in a world that actually, you know, required profitability based on the change of interest rates. And so, you know, Dolingo is an example of a company that we actually bought more of in 22. and that was an example of an early stage growth company that we dollar cost averaged down, right? And that I think we're advantaged in, right?

Because if you're rulebased in what you do or you have a one or three month time frame, you just can't own Duelingo. You can't own more callers. You said people and change. We'll talk more about both, but starting with change. We're in the midst of probably the biggest technology shift or change maybe that any of us will ever see. You've invested and lived through several others, internet, mobile, cloud. Can you put this one in frame of reference with the other ones that you've lived through and you mentioned so many times studying the past and studying history and seeing patterns?

What patterns do you think might apply this time? And what patterns do you need to throw out and and re-underwrite from first principles here? >> So, I started writing about AI and our shareholder letters in 22. >> Yeah. you know and at the time I said having seen internet cloud and mobile this is going to be at least as powerful as internet and I said we're going to go approach this with humility go spend time with the people who are closest to it and constantly be learning and then I also said we're durable is not a thematic investing firm or a compounding investing firm so just because we think something's going to be big doesn't mean we're going to go put our investment meetings aren't going to be AI is going to be big. Let's go buy AI companies. It's going to be let's really understand change and then understand how it the companies that we invest in are going to basically benefit from it or become better by it or at least not get disrupted. I'll lay out in a second think it probably is more impactful than the internet was. It's not only going to affect obviously every technology company which you know you see in the markets but it's also going to impact in this case I think almost every company that you know needs white collar employee and IP employee to drive their work. So let let me start

with the second one first because I think less people have talked about that one. So, as a student of business, most people would know that by the end of the 2010s, everyone knew that if you were a product based business, you needed to understand your China cost, right? I mean, it was kind of on the cover of every business magazine and then every popular magazine in the tens. And basically all that meant was if you in in a global supply chain, if there was a part of the world with huge scale and resources like China in the Far East that could make product substantially cheaper when you landed it, you know, at your factory or to the consumer, you had to understand it and if you didn't leverage it yourself, you were going to basically go out of business.

That was the first derivative. The second derivative is actually there's a lot of businesses that are spread businesses. You know, you look at a lot of distribution businesses as an example. If you distribute, you talk about a great business like HVAC, the industry tends to put a spread on the raw material. If your HVAC unit basically inflates at 3 to 5%, that's good. And if your HVAC, you know, deflates at 3 to 5%, that's bad. And so if you were a spread business on top of it, you know, that was problematic.

Every company that was product based or derivative product based had to understand China cost. And I think the same thing applies to AI. But I think it's not product based this time. It's you know IP based. So let's go let's go back to Max as an example. So, a firm most people would think about and correctly so as, you know, basically a fintech company that basically empowers people to get access to credit in a safe way and actually pretty compliant, friendly way with no tricks. And he's doing even more than that now. But at the end of the day, because he is regulated, he has a lot of legal cost in the company, right? He's got hundreds of thousands of contracts with merchants. He's got to monitor his partners on how they basically communicate credit. And that just requires a lot of people. And if you talk to him and he's talked publicly about this, he's got great belief that a firm can grow at the rates it's growing at for a reasonable period of time. In addition, they can do it without adding headcount. And the reason for that obviously he's going to go lean out a lot of processes that were not possible to go do before AI. I'll tell you a really funny story with that. So he calls, you know, I I I learned so much from him. So I I talked to him one day after he reports earnings and he explains to me, Henry, this what you know, you're always asking me about how I'm using AI to become more efficient and you know, I feel like I was late to the curb, but I finally figured it out.

And so he says, you know, I have this team that goes around the company and understands processes and we start from not a cost standpoint, but we start from a leaning out standpoint. And I think like I'm making real progress there. And that's why I'm able to make this public pronouncement. And he's like, isn't this great? >> >> I say to Max, why don't you come to DC and let's go see Mitch Rails >> because Danaher, you know who who he and his brother started and he's chairman of has been doing this for 40 years. You know, it's called DBS. And they basically brought Kaizen, you know, back to the US. And they basically started, they're obviously more of a healthcare company now, by going into factories, putting processes up in whiteboards, studying how they could lean them out, basically leaning them out and coming back in a month later to make sure that because change is hard that the change is held. And then they basically built a whole business system which has basically you know not only helped build Danaher but you know there's basically over a dozen Fortune 500 CEOs in the United States who basically started their jobs at Danaher including the guy who just have turned around GE. So since you're so excited about this let's actually go to the you know essentially the >> the teacher of the godfather in the United States. So the reason I say that is this is just so profound it's even hard to get your head around

right that we've been able you know Mitch would say for 40 years because at China we've been able to really lean out product based businesses working capital but in many ways I feel like we're just getting started on processes that are done by humans.

The second example that I'll talk about and I'm talk trying to talk about things that haven't been talked about as much on this show. When I first really understood what was going on the internet, I ran a global TMT fund and my largest investment was Amazon, right? And we invested in that one. It was like a \$10 billion company. So I used to go to Seattle twice a year. So interestingly things you remember because it was far from Baltimore. not no one would come with me and it was a small company and people thought I understood it and I used to go you know have lunch twice a year with Jeff Bezos right at the time I worked for the firm that was his largest outside shareholder and it was obviously my research position for the firm and what I learned so many things from those meetings but one of the things I learned is the very best businesses that leverage technology leverage it in a way where they use it to lower costs and drive revenue that result in them gaining 30% or more incremental market share in their end market. And then they take that unity economic advantage and they reinvest it in something that is persistent.

even if their competition were to wake up tomorrow and do the exact same thing with people just as good as they are. >> And to me, you know, that's one of the definitions of durable of a competitive advantage is if your competitor basically does a competitive mode attack doing the exact same thing with people as well or >> doesn't matter too far ahead. And as we all have come to understand with Amazon, they took that 3 to 5% cost advantage of of getting that box to you and their ability to put more than one box, one item in the box, and they use that economic advantage to then go build fulfillment centers that are physical to basically reinvest into capital and infrastructure that allow them to go down that 3 to 5% cost curve for 20 years. And then, you know, as I said earlier in the show, they woke up And the only people who could play their game when eventually everyone realized what they were doing were the people who still had the scale and the customer relationships and the trust of Walmart and Costco. And then eventually when they figured it out, all three of them were great. Now the problem is the rest, you know, the rest of retail was not was not so good.

>> And so that's what we think about here. So, if I if I say it back to you, we're about we've seen through Mitch and others like him this 40-year benefit of Kaizen brought to physical product world and that AI represents a sort of kickoff of Kaizen to human work world and that that is going to have lots of stories like the Amazon story you just said where someone gets on one of these curves early and they can't be caught.

And so, you're trying, I'm sure, define who those people might be. So, we're trying to do two things, Patrick. We're trying to find the people who that might be. And then we're trying to make sure we don't get >> mistakenly own a company that based on last generation competitive risk was a great company and and correctly we thought was competitively advantaged and had a good operating culture and was led by highquality people who thought like owners, but because discontinuous change changed the world, they weren't able to adapt. Now, ideally what we go do is we go find those already advantaged companies and then they leverage this to go from good to great. If you think about all the people that have navigated change as CEOs, the best that you've worked with, I'm an investor with Dave Duffield in his latest company and so he comes to mind

because now he's tackling AI.

and the guy is incredible. If you think about whether it's Mitch or Jeff or Dave or you know people like this that you've seen operate, what methods have you impressed you the most of how they themselves adapt first their own mentality and then their teams to these fast changing circumstances? And this is a question for everyone out there that's running businesses that is facing this same change that's a risk and an opportunity at the same time.

>> Yeah. So let's let's go pick on Luis, right? We talked about Luis earlier, right? So, Duolingo has a lot of opportunity with AI and a lot of risk, right? And the stock depending on the day reflects it, right? Like when Open AI demos how you can use Open AI to basically do translation, a lot of times the stock goes down. or when Apple shows you how AirPods can be used to in the physical world live translation the stock goes down and actually I don't think the market's wrong those now it's probably wrong the magnitude but I think what the market is saying is >> risk >> there's a risk here so that that's probably in our portfolio one of the higher risk names but what do we look for in you know in Louise or Max or or Dave, you know, Duffield. I think the first thing we look about is a business that already is operating well, right? Because if you're not operating well when you have to deal with change, you're you're not going to be able to like do two things at once, right? You can't do a turnaround and do well. I think the second thing we would say is a business that already was winning in its you know first end market right so you know all the definitions we would have about winning right you know substantially gaining market share driving real economic profit that allows it to reinvest in this next scurve and also the other thing we really care about is people. We we really stress resiliency at durable. It's one of the reasons we like so much investing in act two managers, right? We can go study their resiliency, right? So when you're when you're an investor in Max and you saw how resilient he was in slide and now you understand how he's got to be resilient to implement AI to lean out his cost and drive his revenue before his competition does. you're like, we've seen him, you know, under stress before, right? And then, you know, I think you're looking for people who have a perspective, can execute, but also are humble, right? Because we at durable write down our views on AI every six months and we updated them.

And as we've gone more into this period of change, probably we're less wrong, our our perspective is more informed, you would say, than it was, you know, as we change it every 6 months. But we're we're learning, right? And this is we have the benefit of having a job that allows us spend our time reading and thinking and talking to smart people. So even if these are really talented people, most likely they don't have as much time to go do it as we we do. And we have to be very humble in our approach. So they have to be a have a perspective figure out how to go do this not be paralyzed but they also have to be humble and constantly learning. And you know the last thing I think practically we have to think about as investors is backs to the memo like if you have a high-risk situation which we would all agree Duolingo is and you know a firm is and you're really close to that part of the change then you need to be compensated for the risk.

What we would tell people on Duolingo is yeah like because of this risk the discount rate has gone up but probably commensurate the opportunity has also gone up. we can articulate it, right? He's Luis has talked about being 20x faster and generating content and we've already seen it. You know, he's publicly said he developed

chess, which is doing incredibly well and you know, my kids really love that product. I mean, they're addicted to it. And he de first it was two people for six months and then he added another four people and he developed a product in nine months.

That's the best product he's ever done. And if you ever talk to him, how long would it have taken in the past? He's like, I don't know. I probably need four to six x as many people and it would have taken them four times as long. And so you could say a startup could do that, but he's doing it. He's doing it on his platform. That product is well over a million DAUs and is growing at astronomical rates and it's a great underserved end market. It could be a huge business.

Yes, the discount rate has gone up, but this company was purpose-built for AI. You actually have a person who, you know, studied AI and taught it at Carnegi Melon and has an organization of a players who are agile in his company and is humble and constantly learning a proof point on how he it's making him faster than other people. it's driving real value and obviously that means the probability of it going from a point solution or couple products to the suite is higher >> and so you know that's what we look for.

Can I stack a couple of the things that you've said that interest me the most into like a big even bigger question? If I take physical kaizen and digital kaizen just to, you know, shrink the concepts down. If I were to have those that were to have a kid, it might be robotics. And and so I'm really curious how you approach the potential with an unknown timeline that we might get like a second wave of, you know, the physical labor economy is way bigger than the the digital labor economy that we may get a second application of Kaizen over the next 40 years like the first one we saw from Mitch Mitching Company. How do you think how do you think about that opportunity and potential change? It's something we have really thought hard about and here here's what I what what we have tried to do right so first of all we have tried to get smart by by meeting with the entrepreneurs and talking to the companies that we're involved in that we know that are leading this area just to try to learn and we only recently did this with robot otic. So if we started writing down our conclusions and then being humble that it could change every you know 6 months in AI in what you would say is more data businesses or digital businesses.

We only started doing this literally in the last month where we documented it for the first time. And so I'm gonna I'm gonna do something that I don't love to do, which I know our views here are very early and probably deeply wrong, but I'll give you all our initial conclusions, right? Which is in certain use cases, it's pretty clear that already the cost is lower than the equivalent analog process or basically >> physical labor process.

>> Physical label process. And yet, as we all know, this is the earliest and worst robotics is going to be. And because machines are iterating with machines and it's being powered by general purpose models, not by specific purpose models, this is riding, you know, a curve that is definitely geometric. And so back to this mental model of Amazon that drives so much of what we think about durability at durable is what Amazon was able to do is ride a cost curve where they were deflating the cost of sending a box out at 3 to 5% a year for 20 straight years. And the people who did not leverage the right distribution infrastructure, the right investment in robotics at that time, you know, they bought KA, the right ML models when they came into play about how to basically

plan inventory and deal with suppliers actually were probably at a curve that probably inflated at 3 to 5% but at best were flat. And that differential in a low margin business, you know, you compound it over five years. Honestly, that's all you need to know.

And that's I think what we're starting to get our heads around at durable, which is if in many areas robotics is at par. Now there's a lot of data that says it's lower cost in certain cases and the use cases are about to go up and the cost on the existing use cases probably don't go down at 3 to 5% at this point in the curve because of the scale brought in the human capital brought in the IP bot on and the fact that you're going to be able to use these general purpose LLMs to power it.

It probably goes down at more like 15 to 20%. But maybe it's more law and it goes down even faster. Well, then we wake up in 5 years and the people who put themselves on one cost curve, if they compete against the people who put themselves on the other cost curve, those could be power law businesses. What we have thought really hard about is who's going to go benefit from this curve where their competition even if they woke up tomorrow even if they put the same amount of money into this problem even if they could hire the same quality of people which is unlikely because they have not invested in the distribution infrastructure or the technological infrastructure to compete on this curve.

you know, at minimum is probably two to three years behind and every day, you know, that they they wait, they're probably getting further behind. It's apparent to everyone at Durable why our understanding of change has been great for our investments in Duolingo and a firm and you know, Shopify. But actually I think it's about to be really advantaged our understanding of people and change as we go invest in the other 70% of the economy.

>> If you think about all the businesses you backed do you have a favorite kind of competitive advantage of source of competitive advantage? So much about your whole process is does it have it already? Is it on its trajectory to get there? There's different kinds you know scale network effects etc. Are there favorites that you find yourself returning to as the best sources of long-term competitive advantage? >> I love physical real estate, >> right? You know, I I love Amazon or, you know, we're investors in Carvana. I love their reconditioning centers because at the end of the day, >> you can't spin those things up.

>> You can't spin those things up. They're these things that are super messy, right? You got to acquire the land. You got to put in the right place. You got to build the right network. Then you got to go stand it up with the right capex and the right systems. And then you have to have the right operating culture. And this is really really hard, right? And if if you put your your real estate in the wrong place, then your your cost of transport's more expensive. And this culture you got to go build there is super hard.

So I I I deeply love you know these physical world modes that exist right and really our portfolio has a lot of them right in one way or the other and that's why when you and I talked about robotics my mind went to distribution right it's like where can robotics basically take already advantaged businesses and make them more advantaged right but >> there's others and then you know the other thing I I really believe is is these soft things

that are incredibly hard, right? So I I I I think about the example of Dan or her so much, right? Because what Mitch and Steve have done is just stunningly hard to imagine that for nearly 40 years you've compounded wealth at 20%.

in something that didn't have deep physical modes or didn't have data network effects like metamite or Google have or or the people who believe deeply in open AI and I I see the potential there just like they do have right so those those data network effects are amazing right where you know the but the ones where you're really sharp on human capital.

You're really sharp on what talent really means. Not not the sticker of talent, right? You're really sharp on your operating excellence, the culture of it, the constant improvement of it, the system behind it like Kazan, and then you allocate capital against your businesses to really hold them accountable. I think it's amazing you know in our portfolio even though if I were to walk you through the businesses that First Service is in which you know Jay Hen's chairman of and what Collier has where he's CEO of he's you know largest shareholder both none of them actually have these super sharp competitive advantage but yet if you really have studied Jay and you truly understand his human capital culture and the and how he basically attracts and hold people accountable and his ability to basically decentralize incentives. So people are aligned in businesses everything from you know residential management of condos to you know basically roofing and restoration and then how they allocate capital. How they sell things that don't have a path to be great and how they buy businesses but they do it in a way where it actually aligns incentives and constant with them. It's just super impressive.

The other thing is if we're going to invest in small companies, those companies by the time they form them tend to be pretty large. And so we we have to basically be pretty sharp at really understanding other competitive advantages. >> You mentioned memo a few times, the memos you write internally. What have you learned makes for a fantastic structure of an investment memo? What works for you? We're a writing culture >> because at the end of the day, human beings are innately human.

And when we are involved in something, it's very hard to have that executive distance that you need to do to really hold yourself accountable to what you thought and actually hold the companies accountable to what you would like them to do. especially since we really do know the people we invest in and we invest in really highquality interesting people and we're deeply rooting for everyone to succeed. So, you know, unlike a venture capital firm or private investing firm, we have to be able to understand when things aren't working out so we can sell them. But just as importantly, if we're going to go invest in something that has real risk by Dualingo, we have to understand when things like Dolingo are really inflecting and maybe we see and other people don't do so, we can go buy more of it. So, we got to be able to do both. And so when we write an investment memo, it's in service of our investment philosophy, making sure we've done the work and we can clearly articulate why is a comp company competitively advantage or will it be?

What what would it have to do? Why is this operating culture excellent or why does it have the seeds of an excellent operating culture? And why does this leader think like an owner where they can basically they make the business better which we define as gaining market share through cycle and we think that they can allocate

internal and external capital such to both drive more durable growth and also make their asset base more valuable over time. And that's that's our investment memo. But then just as importantly through both modeling but clearly spelling out what we're tracking we have to then be able to when we do our quarterly what we what are really our operating reviews at durable where we go through the entire portfolio with the entire investment team on every single investment. We have to look how actually the companies are doing against what we thought they would do. And then every single investment at durable if we own for three years, we actually do a three-year look back on what we underwrote and what it did. And actually that one, you know, it's like so many things in your career you like wish you would have known earlier, right? Like, you know, the great thing about investing and the great investors to me actually are better at 70 than they are at 50. And hopefully, you know, I'm in my 50s. I'm better than I was when I did this at 30. And you just learn, right?

You you you understand patterns better. Hopefully, you remain humble so you don't actually get, you know, get too stuck in your ways. You surround yourself with smarter, better people both internally, externally. But one of them is you develop better processes. And one of the process that we only started like two years ago was we always did quarterly KPIs or operating reviews but we actually didn't go back and look at an investment that we own for three years and just say and when we do them they're so simple. We say three years ago we thought they would do X and now they did Y. Now, of course, the conversation is where was it different and why? But actually, the preparation for that meeting is at least on the written side so simple. It's two slides.

But then of course, what that what we all we're all human and even though we try to hold each other accountable, if you get together every quarter and something deviates a little bit, you tend to excuse it. Of course, if it deviates a little bit for 12 straight quarters, actually, it's kind of staring you in the face. And you know, that's that's why we're such a big believer in investment memos. >> I think in 2022, you went and did like a tour talking to CEOs about the state of the market and and you know, just operating principles and things like this. if you were I'm curious to hear you reflect on that tour, but even more interested to hear if you were to do a tour of every CEO in the portfolio today and maybe you're doing this actively what the message would be today that's different than the message was in 2022.

I felt in 2022 we truly had expertise to add to the conversation and that was at the highest level and by the way I don't say we versus us we all every CEO I talked to every investor I talked to and even Durable who is a fundamental investment firm that really values stuff on cash flow never felt money was going to be free forever actually had made simplifying assumptions based on almost a decade of free money.

Basically, if anyone who has been taught how to value companies understands at the end of the day all companies have to be valued on free cash flow and organic growth. And you know at the time we got to a point where 30% of all treasury bills in the world actually had negative yields and relative to inflation actually you were being paid to borrow which basically means it was logical for venture capitalists to value companies and not care about profitability at all.

It was logical for companies in the public markets to buy lowquality businesses that could never own own their cost of capital but use cheap debt to go do it. It was logical why if you sat on companies boards you really

wouldn't ask hard questions about trading off growth, profitability, and innovation because you didn't have to. And if you go back to the conversation we had when we eventually studied compounding, we went back and we ran that study in periods. We looked at the public markets and we asked ourselves a simple question in the world of positive real rates which is the entire history of the US equity market except for that short period of time, right?

>> Which I don't know if we ever will see again. Yeah, >> there on average about 40 compounders and during the period of time of free money there was 120. So it was three times easier to do it. And then we asked ourselves a simple question, what patterns only exist when money's free? So not surprisingly, everyone would imagine the pattern of driving growth and profitability is perennial and actually works regardless whether money is free or not. The other thing that was really interesting, which was really important to us and gave us confidence to go buy more of the Dualingos in 22 when we did this work, is that if you're a small company, you don't have to be gap profitable and you don't even have to have an ROI that is above your cost of capital, but you do have to show progress in your your path towards it. And then what doesn't work? Well, a company that doesn't earn financial returns and is showing no progress. And the other one that doesn't work, which we don't do a lot of, was go buy a lowquality return business at a high price, but leverage, you know, really cheap debt. So I felt strongly because we had seen cycles before and because we truly had expertise and also because we're really are companies that we invest in long-term partner like we want to invest in companies that are private and still own them when they're public. We want to help them as transition. I thought we had expertise and a perspective that many people had not gotten before. And so, you know, to reference what this meant was we had these conversations with a number of our companies that were in the situation. And so we we had some version of this conversation with Aman at Toast, with Luis at Dualingo, you know, with Max at a firm. And all of them were a little different, right? So like as an example with Louise, you know, I had dinner with him and the CFO and his CFO is very talented just like he is and I just presented them the data and I, you know, kind of knowing them, I knew they would have a lot of questions on it and they asked a lot of good questions and, you know, the the other thing I said to them is look, Luis, when when we invest in your company, you know, one of the things I always ask people is, I know, you know, we'll articulate what we're looking for in you, but what are you looking for in us?

And one of the things he said is, "I'm going to be a first-time CEO, and my sense is you're going to see things based on your experience that maybe I don't see because this is new to me." And I said, "The reason I wanted to have dinner with you is not because I have all the answers, but I have a strong view that you're dominant in what you do. AI is amazing for you. You know, AI was just getting started.

You have a very unique human capital culture, but if you're going to communicate to people this strength in the market, it doesn't mean you need to get to your long-term margin targets at 30%. But you have to show progress towards it. With other companies, we restricted the stock. We spent more time with them. We helped them understand what this means. We even helped a bunch of them think about how to communicate what they were going to do in this path of this transition to their investors.

And so that was that to me is different than where we are in 2025 because I felt we had real expertise there and

something to add to the conversation that a lot of these executives hadn't seen before as operators and frankly many of their board members had come of age in a period of time where money was free and frankly probably hadn't been involved as many you know durable companies as we had been involved in.

You know, the answer is I think probably we're more back to learning and normal interaction than we are kind of having a perspective that, you know, we're dying to explain to people. >> I I heard that in your early Tro days that you were studying media and you studied 20 or 30 years worth of media history and condensed it down to a very small three or four page report. Can you bring us back to that study and what you learned about me? I'm obviously interested in media. I I'm curious what you learned then about media and how that has evolved ever since.

>> Yeah, I mean we we tend to want to I tend to want to do this. I always believe that if you really understand something, you can make it super concise. >> Yeah. >> And you know where we are with robotics and less so with AI, our internal memos are probably too long because frankly there's too much unknown and so we can't be concise. I was very lucky in media because and it's something we try to do adurable with people because I was an outsider to the media industry. I think I brought fresh perspective to it. And so when I when I was assigned to basically be a media analyst, this is so hard to believe, but the companies that were viewed as the darlings of balancing durability in terms of competitive modes and having strong growth were companies like Comcast, Time Warner, Disney, Viacom And anyway, I I you know did a bunch of work on the companies individually and then I started to really think hard about it and I started to realize that the best businesses inside of all of them had been the cable networks, right? And so if you go back to if you read about media back then the entrepreneurs that you know became the most famous were the ones that launched cable networks right John Hendrickx Ted Turner Bob Johnson by the way John Malone basically backed almost all these people put the most invested so John Malone was at the center of all this and you know basically for 20 years cable networks grew 20% with 20 roes So they were compounders and that's how you had all these entrepreneurs that had become, you know, billionaires and that's how you basically had media companies that really fought over a balance of content and distribution so they could all get their fair share of these this economics.

And then when you went and you looked at a bunch of the other industry, it was like an average ROA business. And that that was what the whole industry was. But the whole thing if you really thought about it a systematic level was predicated on a closed system which is so obvious today right so what the closed system was predicated on I'm only going to show you the product or the TV show that you most want to watch when I can make the most money when you want to consume consume it. So, even in a world of linear TV, even though the most people watched foot watched TV on Sunday night, the worst shows showed up on Sunday night because people had spent their money on the weekend and they were going back to work and they weren't going to go shopping and go out and the best shows showed up on Thursday night. No, friends, the Cosby Show and in the movie business obviously there was windowing and so anyway I was like okay so the best business is cable networks that's why we have this fight over content distribution and then it's all predicated on this closed system and I think I what I believed at the time which obviously proved to be true was that this TMT bubble that had basically burned So many investors and no one wanted to think anything good could come out of at the time actually had laid the seeds of the end of the durability of that industry because even though people lost so much money on telecom infrastructure and laying the seeds of broadband what broadband was enabling

eventually was things like YouTube and Netflix which would break down this whole comp you know basically this closed system that was basically run like an oligop boy.

>> And you know that's basically what my memo summarized was the riskiest thing is to own the durable asset and the safest thing to do is go by the next standard. >> Lots of people will say investing is an apprenticeship business and you yourself have said the best investors are better at 70 than at 50 than at 30. I would love to hear a lot about what you've learned about selecting great people, you know, when you don't know them as well and then making them better as part of Durable over time because that's obviously, you know, that's going to determine how well you do as a business.

So, it's a critical component. How do you do it? One of the major goals I had with Durable when we started Durable was to actually build an investment firm that would be better the day I left and the initial partners left than when we were the best while we were there. >> So I thought really hard about that. >> It's a hell of a goal. >> And I went and I talk about doing a tour. I went on a listening tour and I went to see firms that had a period of greatness and some of them didn't get it done and then some of them actually accomplished that goal. Part of it is how we have structured durables incentives and you know the whole ethos we have internally. It was really a reinforcement of this goal about people. So, you know, you spent time with our team and when you look at the senior people at Durable, you know, Nook Day, one of my partners, incredibly talented woman, you know, she started working with me at 26.

You know, she had never worked in the investment business before. You know, she had finished hers finished her masters at Oxford and she was basically working at a nonprofit. you know, Corey Schaw, he started working with me either 21 or 22 right out of, you know, William and Mary. And then we, you know, we have a host of other people who, you know, really came out of liberal arts, you know, not not like rigorous. I had to work at a bank at an investment firm or you know if I want anytime I interview with people I have to tell people since I was five which is basically what you have to do nowadays to go work at a most investment firms or banks you got to tell people that when I was ever since the age of five I wanted to do exactly what you're doing but all jokes aside we really believe that you have to be an expert in what you do develop into it there's a whole matrix we have about the development of security analysis excellence and how it's a journey right we we do our reviews based on it I tell people look on this sheet this is a journey I'm probably the most experienced security analyst at the firm and I still have a journey to go here I got to get better and then we also believe at the same time that the youngest person in the room on our investment team actually can have the most valuable perspective right so we have an investment team of 12 people and in my career career. A lot of times the best insight comes from the most junior person who's looking at something with a fresh set of eyes. You know, early in a Nook's career when I was looking at consumer companies, she she really helped understand a millennial mindset and then we did a lot of work against it and I think that led to some, you know, great investments both in the public private markets, right? We were, you know, we were private investors in, you know, Door Dash, Sweet Green, Orby Parker, you know, some of the leading companies of the day.

So anyway, what what do we look for? We look for deep intellectual curiosity. If you don't want to constantly learn, that's just not who we are. We want people who really want to learn. We we want to we want people who

compete but want to compete as a team sport. So, you know, we have a lot of athletes. We have a lot of people who work their way through school, you know, financially, right? We want people who are resilient ourselves, right? I mean, all of us have periods of time where we get things wrong. And then if you're going to pass our style of investing in a world where the market has such volatility, even on good companies like call yours, you have to live with the fact that, you know, sometimes your performance isn't going to be good.

Sometimes you got to be resilient and you know you realize you're right, believe in it and sometimes you got to realize you're wrong. Right? And all this is underlied obviously by a level of desire to be excellent at what you do but make your colleagues better. >> And you know this is unique to durable and we're just different here, right? So when people think about being excellent at durable, they have to think about being excellent in what they do and they have to be excellent at making their colleagues better.

>> It's got to be both. You know, we're an and culture. And then obviously we talked about why what we do is just different. Our ability to invest in Dualingo as a private company and still own it today. Our ability to invest in Figma when it's, you know, a \$30 million company and the same person follows a day. We have to have people who are both good at analyzing private companies that are early stage growth companies and then understand scale durable growth companies and understand the subtleties and the nuances of private markets and the relationships and the way governance work but also understand truly being a minority investor.

>> How the public markets >> in in practice that second piece which is you're expected to make your colleagues better. How does that actually work in practice? Like what do people literally do? Is it is it, you know, squishy know it when you see it type stuff or is it more structured than that? >> Look, I'll give you the measurement and then I'll give you how it really works. When we do 360 reviews at Durable, we actually ask everyone to give feedback on what their colleagues did to make it better. And it's not I mean it's important and we're we're a really pleasant culture. We have high quality people, but it's not a Nook helped me this year and she's a nice person.

>> It's if if you're following Door Dash, it's that a Nook helped me understand Door Dash because of her knowledge about Agentic Commerce on Shopify really helped me. Or when we did an investment review as an investment team, she took a special interest and she followed up with me. or she went to a meeting that was important and gave me her perspective. Right? So, we we ask people to basically point to specific investments that that they have. The second thing we do is I'm one of these people who believe we want to have great people. We have to attract great people. We have to basically allow great people to become great and provide the environment. But I also believe we have to have the right amount of process that basically enables true excellence and creativity.

So from an hours perspective probably do less or the same amount as other investment firms but I think the impact is really high. So I'll give you a simple example. We we do the same investment meeting everyone else does on Mondays, but we do an additional meeting where we go through ideas that we're looking at and we gate them together. And so we're going to go spend more time on an investment. Everyone's in the room when we decide to go do it, right? And so people start to learn what is it that's a good use of their time, what's not a good

use of a time. And if it is, if we're going to go look at something, who and I got to go answer these couple questions in the next stage of investment due diligence. Is there a colleague here who can help me do it? We get together on Fridays. And by the way, we do it in the office. We have together, we have lunch as an investment team and we talk about insights. So this is not you don't prepare for this meeting, but this would be, hey, I had an interesting conversation with a CEO or or I was re I maybe this week, I'm sure we'll talk about it. I listened to open AI dev day and this is was what I thought was interesting or maybe I thought about this. Does anyone think about this? So we're trying to look for lateral insights to learn for each other and then you know for sure we do investment reviews where we do deep dive on stocks. You know multiple people look at this. I learned this from you know you know you had Kelly on the firm Lone Pine. Really? I I learned that from Steve. I'm sure Lone Pine still does it.

We we do KPIs where we get we call KPIs operate interviews where we go through the whole portfolio and every colleague reports to everyone else how they did and we do this not not to basically be a session while you're great or I got it wrong. It's more like here's clinically what happened and everyone can >> learn from it but also lend their lens because it's not great bad you know a lot of times it's subtle this thing was good this thing was mixed people can have their lens and then you know we basically get together twice a year and and we we have off sites you can probably tell we have a lot of fun at Durable but our off sites don't look like other people's off sites we we used to do team building activities >> and now KPI reviews >> and now we don't do them right and and why don't we do them >> because actually we're a group of people who likes learning from each other and like sharing insights and the activity we're going to get together for three days it's going to be we're going to basically you know do look backs we're going to look at reviews we're going to go study an industry we're going to go talk to a CEO and then we're going to all learn from something such that we can all make each other better >> it must be very powerful when you're making an initial projection on a KPI or something to know that in the six months and year and two years and three years hence you're going to be it's going to be looked back upon like you probably sharpen your pencil a little bit.

>> You do but you know I think what's special about our culture and I always say I always tell this to people before they join and then you know look we we tend to hire young people and develop them but if you've been anywhere else you don't believe us. People think when we get together and we do KPIs or do three-year look backs or we'll do a session sometimes where we'll look at reinitiations in the portfolio, things we sold before and then we bought back. And a lot of times if we did that, why did we sell it in the first place? Maybe we got it wrong.

We don't do any of this in the spirit of you made a mistake. You know, this is like an environment where you should critique yourself negatively. It's like no, we should be intellectually honest just like we want our executives to be. We want we want to be clinical in what we did, but then we want to do in the spirit to try to learn from it and get better or put our data out there so we can learn from our colleagues who might have a valuable perspective to make us better.

And if we can take the attitude of intellectual, honest, self-improvement, humility, that like that makes us better.
>> When you were doing your tour to learn about the franchises that were better at the end of the founders run

and those that didn't make it, what what what did you learn? I won't mention the names of those who didn't make it because you know the thing about not making it is a little bit like our investment memos when we invest in great people who are trying to build companies. A lot of them do great things and they just don't make it right. I mean as you know there's a lot of in success there's a lot of good fortune.

>> Yeah. So I think what I learned was if you don't architect the system on day one for success then you end up with a lot of conflicts that sometimes undermine what you could have accomplished. We try really really hard at durable not to make compromises. If we go hire someone on the investment team, we want to go hire someone who one day could be a senior partner or one day go, you know, basically manage, you know, the capital base, right? Or if we were to ever launch a new product, go launch that product. We're looking for people who can be as good as I am or Nook is or Cory is or Katherine. We want great people. And so for sure you usually start in our parliament as an associate, right? So you're you're going to start supporting someone and you're truly going to be an apprentice in their way.

And then even when you become an analyst the first three years, you're probably doing real analytical work, but we're probably you're early in your journey. We don't want to hire you. We don't want to promote you unless we think you can actually one day lead lead the investment organization and drive the firm. And the reason I feel that's so important is we just don't have that many >> just like just like the companies. If you don't believe it can get better, you don't do it.

>> Right? So that's hard, right? The other thing that's hard about it is, you know, when I when I went and looked at these firms, I do think there is a level of growth you have to pursue, right? So, durable is a performance-driven organization. We break every tie in dri in pursuit of investment excellence. We haven't really, you know, market ourselves or try to get new investments since 2022.

And why is that? Well, I think we're performing really, really well. But I just basically believe markets are pretty full. And we're a long only firm. We're not going to short. We're not going to really try to time markets. But if you're going to be our investor over time and we're going to do well by you, we should probably take more of your capital when on balance the entry point is lower than higher, right? So, we're going to break everything. We're we're we're going to really understand if we're going to do less what it means to be able on the public side to be able to own meaningful positions and companies to really be able to trade if there's quarterly volatility such that we can buy more when things are attractive you know everything that if we're only going to do you know maybe five I think since 2023 we've done 14 new private investments so we've back to doing five a year if we're only going to go do five and we're going to start relatively small. A lot of times we we start by investing 10 or \$20 million.

It's going to make an impact, you know, for our investors, right? We got to be a performance-driven organization and for our entrepreneurs. We got to be able to do exactly what we've done for Louise. We have to be able to do for Dylan, what we're what I think we're doing for Dylan. We have to be able to support Canva and Bending Spoons them and the next generation of those. So we got to go do that. You know, with that said, I do believe that these investment firms that have persisted actually have done a good job of at some point in time

while the while the initial team was at its you know high performance and so had plenty of runway actually started to you know prove that other people could you know be participate in the investing process right and so you know that's something that you know we we started to do with you know internally with with how we approach the private markets and we got to we got to over time kind of flush that out.

>> What is your pitch to all the great and emerging private companies out there that they should soon or eventually be publicly traded? >> Yeah, this is controversial, right? You know, I this is why I love what we do because first of all, the world keeps on adapting. And when I first started investing in private companies, it was highly controversial that any latestage private company would be valued at at above a billion dollars.

Right? You know, we we talked about Workday earlier. When we led the investment round at at workday at \$2 billion, everyone thought we were crazy. We invested in Twitter at a billion dollars, I was, you know, you know, severely publicly critiqued. Right now, now people look back at that and it's just like, wow, the idea that you would have a billion dollar private company, that's not even newsworthy anymore. What has changed obviously in the private markets is that you can be a growth company that loses money continues or be marginally profitable and and not only be valued at a billion dollars, you can be valued at a hundred billion dollars.

And there's even a view among and I think it's thoughtful. I'm not criticizing it. There's even a view that you can be an indef indefinite private company for for like SpaceX m maybe maybe Elon is correct and SpaceX never has to go public and that's that's really only happened in the last 5 years and some people correctly pointed out that for this might be an incredible path for certain companies right and by the way I think there's some truth in it right So in the ideal situation, you're not beholden to short cycle performance.

So you can basically drive growth, innovation, and at the right point in time, profitability and discipline in your business, but you can do it on a time frame that lines up with your individual business or your own competitive reality and not have to deal with the public markets. I get it. I actually think it's very thoughtful. Here's the good news about life. We're going to actually run an experiment and we're going to we're going to actually know the answer, right?

I'm not saying that that's wrong. Here's what I think. I first of all, I don't think it's for everyone, but I believe the path to building a compounder or even a what some people would say a generational company through the public markets is, you know, proven and if you understand how to do it actually very clear what you do. Let's go back to the compounder studies and then I'll give you an a real life example or two.

When you look at these compounders that were 6x companies in 10 years, the 40 of them, the average one of them has a period of time where the stock goes down 50%. And it doesn't go down 50% only when the market is down 20. They go down 50% when they basically go through trans transition. So, I'll give you an example for my career. Netflix started as a basically a DVD mail business.

And to Reed's credit, he realized that streaming was the future and he wanted to tackle this offensively. Now, like any transition, it's a little messy, right? So, first of all, he tried to split the company, right? He announced >>

I remember. Yeah. the he was gonna have Netflix and Flickster. He had to go back because he violated customer trust and churn spiked. And then the other thing that happened was, you know, in that period of time, you know, the stock he was buying back stock at \$280 and the stock went to \$70. And, you know, I remember this really well. We, when I was a Tro, I led a pipe to basically recapitalize Netflix, right? And Reed's a great entrepreneur for a lot of reasons. And that I remember calling him on a Saturday and saying, "Hey, Reed, look, I could be reading this wrong, but there is a scenario here where the market's right and you have to raise money." And he said, "Henry, what are you even talking about?" And I said, "Reed, I'm a huge admirer of what you're doing."

I believe in what you're doing. I believe it's offensive, but I also believe it's a tough financial transition. You got to go from a variable cost business model where the studios rent you DVDs on you on a usage basis to a fixed cost business model where you got to write big checks to people like Discovery and Disney to basically acquire content plus the stuff he hadn't launched any original but you're investing in original programming. And if you run this scenario that I'm doing on the potential subscriber losses in this transition, you're going to run out of cash or you're going to at least the market's going to think you're going to run out of cash and your stock is going to go down a lot more than \$70. To Reed's credit, he said, "I have not thought about this as much as I thought should."

Let's talk tomorrow. I'll get the CFO on the phone. You go through your scenario. We'll go through ours and I can learn." And look, at the end of the day, when we showed it our data, he's like, "Look, I don't agree with your scenario on subs, but yours is not out of the realm of reasonable thought process." And he ended up raising a pipe. We put when I was at Tro in half of it and I did that and then TCV J Hog, you know, did the other half.

So this to me is like the classic example of a marketleading company embracing a transition. They obviously ended up winning, right? We did that pipe at like \$4.5 billion. Look at the market cap of Netflix today. And but yeah, it was a little messy, but you know, it worked out well. So what what does the public market do? I think first of all it sent a signal to Netflix that actually you're under a real transition here and maybe your assumptions on your financial model are, you know, you need to have a wider fan of scenarios. Two, if you work at Netflix, you could say, well, you had the pain of seeing your stock go from 280 to \$70. By the way, people think that was a great investment. And I always point out to people a year later it was in the 50s, right? So a year later did it look like a great investment, right? But I think what it does is it allowed now you have to do this properly. You have to be resilient. You have to have a culture. But it allowed Reed to basically align external and internal investments and actually get his entire se senior team aligned on what they needed to do, but also realigned on incentives.

And so I point out to people actually I believe to build a great company you have to balance growth, profitability and innovation. You know I talked earlier about if you're a growth company you don't have to trade on a PE but you have to show that path back to the conversation with Dingo and Inoto and a firm in that transition and you're better off doing it sooner rather than later. And two, if you got to go realign your internal team, well, actually realigning people to the right mark, it's actually really helpful. And the people who want to reup reup and the people who do it actually get handsomely rewarded and the people who don't obviously can move on.

And I think that's really really good culturally.

Could I correctly boil this down to the positive value of daily marks and the depth of public markets and their investors that those two things in combination are sort of the the reason why being public might be valuable relative to the private alternative? >> But I I think I I probably because I use the Netflix example when they were fully formed and they were a discipline company. I also think that putting discipline into a company when your corporate culture has already formed and may I don't want to use the word stasis but at a certain scale it's hard to change is not good right so I actually think to run a company well you have to be in the and business not the or business you have to drive growth measured to buy market share in the short term. You have to drive innovation or allocate capital well to position yourself better for the future. And you have to basically drive profitability partially. Profitability allows you to basically invest. But part profitability actually forces you to drive efficiency and discipline through the organization and and make sharp decisions on capital.

And what I always tell people about this is you should think about your CFO's function not as a policeman but actually as someone who basically sets standards that forces you to make sharp decisions. And as we I think people realize this more today than they did a couple years ago. Actually a lot of times when you prioritize and you focus on what really matters actually agility comes in and excellence come in you accomplish more. And when you try to do too much and essentially investment has no cost, a lot of times it's lays and it's not sharp.

>> I feel like we've covered so much ground. I'm curious if there's any other ingredient in Durable story or your story that that we haven't covered that you feel like is essential to understanding you and and what you're doing and why you're doing it. >> I think we want to have fun and we actually root for everyone. The reason I say this is I'm a huge sports fan. A huge sports fan. And I love studying sports. And to me there's two types of like competitive greatness and they both work.

There's Michael Jordan who basically was such a fierce competitor that essentially if you didn't rise to his level, you know, he like drove you out of there, right? I mean, and it works, right? And those Bulls showed up with a chip on their shoulder every game and it was amazing and they were great. And then there are the people who play basketball and they say, "This game is great and we want to we want to have fun and we want to elevate the game and we want to win." And the people who compete with us, we think they're great and we're rooting for them. Now, of course, if we're going to play against them, we're going to be competitive on that day and we're going to win. But we want to actually have fun and actually we believe everyone can win. And I think that's like if you that's durable, right? And I think that's really important to me, right?

Like when we invest in people, that's the kind of person we want to invest in. When when you know when we do, we're public market investors at our core. If we have to, and we did, if we because we think it's right for our clients, have to go sell a firm, which we did because we believe from a riskreward standpoint, we have to go do it. We're going to go do it. You know, I always say it's not our money, it's our investors money. We got to be fiduciari first. But we when we did that want to see Max win, and we never stopped talking to Max. In fact, I think he would tell you some of the things in our relationship where he learned from me more than I learned from him was actually in the period of time where we didn't own his stock because we don't think about it as a

stock. We think about as we want to see Max win and even the investors I don't think about competing against investors. I mean, there's so many investors who I respect and honestly if they're doing their craft well and they're high quality people, we want to see them win.

And that just that is so core to the way we deal with people and the way we, you know, hold ourselves accountable. >> Is that like the Steph Curry Wizards at their peak approach to to contrast against the Jordan approach or something? >> Yeah. I mean, that's exactly how I think about the Warriors, right? Like Steve Curry I think is amazing. John Wooden amazing. I think John Wooden is the greatest coach of all time. Like think about what John Wooden wanted from his players. He wanted them to be great people. He didn't necessarily believe they all had the same modes. I mean, Kareem Abdul Jabbar and Bill Walton, you know, maybe the two greatest college basketball players of all time in their eras, but definitely in the top five, totally different people. And he accepted that, but he wanted them to be great, not only as basketball players, but as people. and he was measuring UCLA against that. And frankly, of course, the output of that is, you know, the success they had. And to me, that was the >> that was the Lakers with Magic Johnson, right? Like you watch those guys play basketball >> and they just were having fun and they were elevating the game. I remember going and seeing the Warriors, you know, when Steph and Draymond and Clay were just kind of coming up and the energy of those people was amazing and they transformed the game, right?

They changed the three-point shot and then of course when you see greatness like that, you got to go learn from it. And of course, I've gone and understand the way Steve Kerr is >> and how he cares about competitiveness, but he cares about mindfulness. He cares about fun. If you're going to be a new warrior, he's going to actually go visit you in your hometown to truly understand who you are as a person, right? And I mean, that to me is great. And that's that to me is part of what being durable is, right? It's a wonderful excuse to ask you my traditional closing question.

What is the kindest thing that anyone's ever done for you? >> You know, I prepared for this one, Patrick, because I do listen to your show. So, I have to say it's my mom. You know, my parents got divorced when I was young, and my mom, you know, really raised me, and I I I learned so much from her. And the thing my mom did for me that you know in hindsight was so wise and proved to be so kind was I took a leave of absence from Harvard to go work on a campaign for a state representative running for US House of Representatives and she was totally supportive of that.

And then he was expected to lose. And in a long story, I became his campaign manager and ended up winning. >> You were 19? >> Yeah, I was 19. And I came to her and I said, "Mom, I want to go to Washington DC and be, you know, chief of staff for, you know, Congressman Deutsch or Congressman Deutsch." And she said, "Wow, you really want to do that?" And I said, "Yes." And I said, "In order to do that, I can't take another leave of absence from Harvard. They don't let you do that. I have to drop out." And she she was not on the Bill Gates or I guess future Zuckerberg belief in the world. It was not her ethos, but she was really accepting. She was very very thoughtful and listened to me. And she said, "Henry, if that's what you really want to do, it sounds like very thoughtful.

It's a it's a very adult decision. And if you're going to go do that, I'm always here for you. I love you. I'll always be your mother. You come to me with anything. But what it practically means is you need to be responsible for basically paying for your education, right? Because you say you want to go back there. I'm going to take you at your word, but you know, you got to go do this now as an adult because you're making a real adult decision. And that was in, you know, and I tell this story to my two sons because I think it was frankly very important, but also kind because it it taught me that if you're going to go make major decisions, you have to be thoughtful about them and people will support you, but you have to be able to basically be responsible for the consequences.

>> An amazing, beautiful story. Different flavor than lots of these answers that I get. I love it. Henry, thank you so much for your time. >> Thank you.