

Holdings Update: Buy Intuit - Sell Automatic Data Processing

Automatic Data Processing Sale

In September 2017, Jensen's Quality Growth Investment Team sold Automatic Data Processing (ADP), a human capital management solutions company, from the Portfolio. ADP reached our estimate of full intrinsic value and as a result of our discipline, we sold the position.

The company is currently in a proxy fight with Bill Ackman's Pershing Square Capital Management for control of the company. ADP is transitioning from a traditional payroll processor to a human capital management cloud-based services provider. Pershing Square's thesis is that the company should migrate faster with higher profitability and should replace the CEO, Carlos Rodriguez, to accomplish this goal. While we do not necessarily share the same thesis as Pershing Square, we are cautious about ADP's transition and its impact on our view of the company's fundamentals and risk profile. Going forward, we will monitor the company as a bench company. We will consider adding ADP back into the Jensen Quality Growth Portfolio in the future if the fundamentals, risk profile and valuation align to our expectations of a Jensen Quality Growth company.

Intuit Buy

In September 2017, Jensen's Quality Growth Investment Team added Intuit to the Jensen Quality Growth Portfolio. The company is a provider of innovative, user-friendly business and financial management software and cloud services for small businesses, the self-employed, accounting professionals and do-it-yourself tax preparers.

We believe Intuit has many attractive competitive advantages such as products with strong brands, innovation, economies of scale and scope and high switching costs. As a result, the company's core products, QuickBooks and TurboTax, are #1 in their markets and drive what we deem are the company's strong financials.

QuickBooks is a software product that enables the self-employed, small business and accountants to accept payments, manage and pay bills, and carry out payroll functions. In essence, it's the operating system of small businesses, and it contributes to approximately half of Intuit's revenue.

A compelling reason to add Intuit to the Portfolio now, is the company's migration of QuickBooks from a desktop software product to a cloud service. By shifting traditional software to the cloud, Intuit is able to stabilize the QuickBooks revenue from one-time purchases to a monthly, annuity-like service which we find to be a more attractive model. Additionally, Intuit can more easily add additional services such as payroll and payments and, as a result, realize greater economies of scope as well as

increase switching costs. Lastly, by migrating QuickBooks to the cloud, the company can tap new global markets more efficiently than it can with its desktop version. QuickBooks is currently available in the US, Canada, UK, and Australia and is expanding into France, India, and Brazil. Due to its success, the QuickBooks segment sales has grown approximately 10% on average over the last 5 years.

The other half of Intuit's business is tax preparation software which is divided between consumers and professional accountants. This part of the business is driven by Intuit's well known and highly regarded consumer tax product, TurboTax. Intuit dominates both the professional and do-it-yourself markets with leading market share in each by successfully creating software that makes the onerous task of preparing and filing taxes relatively easy. Despite anemic underlying market growth, Intuit's consumer tax prep segment has averaged growth in the high single digits over the past 5 years due to its ability to take share and pricing power.

As long term quality growth investors, we favor Intuit's shifting businesses mix. QuickBooks' stable annuity-like revenue stream is growing faster than the highly successful, but seasonal, tax preparation business. Going forward, we expect QuickBooks will represent a larger share of Intuit's business. As a result, we expect the company's strong financials to further stabilize, and in our opinion, enhance its quality growth attributes.

In our view, Intuit demonstrates the 'Quality Growth' attributes we favor including compelling growth drivers, strong competitive advantages, high returns on capital, an effective management team, and consistent free cash flow generation. We are pleased to add Intuit to the Jensen Quality Growth Portfolio.

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