

Company Participants

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Conference Call Participants

Operator

William Ackman

Welcome to the Pershing Square Q1 Investor Conference Call. As a reminder, we sent the legal disclaimer to all participants and it's available online. We're going to be providing commentary on our portfolio companies. We will as usual be somewhat limited in discussing companies where we have a board representation in terms of the disclosures. We've got a significant number of questions in advance this quarter. We're going to try to integrate as many of those questions as possible into the presentation. But we're going to do our best to answer as many of those questions we didn't get to at the end of the call. A replay of today's call will be available for two weeks until Wednesday June 10th. [Operator Instructions]

I'll update you on performance because we won't publish these numbers until 4:00 p.m. this evening but we're off to a very, very strong start year-to-date depending on which fund anywhere between 22% and 27% net returns for the year. That has come as we'll discuss further as a result of our building a large hedge sort of in advance to the market decline and then unwind that hedge and redeploying that capital. And we'll talk about that in some detail. It's been obviously a very unusual year in markets and in the global economy. And of course from a health pandemic point of view remarkably I guess remarkably some people might add the S&P is only down around 7% year-to-date. But that 7% actually belies what's going on underneath the surface looking at my computer screen as we speak.

I think the vast majority of stocks that I'm at least following are down substantially for the year but there are companies like Amazon, Facebook, Chipotle and others that are doing quite well. So it's really been a year of tremendous divergence just another way to get at that is with the markets down 7% the S&P, the average stock in the S&P 500 is down 14%. So the difference between a market weighted index and sort of what's going on underneath the surface and we feel quite pleased with our results particularly in light of on a relative basis relative to the S&P and sort of relative to, sort of the average company in the universe that we generally invest in.

In terms of exposures, our exposures have been reduced somewhat as of May 26, we made some sales which we'll discuss further anywhere between 85% and 98% invested for the public fund that means we've got about 20% cash and for the private funds 12% between and 15%. The big news of this year for Pershing Square really began in January as we began to get more and more concerned about the virus both in terms of health implications, but actually our concern beyond health implications is that the economic impact was potentially much more severe. Following this is a case where if you could just look East, see what was happening in China and you know the Chinese were incredibly aggressive in shutting down the virus by basically quarantine a very, very large city and region and then shutting down their big portions of their economy. And as we thought about that one, we were quite unfortunately confident the virus would might have asymptomatic spread and just the inherently interconnected nature of the world that this would not be long before it was on our shores. And that

our country would have a more difficult time shutting down or taking some of the steps that were taken in China.

So we had a lot of concern about the health implications of the virus and then also concerned about ultimately what we expected would happen would be a global economic shutdown. And having not seen one of these before and really no one living has experienced anything like this, we thought the market reaction would be very negative. And yes as our concern grew over the course of February, we started thinking about how do we hedge such an event or do we sell our existing holdings, how do we think about managing this risk for our investors. And fortunately the nature of the companies we own sort of the simple predictable free cash flow generative dominant companies that are strong balance sheets and dominant market positions are the kinds of businesses that are meant to withstand events black swan type events. We, in our general view as we thought through each company our portfolio we said look each one of them is going to be affected to varying degrees but we were quite comfortable that all would survive.

And we thought that the events of the virus would be relatively short-lived in terms of their impact on the businesses we owned and we couldn't predict with sort of specificity what the market impact would be. How much stocks would go down and so rather than selling companies we liked and we've owned for years, we said look we should really hedge this risk. And we looked at alternatives for hedges. One choice became sort of very clear and the other interesting event that really took transpired over even the last decade but in particular over the last year or 18-months or so was a dramatic continuation of a decline in credit spreads with respect to corporate credit. And so at the time we were thinking about hedging this risk credit spreads and corporate obligations were extremely tight. And we thought it was an interesting asymmetric that without a virus risk just a theory that how much tighter spreads could get. In fact, if you looked at the credit spread indices, they were actually tighter than the all-time tight. Once you took out a few credits that were substantially wider than the rest of the credit in the year -- indices. If you go back to 2017 timeframe credit spreads were similarly tight, however, all the spreads were about the same.

Here we had spreads much tighter that brought down the average to the levels of a decade ago but with some wider spread credits. Think of Macy's department stores, some energy companies et cetera causing the indices to be at or around the same spreads as before. So we thought this was a very unlikely for spreads to tighten further and if we thought would happen we believe spreads would widen. And we began building a very large short, if you will, in the credit markets that began -- we started building that position on February 24th, position peaked all over \$70 billion notional and we completed the purchase of credit default swaps on March 2nd. And then over the next 10 days as the market started to react to the virus credit spreads gapped out very widely and over that period, the other thing that happened is the federal government started getting much more aggressive and acting much more quickly than they had during the financial crisis and talking about what they would do to mitigate the impact as the credit markets were starting to seize up.

Some of the same events in the credit markets, money market funds starting to actually have some risk dysfunction in the Treasury. The market for Treasuries, one of the most liquid markets and I think the relatively recent experience with federal government in dealing with the last financial crisis caused them to act more quickly. Our position had ballooned in value from being worth zero the day we put it on to a peak of \$2.7 billion on March 12. And the stock market was down 25% or so at the same time. And so as we looked at the relative value of our hedge versus equities, it seemed pretty clear to us that the right decision was to begin to unwind the position. And we started that process on the 12th and we also started investing capital on the 12th. We put, as we look at these numbers in detail between the 12th and the 18th, we had invested \$2 billion in the market and had unwound a \$1.3 billion of our hedge and then we're able to exit completely over the next several days.

And we were kind of pleased with that outcome obviously because we were able to monetize the hedge for real value and we were deployed the money not at the absolute bottom of the market. We had some days where we were at the bottom but when you're investing that much capital in a relatively small number of investments, it just takes time and so we had to buy, if you will, on the way down and then even bought a bit on the way back up. So that's really the big event of the quarter and actually the last couple of months and then as markets have recovered, as some of the perceived risk of the virus started to fade, stocks have and as markets have; investors have differentiated between companies that are survivors that in some cases will benefit from a competitive standpoint as a result of the impact of the virus. We've been a -- our portfolio has been a big beneficiary.

Just to give you some of the detail on investments in which we increased our stakes. We bought more stock in Agilent. We increased our position by 16% an average price of 64:57. We added, increased our position in Hilton by little more than a third at an average price of \$70.07. We bought in a transaction with the company. We increased our position in Howard Hughes by 157%. In Lowe's and again these are share count numbers not

dollar numbers. Lowe's, we increased our position by 52% in average price of 84, our restaurant brands by 55% at an average price of 41.65 and we rebuilt our position in its entirety in Starbucks. We also added to our position in Berkshire, but it's not on this page.

Since the time of our additions, each of those names Agilent's up 33%, Hilton up 17%, Howard Hughes' is flat; Lowe's up 47%, Restaurant Brands up 30%, Starbucks up 29%. So far so good and we still think everything we currently own is undervalued. The one name missing on the list is Berkshire Hathaway. We made a decision to exit Berkshire in the last few weeks and we'll talk about that further in the detailed kind of commentary.

Briefly on Starbucks, we built our original position Starbucks in sort of July 2018 at around \$51 a share. We exited toward the end of January around \$86.30 a share. Then we repurchase the position at \$60 a share and we tend not to be big traders, but we spent a fair amount of time trading and we did so working -- the whole team working from home. And we're quite pleased that our ability to run the firm very effectively working from home. We also build two very small positions. One in Blackstone and the other in Park Hotel both got to very interesting evaluations companies that we had followed over time. Blackstone, we were buying stock in the \$33, \$34 range. Park hotel in the \$45 range, but they were trading at those prices for a relatively short period of time. We didn't build a meaningful enough stake in either and as is sort of our general practice with Park sort of doubled Blackstone up substantially from where we had purchased it and ultimately we did not believe that we'd be able to buy more to make it a meaningful enough investment we exited Blackstone and Park hotels as well.

With that when why don't we talk about Berkshire? And Ryan, why don't you update our investors on investment in Berkshire from inception and our decision to exit recently.

Ryan Israel

Sure. And may be to start with kind of taking in terms of how we thought about exiting and then rewinding well our initial thesis was, I think, we look at today's environment just think about the high level of volatility and sort of as you talked about earlier in the call the dispersion of how stocks have performed this year. We think it's a very different environment and we made the investment Berkshire a year ago. We continue to think Berkshire will be a strong investment over the longer term. But we also think the current environment means there may be more than typical opportunities for us to see very high returning investments. And so we wanted to make sure we had more cash to be able to move nimbly if those investments present themselves.

If you look back a year ago when we made our investment Berkshire, we really laid out a thesis that was threefold. The first is that the company has a high-quality portfolio of businesses across the insurance and industrial space and that the market had not appreciated that. Second that these businesses particularly the larger ones had a pretty meaningful opportunity to improve the profit margins relative to the levels that peers had operated at. And third, the Berkshire had a large cash position and we thought over time it would be able to achieve attractive returns by investing that cash and share repurchases marketable securities, transactions and business acquisitions. And since we made our investment in Berkshire, we think that the high-quality nature of its portfolio is really shown through. We also think it's done a good job expanding operating margins particularly at its largest industrial asset, the Burlington Northern Railroad.

For example, if you look at the insurance business, float was able to grow to \$130 billion which has grown 5% last year and it's really incredible at the scale the Berkshire is dealing with. And at the same time they achieve that float at a negative cost which continues to be sort of industry-leading and just really unimaginable and then Burlington Northern, the operating ratio improved by 200 basis points. So I think really kind of our first and second thesis, those points have played out in relatively short order. We look at the third, the capital allocation, Berkshire did repurchase \$5 billion worth of stock over the last year but in spite of that their cash is actually grown and they now have \$20 billion more when we made the investment and that now approximates about a third of the company's market value.

So we still remain optimistic that over time Berkshire will deploy its cash attractively, but we also think in the near term the most likely outcome where Berkshire would deploy the cash would be in an outcome in which there would be a number of very high returning opportunities that we could also invest in, which is why we thought it would be good to have the cash in case that opportunity were to present itself.

William Ackman

I think the other point I would make is the one advantage we have versus Berkshire, it's just relative scale. Berkshire has the problem, if you will, of deploying one \$130 billion of capital or some fraction of that number is still a very large number relative to the -- it could be available in buying one equity at a time whereas by virtue of our much, much smaller size, today we have \$10 billion of capital to invest. We can be much more nimble and so our view was generally we should take advantage of that nimbleness, preserve some extra liquidity in the event that prices get more attractive again.

Let me walk through the rest of the portfolio. Lowe's is a company that's actually stock was crushed during the crisis. It's now up for the year about 4% maybe Charles, you can walk through the events of the quarter and why Lowe's has been so resilient.

Charles Korn

Sure. Happy to do that. Thank you, Bill. So Lowe's is unique amongst most of our holdings and that the company is both a direct near-term beneficiary and very likely a longer-term beneficiary from Covid-19. So in recent months what's happened is Lowe's business has actually witnessed significant demand acceleration as Americans have engaged in self isolation and Lowe's remained open for business as its designated essential retailer. Early in the quarter, Lowe's experienced demand acceleration in categories such as appliances, in cleaning supplies as consumers prepared for self isolation, but as the quarter progressed that gave way to kind of broad-based uptick and DIY projects as consumer sheltered at home. These trends manifested themselves in Lowe's reporting extremely robust Q1 US same-store sales growth of 12% which is a pretty incredible figure for this fairly mature business. And notably the comparable sales accelerated throughout the quarter from plus 5% in February to plus 9% in March and plus 20% in April.

And that strength in April has continued into May. And these sales trends translated into significant year-over-year gross profit, operating profit and earnings growth in the quarter despite \$320 million of investment by Lowe's in direct response to Covid-19 largely in the form of special payments to Lowe's associates. Lowe's also realized robust omni-channel growth, which grew at 80% in Q1 and exited the quarter at a triple digit growth rate. Now in prior quarters recall Lowe's omni-channel growth has been subdued as the company has been engaged in re-platforming its technology stack to Google cloud. And although that effort is still underway, Lowe's was in a position to benefit from enhanced online demand in this quarter. And we would expect to see enhanced feature and functionality on Lowe's omni channel platforms as it completes his re-platforming in the coming months. And while it's difficult to predict how the home improvement demand environment will evolve in the coming quarters, we believe Covid-19 is also likely to prove to be a long-term benefit for Lowe's.

Historically as consumers spend more time in their homes, they've shown a greater propensity to do repair and other home related upgrades. And while it's still early management noted on their recent quarterly conference call that they're seeing continued robust comparable sales growth in the markets and regions that have lifted formal shelter-in-place restrictions. Now as Bill discussed earlier, we use the market dislocation in March to opportunistically acquire an additional four million shares in the low 80s taking up our position roughly 50% and while Lowe's is appreciated significantly from its March lows based on current trending, we estimate Lowe's is still only trading at roughly 16x to 17x next 12-months earnings which really doesn't incorporate the potential for significant future profit improvement as they engage in their business transformation plans.

Now for context, this compares with Home Depot which presently trades at roughly 24x next 12-months earnings. And so we believe that Lowe's has the potential to generate accelerated earnings growth as it realizes its 12% operating margin target in the coming years. Importantly, management recently described that as a quote and I'm quoting here, stop along our journey, recall Home Depot's at 14.5% roughly. So achieving the current medium-term target of 12% could equate to more than \$10 of earnings per share and as such we believe that Lowe's has the potential to appreciate substantially as the company continues to progress on its business transformation and is well-positioned in the current environment.

William Ackman

Thanks very much, Charles. What's interesting to us is management's done a superb job executing during this very challenging time. The company's a bit of a turnaround in terms of the opportunity for both sales productivity and margin expansion. It trades at a massive multiple discount to Home Depot and I would argue you should pay a premium because the multiple that your earnings that you're assigning here is based on earnings that sort of understate ultimately what we expect the company to achieve. So we think this the opportunity, we had an opportunity to buy. We bought 4.3 million shares for \$84 a share just six weeks ago. That was as I said at the time a bargain of a lifetime.

Okay, restaurant brands. Feroz, why don't you take us through and on updating here?

Feroz Qayyum

All right. Thanks Bill. So the impact to restaurant brand of sales from measures to contain the coronavirus was immediate, but frankly quite brief. Thanks to the company's quick actions and its off-premise value focus business model, its sales have either already meaningfully recovered or are already well on their way to recovering depending on the brand and the geography. So as the virus spread across the world the company was able to leverage its early experience in China. And proactively began taking actions to mitigate the impact from the virus. To restore customer confidence and demand they quickly bolstered safety procedures and shifted their marketing dollars to highlight their off-premise options, which include drive-through, digital and curbside pickup.

To support their franchisees, the company has moved to variable rent at locations and controls. They've deferred near-term rent payments and are also acting as a source of additional immediate liquidity through rebates and cash advance programs. They have also temporarily halted franchisee capital commitments and have engaged with vendors and lenders to both secure extensions as well as temporary lines of credits for its franchisees. Now looking at the trends at each of its concepts at Burger King in the US, same store sales bottomed in late March but we actually believe they've already improved to near flat. And while some international markets were closed due to government mandated lock downs, many have begun to slowly open albeit with sort of limited operations.

At Popeye's in the US, same store sales were growing 30% plus prior to the onset of the coronavirus and while their sales briefly slipped, they have quickly rebounded to pre Corona levels really highlighting the strength of the brand and customer demand. And at Tim Hortons, while sales have retraded considerably from their bottom in March, we believe that their full recovery is likely to correlate with easing of the shelter-in-place orders. And frankly that is because of the routine driven nature of Tim Hortons' coffee, breakfast and snack business. Now luckily given that the impact of the coronavirus have been minimal in Canada today, and that's where the vast majority of Tim Hortons' restaurants operate, we believe that the easing of shelter-in-place orders and the resulting recovery will be smoother there than in other parts of the world.

Now turning to sort of the actions management is taking for the future. The company is also using this opportunity to accelerate its efforts particularly in digital and delivery. And is already seeing encouraging adoption across its concepts. So for example digital sales now represent about 9% of sales at Burger King; 15% of Popeyes and more than 30% of Tim Hortons. Tim Hortons also pivoted their loyalty program to a more points based structure and shifted their annual roll up the rim campaign to completely digital and that helped them nearly double their loyalty guest registrations to about 45%. Remember, longer-term the company sees this as a crucial step to helping unlock personalized one-on-one marketing, which should help offset the negative impact from sales from the loyalty redemptions.

In terms of capital structure, restaurant brands also shored up its balance sheet by issuing additional notes and they also drew down on their revolver. So they ended Q1 with approximately \$3 billion in cash. And so we believe that the company has more than ample cash to both operate and assist franchisees with deferrals as needed. The franchisees have also been major beneficiaries from various government program relief programs that are providing both grants, as well as additional access to loans. And so looking ahead, we actually believe that each of restaurant brands concepts will emerge stronger from the crisis. First, while competitors in the restaurant space have needed to make wholesale changes to how they operate, restaurant brands has really only needed to make minor tweaks as the vast majority of its sales come from things like drive-through, takeout and delivery all of which are social distancing friendly methods of interaction for the customer.

Second, even as shelter-in-place restrictions ease, the continuing social distancing measures are likely to have a materially negative impact on competitors. So we believe restaurant brands franchisees will likely benefit from an easier competitive environment, see lower input prices, and have favorable real estate locations being made available to them. And then lastly, with their strong value offerings, we believe that each of restaurant brands concepts is likely to benefit from consumers trading down as they become more budget-conscious. The longer term, we believe that restaurant brands' unit growth opportunity is still very much intact. And we expect unit growth to return to its mid-single digit growth rate after the crisis is over. And so while the restaurant branch stock prices recovered more than 90% from its bottom in March, it is still materially below where it was prior to the onset of the coronavirus.

We believe that the current valuation frankly does not reflect its business fundamentals. The fact that its competitive position is strengthening; the fact that it has ample liquidity and the fact that its long-term unit growth potential is still very much intact. We believe that its investors gain more clarity around the long term impact of the coronavirus on consumer habits and as underlying sales trends that each of its brands continue to improve their share price will likely more reflect, better reflect our view of its business fundamentals.

William Ackman

Great. Great presentation for us. Just one question on input prices. Obviously, following what's going on with beef processing facilities. Are we concerned at all about beef prices in terms of input cost for the company?

Feroz Qayyum

Sure. So this is a question that Jose was asked on the call. And frankly each of the restaurateurs has been asked. The company is managing this very closely. And frankly given its scale, it's able to get and get supply that is better managed than other restaurateur. So far it's not been an issue for restaurant brands, but it's certainly managing it very closely.

William Ackman

Okay. Great. While we're on the topic of restaurants, Anthony talks to us about Chipotle. By the way Chipotle was the only big frustration during the quarter. We often find having board representation valuable in terms of ability to sort of influence management's and boards and help provide advice and oversight. The downside is we do have trading restrictions associated with being on a board of a company and that's true in the case of Chipotle where we still have a representative and the downside of that is that Chipotle stock reached a low in the last I guess 60 days of the mid 400s and we were very frustrated that we couldn't buy stock at that price. But stock is up a 19.5% year-to-date near a new high. Anthony, why?

Anthony Massaro

Sure. Thanks Bill. So since the onset of the Covid-19 crisis, Chipotle management has done an outstanding job pivoting their strategy to focus on serving the customer digitally. Digital pickup and delivery sales now account for nearly 70% of total sales at Chipotle, which is up from just under 20% at the end of last year [Tech Difficulty] this shift was driven by changing consumer behavior as a result of the virus. In addition to a reallocation of marketing spends from menu innovation, towards digital and delivery and away from live sports and traditional TV to social media and streaming channels. This is evident in the results in the first three weeks in April during which in-store sales decline 75% year-on-year as dining routes are closed across the country, but delivery sales increased 150% and order ahead and pickup grew 120%. Management expects these digital sales gains to be durable for a few reasons. One, digital sales had historically been very sticky in general. Two, dinner which has long been a growth opportunity for Chipotle is outperforming the core lunch day part and is introducing consumers to a new occasion and creating new habits.

And three, loyalty sign ups have skyrocketed with 11.5 enrolled members currently up from 8.5 million at year-end 2019 which will be a tremendous long term asset for the company in terms of personalized marketing and customer relationship management. As a result of management's proactive and decisive actions, same-store sales are already well on the path to recovery. The brand had excellent momentum in January and February which is really a continuation of the outstanding recovery that you saw last year. Same store sales in the first two months of this year were up 12% between and 13% excluding the benefit from leap year. And that was lapping a 10% comp in the first quarter of 2019. So a low 20s percent two years stack which is very impressive. Sales trends then worsened along with the virus situation in the US before dropping it down 35% in the second half of March as dining room closures are implemented.

The trend then improved from down 35 to the negative high teens in the third week of April which was driven by the aforementioned pivot to digital, consumer fatigue with cooking following a period of pantry loading and also by stimulus money and unemployment benefits kicking in for those who have been most impacted by the crisis. As Bill mentioned earlier, Chipotle stock is up about 20% year-to-date which is about 26 or 27 percentage points ahead of broader market as investors recognize that Chipotle could emerge from this crisis even stronger and more valuable than it was before. The company has an opportunity for structurally higher average restaurant sales if digital sales gains can be sustained once in store sales recover. As Feroz mentioned earlier, competitive dynamics in the restaurant industry as a whole have improved which should allow for Chipotle to gain market share, as well as enhance the company's ability to recruit and retain talented workers.

Finally, the company has a fortress balance sheet with \$900 million of cash; \$1.5 billion of total liquidity following a \$600 million revolver that the company announced earlier this month. And zero debt which will allow Chipotle to play offense and invest to grow the business even in the current environment. Areas that are ripe for investment include new stores most of it will feature Chipotlanes which are digital drive throughs, technology initiatives, menu innovations such as queso blanco, and most importantly people including the store crew and managers who are working hard to drive the recovery every day.

William Ackman

Excellent. Brian and his team have done an incredible job and we are very enthusiastic results that they've achieved. So Hilton, Hilton is a business that was probably along with Howard Hughes the most impacted as a result of Covid. And will probably take the longest, amongst the longest to recover, but we still in the stock we bought more. So, Ryan, why?

Ryan Israel

Sure. So I think it's absolutely right. Hilton's earnings in particular are going to be impacted in the near term very substantially by coronavirus because people aren't traveling whether it's for leisure or business. And so we actually think that revPAR which is their metric for same-store sales growth could even be down more than 50% this year. So it's obviously had an impact and one of the reasons why we were able to increase our position significantly. Interestingly even though certainly there is a fair amount of near-term pain, we actually think this may help Hilton's long-term benefit over time. For one, it shows and highlights the resilience of the company's business model. Then secondly, we think it does present them with an opportunity to take a fair amount of market share over time for independent hotels and some competitors who are can be much weaker coming out of this crisis in Hilton.

In terms of its resilient business model even though we think it's possible revenue may be down by about 50% this year, we expect earnings actually to still be positive, which I think just highlights how flexible this asset like model cost structure is. And then also management noted on the call earlier this month that even in spite of everything that's going on coronavirus, they still think that they'll be able to grow their room count by about 3% this year. That's about half the level they expected at the beginning of the year, but they think that they have not lost any of that remainder of the 3%. They think they'll get that back next year in addition to the typical pace.

So you've got a business that has revenues 50%. It's still going to be profitable in our view and where we believe that there's still a long runway both in the near term and long term for units to grow. In terms of taking market share over time though we think that Hilton was already doing the right things before coronavirus and has really stepped up its game in areas like cleanliness standards since the crisis occurred. And that will be very important in helping consumers choose to come to Hilton's property. So give an example of some of the technology they're investing in, Hilton has been investing in digital check-in, keyless room entry and in-room controls, all these things can be controlled on your smart phone, which gives their guests a lot more control over their own environment on their own devices.

And they recently launched what they call them a clean stay partnership with Lysol in the Mayo Clinic and that's going to make sure that the rooms are set up to the best cleanliness standards that are there to give guests confidence they can come back the Hilton. I think both of these things are going to be a big advantage for the company relative to some of its smaller competitors and the independent hotels who won't have the scale to be able to do this. And we think it's just going to further improve the value proposition to be a Hilton franchisee. So over time we do expect that Hilton will recover to the level of where its revenues and RevPAR were before the crisis and we think they're likely even perhaps be at a slightly more accelerated growth. The question is really just how long does it take.

Our view is that it's going to likely take several years but we think even if it takes longer than that when we kind of do our math to figure out what Hilton is worth on a discounted cash flow basis, even if the recovery were to take three or five years we still think that the company is very undervalued at the current share price and is likely to generate very strong returns from here.

William Ackman

And I think Christopher said who runs the company it has had the benefit of managing through a crisis. It was a different kind of crisis but the financial crisis combined with at the time a much, much more leveraged balance

sheet because the company had been taking private I think just the year before. And so the discipline and experience you have from that while this is obviously different situation, we've been incredibly impressed with how the company has managed through this period. And so again initially very dramatic stock price reaction, stock got cut in half and had has recovered quite meaningfully but we do believe the Covid crisis if you will has reduced the intrinsic value of the company. But the lower share price has more than compensated for that reduction in intrinsic value.

Okay. Agilent, Bharath, why don't you to bring us up to date?

Bharath Alamanda

Sure. Thanks, Bill. We discussed our investment in Agilent at some length at our Annual Investor presentation but as a quick reminder our thesis on the company is that it's a high quality business with a high degree of recurring revenue and a significant margin expansion opportunity. When you look at this quarter's earnings which company reports last week both top-line and operating profit results were really confirmatory about thesis? For fiscal Q2 which includes the month of April, organic revenue only decline 2% despite the impact of Covid-19. The stable performance was really supported by the company's highly resilient service and consumables business which accounts for 60% of total revenue and actually grew 2% in the quarter. On a more granular basis even in the month of April which was the most impacted by the pandemic, organic revenue only declined 6.5%.

The company has noted that May results today are trending in line with April and guided to perform and slightly improving thereafter. In China which accounts for 20% of total revenue, the company has seen a strong rebound growing 4% in the quarter and 20% in April. And in their other geographies revenue declines have stabilized and are starting to see early signs of recovery in certain pockets. Despite the meaningful business disruption from Covid-19, the Agilent team has done an excellent job of maintaining a high level connectivity with customers. So for example, they're leveraging same investments and digital channels to enable field service reps to remotely assist customers where they can't access the lab due to government restrictions.

In the near term, Agilent's directly contributing to Covid-19 research and testing efforts through offerings like its PCR and automated liquid handling instruments and the consumables that go along with them. Over time, we expect the pandemic will materially accelerate investments in testing and quality control across all end markets from pharma to food safety. And we believe Agilent is very well-positioned to capture this increase in demand for its products and offerings. The other notable result we were impressed with this quarter was the company's improvement and its operating profitability. EBIT margins increased 50 basis points year-over-year despite a modest decline in organic revenue. Margin expansion was really driven by strong expense control and targeted reductions in discretionary SG&A expenses.

We believe Agilent's ability to increase margins in this challenging environment really just goes to highlight the magnitude of its future margin expansion potential. In fact, we think that Covid-19 has provided the company with a timely opportunity to take a closer look at its cost structure and accelerate operational improvements that will lead to more efficient and profitable growth in the future. So we still believe Agilent's current valuation does not fully reflect the company's high-quality business model. It's increasing mix of recurring revenue and robust earnings growth potential. We expect the combination of strong revenue growth and significant margin expansion is going to allow the company to grow earnings per share at a mid-teens annual rate for the foreseeable future driving long-term shareholder value.

William Ackman

Great. Thanks for that update, Bharath. Anthony, why don't you take us through Starbucks? Not often we buy something sell it completely and then have the opportunity to repurchase it again 60-days later. So it's interesting from a trading point of view. Go ahead.

Anthony Massaro

Yes, very much so. Thanks Bill. So the market dislocation in March enabled us to acquire a new investment in Starbucks at an average price of about \$60 per share. This is more than 30% below the average stock price at which we sold our prior investment in the company only two to three months earlier. At \$60 per share, we estimate we were paying a valuation of approximately 19x forward earnings before the impact of coronavirus. Incidentally, this is the same multiple in which we purchased our first investment in Starbucks which ultimately generated a 73% return over our 19 month holding period. As expected, Starbucks has had more severe near-

term sales pressure than our other restaurant holdings. This is really due to three factors. One, broad-based temporary store closures in both the US and China, which the company did proactively.

Two, the breakfast day part which represents about half of sales in the US is more routine driven and is often purchased on the way to work and school and is suffering a bit in the work from home environment. And three, company's products are somewhat of a more discretionary purchase, although coffee consumption itself is very habitual which provides a nice offset to that. Despite a somewhat longer path to recovery, we believe that like Chipotle and QSR, Starbucks will weather the current storm and emerge even stronger than it was before. When the company reported earnings on April 28, CEO, Kevin Johnson, stated that both in the US and China were in the strongest competitive position that we've been in the history of the company.

We believe that this flex in the US the company's leading digital ecosystem which many competitors lack and is now more important than ever before. And in China, we're currently witnessing the ongoing demise of key competitor Luckin and coffee following the discovery of financial fraud at that company. Turning back to the US, Starbucks brand momentum was excellent pre-crisis with same store sales growth between 6% and 7% from January 1st through March 11th excluding leap year benefit. The company transition to a drive-through only model in the second half of March which resulted in peak store closures of 56% of the store base. As the virus has slowed Starbucks has moved from 50% of stores open in late April to over 85% of stores open today. Cafe seating is still largely closed across the country and the company is focused on serving customers through limited contact channels including drive through, mobile order and pay with contact with pickup and delivery.

This model works well in the US as approximately 80% of customer occasions pre-Covid were to go orders. Same store sales for stores that are open have been trending around the 25% decline in both April and May. We expect this will accelerate over the coming months as consumers start to resume their routines, awareness that stores are actually open grows and the company's marketing program which was largely put on hold during the depths of the crisis is now reactivated. The company's other home market China provides a useful roadmap for what the recovery could look like in the US. Given if the virus happened earlier in China, virtually all stores in that country were open as of late March, feeding with social distancing has offered in over 80% of stores there which reflects the fact that 80% of China's sales pre-Covid were consumed on premise, so it's the inverse business mix of the US from an often on-premise perspective.

Same store sales in China for stores that are open have improved materially from down 35% in April to down 20% as of May 21st. We believe the reopening of schools in early May in China was likely a key driver of this improvement as it allowed both parents and students to resume their routines. Starbucks management expects a substantial recovery in China, which they define as a return to positive same-store sales growth by the end of this fiscal year on September 30th with the US to follow in fiscal 2021.

William Ackman

Okay. Great. Again another management team, I think the consistent theme here is that each of the companies we own is well capitalized dominant business with dominant brands, best-in-class technology and the competitive environment in which they're operating, unfortunately for sort of smaller, less well capitalized competitors it has become more favorable for Starbucks. And the same is true for Lowe's, restaurant brands Chipotle, Hilton into the benefit of owning sort of best-in-class dominant companies. With that let's talk about Howard Hughes. Ben, why don't you just update on sort of the quarter pre the events of the crisis sort of taking hold and then I'll cover from there.

Ben Hakim

Great. So Howard Hughes had experienced excellent business progress through the end of last year. And was on its way to the strongest performance ever in the first quarter of 2020 until the onset of pandemic in early March. Land sales across Howard Hughes's master plan communities in Houston and Las Vegas were among the strongest in its history with price per residential acres sold posting growth of nearly 6% in the first quarter across the portfolio. And new home sales increased 24% in the first quarter led by a 41% increase in Bridgeland and 27% increase at Summerlin. In Hawaii, Ward Village continue to experience strong sales momentum, its latest luxury Tower, Victoria Place which recently launched sales in December 2019 was already approximately 65% pre-sold as of the end of March which makes it the fastest selling tower at Ward Village.

Howard Hughes is also nearly fully sold at its other condo towers and has no building deliveries until late 2021 or 2022 which positions them well for the current pandemic. Operating asset NOI grew by 24% in the first quarter which was driven primarily by Howard Hughes's acquisition of the Woodland Towers in portfolio in

Houston. And despite the pandemic and oil price volatility, Howard Hughes was able to execute a 134,000 square foot office lease with Western Midstream in the recently acquired Woodland Towers. The company also made significant progress on its strategic transformation plan announced last October. Importantly, the management team made significant progress on its goal to reduce overhead expenses by \$50 million. They expect to see those reductions materialized over the coming quarters as they complete the corporate office relocation to the Woodlands and Dallas later this year.

And in line with its commitment to dispose non-core assets, Howard Hughes closed on the sale of a built to suit cancer facility which was sold for \$150 million in the quarter. And lastly, the move to a decentralized operating model focused around its core NPCs enabled Howard Hughes to react more nimbly and efficiently to navigate the current environment. Of course, the Covid pandemic began to have a significant impact on Howard Hughes starting in late March. So, Bill, I'll turn it back to you to provide an update on the company's actions since the start of the pandemic.

William Ackman

Sure. So the most significant impact of the crisis in the short term was that Howard Hughes's in the middle of an asset disposal process -- again became a problem but process to kind of focus its capital and it's sort of team under the core NPC business and we actually were in contract negotiations to sell the hotel assets. The three hotels that are in the Woodlands at a very attractive valuation and the contract, indeed, the buyer basically the buyers in that case walked away from those deals and then we had a number of other transactions at various stages of completion that we thought were likely on terms that were favorable to the company. And in light of the crisis those buyers walked away. So one, the prospect of near-term significant asset sales has certainly been pushed out for a number of the company's assets. And some of those assets hotel assets today are certainly not marketable anywhere near what we think the real valuations are for those assets.

So that was a negative from a focus perspective and from a capital raising perspective. The other negative of course is that the company closed its hotels and its retail assets were basically shut down and retail tenants although the collections were actually relatively good compared to others, I think approaching 40% these are assets go from being cash flow positive to fairly quickly cash flow negative assets. Howard Hughes owns property, the other significant asset to be affected was the South Street Seaport which is basically but an entertainment asset with an outdoor concert venue, various restaurants, and it's also under construction that construction was halted as a result of the crisis. So that sits in certainly in a more difficult stage and then of course the crisis itself raised questions about are people going to still buy lots to build, or home builders going to build going to buy lots are more importantly are the home buyers going to buy homes and without that now the company's cash that it generates from lot sale business could come to a halt.

Company also owns a big percentage of assets are in Las Vegas with Las Vegas and casinos shut down, an entertainment driven economy that of course was a concern. And faced with it and then I guess the last point I would make is that the company took on a decent amount of debt in a bridge loan format to acquire the two remaining sort of Anadarko towers in The Woodlands which gave the company kind of strategic control really all of the best assets and best real estate for building new buildings, but unfortunately before the securitized financing for that asset closed, the crisis hit and the company had a bridge loan and outstanding. And as a result of all of that the Board took a very hard look at risk and reward. And the probability of the virus continuing to have a negative effect on the company. And the company decided to raise capital and the only form of capital that was available to company and really the only prudent form of capital in light of everything that's going on was equity capital. And once the Board decide he was going to raise equity, we expressed an interest in participating at which point the company did launch an offering where we purchase \$500 million stock and other investors other shareholders purchased a \$100 million of stock and the offering was structured almost like a rights offering in that the bankers endeavor to contact as many of the shareholders as possible to give them an opportunity to participate in the transaction.

So it's a successful equity raise. It positions the company in a very strong place with a \$1 billion of cash on the balance sheet and really sort of almost no matter what happens over the next couple of years the company is in a very -- is in a strong position to continue its business. I think on the positive side, it appears that people are valuing owning a home perhaps even more than they did pre-crisis and without giving away too many details you can just look at the National Statistics that people are buying homes. The combination of low rates and perhaps being stuck in an apartment or people saying what I'm not going to travel as much same reason why people are investing in their home. And doing a new kitchen, new bathroom, people are actually going out and buying homes. And we're seeing that actually very recently we're seeing a nice rebound at Howard Hughes. And we hope it continues. So we continue to like this company. We think they're doing an excellent job. The most

impacted of every business or each of the businesses we own in the portfolio, but with this improvement in the balance sheet, the company is now very strong and we expect if the country reopens successfully, Las Vegas will come back.

Houston had sort of a double or Black Swan event correlated black swan event. The combination of the global shutdown, a price war kind of the fracturing of OPEC, Russia participants led to negative prices briefly for oil that was kind of a fascinating moment in the oil market, some stabilization that we've seen but oil prices are still down by almost half since the beginning of the year. This puts into question a lot of the shale producers are relatively highly levered. The whole energy space is under a huge amount of stress and of course Houston it's really the energy capital of country. And so that obviously raises some questions. We got a question from a shareholder how do you think about the impact powers using the oil market slump. While acknowledging the cyclical nature of the oil market to what extent do you think this may be a secular permanent bear market for US shale?

The answer there is I'd rather not predict US shale but from the Howard Hughes perspective, I give you a couple data points. One is in the 2016 kind of oil crisis where prices drop to \$20 a barrel, you did see a fair amount of vacancy emerge in the office market in Houston, but then interestingly rents, both rents and occupancy remains stable in The Woodlands. And then Houston, I think has come a long way from the Houston of 20 or 30 years ago. It's a much more diversified economy. And Texas itself has become a highly desirable place for people to move to combination of sort of low taxes or zero to some state taxes and a warmer climate. Houston also has the benefit of being one of the larger ports in the country. It's notable that Tesla has announced that they're considering both a factory and even a headquarter move. And the two states are considering our Las Vegas and Texas where Howard Hughes has the bulk of its assets.

And I think if people lose their job in the energy sector these will be engineers, many engineers freed up to work in other sectors which is why you're seeing an influx of companies to Houston. So we're bullish on Texas. It's continuing to see an influx of population growth companies moving there and the Woodlands and Bridgeland in particular two assets we own are really the kind of communities that people like to live in this environment. A master-planned community with where you can walk to work and you can walk to the retail. You can go to your place of worship. Your kids can ride a bicycle. It's safe. Those are, I think, it's going to be environments that benefit over the long term.

So, yes, Howard Hughes was definitely impaired in terms of its value as a result of the crisis, but the stock price moved from 125 to 50. We thought much more than compensated for not the events of the crisis. Not note, Fannie Freddie, been some significant developments in the last just week, Anthony, if you can do a quick summary there because we're running out of time. And I want to get to some of these other questions, if I can.

Anthony Massaro

Sure. So the most significant development from the GSEs since our April 6 letter was really the re-proposal of Fannie Freddie's capitol rule last week. There's a lot to like in the new rule including lower pro cyclical and a stated focus on ending the conservatorships. The biggest negative is that the required capital ratio has been increased to about 4% of assets and guarantees up from 2.5% previously. We think a 4% level is excessive in light of the business models of Fannie and Freddie which are substantially lower risk now than they were pre global financial crisis. It's important to understand that a higher capital ratio is not free. 4% capital ratio would require a significant increase in guarantee fees to insure a new business is written at an adequate return, which would mean higher mortgage costs for middle-class homeowners.

There's a 60-day comment period on the rule which opens in the next few weeks and then we expect the rule will be finalized by year-end. Another important development this month was the hiring of financial advisors or the announcement of requests for proposals to hire financial advisors for both Fannie and Freddie. This follows the appointment of Houlihan Lokey as Financial Adviser to Fannie and Freddie's regulator FHFA which was announced in February having all the advisors in place is a good further step towards ending the conservatorship and eventually recapitalizing both companies. And then finally we think the Covid-19 crisis has served as a powerful reminder of the importance of raising private capital at Fannie and Freddie. Earnings of both companies declined significantly in Q1 due to pandemic related loan loss provisions highlighting the need for private capital to absorb potential quarterly losses should they occur in the future.

The credit risk transfer market which the companies have relied on quite a bit since the financial crisis is now essentially frozen. The new capital rule appropriately recognizes the superiority of on balance sheet equity capital to these untested instruments, which are typically only written when times are good. And finally Fannie

and Freddie continue to play their counter-cyclical role today in the housing finance market as they have done successfully for decades, including through advancing mortgage-backed security payments on two-thirds of the 12-month forbearance period, which is being offered to borrowers who have been impacted by the crisis, as well as stepping up to guarantee new mortgages as non agency players have stepped back from the market.

William Ackman

Thank you, Anthony. Why don't I just get to some questions? We are approaching 12 o'clock maybe give us a few more minutes if we can cover some of them. With the inability of a strategic review to get a buyer involved is a question of Howard Hughes. How do you think about the IRR on your Howard Hughes investment especially in light of the time needed to monetize this development?

So we do not think that Howard Hughes will be sold or monetized in the future. We think it will remain a public company, a growing concern we now own about 30% of the company. We do this as an investment that we can earn an attractive IRR for a very long term holding period, particularly from this share price question. Can you explain in greater details the cost of maintaining total return swaps versus FERC to taxes, if the IRR of the investments going to be high over time. Surely financing costs do not outweigh the possible capital gains you have to pay.

So for two of our funds are offshore and they are real estate related companies do have to pay FERC related taxes. We held this position initially in the offshore funds in a total return format which cost is effectively a financing cost where the notional amount of the cost is the market, approximate the market value of the position. We're paying a financing cost for the entire position and if FERC attacks are basically equal to the corporate tax on the capital gain we earn when we sell the investment. And if you think about this as a very long dated investment or one you perhaps hold theoretically forever you never pay the FERC to tax. And FERC to taxes also I think there's a decent chance that over time they'll get waived. The US does not want to discourage investment in real estate particularly if we're going to go through a difficult real estate period.

So it was the -- and you pay the tax on a gain versus you pay a financing cost on the market value of the entire position and you can build your own model, but and with your own assumptions but we just felt beyond just the financing the cost difference owning stock, we take no credit risk, no counterparty risk and you have votes which give you influence. We found superior to owning this in a total return swap format.

Hilton, to what extent do you think the crisis may in general changes in consumer and corporate behaviors may affect your portfolio companies? For example Hilton's exposure to business travel in a world where businesses may end up materially reduces the amount of travel and face to face meetings.

So we spent a lot of time thinking about this question vis-à-vis every portfolio company. We addressed it somewhat in our annual letter. I apologize you may hear the loan being on hotel side. But and we do think that there will be an impact on business travel certainly on the margin and how much is at this point unknown. At the same time, I think the experience of all of us working from home working on Zoom is that there are real benefits to in person meeting that cannot be accomplished by video. And you imagine your corporation and you're trying to win a piece of business and your competitor is willing to get on a plane and fly to Singapore and make the case and versus someone says, look, I'll just do a Zoom call. I don't know, if you think about the money management business for example. I don't know how much capital is going to get allocated to a new manager who on a Zoom calls.

In the same way I found it difficult to hire someone by Zoom. I think it's difficult to make an important business decision whether it's committing capital or signing a long-term contract with someone that you have not physically met. So we do think there's a long-term future for business travel. On the consumer side, where we think there's going to be once people feel safe in traveling, we think there will be a very rapid rebound and again assuming people can continue to -- they can continue to afford to travel. I think people will -- the being stuck at home people are dreaming of whatever beach or city they'd love to go visit. And I think as soon as they feel comfortable they're going to do so. And you're seeing some of that in China already with holiday weekends hotels having pretty full occupancy.

QSR. Why do you continue to think 3Gs model of cost control can work an environment which has proved that some cost cannot be cut without damaging impacts on revenue?

QSR is the business here is not being driven by cost control. There was an initial opportunity for in each acquisition that they've done for them to kind of right-size the corporate overhead in of each business, but in

certainly the restaurant brands case they have all these brands or some of these brands for example Burger King was starved for capital. The stores were under invested in and this management team was a catalyst for significant investments in these brands. That's really enabled the turnaround of the company. So we do not think that sort of the criticisms of 3G I think largely relate to their investment in and craft, but we don't think they apply here.

On F2, how do you assess the risk that in case of no settlement the government can essentially convert senior preferred stock into common stock?

I think that's the government already owns 80% of the common stock of these two companies. The incremental value the government gets from converting its preferred stock and kind of diluting itself if you will and wiping out the common shareholder. I don't see much value there to the government and I think the significant litigation risk, and more importantly these companies need to raise private capital and how the common shareholders are treated will affect both of these companies ability to raise capital. And I think the last thing the Treasury secretary, or the Federal Housing Finance Authority is going to do right now is something that's clearly anti shareholder because it's these shareholders that will be part of the refinancing of recapitalization of the companies. Notably, a lot of people, the press tend to write about Fannie and Freddie as being a hedge fund stock but interestingly the largest shareholders are publicly disclosed shareholders of Fannie and Freddie is the Capital Group which is one of the largest mutual fund companies with millions of small shareholders. They own about 10% or maybe a little bit more than 10% of both Fannie and Freddie and it are a real investment.

And I know everyone doesn't like hedge funds but this is Middle America that will get wiped if the government were to do such a thing. Let me take three more minutes of questions. Central plank of your bullish turn on equity markets. Was the US government seemingly finally taking the required action to lock shut down the economy giving their miss handling in the crisis and the best confused messaging since then? Are you still as confident as you were?

So everything we do is probabilistic. It's not sort of confident or not confident but our thesis on unwinding our hedges and reinvesting in the portfolio was driven by a couple things. One the value of the hedge had gone from zero to \$2.6 billion and we believed that the government was taking a series of steps that would reduce meaningfully the corporate credit risk and kind of systemic risk we thought that would cause spreads to narrow. That's why we unwound the hedge at a large profit. And the other reason why we did so is we thought the opportunity cost, if you will, of that capital with stocks trading at with Lowe's trading it whatever it was \$78 a share or something. We felt that was a better use of our money to take money out of a hedge and invest in stocks. And we're -- the companies we own if you think about these businesses, Agilent, the restaurant companies, Lowe's walking our way down the list. Each of them has different degrees of exposure impact from the crisis, but we think they all survive pretty much no matter what happens. And the environment is such that their competitive position, Hilton's competitive position is going to be stronger as a result.

The same thing is really true for pretty much every company in our portfolio. Even Fannie Freddie, the threat of competition to Fannie and Freddie is really that's made -- been made clear that there really is no future for the housing finance system that can survive the inevitable periodic crises other than a well capitalized privatized Fannie and Freddie. So we really think the crisis if anything reinforced the importance and the nature of the principles that we apply, we invest in the market. I want take one more minute.

Once you have made the decision to reinvest, CDS proceeds to the market did you not consider reinvesting in equity such as ADP and Raytheon. What made you UTX? What made you choose for example Howard Hughes over other stocks? We've had a very high-level engagement tool recently.

So we did actually focus on, there are a lot of stocks trading that we looked at like inexpensive prices. We focused our capital on situations that we knew the best. We didn't -- we thought there was a risk that the opportunity to buy would be a very finite opportunity and we therefore focused our analysis and our capital on situations that we could come up to speed with very quickly and those included obviously everything we owned in the existing portfolio plus investments that we had owned recently. And so we, but we made a decision to invest in the companies we invested in based on price, based on our level of confidence in our ability to predict kind of the future outcome for each business. And that's what led us to the portfolio that we currently owned.

We did take actually pretty large stake in a company in the middle of the crisis at prices that look very, very attractive. We ended up selling that investment at about the price we paid as we felt more comfortable reinvesting. We had an opportunity for example to put capital in Howard Hughes at a -- what we believed to be a

very attractive price. And we felt that to be a better risk reward than the position that we sold. Time will tell whether each of these decisions were good decisions.

Anyway I think this was obviously a very good period for Pershing Square. We are excited to have another very strong year on an absolute and on a relative basis. One of our strongest years ever more than 30 percentage points ahead of the S&P year-to-date. And we still like what we own and we still think the stocks are cheap. So with that I will pause and thank you for joining and we look forward to communicating with you, I guess, for the mid year report. Have a nice day. Stay safe. Bye.

End of Q&A

Operator

Thank you, everyone. This concludes your conference call for today. You may now disconnect.