ROCKBRIDGE
CAPITAL MANAGEMENT

July 2024

Dear Friends and Fellow Investors,

Welcome.

Rockbridge Capital Management opened its doors on May 8th, building on more than a third of a century of professional equity management experience. Since then, we have been gratified and even a bit overwhelmed by the favorable response of investors and the investment community to our message: great businesses, great managers, great prices. This initial investor letter describes why Rockbridge exists and what you should expect from us. It is a series of declarations. It is our mission statement.

Any business must answer three existential questions: What, Why and How?[1] Below are Rockbridge Capital Management's responses.

1. What? Rockbridge is an investment management firm.

2. Why? To provide returns that exceed those investors can achieve for themselves by investing in a low-cost, unmanaged index fund.

3. How? Via the construction of concentrated portfolios of publicly-traded equities. Three key components will drive investment decisions: a sustainably high return on invested capital, excellent shareholder-friendly management and a bargain valuation at the time of acquisition.

Let us go deeper into these three criteria. It is difficult for active investment managers to exceed the returns of a broad market index such as the S&P 500 over any meaningful period, which we consider to be 5 years at a minimum. The index return is available to investors essentially for free via index funds, as compared to the 1.0% to 3.0% often charged by active managers. This option means that an active manager who does not generate returns exceeding the S&P 500 subtracts value. It is like paying for cable television when the same programming is available for free. To the extent that the active manager produces returns that are less than the index, he or she has effectively destroyed capital. The consequences of this capital destruction are particularly acute in the case of retirees and not-for-profits that rely on investment returns.

To illustrate, consider the example of an owner of a $500,000 tax-free retirement account who invests over a 20-year period. At the historical stock market average return of about 10%, the owner would have an account balance of $3,363,745 at the end of the 20 years. If the active manager produces an average net return of 9% over this same period, the owner's account balance would be $2,802,205. The return difference of only 1% per year costs the account owner

[1] With thanks to Lou Brown, who introduced us to the "What, Why and How" framework.

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$561,545. Depending on one's circumstances, this difference can drastically alter the options available to the retiree or not-for-profit. Ironically, only the rich can afford mediocre money management, but no one should tolerate it. Plumbers add value. So do electricians and practitioners of most other occupations. Your investment manager should be no exception. We encourage you to ask your existing investment manager if he or she has earned their keep, and if not, a hard conversation should follow.

In short, Rockbridge believes the obvious. Active management is not worth the cost unless it generates above-average returns over the long run. Only a handful of investors, most notably Warren Buffett, have done this. Rockbridge aims to be among them. It is a difficult bogey. According to Standard & Poor's, 88% of all large-cap mutual fund managers underperformed the S&P 500 over the past 15 years.[2] Rockbridge's chief measure of success will be its record of net returns compared to the broad market over rolling five-year periods. The entire firm is organized around this objective. Rockbridge will not be driven by the size of assets under management. That is not to say we do not seek growth, for we do, but Rockbridge believes that the best path to growth is to compound *existing* capital at above-average rates.

Rockbridge's Investment Philosophy

Rockbridge was founded on the simple belief that inherently superior businesses run by honest, competent managers and capital allocators will compound at above-average rates. Purchased at a bargain price, such businesses will create wealth at above-market rates over the long-term.

Terms such as "inherently superior" are fuzzy, so we will use our investment in Copart as an example to help define the concept. Copart auctions salvaged automobiles that have been declared a total loss. Copart takes a fee from the auction proceeds and the balance is paid to the insurer. Heavily damaged vehicles may be sold to dismantlers or for scrap but more often, vehicles are drivable or can be restored by refurbishers to roadworthiness. Essentially, Copart recycles totaled automobiles.

The company thinks in 20-year terms, unlike most publicly traded companies who are thinking about the next quarter's earnings. For instance, to support its insurance company customers, Copart has accumulated more than 200 storage facilities (yards) around the country since its founding in the 1980s. Copart made the critical decision decades ago to absorb the short-term pain of buying instead of leasing its locations. Its main competitor did the opposite. That competitor has experienced rent increases and lease terminations, especially when exurbs have encroached upon a salvage yard that today might be better suited for redevelopment. This permanent advantage means that without lifting a finger, Copart grows stronger day by day, and its competition gets weaker.

Copart also had the foresight to invent the online auction market for salvage vehicles, which allows buyers to transact from their computer screen or mobile device instead of strolling through lanes of cars at physical locations. Online auctions expose Copart's inventory to more buyers, and the surge of new buyers has benefited the selling insurance companies by driving prices upward. In financial terms, Copart has created greater liquidity for buyers and sellers, a

[2] Source: S&P Dow Jones Indices

true "two-sided market." In the meantime, Copart has kept vehicles off the scrap pile by lengthening their service lives, which is good for the planet.

Copart has net profit margins in the 30%+ range and returns on invested capital in the high teens and low 20% range. These are multiples of the average S&P 500 company and more resemble a software business than one anchored by 200 yards full of salvage vehicles. The balance sheet is awash in cash. Importantly, the enormous cash flow generated by the business is reinvested for the long term by extraordinarily gifted managers and capital allocators.[3] Copart's business model, its capable and long term oriented management, and an unassailable business franchise add up to a multi-year, possibly multi-decade, compounding opportunity.

The Market

It is impossible to predict where the market is going to go but it is possible to know where the market is, and the market is high based on the outlook for earnings. The economy appears healthy, but prices for the businesses with the qualities we seek are indisputably high, making it hard to put cash to work. Thankfully, cash earns about 5%. Rapidly rising valuations for a narrow group of large technology businesses concentrated in the artificial intelligence world have dragged the entire market skyward. Rockbridge is an accidental but significant beneficiary through its long-standing investments in Microsoft and Amazon. Outside of the technology sector, returns have been far more modest.

Trying to predict the market impact of the historically unsettled domestic political environment is a fool's errand so we will not try. Elections do impact tax and spending policies, which have identifiable results, so we focus our attention there. We also monitor our businesses for the effects of onshoring, the retreat from globalization, the rise of authoritarianism, warfare and climate change.

Investor Service

Rockbridge further believes that best-in-class client service and a completely trustworthy staff are "table stakes" – that is, they are to be assumed. We cannot guarantee investment results, but service levels are within our control, so expect the best. If you experience anything less, please let us know.

Who We Are

Rockbridge has assembled an experienced, highly talented and equally motivated staff. Look to see it expand in the coming months. We are all here to serve.

Peter Keefe graduated from Washington and Lee University and sat on its Board of Trustees from 2006 until 2013. He worked for the New York Stock Exchange member firm Johnston, Lemon & Co., Incorporated from 1980 until1991, lastly as its Director of Research. From 1991 until 2024, he was employed by Avenir Corporation, a Washington, D.C.–area investment management firm, most recently as its Executive Chairman.

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[3] The fascinating history of Copart is told in *Junk to Gold: From Salvage to the World's Largest Online Auto Auction,* written by Willis Johnson, Copart's founder.

Dennis Kelly is Rockbridge's Chief Financial Officer and Chief Operating Officer. He served as Executive Vice President of a transactions company overseeing commercial office and hospitality assets and as General Manager of a division of a nationwide financial services firm. In government service, he directed multi-million-dollar Army Information Technology acquisition projects. Dennis holds a BA from Virginia Tech, an MA from Catholic University, and is a Certified Management Consultant emeritus. He is a life member of the American Association of Individual Investors and the Association of the Army of the United States.

Quinten Petro is a Portfolio Administrator and Research Analyst at Rockbridge. He graduated from James Madison University in 2020. He has four years of experience in the financial services industry including Morgan Stanley, Nithio, a D.C. based fintech startup, and The Edgar Lomax Company, an Alexandria, Virginia-based investment management firm. He is a CFA Level II candidate.

In closing

You have entrusted your irreplaceable capital to our care. We will never forget whose money it is. Rockbridge is a financial institution, but its purpose is to add value to the lives and missions of the people and institutions we serve. We look forward to many years of successful compounding and thank you for joining us on this journey. Please stay in touch. We want to hear from you.

Best regards,

Peter C. Keefe

Rockbridge Capital Management takes its name from the Virginia county of the same name, home to the Natural Bridge of Virginia, a 200 foot high bridge of rock carved by Cedar Creek. It was once owned by Thomas Jefferson, who referred to it as "the most Sublime of nature's works."

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