



# Investment Manager's Report

## LETTER TO SHAREHOLDERS

### To the Shareholders of Pershing Square Holdings, Ltd.:

2019 was an extraordinary year for PSH. We generated our best NAV returns in Pershing Square Capital Management, L.P.'s 16-year history with a total NAV return including dividends of 58.1%, and a total stock price return of 51.2%.<sup>5</sup> 2019 was also an excellent year for our portfolio companies as their operating and business progress largely kept pace with their stock price returns. We made two new investments, Agilent and Berkshire Hathaway, and exited three positions. We incurred no mark-to-market or realized losses on any of our holdings in 2019, a first for Pershing Square.

We continued to make progress after the turn of the year. In advance of recent market declines, in January we sold our stake in Starbucks as it approached our estimate of intrinsic value. In February, we sold a third of our stake in Chipotle in order to reduce what had become an outsized position. At the time of sale, Chipotle represented more than 20% of the portfolio due to the company's substantial business progress and strong share price appreciation.

Earlier this year, we were sufficiently concerned about the health and economic implications of the coronavirus that we considered, for the first time ever, liquidating the portfolio in its entirety because we believed it was likely that markets would decline materially. After a careful review of the portfolio, we concluded that a hedging strategy was more consistent with our long-term ownership philosophy, and would likely lead to a better long-term outcome than selling off all of our assets. To mitigate coronavirus risk, in late February, we entered into a series of large hedging transactions in the credit default swap market that have offset the substantial stock price declines of our investment holdings in the recent market downdraft.

After the initial market decline, we unwound our credit hedges and redeployed a substantial majority of capital by adding to existing investments including Restaurant Brands, Lowe's, Hilton, and Berkshire Hathaway, and by investing \$500 million (\$432 million from PSH) in a secondary share offering by Howard Hughes. We also re-established a position in Starbucks. PSH has approximately 18% of the portfolio in free cash, and we are continuing to look for only the most extraordinary opportunities.

We believe that our success in 2019 was driven by a series of organizational and investment-related changes we implemented in late 2017. In sum, we focused our investment strategy on the core principles that have driven our high rates of return since the inception of Pershing Square, and restructured the organization to an investment-centric operation without the attendant requirements to continually raise capital. Today, 85% of our total assets – approximately \$7.2 billion out of \$8.5 billion – is represented by Pershing Square Holdings.<sup>6</sup> Our competition is principally comprised of passive investors, and active investors with impermanent capital. Our greater capital stability is an important structural competitive advantage for our long-term investment strategy that should enable us to generate high risk-adjusted returns over the long term.

While we continue to manage two private funds for long-term investors of the firm, we are no longer actively raising capital for these vehicles. As a result, we are now able to operate with greater focus and substantially improved productivity. In addition, we moved last May from hedge-fund central in midtown Manhattan to our new office at 787 Eleventh Avenue, on the far west side in a neighborhood known as Hell's Kitchen. Without marketing or investor relations responsibilities, the investment team's resources are now entirely dedicated to investment analysis, selection, monitoring, and portfolio management.



During the year, PSH engaged in a series of corporate transactions including the initiation of a quarterly ten-cent dividend, the launch of a series of buyback programs totaling \$300 million, and the issuance of a 20-year bond (callable beginning in year 10 and at par by year 15). Since the inception of PSH's buyback program on May 2, 2017, PSH has acquired \$650 million of its shares representing 17.7% of initial shares outstanding.<sup>7</sup> We continue to believe that PSH is undervalued at current market prices and NAV discount levels, and we have substantial available free cash. We have therefore continued to opportunistically buy back shares.

During 2019 and after year end, affiliates of the Investment Manager continued to acquire additional shares of PSH. Unlike many other closed ended funds where the investment manager has only a *de minimis* investment, in PSH, the manager is by far the largest investor. We now own more than 22% of the fully diluted shares outstanding, representing \$1.28 billion of PSH's equity.<sup>8</sup> Our large ownership stake in PSH materially improves the manager's alignment of interests with other shareholders, particularly when compared with other investment funds.

As a result of the incentive fee, we receive a larger percentage of the profits than other shareholders to compensate us for managing the portfolio. Many critics of incentive fees argue that they give investment managers an incentive to take excessive risk because if a fund is profitable, the manager receives a fee, but if the fund loses money, the manager can walk away without personal losses. In other words, if the manager does not have a substantial ownership stake in the fund, the incentive fee can be considered a free, or nearly free, option which increases the incentive to take risk because options become more valuable with increased volatility.

At PSH, the fact that affiliates of the manager own more than 22% of shares outstanding minimizes the incentive for the manager to take excessive risks, as losses are borne proportionately by the manager with other investors. In other words, the risk of loss and opportunity for gain of our large shareholding overwhelm the option value of the incentive fee. Furthermore, in our case, our PSH ownership is a disproportionately larger percentage of our net worths than for nearly all of our unaffiliated shareholders, so our principal incentive is to protect PSH from permanent losses, and then to maximize long-term profits.

## Coronavirus

It would be inappropriate to write about the investment implications of the coronavirus without first acknowledging the severe health implications and tragic loss of life that we are all experiencing in our own neighborhoods, nations, and around the globe. It was in fact our initial focus on the health risks of the virus that led to our decision to deploy a hedging strategy to protect PSH's investment portfolio. Health and wealth are highly correlated, and we therefore must solve this global health crisis in order for global GDP to grow, and for job and wealth creation to occur.

We have previously summarized our thoughts on the coronavirus and our hedging strategy in a series of communications beginning on March 3rd ([Link](#)) when we disclosed that we had entered into hedging transactions, on March 9th ([Link](#)) when we disclosed the positive effect of the hedges on NAV, and on March 25th ([Link](#)) and March 26th ([Link](#)) when we provided detailed information about the unwinding of our hedges, and the reinvestment of capital in our portfolio and in certain new investments. Rather than repeat our coronavirus analysis in detail again here, I provide a short summary and then elaborate on the portfolio-specific implications of the virus.

On March 3, 2020, we disclosed in a press release that we had acquired large notional hedges which had asymmetric payoff characteristics. We did so because of our concern about the likely negative effect of the coronavirus on the U.S. and global economy, and on equity and credit markets. Our hedges were in the form of the purchase of credit default swaps (CDS) on the U.S. investment grade and high yield credit indices, and the European investment grade credit index.



After we purchased these hedges, U.S. and global equity and credit markets declined dramatically, and our hedges increased in value from zero to a peak of \$2.7 billion (in PSH \$2.3 billion).<sup>9</sup> At this value, our hedges were worth approximately 40% of our total capital as our equity investments declined substantially over the same period.

The risk of remaining short credit versus the potential rewards became less attractive as the hedges increased in value. Furthermore, the opportunity cost of this capital increased as the proceeds from the hedges could be reinvested in our portfolio companies and other new opportunities at highly discounted valuations.

As various U.S. state, city and local governments began to aggressively confront the health and economic risks of the coronavirus through unprecedented non-essential business closures and shelter-in-place/stay-at-home implementations or “lockdowns,” we believed that our worst case fears would not be realized.

The U.S. federal government and the U.S. Treasury have also intervened in financial markets in an unprecedented fashion, and Congress has passed legislation which will help bridge the economy and our country’s workforce and citizens during what we believe to be a temporary but massive and extremely painful economic shock. We have been encouraged by the Treasury Secretary’s and the Administration’s all-in approach to mitigating the damage to the capital markets, and for keeping financial markets functioning and open, which are critical for our economy and capitalism to work.

For all of the above reasons, as we became increasingly positive on equity and credit markets, beginning on March 12th and entirely on March 23rd, we completed the exit of our hedges which generated total proceeds of \$2.6 billion for the Pershing Square funds (\$2.1 billion for PSH), compared with premiums paid and commissions totaling \$27 million. These gains offset a similar amount of mark-to-market losses in our equity portfolio.

We have redeployed the substantial majority of our net proceeds from these hedges by adding to our investments in Agilent, Berkshire Hathaway, Hilton, Lowe’s, Howard Hughes, Restaurant Brands, and by repurchasing our stake in Starbucks. We have done so at deeply discounted prices and now own substantially larger stakes in each company. Even after these additional investments, we maintain a cash position of about 18% of the portfolio.

In summary, as a result of the reinvestment of the proceeds from our hedging transactions, we have four percentage points more cash (free cash before the decline was equal to 14% of the portfolio), and we have increased our stakes in Agilent by 16%, Berkshire Hathaway by 39%, Hilton by 34%, Howard Hughes by 158%, Lowe’s by 46%, and Restaurant Brands by 26%. We have also reestablished a 10% of capital position in Starbucks. If our portfolio companies grow in value and their stock prices increase over the long term as we expect, the long-term returns for PSH will be substantially greater than before as a result of the reinvestment of the proceeds from the hedging transactions.

You might ask whether it was prudent for us to have unwound hedges and reinvested capital without knowing whether equity markets had bottomed. We of course do not know whether the recent lows that have been achieved will be breached by further market declines. Our decision to unwind our hedges was driven by the less favorable risk-reward ratio offered by our credit hedges as spreads widened, and the much more favorable risk-reward ratio presented by the then-trading values of companies in which we bought shares. At the prices paid and based on our estimates of the long-term cash flows these businesses will generate, we believe our recent acquisitions will generate very high rates of return over a multi-year holding period. If stock prices decline further, the returns we could have earned by waiting to invest capital would be even higher. We have kept substantial cash on hand to allow us to buy more at lower prices if markets decline further.



In our experience, it is difficult for a large investor to buy stocks while markets are recovering as liquidity is generally limited when markets rise rapidly. It would not be a surprise to see a rapid recovery in the stock market when investors have greater confidence that the risks of the virus are largely behind us. We have therefore chosen to be a substantial buyer as markets have declined. While it is difficult to predict when markets will make a full recovery, we believe that the factors for a stock market recovery are coming into view. Namely, nearly the entire country and much of the world are essentially in lockdown, which implies that the number of cases and resulting deaths should peak over the next several months. This combined with the availability of cheaper and faster testing will enable many employees to go back to work allowing the U.S. and other countries to begin an economic recovery.

We are not, however, predicting a V-shaped recovery as it will be sometime before the virus' impact can be eliminated, and the required social distancing and other virus-safe behavioral requirements will somewhat restrain the global economy. Furthermore, the psychological and financial impact of the economic shock we are currently experiencing will likely cause many consumers to be hesitant about opening their wallets until the passage of time heals memories of this challenging time, and corporate and consumer balance sheets are repaired.

To share a note of optimism, the enormous economic and reputational incentives to discover therapeutic cures, more accurate, faster and cheaper testing, and a vaccine are driving scientists, technologists, corporations, governments and academic and research institutions around the globe to work toward a solution to our global malaise. This increases the likelihood that we may be positively surprised with a faster than expected cure or other mitigants to the virus and its negative health and economic effects.

It is important to be reminded that the value of a business is the present value of the cash it generates over its life. While many investors and market commentators use the heuristic of assigning a price-earnings multiple to analyst estimates of next year's earnings, this simplistic approach is not valid for the current environment, as the next 12 months of earnings are not representative of the true long-term earnings power of most companies.

The revenues and earnings for the majority of businesses over the next year or so will be extremely poor, and in some cases disastrous, but for companies with strong balance sheets, dominant market positions, and which do not need access to capital, the virus will likely only disrupt the next 12 to 24 months of cash flows. In a discounted cash flow valuation of a company, the loss or disruption of the first, and possibly second, year of cash flows, does not generally destroy more than 5% to 10% of the value of the business. The fact that many stocks have declined by 30% to 60% or more from levels that did not appear to be overvalued suggests that there are many compelling bargains in the equity markets. We discuss some of these opportunities in our portfolio below.

### **The Impact of Coronavirus on our Portfolio Companies**

The important question is what impact will the virus have on our portfolio companies? We are fortunate to own businesses that are designed to withstand the test of time. Our strategy of investing in simple, predictable, free-cash-flow-generative, conservatively financed companies with limited exposure to extrinsic factors we cannot control should serve us well in the current, highly stressed environment. Importantly, our portfolio companies are generally considered essential businesses, and for the most part will remain open to the extent possible during a state and/or a national shutdown. All of our portfolio companies, however, will be affected to varying degrees in the short term by the virus' impact on the global economy. Below, we share a few observations on the short- and long-term impact of the crisis on each of our companies.



As a provider of testing equipment for labs around the globe, **Agilent** is well positioned to benefit from increasing investments in healthcare, safety-related testing, pharmaceuticals, and other industries where highly accurate testing is essential for environmental, safety, product design, quality control, and other reasons. In the short term, Agilent will be affected somewhat by the recent closure of university labs, generally lower global business activity, and the impact of lower energy prices on a small portion of the company's customer base. In sum, we believe the net impact of the virus on Agilent's long-term intrinsic value to be minimal.

**Berkshire Hathaway** was built by Warren Buffett to withstand a global economic shock like this one. With more than \$120 billion of free cash available for investment, Berkshire is well positioned to deploy capital opportunistically. Pandemics are generally excluded from insurance policies, and we believe that Berkshire's insurance operations have limited exposure to the coronavirus. Berkshire is also highly advantaged in being able to invest its insurance company capital in equities when compared with other insurers who are generally limited to fixed income investments where there is little yield to be found.

Berkshire's privately owned portfolio of industrial and other businesses will absorb some short-term economic impact from the virus. In light of Berkshire's extraordinarily strong financial position and the nature of the portfolio companies it owns, we believe that Berkshire will not be materially negatively impacted as a result of the crisis. Rather, we believe that Berkshire will emerge from this crisis as a more valuable enterprise as the market decline will enable it to invest a substantial portion of its cash in investments which will accelerate its long-term growth in intrinsic value.

We believe that restaurants that have easy-to-use digital ordering, delivery, and drive-thru will emerge stronger from this crisis, as their customers will become more accustomed to ordering home delivery on the company's mobile apps, and using the drive-thru or digital order ahead for takeout orders (including Chipotlanes). While we expect that **Chipotle** – the **Restaurant Brands** concepts of Burger King, Popeye's and Tim Horton's – as well as **Starbucks** will lose a substantial amount of sales during shutdowns, they will likely gain digital and delivery market share during this period, and will thereby emerge stronger from the crisis.

Chipotle's burrito and bowl offerings are ideally suited for delivery, and offer families a healthy alternative to cooking at home. We expect Chipotle's superb digital delivery offering should benefit as its customers order home delivery of the company's low-priced, healthy, high quality food. For Restaurant Brands' concepts, drive-thru, pickup and delivery represent about two-thirds of sales suggesting that they are well positioned to provide low-cost food in the current environment. Starbucks' superb digital offering, delivery, and no-touch pick up are well adapted to service its consumers' global coffee habit, particularly when compared with competitors who have not built digital and delivery offerings.

**Lowe's** should also emerge stronger following the crisis as it has the capital structure and cash flows to withstand any short-term negative impact on its business. As consumers spend more time in their homes, they have historically shown a greater propensity to do repair and other home-related upgrades for which Lowe's will be a beneficiary. As a provider of cleaning supplies, masks, goggles, protective equipment and clothing, and appliances, Lowe's is also an important supplier of crisis-related items. We expect Lowe's to emerge a stronger, more dominant and more profitable company after the crisis.

**Fannie Mae** and **Freddie Mac** have already proven themselves essential to the U.S. housing finance system, which is a critically important bulwark for the U.S. economy. The current disarray in the non-agency residential and rental housing mortgage market, which has recently occurred as a result of the crisis, will remind the Congress and the American people



of the critically important function that Fannie and Freddie perform during periods of economic stress. The crisis has also made manifestly clear the need to recapitalize Fannie and Freddie so that the private sector becomes the first loss capital in the housing finance system, which should provide even greater urgency for a recapitalization and privatization of the two companies. While we wait for the necessary steps for this to occur, both companies are quickly rebuilding needed capital through retained earnings. For these reasons, we believe that Fannie and Freddie will emerge as even stronger and more essential enterprises after the crisis.

**The Howard Hughes Corporation** has significant short-term exposure to the crisis. In particular, the decline in oil prices will negatively impact Houston, the location of the Woodlands and Bridgelands, two of HHC's master-planned communities. HHC's Summerlin master plan community will also be affected by the virus' impact on the casino and conference business in Las Vegas. The company's other assets will also be impacted to varying degrees. In order to mitigate these risks, on Friday, March 27th, HHC completed a \$600 million equity offering, the first such equity offering of any company since the crisis began. HHC was able to complete the offering as a result of a \$500 million investment from Pershing Square (\$432 million from PSH) and \$100 million from other long-term oriented shareholders.

The independent directors of HHC made a decision to raise capital to ensure the company would maintain a fortress balance sheet, now with more than \$1 billion of cash, in light of the potential short- to intermediate-term impact of the crisis on the company's business. We believe that HHC will continue to create substantial long-term value for its shareholders, and that its portfolio of small cities with large population inflows will remain highly desirable places to live and work. We therefore viewed the opportunity to increase our investment to approximately 30% of the company to be highly attractive at the current share price.<sup>10</sup> While there is more short-term risk to HHC's business, we believe that this risk is more than compensated for by the opportunity to invest capital at the current valuation.

The hotel industry and **Hilton** have been highly impacted by the crisis as many hotels have closed or are experiencing very large declines in occupancy. As a result, we expect Hilton's revenues to decline over the next several or more quarters, and to begin to recover with increases in economic activity as the global economy reopens. After adjusting Hilton's intrinsic value for the impact on our valuation from reduced revenues and cash flows, we continue to believe that Hilton stock is highly attractive at current valuations. We also believe that the crisis will cause independent hotels to seek an affiliation with global brands like Hilton, which will contribute to the company's long-term growth. Hilton is well positioned to succeed because it has the best management team in the industry, a portfolio of great brands, a dominant market position, a capital-light economic model, and a strong balance sheet.

In all of our portfolio companies, we are fortunate in their being led by superb management teams who have the skills, leadership qualities, and adaptability to manage through these challenging times. We are extraordinarily grateful for their leadership.

We continue to expect that markets (and our performance) will remain volatile, and therefore, new opportunities may present themselves that are superior to investments we currently own. This may lead us to sell certain of our existing holdings including investments we recently purchased. We may also choose to reestablish similar or different forms of hedges or raise or deploy more cash based on developments with the coronavirus and other market factors. In other words, we are more likely to change our investment positioning and/or have higher portfolio turnover in this environment than we typically do.



We are in one of the most challenging periods of time for our country, and for the world. Tens of thousands of people have or will soon become severely sick, and many will die. Millions will lose jobs and struggle to regain employment. This is a global tragedy that could have been prevented with better long-term planning, which should have begun more than a decade ago. I have always said that experience is making mistakes and learning from them. And learn from this we must.

We are all incredibly fortunate to work alongside a superb team of talented, motivated, extremely high-quality human beings at Pershing Square. The recent market turmoil when combined with our transition to working from home would be a challenge to any company. I am proud to say that every team at Pershing Square rose to the challenge enabling us to flawlessly execute during this challenging period.

Thank you for your long-term commitment to Pershing Square. We are honored and fortunate to manage capital on behalf of investors who have committed to us for the long term.

Sincerely,

William A. Ackman



## 2019 PORTFOLIO UPDATE

### Performance Attribution

Below are the contributors and detractors to gross performance of the portfolio of the Company for 2019 and year-to-date 2020<sup>(1)</sup>.

January 1, 2019 – December 31, 2019		January 1, 2020 – March 31, 2020	
Chipotle Mexican Grill, Inc.	14.7 %	Index CDS (Hedge)	37.7 %
Hilton Worldwide Holdings Inc.	9.0 %	Starbucks Corporation	1.0 %
Starbucks Corporation	5.7 %	Share Buyback Accretion	0.8 %
Lowe's Companies Inc.	5.3 %	Bond Interest Expense	(0.3)%
Restaurant Brands International Inc.	4.5 %	Agilent Technologies Inc.	(2.0)%
Federal National Mortgage Association	4.5 %	Federal Home Loan Mortgage Corporation	(2.2)%
Automatic Data Processing, Inc.	4.4 %	Berkshire Hathaway Inc.	(2.4)%
Federal Home Loan Mortgage Corporation	2.7 %	Chipotle Mexican Grill, Inc.	(2.9)%
The Howard Hughes Corporation	2.6 %	Federal National Mortgage Association	(3.1)%
United Technologies Corporation	2.4 %	Lowe's Companies Inc.	(3.9)%
Agilent Technologies Inc.	2.1 %	Restaurant Brands International Inc.	(5.0)%
Berkshire Hathaway Inc.	1.9 %	Hilton Worldwide Holdings Inc.	(6.5)%
Share Buyback Accretion	1.9 %	The Howard Hughes Corporation	(7.2)%
Platform Specialty Products Corporation	1.0 %	All Other Positions and Other Income and Expense	0.3 %
Other Income and Expense	0.2 %		
Bond Interest Expense	(1.8)%		
<b>Net Contributors and Detractors</b>	<b>61.1 %</b>	<b>Net Contributors and Detractors</b>	<b>4.3 %</b>

Positions with contributions or detractions to performance of 50 basis points or more are listed above separately, while positions with contributions or detractions to performance of less than 50 basis points are aggregated, except for accretion and bond interest expense. Past performance is not a guarantee of future results. All investments involve risk, including the loss of principal. Please see accompanying endnotes and important disclaimers on pages 95-97.

In this year's portfolio update, we report on the business progress made by our portfolio companies in 2019. In the Investment Manager's letter, we have previously summarized the impact of the coronavirus on these companies, and therefore do not do so again below.

### Agilent ("A")

In 2019, PSH initiated an investment in Agilent, a leading analytical measurement and testing company. Agilent is a high-quality business with a strong competitive position in an attractive industry experiencing long-term secular growth. Agilent primarily sells chromatography and mass spectrometry instruments and the associated consumables and aftermarket services. Agilent's products and services enable mission-critical measurement and testing activities across a diversified set of end markets, including pharmaceuticals, chemicals, energy, food safety, environmental testing, and forensics.



Agilent operates with an advantaged “razor/razor blade” business model whereby profitable instrument sales enlarge the company’s installed base and drive recurring sales of highly profitable consumables and services. Recurring revenue from consumables and services have historically grown at about double the rate of instrument sales, and now comprise nearly 60% of the company’s total revenues.

The growth and stability of Agilent’s recurring revenue has allowed the company to generate annual organic revenue growth of 6% over the last decade with its worst year revenue decline of 2% in the 2009 financial crisis. Agilent’s future growth prospects remain strong as increasing regulatory standards and heightened consumer expectations drive further demand for analytical measurement and testing. As Agilent continues to increase the attachment rate of its consumables and services, recurring revenues will become an increasing percentage of overall revenues, as their growth rate is higher than instrument sales. Over time, we expect that Agilent will become an even more annuity-like, faster-growing business.

Since 2014, when Agilent spun off its more cyclical electronic measurement and testing business and appointed Mike McMullen as CEO, the company has generated 6% annual organic revenue growth while increasing profit margins by more than five percentage points, and delivering annual EPS growth of 15%. Despite this progress, Agilent’s current 26% EBITDA margins are approximately nine percentage points lower than its closest peer, Waters Corp., despite having a revenue base more than twice as large. Agilent’s lower EBITDA margins reflect lower gross profit margins, slightly higher R&D, and significantly higher overhead expenses. Given Agilent’s meaningful scale advantage, we believe that the company should be able to more than close the margin gap with Waters.

In 2019, Agilent’s organic revenue grew 5% due to 10% growth in its recurring consumables and services business, its highest level of growth since the spinoff over five years ago. The company’s instrument business declined 1% due primarily to weakness in China, where government-led initiatives that are aimed at broadening access to generic pharmaceutical drugs and transitioning to a more scalable model for food safety testing, have led to a temporary deferral of instrument purchases. Although instrument sales may remain soft in the near-term, these Chinese government initiatives are likely to ultimately result in a significant increase in demand for Agilent’s products and services over time, and further accelerate the company’s revenue growth from current levels.

For the year, Agilent’s operating profit grew 9% as margins increased 80 basis points due to an impressive 300 basis points of margin expansion in the consumables and services business. Earnings per share increased by 11%.

Agilent’s current valuation does not reflect the company’s high-quality business model, increasing mix of recurring revenue, strong long-term growth potential, and significant margin expansion opportunity. We believe the combination of Agilent’s strong growth potential, significant margin expansion opportunity, and lower tax rate will allow the company to grow earnings per share at a mid-to-high teens annual rate for the foreseeable future driving long-term shareholder value.

### Chipotle Mexican Grill (“CMG”)

Chipotle achieved outstanding operating performance in 2019 due to the successful business transformation led by CEO Brian Niccol and his team. Same-store sales grew 11%, with 7% transaction growth. Each quarter sales grew faster than the previous one on both a one-year and two-year basis. Chipotle’s digital business nearly doubled from 2018 levels, and now accounts for 20% of sales as customers increasingly choose to access Chipotle through order-ahead pickup and delivery. The successful launches of Lifestyle Bowl salads in January, the Chipotle Rewards loyalty program in March, and the carne asada limited time offering in September fueled sales momentum throughout the year.



Robust sales growth drove substantial operating leverage, highlighting the strength of Chipotle's economic model. Restaurant margins expanded 1.8 percentage points in 2019 to 20.5%, while average restaurant sales grew 10% to \$2.2 million. Management estimates that restaurant margins will reach 25% or more once average restaurant sales return to peak historical levels of \$2.5 million, a sales level previously attained with no meaningful contribution from digital orders.

Chipotle has an extensive pipeline of initiatives to drive continued momentum in 2020 and beyond. Management plans to introduce a few new menu items each year, including queso blanco which was launched nationwide on February 27 following strong customer feedback in test markets. The company's Chipotlane digital drive-thru channel will be installed in most newly opened restaurants, which should further enhance the company's high returns on capital and new-unit productivity. The company's loyalty program will also be a major focus for 2020, including the buildout of database marketing and personalization capabilities. We are confident that management will continue to execute on Chipotle's substantial unrealized growth potential for many years to come.

### **Restaurant Brands International (“QSR”)**

QSR's strong performance in 2019 continued to demonstrate the attractiveness of its high-quality, royalty-based franchised business model. Its three brands – Burger King, Tim Hortons and Popeyes – all have significant long-term growth potential. QSR's unique business model has allowed it to capitalize on its underlying brands' growth with minimal capital investment. The company grew total net units by 5%, with 6% growth at Burger King, 2% at Tim Hortons, and 7% at Popeyes. While same-store sales declined slightly at Tim Hortons, they increased by 3% at Burger King and 12% at Popeyes. QSR's strong overall performance led to 7% organic EBITDA growth in 2019.

Burger King's strong performance was bolstered by the launch of the Impossible Whopper and the continued expansion of delivery. Popeyes' strong results were driven by the launch of its iconic chicken sandwich, which is now considered one of the most successful product launches in the industry's history. Tim Hortons' results suffered during the year partly due to the launch of Tims Rewards, its loyalty program, which resulted in a headwind for same-store sales, as the negative impact from rewards redemptions more than offset the growth in incremental customer transactions. Management recently made improvements to the loyalty program that should moderate the program's negative impact on same-store sales. The company is working on several new initiatives to return the brand to its historical levels of growth.

### **Lowe's Companies (“LOW”)**

Lowe's is a high-quality business with significant long-term earnings growth potential. We initiated our investment in Lowe's in mid-2018 because we believed a new high-caliber management team would be able to narrow the performance gap with Home Depot that had materialized over the preceding decade. In late 2018, Lowe's outlined a credible plan to turn around the company, which we expect will improve margins and accelerate same-store sales growth.

In 2019, Lowe's began to lay the foundation for its multi-year transformation by working to reestablish best-in-class retail fundamentals including improved customer service and product merchandising, reduced structural costs and labor efficiencies, modernized technology systems, and expanded distribution capabilities. While significant progress was made in 2019, Lowe's experienced issues related to legacy pricing systems which pressured gross margins in 2019. 2019 U.S. same-store sales grew 3% and earnings-per-share grew 12%.

2020 will see Lowe's shift its attention from basic retail fundamentals to more strategic initiatives including improving omnichannel capabilities and investing behind the Pro customer (the professional tradesmen that perform repair and maintenance, remodeling and construction services for others). Lowe's will also be re-platforming its decade-old ecommerce platform in the coming months, which, when complete, will dramatically enhance functionality and the overall user experience, accelerating sales growth.



We believe that Lowe's is well positioned for the future given the critical function it fulfills in the retail ecosystem, its conservatively financed balance sheet, and significant cash flow generation.

### **Hilton Worldwide Holdings Inc. ("HLT")**

Hilton is a high-quality, asset light, high-margin business with significant long-term growth potential led by a superb management team. We invested in Hilton because we believe Hilton has a unique value proposition which allows the business to sustain attractive high-single-digit, top-line growth, which, coupled with cost-control and a robust share repurchase program, should allow it to compound earnings per share at a mid-teens growth rate over the long-term. We believe this was underappreciated by the market at the time we made our investment in 2018.

Hilton delivered strong business performance in 2019. With only 1% systemwide comparable sales growth ("RevPAR"), franchise, licensing and management revenue grew 8%, and earnings increased 14%. This performance was driven by robust net unit growth of 7%, and significant share repurchases, highlighting Hilton's unique ability to grow earnings and generate substantial free cash flow even in a softer lodging environment. At the end of 2019, Hilton's development pipeline consisted of over 387,000 rooms in 116 countries, half of which are under construction (amounting to 40% of its existing room base), which should provide a continued runway for net unit growth over the coming years.

### **Berkshire Hathaway ("BRK.B")**

Berkshire was one of PSH's two new investments in 2019. As long admirers of the company, we took advantage of the opportunity to invest at a valuation which represents one of its widest discounts to intrinsic value in many years. Berkshire's discounted valuation, large excess cash balances, and substantial margin opportunities at several key operating subsidiaries provided an attractive investment opportunity.

Berkshire's primary asset, the world's largest insurance business representing roughly half of the company's value, performed well in 2019. Berkshire's float (the net premiums received held on Berkshire's balance sheet that will be used to pay for expected losses in the future) grew at a 5% rate. Its insurance operations generated an underwriting profit (i.e. a negative cost of float), and net tangible book value grew by 45% driven by appreciation in Berkshire's investment portfolio and growing investment income.

Since the end of 2007, Berkshire has averaged an 8% annual rate of return on its insurance investment portfolio with an average of 20% of its portfolio in cash. While we expect the investment portfolio to be volatile in any given quarter or year, we believe the value of Berkshire's investments will grow significantly over time.

Berkshire's industrial business also performed well in 2019 with profits at Berkshire's non-insurance segment increasing by 3%. This performance was driven by strong results at Berkshire's Utilities & Energy portfolio which realized 8% net income growth. Burlington Northern Santa Fe reported 5% net income growth, as the railroad's operating ratio increased by two percentage points amidst a weak volume growth environment for the rail sector. Despite solid operating ratio improvement in 2019, BNSF still has significant opportunity for further improvement.

Progress in these two business units was partially offset by flat net income growth at the Manufacturing, Service & Retailing segment, which was impacted by certain negative one-time events offsetting growth in many of the other businesses in the segment. Notably, net income declined 15% at Lubrizol (one of the largest businesses in this segment) which experienced a major business disruption following a fire at one of its factories.



## The Howard Hughes Corporation (“HHC”)

2019 was a year of significant organizational change for HHC. In June 2019, HHC’s Board of Directors announced a detailed review of all potential strategic alternatives. Following a thorough review, in October 2019 the Board concluded that the best interests of shareholders would be served by HHC executing a transformation plan under new executive leadership.

The company named Paul Layne as new CEO. Paul had previously served as President of HHC’s Central Region, responsible for its master planned communities (“MPC”) in Houston, which includes The Woodlands, The Woodlands Hills and Bridgeland. Under Paul’s leadership, HHC is in the early innings of executing on a three-pillared transformation plan designed to create a lean, decentralized organization built around the company’s core MPC business. The plan’s three pillars are:

- **Streamlined organizational structure** and a \$50 million per annum reduction in overhead expenses, achieved in part by relocating HHC’s headquarters from Dallas to The Woodlands in Houston
- **Sale of \$2 billion of non-core assets** with estimated net cash proceeds of \$600 million which can be redeployed into development opportunities in the MPCs and possible share repurchases
- **Accelerated growth in the core MPC business**, where the company has extensive demand for attractive, near-to intermediate-term capital deployment opportunities, as evidenced by the recently announced \$565 million acquisition of premium office space in The Woodlands

The company continued to demonstrate solid underlying business momentum amid substantial organizational transformation. In 2019, HHC recorded the highest level of residential land sales in its history. Operating asset NOI grew 20% on a full year basis driven by new development and continued stabilization of existing assets. Sales of units in HHC’s Ward Village in Hawaii remained strong, with its latest luxury condo tower more than 50% pre-sold less than two months after launching public pre-sales.

## Fannie Mae (“FNMA”, or “Fannie”) and Freddie Mac (“FMCC”, or “Freddie”)

FNMA and FMCC common and preferred shares performed exceptionally well in 2019 as major progress was made towards ending their conservatorships. Key milestones achieved include the appointment of Mark Calabria as FHFA Director in April, the release of Treasury’s Housing Finance Reform Plan followed by the effective suspension of the net worth sweep in September, and favorable decisions in both the Fifth Circuit and Court of Federal Claims. This progress continued in February when FHFA hired Houlihan Lokey as a financial advisor to assist in developing a plan to end the conservatorships.

The next major milestones include the re-proposal of the GSE capital rule, which is now expected by late May, and a Fourth Amendment to the Preferred Stock Purchase Agreements, which will be negotiated between FHFA and Treasury and is expected by end of the year.

## Exited Positions

As previously disclosed, we exited our positions in Platform Specialty Products, United Technologies, and Automatic Data Processing.



## PUBLIC ACTIVIST INVESTMENTS SINCE INCEPTION <sup>(12)</sup>

### Long Activist Positions

 2004	 2004	 2004	Atlantic Realty Trust 2004	 2004	 2005	 2005
 2006	 2006	 2007	 2008	 2008	 2008	 2009
 2010	 2010	 2010	 2010	 2010	 2011	Justice Holdings Ltd. 2011
 2012	 2013	 2013	 2013	 2013	 2014	 2014
 2015	 2015	 2015	 2016	 2017	 2018	 2018
 2018	 2018	 2019				

### Short Activist Positions\*

 2004	 2005	 2007	 2007	 2007	 2012
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\* Short Activist Positions includes options, credit default swaps and other instruments that provide short economic exposure.

The companies on this page reflect all of the portfolio companies, long and short, as of March 31, 2020, in respect of which (a) PSCM or any Pershing Square fund, as applicable, has filed Schedule 13D, Form 4 or a similar non-US filing or has made a Hart-Scott Rodino filing; or (b) PSCM has publicly recommended changes to the company's strategy in an investment-specific white paper, letter or presentation.

Past performance is not a guarantee of future results. All investments involve risk, including the loss of principal. Please see accompanying endnotes and disclaimers on pages 95-97.



# Endnotes and Disclaimers

## ENDNOTES TO CHAIRMAN'S STATEMENT

<sup>i</sup> Please see Endnote 3 in "Endnotes to Company Performance and Investment Manager's Report".

<sup>ii</sup> Calculated with respect to Public Shares only and as of December 31, 2019. Performance results are presented on a net-of-fees basis. Net returns include the reinvestment of all dividends, interest, and capital gains from underlying portfolio companies and assume an investor has participated in any "new issues" as such term is defined under Rules 5130 and 5131 of FINRA. Net returns also reflect the deduction of, among other things, management fees, brokerage commissions, administrative expenses and performance allocation/fees (if any). Performance is based on the dollar return for the specific period, including any and all dividends paid by the Company, calculated from the beginning of such period to the end of such period. Past performance is not a guarantee of future results.

<sup>iii</sup> As of March 31, 2020.

<sup>iv</sup> The weighted average dividend yield of the S&P 500 was 2.5% as of April 1, 2020.

<sup>v</sup> Free float refers to the number of Public Shares not owned by affiliates of Pershing Square. Holdings of affiliates of the Investment Manager have not been aggregated for regulatory reporting purposes.

<sup>vi</sup> Calculated using trading price of the 2022 Bonds at time of issuance of the 2039 Bonds (July 25, 2019), adjusted for the difference in term.

<sup>vii</sup> The Company's share price performance takes into account its dividends paid.

<sup>viii</sup> The Company's total debt to capital ratio is calculated in accordance with the "Total Indebtedness to Total Capital Ratio" under the PSH Bonds' Indenture. Under the Indenture, the Company's "Total Capital" reflects the sum of its NAV and its "Total Indebtedness". Total Indebtedness reflects the total "Indebtedness" of the Company and any consolidated subsidiaries (excluding any margin debt that does not exceed 10% of the Company's total capital), plus the proportionate amount of indebtedness of any unconsolidated subsidiary or affiliated special investment vehicle.

As defined in the Indenture, "Indebtedness" reflects indebtedness (i) in respect of borrowed money, (ii) evidenced by bonds, notes, debentures or similar instruments or letters of credit (or reimbursement agreements in respect thereof), representing capital lease obligations, (iv) representing the balance deferred and unpaid of the purchase price of any property or services (excluding accrued expenses and trade payables in the ordinary course of business) due more than one year after such property is acquired or such services are completed or (v) in respect of the Company's capital stock that is repayable or redeemable, pursuant to a sinking fund obligation or otherwise, or preferred stock of any of the Company's future subsidiaries. Indebtedness does not include, among other things, NAV attributable to any management shares or hedging obligations or other derivative transactions and any obligation to return collateral posted by counterparties in respect thereto.

## ENDNOTES TO COMPANY PERFORMANCE AND INVESTMENT MANAGER'S REPORT

1. Performance results are presented on a net-of-fees basis. Net returns include the reinvestment of all dividends, interest, and capital gains from underlying portfolio companies and reflect the deduction of, among other things, management fees, brokerage commissions, administrative expenses and accrued and/or crystallized performance allocation/fees (if any). Performance results assume an investor has been invested in PSLP since inception, has not invested in Tranche G, and has participated in any "new issues," as such term is defined under Rules 5130 and 5131 of FINRA. Where the Company's performance is presented with that of PSLP, results also assume that an investor invested in PSLP at its inception on January 1, 2004 and converted to PSH at its inception on December 31, 2012. Depending on the timing of an individual investor's specific investment in the Company and/or PSLP, net performance for an individual investor may vary from the net performance as stated herein. The Company's performance is based on the dollar return for the specific period, including any and all dividends paid by the Company, calculated from the beginning of such period to the end of such period. The cumulative return for an investor who invested in PSH at its inception through March 31, 2020 is 64.6%.



2. PSLP's net performance results are presented as it is the Pershing Square fund with the longest track record and substantially the same investment strategy to the Company. The inception date for PSLP is January 1, 2004. In 2004, Pershing Square earned a \$1.5 million (approximately 3.9%) annual management fee and PSLP's general partner earned a performance allocation equal to 20% above a 6% hurdle from PSLP, in accordance with the terms of the limited partnership agreement of PSLP then in effect. That limited partnership agreement was later amended to provide for a 1.5% annual management fee and 20% performance allocation effective January 1, 2005. The net returns for PSLP presented herein reflect the different fee arrangements in 2004, and subsequently, except that the performance of the tranche of interests subject to a 30% performance allocation and a 5% hard hurdle (non-cumulative) issued on January 1, 2017 is not reflected in PSLP's returns. In addition, pursuant to a separate agreement, in 2004 the sole unaffiliated limited partner of PSLP paid Pershing Square an additional \$840,000 for overhead expenses in connection with services provided unrelated to PSLP, which have not been taken into account in determining PSLP's net returns. To the extent that such overhead expenses had been included as fund expenses of PSLP, net returns would have been lower.
3. The S&P 500 Total Return Index ("index") has been selected for purposes of comparing the performance of an investment in the Company or PSLP, as applicable, with a well-known, broad-based equity benchmark. The statistical data regarding the index has been obtained from Bloomberg and the returns are calculated assuming all dividends are reinvested. The index is not subject to any of the fees or expenses to which the Pershing Square funds are subject. The Pershing Square funds are not restricted to investing in those securities which comprise this index, their performance may or may not correlate to this index and they should not be considered a proxy for this index. The volatility of an index may materially differ from the volatility of the Pershing Square funds' portfolios. The S&P 500 is comprised of a representative sample of 500 U.S. large cap companies. The index is an unmanaged, float-weighted index with each stock's weight in the index in proportion to its float, as determined by Standard & Poor's. The S&P 500 index is proprietary to and is calculated, distributed and marketed by S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC), its affiliates and/or its licensors and has been licensed for use. S&P® and S&P 500®, among other famous marks, are registered trademarks of Standard & Poor's Financial Services LLC. © 2020 S&P Dow Jones Indices LLC, its affiliates and/or its licensors. All rights reserved.
4. The inception date for the Company is December 31, 2012 and the inception date for PSLP is January 1, 2004. The performance data presented on page 2 under "Cumulative (Since Inception)" is calculated from January 1, 2004.
5. NAV performance is presented as net returns and is compared to Pershing Square funds with substantially the same investment strategy to the Company. Please also refer to endnotes ii and vii of the Chairman's Statement.
6. PSH's assets are financed by \$5.8 billion of equity and \$1.4 billion of debt.
7. Reflects Public Shares outstanding as of October 13, 2014.
8. Holdings of affiliates of the Investment Manager have not been aggregated for regulatory reporting purposes.
9. Reflects peak intraday credit spreads obtained from Bloomberg.
10. Reflects the cumulative investment of all Pershing Square funds.
11. This report reflects the contributors and detractors to the performance of the portfolio of the Company. Other than share buyback accretion and bond interest expense, positions with contributions or detractions to performance of 50 basis points or more are listed separately, while positions with contributions or detractions to performance of less than 50 basis points are aggregated. Since June 20, 2019, the Company has engaged in share repurchases whereby its buyback agent has repurchased Public Shares subject to certain limitations. The accretion from the share buyback program is reflected herein.

The contributions and detractions to performance presented herein are based on gross returns which do not reflect deduction of certain fees or expenses charged to the Company, including, without limitation, management fees and accrued performance allocation/fees (if any). Inclusion of such fees and expenses would produce lower returns than presented here.



In addition, at times, Pershing Square may engage in hedging transactions to seek to reduce risk in the portfolio, including investment-specific hedges that do not relate to the underlying securities of an issuer in which the Company is invested.

For each issuer, the gross returns reflected herein (i) include only returns on the investment in the underlying issuer and the hedge positions that directly relate to the securities that reference the underlying issuer (e.g., if the Company was long Issuer A stock and also purchased puts on Issuer A stock, the gross return reflects the profit/loss on the stock and the profit/loss on the put); (ii) do not reflect the cost/benefit of hedges that do not relate to the securities that reference the underlying issuer (e.g., if the Company was long Issuer A stock and short Issuer B stock, the profit/loss on the Issuer B stock is not included in the gross returns attributable to the investment in Issuer A); and (iii) do not reflect the cost/benefit of portfolio hedges. Performance with respect to currency hedging related to a specific issuer is included in the overall performance attribution of such issuer. For all other currency derivatives, the long/short classification is determined by the non-USD leg of the derivative. For example, a long USD call/GBP put option position would be considered a short exposure, and a long USD put/GBP call option would be considered a long exposure.

The contributors and detractors to the gross returns presented herein are for illustrative purposes only. The securities on this list may not have been held by the Company for the entire calendar year. All investments involve risk including the loss of principal. It should not be assumed that investments made in the future will be profitable or will equal the performance of the securities on this list. Past performance is not indicative of future results. Please refer to the net performance figures presented on page 2.

12. While the Pershing Square funds are concentrated and often take an active role with respect to certain investments, they will own, and in the past have owned, a larger number of investments, including passive investments and hedging-related positions. “Short Activist Positions” includes options, credit default swaps and other instruments that provide short economic exposure. All trademarks are the property of their respective owners.

It should not be assumed that any of the securities transactions or holdings discussed herein were or will prove to be profitable, or that the investment recommendations or decisions Pershing Square makes in the future will be profitable or will equal the investment performance of the securities discussed herein. Companies shown in this figure are meant to demonstrate Pershing Square’s active investment style and the types of industries in which the Pershing Square funds invest and were not selected based on past performance.

#### *Limitations of Performance Data*

Past performance is not necessarily indicative of future results. All investments involve risk including the loss of principal. This report does not constitute a recommendation, an offer to sell or a solicitation of an offer to purchase any security or investment product. This report contains information and analyses relating to all publicly disclosed positions above 50 basis points in the Company’s portfolio during 2019. Pershing Square may currently or in the future buy, sell, cover or otherwise change the form of its investment in the companies discussed in this report for any reason. Pershing Square hereby disclaims any duty to provide any updates or changes to the information contained here including, without limitation, the manner or type of any Pershing Square investment.

#### *Forward-Looking Statements*

This report also contains forward-looking statements, which reflect Pershing Square’s views. These forward-looking statements can be identified by reference to words such as “believe”, “expect”, “potential”, “continue”, “may”, “will”, “should”, “seek”, “approximately”, “predict”, “intend”, “plan”, “estimate”, “anticipate” or other comparable words. These forward-looking statements are subject to various risks, uncertainties and assumptions. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. Should any assumptions underlying the forward-looking statements contained herein prove to be incorrect, the actual outcome or results may differ materially from outcomes or results projected in these statements. None of the Company, Pershing Square or any of their respective affiliates undertakes any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by applicable law or regulation.



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