ValueInvestor INSIGHT
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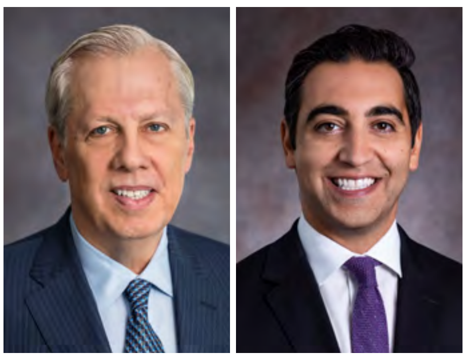
Investor Insight: Harris Associates

Clyde McGregor and Michael Nicolas of Harris Associates describe what's changed in how they assess management, what aspects of business quality matter most to them, why the fixed-income side of their portfolio has gotten more interesting, and why they see unrecognized value in Capital One, KKR & Co., Intercontinental Exchange and Lithia Motors.

INVESTOR INSIGHT



Harris Associates
Clyde McGregor *(l)*, Michael Nicolas *(r)*

Investment Focus: Seek companies trading at deep discounts to estimated intrinsic values that are expected to grow through the efforts of able and aligned leaders.

He's run the Oakmark Equity and Income Fund since its 1995 launch and Clyde McGregor considers its reason for being more relevant today than ever. As a balanced fund owning stocks and bonds, the portfolio is meant to capture the majority of equity returns while reducing volatility that can cause clients to panic and sell at the wrong time. "Volatility causes people to lose their bearing," he says. "We hope to keep them grounded and roll with the punches the equity market often throws."

The now $6.2 billion (assets) fund since inception has earned a net annualized 9.3%, vs. 6.6% for Lipper's Balanced Fund Index. Among areas in which McGregor and fellow PM Michael Nicolas see equity opportunity today: financial exchanges, private equity, credit cards and auto dealers.

Clyde, as the longest-tenured member of the Oakmark Funds' investment team, can you shed any light on the evolution of the firm's long-held "Value + Quality + Management" investment philosophy?

Clyde McGregor: I know you've heard it a number of times, but our basic approach is to invest in businesses meeting three criteria: The stocks trade at a significant discount to our estimate of intrinsic value. We see a clear path to growth in per-share value over time. And we invest with management teams that think and act like owners.

When I started here in 1981 we didn't articulate it that way. The firm was founded in 1976 and I would say for the first several years we were basically a cheap-stock firm at a time when stocks were incredibly cheap. I was just an analyst, but early in my tenure we ran into our first real value trap, a big supplier to Sears with a very cheap stock but also a deteriorating business as Sears itself was at the early stages of an inexorable decline. The powers that be at the firm recognized that we needed to more intentionally think about and measure business quality and pay closer attention to a company's ability to grow intrinsic value per share. We hadn't really done that before, but have ever since.

Has finding management teams that think and act like owners become harder or easier?

CM: There are a few aspects to that. On the one hand I would say the percentage of management teams that in general think and act like owners has increased, particularly in Asia but also in Europe. What that means to us is that they have a clear strategy and a successful track record in deploying capital to maximize long-term per-share value. They own meaningful amounts of shares. They have company stock repurchase programs that are active when the stock is down and not active when it's up.

But evaluating management is still the hardest part. Our mistakes tend to be less about how we value a business or its ability to grow intrinsic value per share and more in overrating management or misreading their intentions. It's certainly not for lack of effort, but I would say that has gotten somewhat more difficult given how scripted interactions with management teams have become. In the 1980s and 1990s you could generally have the types of conversations that made it a bit easier to determine if management might end up saying one thing and choosing to do something else, particularly when it comes to acquisitions. A large dilutive acquisition is a typical example of how management can undermine an otherwise sound investment case.

Has your definition of value evolved?

Michael Nicolas: We may have a broader definition of value than many of our peers. A value investment to us is simply a business that trades below our estimate of intrinsic value, and the standard for that of around 60-65 cents on the dollar has been fairly consistent over time. Most of our holdings would profile as traditional value, trading at low multiples of reported earnings or book value. But sometimes we'll find good value in higher quality, faster growing businesses like Alphabet and Amazon – both top-10 holdings in the Equity and Income Fund – that may be underearning for a variety of reasons and as a result offer opportunity.

CM: We also can find value in what might be considered lower quality businesses, where returns aren't as high or the business is more cyclical. Glencore [London: GLEN] is also a top position, and quality there means more that it is one of the dominant producers of very important materials as the economy evolves toward greater levels of electrification. We also own General Motors [GM], which so far has not been a particularly successful investment but we believe management in most respects is acting like owners in allocating capital, the balance sheet is much improved, and we think the company can continue to grow intrinsic value per share. It's hard to argue it's the highest quality business, but the stock is just incredibly cheap at around 6x both trailing and forward earnings. The share price [now around $38] isn't far from where it was after GM came public again in 2013 after its bankruptcy and reorganization, but the company has made a lot of money in the interim and is much better positioned for the future than it was then.

Where I've concluded our most insightful information in estimating value comes from is actual transactions involving comparable or otherwise relevant companies. We try to understand at a detailed level how and whether the economics work for the purchasing company at a given price. I'm always more interested in an idea when the fundamental cheapness we see is confirmed and supported by transactions taking place in the real world.

Describe using some relatively new portfolio additions why the stocks of what you consider well-run, growing businesses can get cheap from time to time.

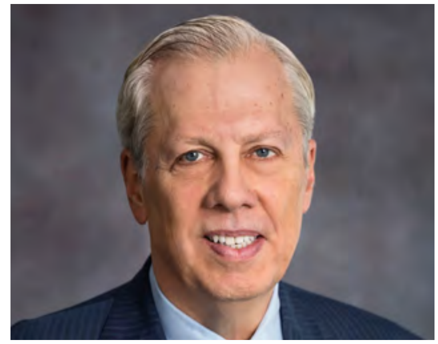
MN: Masco [MAS], which sells home-improvement and building products, would be a good example. Management over the past several years has sold off more cyclical, lower-return businesses to focus the company primarily on its strong and recognizable brands in coatings and plumbing fixtures, categories that tend to be more resilient, have better competitive dynamics, and generate higher margins. We think that's getting lost today when the short-term financial outlook isn't great due to the negative impact higher interest rates have had on the housing market. Masco's stock today [at around $57.30] trades at only 11x our estimate of normal earnings, well below both historical levels and the 20x or so P/Es at which consumer-products companies with similar margin and return-on-capital profiles are currently priced.

ON ESTIMATING VALUE:

Our most useful information on estimating value comes from actual transactions involving relevant companies.

CM: We added a new position in the first quarter in Corebridge Financial [CRBG], a life insurance and retirement-products company that was partially spun off from American International Group last fall. We knew the business as owners of AIG stock and generally consider it a better run and more diversified player in a market where a number of variable annuity-focused competitors have struggled. There are legitimate concerns for Corebridge around some commercial real estate exposure in its investment portfolio. The market also doesn't like the overhang from AIG still owning a majority stake and its filing to sell part of that down in a secondary share sale announced earlier this month.

So we understand why the shares might be out of favor, but think it's been overdone. At today's price [of around $17.75], the shares trade at less than 4x what we think is the normalized earnings power of the business. We're also willing to wait for the ownership overhang to resolve itself. We were surprised AIG was selling at such a cheap price, but they said they were doing it only because they thought their own stock was just as cheap and wanted to buy



Clyde McGregor

Mixed Emotions

At the end of this year Harris Associates' portfolio manager Clyde McGregor plans to retire after an illustrious 42-year career with the firm. More than comfortable with his decision to step aside to make room for a talented next generation of colleagues, the 70-year-old admits to "mixed emotions" on the prospect of being retired. "The daily grind of this business has never been a grind to me," he says. "I find the work fun, engaging and interesting and will miss being part of the team."

As for what's next, that's still to be determined. "I have a retirement coach and we're in the process of working on that," he says. "I'm seriously considering going back to school to study ornithology, but will I actually do that? I'll figure it out, but I'm not yet sure who the retired Clyde is going to be."

Any parting advice for those interested in a career in investing? "Many of the things you do are not going to work out, and if you're right 60-65% of the time you're probably going to be very successful," he says. "To be happy and thrive in this business you have to be wired in a way that you never let disappointment keep you from getting right back up and out on the field again."

more of it back. As reasons go, that's a pretty good one.

At two other times we've spoken over the past 10 years you've been less than enthused about the fixed income side of your portfolio. Has that changed?

CM: I should first acknowledge that one of my biggest mistakes as an investor has been in believing that interest rates could not stay as suppressed as they were for as long as they did over much of the period since the financial crisis. In retrospect, we were not as well positioned to benefit from interest rates continuing to fall as we could have been.

One thing we did as a firm in the latter stages of the low-interest-rate cycle was to build out our fixed-income team in preparation for what we thought was an inevitable rise in interest rates that would make fixed income more competitive for space in the portfolio. We've added expertise in mortgage securities and structured-finance products and that has translated into what we consider a more diversified and attractive fixed-income book.

In terms of positioning, after a long time overweight equities, we're now running at what we consider a more neutral state – roughly 60% in equities and 40% in fixed income. We've pushed out the duration of our fixed income to close to six years, where we've typically not been more than four. Overall, the risk-adjusted return profiles of our equity and fixed income opportunities are more balanced than they've been in some time.

Are there areas in today's recently benign market environment where you're seeing incrementally more opportunity rather than less?

MN: If you look at the S&P 500 trading at just under 20x earnings, that on the surface doesn't seem like a table-pounding opportunity. But we are finding pockets of interest. During the second half of last year we saw unusually attractive value in some of our historically faster growing technology businesses. Today we're seeing good value in economically sensitive areas, like financials – both non-banks and banks – and in consumer discretionary sectors, including almost anything automotive-related. Many of our holdings in these areas are deeply out of favor, trading at single-digit multiples of our estimates of normalized earnings.

Let's talk in more detail about one of those, bank holding company Capital One Financial [COF].

MN: Capital One is a highly disciplined lender that only competes in categories where it believes it can differentiate itself through either scale or technology. That has led to a focus on credit-card lending, which accounts for about 70% of our estimate of normal earnings. The remainder comes mostly from auto loans and some commercial and industrial lending.

Founder and CEO Richard Fairbank very much exemplifies what we're looking for in management. He built the company from the ground up into a top-10 U.S. bank in less than three decades. He owns a lot of stock, doesn't manage to quarterly sell-side expectations, and is laser-focused on maximizing long-term per-share value.

INVESTMENT SNAPSHOT

Capital One Financial
(NYSE: COF)

Business: Provider of branded and private-label credit cards as well as consumer and commercial banking services primarily in the U.S. Northeast, Middle Atlantic and South.

Share Information (@6/29/23):

Price	**109.26**
52-Week Range	83.93 – 123.09
Dividend Yield	2.2%
Market Cap	$41.72 billion

Financials (TTM):

Revenue	$27.02 billion
Operating Profit Margin	27.9%
Net Profit Margin	21.9%

Valuation Metrics
(@6/29/23):

	COF	S&P 500
P/E (TTM)	7.5	19.6
Forward P/E (Est.)	8.3	19.8

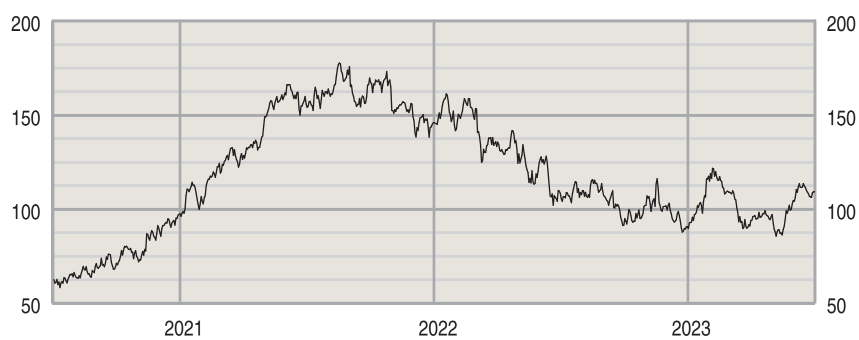
Largest Institutional Owners
(@3/31/23 or latest filing):

Company	% Owned
Dodge & Cox	9.2%
Vanguard Group	8.3%
BlackRock	6.5%
State Street	4.2%
Harris Assoc	4.0%

Short Interest (as of 6/15/23):

Shares Short/Float	2.5%

COF PRICE HISTORY



THE BOTTOM LINE

Michael Nicolas believes the company is better positioned and capitalized to ride out a recessionary economy than the market appears to expect in pricing its stock at 6x his estimate of normalized EPS and at only a modest premium to tangible book value. Banks with its return profile have historically been worth closer to 2x tangible book, he says.

Sources: Company reports, other publicly available information

The culture is very much data-driven and they're flexible in scaling up and down emphasis both on lending asset classes and on different credit profiles within those classes. It all depends on where the risk-adjusted returns appear to be the highest.

The industry structure in credit-card lending is fairly attractive, concentrated in a half-dozen national players in the U.S. Pricing tends to be rational and not the only focus of competition, as other factors like rewards, brand affinity and existing banking relationships also matter to the consumer. Capital One has historically been considered a more mid-market player, but has had success of late moving upmarket with its Venture X card, which competes head on with premium offerings from Chase and American Express.

The company's stock has been under pressure, primarily due to general concerns about a recession and the impact that could have on consumer credit quality. Here we think the level of fear priced into the stock is misplaced. Bad-debt expense is increasing from an extremely low post-pandemic base, so this normalization shouldn't be unexpected. Capital One also continues to strengthen its balance sheet by growing earnings and reserves. Its capital levels are well in excess of even the stricter regulatory requirements some analysts are expecting for U.S. banks and are expected to stay above minimum requirements even under the draconian economic conditions envisioned in Federal Reserve stress tests. We think that's indicative of how the company manages capital. As Rich Fairbank has said, "I've never met anyone who thought they had too much capital in a downturn."

How inexpensive do you consider the company's shares at the current price of around $109.25?

MN: We expect the company to earn mid-teens returns on tangible common equity [ROTCE] through the cycle, but the stock today trades at 6x our estimate of normal earnings and at only a modest premium to tangible book value. If you look back over time, a high-performing bank with a mid-teens ROTCE should be worth closer to 2x tangible book. That's also been the average valuation paid in private-market bank transactions going back to 2015.

Sticking with financials, why are you high on the investment prospects for private-equity firm KKR & Co. [KKR]?

MN: KKR is well-known as one of the largest alternative-asset managers in the world, with more than $500 billion in assets under management [AUM] spread across an expanding base that includes private equity, real estate, infrastructure, insurance and credit. Through its scale, reputation, relationships and track record it has taken market share in alternative assets, while alternative assets continue to take share from other asset categories.

The company makes money in two primary ways, earning management fees on assets under management and incentive fees, or carried interest, on realized profits in their funds. The management-fee stream grows with AUM, and tends to be quite sticky given that approximately 80% of the company's private-market assets are held under capital commitments of eight years or longer. Carried interest,

INVESTMENT SNAPSHOT

KKR & Co.
(NYSE: KKR)

Business: Asset manager offering private equity, energy, infrastructure, real estate, credit and hedge funds; in 2021 acquired a majority stake in insurer Global Atlantic.

Share Information (@6/29/23):

Price	**55.95**
52-Week Range	41.77– 60.53
Dividend Yield	1.2%
Market Cap	$48.29 billion

Financials (TTM):

Revenue	$6.15 billion
Operating Profit Margin	(-31.5%)
Net Profit Margin	(-8.3%)

Valuation Metrics
(@6/29/23):

	KKR	S&P 500
P/E (TTM)	n/a	19.6
Forward P/E (Est.)	15.1	19.8

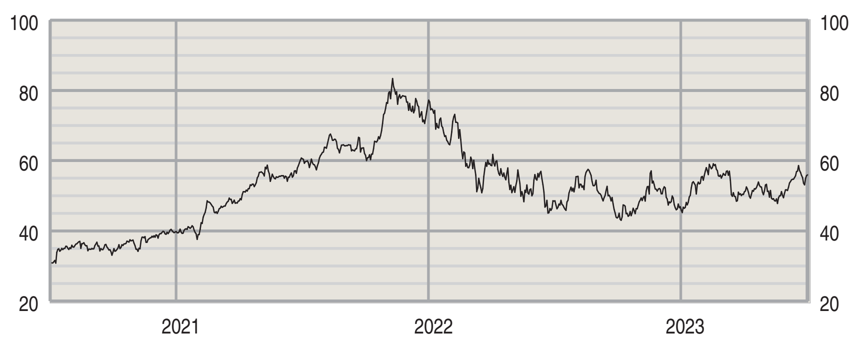
Largest Institutional Owners
(@3/31/23 or latest filing):

Company	% Owned
Capital Research & Mgmt	6.1%
Vanguard Group	4.6%
BlackRock	4.0%
T. Rowe Price	3.2%
Harris Assoc	3.1%

Short Interest (as of 6/15/23):

Shares Short/Float	1.6%

KKR PRICE HISTORY



THE BOTTOM LINE

The company's earnings power has been significantly enhanced in recent years by the rapid growth of its assets under management and the diversification of its business lines, says Michael Nicolas. That is not reflected in its stock, he says, which trades at a heavy discount to the S&P 500 and near its lowest relative valuation to the index in five years.

Sources: Company reports, other publicly available information

typically 20% or so, is assessed on profits generated when investments are monetized, which can make that revenue stream very volatile. We'd argue that because of that volatility the market can at times significantly underappreciate the incentive-fee component of the business.

The industry backdrop has become more challenging. KKR has an exceptional investment track record, but there is risk that a higher interest rate environment may make it tougher to replicate those returns going forward. Monetization events are way down this year, causing a short-term hit to incentive fees. While raising assets has not been a problem for KKR – last year was its second-largest fund-raising year in history – some prominent firms in the industry are falling well short in raising money as institutional investors have pulled back on commitment levels in a rockier market environment.

Our basic thesis is that while there might be some short-term impacts from the current market backdrop, KKR is well positioned to continue taking share in an attractive market with attractive secular growth prospects. Its management is first rate, owns a lot of stock, and has consistently made disciplined and thoughtful tradeoffs in allocating capital. With conservative assumptions that we think take full account of the outstanding risks in arriving at what's normal, we think the shares are quite undervalued.

Explain how you're looking at valuation from today's share price of just under $56.

MN: We estimate the company's balance-sheet investments, mostly in its own funds, are worth approximately $19 per share, or more than one-third of the current market cap. Subtracting that from today's price, the stock trades at just over 12x our roughly $3 per share estimate of normal earnings. If the shares on that basis traded for the same multiple as an equally high-quality peer like Blackstone, that alone would result in 40% upside in the price.

And that doesn't really contemplate the growth potential from here. Even if we assume some moderation in gross investment returns, incentive fees are poised to grow rapidly. Carried-interest earnings today are being generated from funds deployed five-plus years ago, when KKR had one-fourth its current AUM. There is significantly more capital at work today, and there will be significantly more carry to harvest in the future. The firm is also expanding capital-markets activities to assist portfolio companies with debt and equity capital raises. In addition, there's a lot of potential white space for growth in developing products for retail investors.

EPS has more than doubled over the past five years, and management believes the company should double earnings again over the next five years, which we don't think is unreasonable. That isn't the profile of a company whose stock is trading at a heavy discount to the S&P 500 on depressed earnings and near its lowest relative multiple to the index over the past half decade.

Describe your investment case today for Intercontinental Exchange [ICE].

MN: This is another good example where the quality of the management is an important part of the investment case. Through

INVESTMENT SNAPSHOT

Intercontinental Exchange
(NYSE: ICE)

Business: Designs, develops and operates digital platforms primarily serving three operating segments: exchanges, fixed income/data services and mortgage technology.

Share Information (@6/29/23):

Price	**112.28**
52-Week Range	88.60 – 113.15
Dividend Yield	1.5%
Market Cap	$62.86 billion

Financials (TTM):

Revenue	$7.29 billion
Operating Profit Margin	51.0%
Net Profit Margin	19.8%

Valuation Metrics
(@6/29/23):

	ICE	S&P 500
P/E (TTM)	43.4	19.6
Forward P/E (Est.)	20.3	19.8

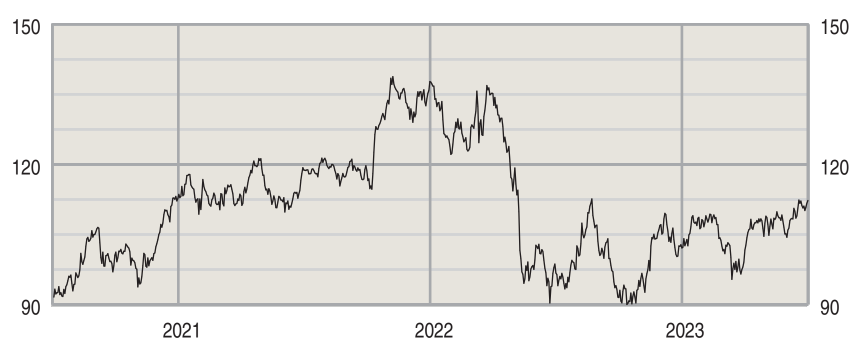
Largest Institutional Owners
(@3/31/23 or latest filing):

Company	% Owned
Vanguard Group	8.2%
BlackRock	7.4%
State Street	4.0%
Morgan Stanley Inv Mgmt	3.3%
Harris Assoc	2.2%

Short Interest (as of 6/15/23):

Shares Short/Float	0.9%

ICE PRICE HISTORY



THE BOTTOM LINE

Challenges in the mortgage market are masking the potential of the company's mortgage-technology division to become a comparable franchise to its exchange and data businesses, says Michael Nicolas. Based on his DCF analysis and on prices paid in relevant M&A transactions, he thinks the stock's fair value is at least 50% above the current price.

Sources: Company reports, other publicly available information

a series of shrewd acquisitions and excellent operational execution, founder and CEO Jeff Sprecher has built the company into a leader in three primary segments: exchanges, fixed income/data services and mortgage technology. Over half the revenue comes from recurring sources like data feeds and software subscriptions, and the company has dominant competitive positions in many of its exchange-traded products.

The exchange segment, accounting for just under 60% of total revenues, has both offensive and defensive attributes we find attractive. The business doesn't require a lot of capital, generates high margins, and should grow at a mid-single-digit annual rate or better over time through growth in financial market participation and consistent new-product introductions. Trading volumes also often have countercyclical tendencies, increasing in uncertain economic environments. That's all contributed, through some very challenging times, to the company's 17 consecutive years of EPS growth.

The bond pricing and data business competes primarily with Bloomberg, generating high margins and a significant share of its revenue from recurring subscriptions. It's the mortgage-technology business today, however, that has probably the most incremental potential. One of ICE's core competencies has been to transform previously analog businesses into digital ones, improving execution and lowering costs for industry participants. It sees a particularly compelling opportunity to do so in the mortgage value chain, which I don't think anyone would characterize as a seamless, efficient ecosystem.

While we think the long-term potential in the mortgage business is high, that's been tempered in the short term by the sharp falloff in mortgage originations due to the rise in interest rates. There's also uncertainty over the company's latest announced acquisition of loan-servicing company Black Knight [BKI]. Combining that firm's servicing software with ICE's digital origination and closing platform would likely be a really compelling proposition for many mortgage lenders, but in April the Federal Trade Commission petitioned a federal court to halt the acquisition. Given the actual competitive overlap between the businesses, management is confident – possibly with some concessions – that the deal will close. The market seems more skeptical, but we like the stock either way.

ON ARTIFICIAL INTELLIGENCE:

We're obviously interested ... but if it turns out Nvidia at 38x sales ends up making sense, we'll probably miss that.

From today's price of around $112, how do you think the shares might be more reasonably valued?

MN: Consensus earnings expectations for next year are around $6 per share. Assuming a more normal mortgage market, especially with respect to refinancings, we think would add another 40 cents or so in earnings power. We also believe the Black Knight deal if it closes would be nicely accretive, adding something like 60 cents to that normalized per-share estimate. With or without Black Knight, the shares on those estimates today trade at a valuation discount to the S&P 500 and at close to their lowest relative P/E ever versus the index. We like buying great businesses at average prices and think the shares today offer an opportunity to do just that.

There's a long list of private-market comps for exchanges and data-analytics assets. CME paid 12x sales for the New York Mercantile Exchange. ICE itself bought the New York Board of Trade for 12x sales. S&P Global bought IHS Markit at 10x sales. FactSet last year paid 11x sales for CUSIP Global Services. I don't know if there's one perfect comp for ICE, but based on our discounted-cash-flow analysis and the average price-to-sales levels paid in what we think are relevant transactions, we think fair value is at least 50% above the current stock price.

From financials to automotive retail, describe what you think the market is missing in Lithia Motors [LAD].

MN: Lithia is the largest franchised auto dealer group in the U.S., having recently surpassed AutoNation. It has a long history of creating shareholder value through best-in-class operations and acquisitions of smaller dealers that yield attractive returns. Since Bryan DeBoer – the grandson of the founder – took over as CEO in 2012, earnings per share has grown 13-fold and the share price has appreciated by a similar amount.

Despite being the biggest player, Lithia has only about 2% of the market so there's continued runway for growth through accretive M&A. The company typically purchases underperforming dealers at 4-7x EBITDA, dramatically improves their operations and cash flow, and then subsequently recycles the incremental profits into more deals. The overall revenue mix is fairly diversified, with roughly 20% coming from new cars, 20% from used cars, 30% from parts and service, and 30% from finance, insurance and warranty.

Lithia isn't the highest quality business – it sells commoditized products at low margins in a cyclical end market. There are, however, advantages for the industry leaders. Auto dealers are governed by franchise laws and OEM agreements that allow manufacturers to dictate who can buy a dealership, what brands they sell and their selling and service radius. In a sense, these laws create local brand monopolies for dealers. The rules also discourage external players – think private equity – from entering the market through M&A due to challenging approval and sign-off requirements. All this plus its track record makes Lithia an advantaged buyer.

The company has also stood up two new business lines since 2019. The first is a captive finance subsidiary, called Driveway Financial, which aims to capitalize on Lithia's detailed knowledge of customers and transactions to originate themselves close to 20% of the loans on their car sales over time. The business has shown good progress, but currently loses money due to some unique accounting rules for reserve requirements that should level out over time. Management thinks this business can add as much as $15 per share to steady-state earnings power over time.

The other emerging business, just called Driveway, is an e-commerce platform for customers who want to conduct all or part of their car-buying process online. This market has been relatively slow to move online, but Lithia should be well-positioned to benefit if buying behavior shifts away from person-to-person interaction. It has all the ingredients to be successful – hundreds of stores and servicing centers, nationwide coverage, huge inventory. They're being thoughtful about how they're building this business and while we're not incorporating any upside into our models for it, it has the potential to be a meaningful growth driver longer term.

Is this another example where the current industry dynamic is crowding out long-term optimism?

MN: The company was a clear Covid beneficiary, as gross profit per car exploded in the positive industry environment of the past few years. The normalization process is now underway, and when the industry trend is downward sloping it can be off-putting to many investors. On our $35 per share estimate of core normal earnings power today, the stock trades at just over 8.5x earnings. Layering in additional M&A and an earnings contribution from Driveway Financial, we believe the company is trading for just 6.5x normal earnings. On management's own 2025 earnings target, the P/E is even lower at 5.5x.

Now around $303, what do you believe the shares are more reasonably worth?

MN: The stock has historically traded at a low double-digit earnings multiple, so if we apply an 11-12x P/E to our normal estimates and give some credit for Driveway Financial's steady-state earnings power, we see greater than 50% upside potential in the shares. In management's $55-per-share 2025 profit target they assume continued acquisitions, further progress for Driveway Financial, and significant savings in selling, general and administrative expenses. We don't have to buy into all of their assumptions to see incremental upside. Given their track record, we're not too quick to bet against management here.

Describe one or two stocks you've sold recently and why.

MN: Our favorite reason for selling is when we've done a good job of estimating intrinsic value and the stock nears or hits our estimate. That was the case with Howmet Aerospace [HWM], a company run by a CEO, John Plant, who we highly respect and who has done a terrific job in improving the firm's cost structure and in driving price for its highly technical and mission-critical aerospace components. As aerospace demand started to recover and the market better recognized the transformation under Plant, the stock appreciated considerably and we sold during the first quarter when it started trading at well above a market forward earnings multiple.

We'll also sell when we've lost faith in management's ability to allocate capital or run the business, or if our updated es-

INVESTMENT SNAPSHOT

Lithia Motors
(NYSE: LAD)

Business: Owns and operates a nationwide network of dealerships selling domestic, import and luxury automobiles; also operates the Driveway online car-retail platform.

Share Information (@6/29/23):

Price	**302.80**
52-Week Range	180.00 – 307.43
Dividend Yield	0.7%
Market Cap	$8.34 billion

Financials (TTM):

Revenue	$28.46 billion
Operating Profit Margin	6.4%
Net Profit Margin	4.0%

Valuation Metrics (@6/29/23):

	LAD	S&P 500
P/E (TTM)	7.4	19.6
Forward P/E (Est.)	8.9	19.8

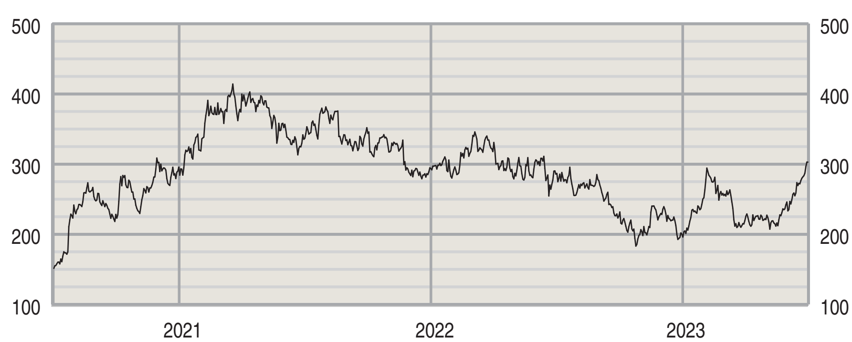
Largest Institutional Owners (@3/31/23 or latest filing):

Company	% Owned
Vanguard Group	10.2%
BlackRock	8.8%
Abrams Capital	8.5%
MFN Partners	5.6%
Harris Assoc	5.5%

Short Interest (as of 6/15/23):

Shares Short/Float	11.4%

LAD PRICE HISTORY



THE BOTTOM LINE

Its industry is coming down from a pandemic-related high, but Michael Nicolas believes the company's future is bright as it continues to consolidate a still-fragmented market and benefits from developing lending and e-commerce initiatives. Applying an historical P/E multiple to his estimate of normalized earnings, he sees at least 50% share-price upside.

Sources: Company reports, other publicly available information

timate of per share value growth is veering far from our original mark. Our sale of medical-device manufacturer LivaNova [LIVN] is a good example of an investment that failed to perform in line with our expectations. The management team didn't deliver against their targets, there were multiple setbacks within the company's pipeline, and we saw consistent value leakage from unexpected restructuring charges and legal settlements. The stock relative to private-market values was and is still technically cheap on an enterprise value to sales basis, but that wasn't reason enough to hold it against better risk/reward opportunities elsewhere.

Is there a recent example of an investment you'd characterize as a mistake?

CM: I mentioned earlier that we usually do a pretty fair job of estimating intrinsic value, but one example where we could have done better would be in natural-gas E&P company PDC Energy [PDCE]. It wasn't at all a bad investment because we bought it in 2020 when the energy market was falling apart, but now that Chevron has agreed to buy PDC it appears we overestimated its intrinsic value. The lesson here for smaller E&Ps is that you need to be careful in extrapolating values from other transactions too broadly. Individual properties have their own unique characteristics and only a limited number of acquirers can take full advantage of all those varied characteristics. It's always better to have profitable mistakes, but that doesn't mean we didn't make one here.

We'd be remiss if we didn't ask about artificial intelligence. Is this an actionable investment topic for you at this point?

CM: This is one area where my age is an advantage – I'm retiring at the end of this year and it's going to be up to Mike and others here to figure that all out.

Kidding aside, we're obviously interested in the topic and actively experimenting with it ourselves to see if we can put it to our advantage in our work. It's just too early to say what the investment implications will be for us. At this point we'd argue there's a better-than-average chance the platform technology companies that have already done so well – and some of which we own – will be net beneficiaries of AI. If it turns out that Nvidia at 38x trailing sales ends up making sense, we'll probably miss that. VII