ValueInvestor INSIGHT

The Leading Authority on Value Investing

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Earning Your Keep

Harris Associates' Bill Nygren and Michael Nicolas describe what they look for in a good investment idea, why they're more clearly articulating their "mistake management process," what thoughts come to mind about Warren Buffett, and what they believe the market is missing today in Airbnb, First Citizens Bancshares, Keurig Dr Pepper and Phillips 66.

INVESTOR INSIGHT

Harris Associates
Bill Nygren (*l*), Michael Nicolas (*r*)

Investment Focus: Seek companies trading at steep discounts to estimated value, with value that grows over time and management that thinks and acts like owners.

Fundamental equity investors today face a stark challenge that wasn't so present when Bill Nygren first entered the business in the late 1970s, namely, as he puts it, that "you have to bring something to the table that someone else can't offer via computer for almost free."

Nygren has successfully done that since launching Harris Associates' Oakmark Fund in 1991, guiding the now $24 billion (assets) fund to a net annualized 12.6% return, vs. 10.4% for the S&P 500. Focused on uncovering value that isn't readily apparent in the current financials, he and co-portfolio managers Michael Nicolas and Robert Bierig see unrecognized opportunity today in such areas as online travel services, soft drinks, U.S. regional banking, and midstream and downstream energy.

It's been an interesting month. Describe how you've been working through the equity market's machinations thus far.

Bill Nygren: If someone had taken the first four and a half months of the year off and then came back and saw the S&P 500 up a fraction of a percent and the Russell 2000 Value up a bit more than that, they'd probably shrug their shoulders and say that sounds fairly reasonable. Markets were maybe a touch high going into the year and the Mag Seven was leading the way, so that the market wasn't up much and that smaller stocks were doing relatively better wouldn't seem to be much of a surprise.

Obviously those of us who were in the office every day earlier this month went through kind of a crazy environment. We went back to a playbook that's worked well for us, most recently in the Covid shutdown of 2020 and in the economic slowdown in 2022. In both cases we had our analysts update their numbers on every company assuming no economic growth in 2026, effectively pushing the normal estimates on which we base our valuations out another year. We also asked them to assign a rating to each stock to try to capture how significant tariff effects might be that weren't incorporated into our normalized estimates. We warned everyone that while this is never an 8-to-5 job it may feel more like a 24/7 job for a while, but they were probably going to earn most of their pay for this year over the next few weeks.

We had far from perfect information, but we didn't consider that a defense to keep the portfolio the way it had been invested prior to Liberation Day. Our estimates of value had changed, and share prices in many cases had significantly changed. We redefined what we wanted the portfolio to look like, which consisted of selling roughly one-third of the Oakmark Fund names and reallocating capital mostly into other existing positions. We expected based on historical experience when the market falls 20% that we'd have a couple months to transition the portfolio from where it was to where we thought it should be.

For two weeks we were about five times as active as usual in trading the portfolio, but the rapid snap back in the market meant we had to scale back on the changes. With 20/20 hindsight it would have been better if we had moved even more rapidly, but I'm quite confident the changes we did make meaningfully added value. That's against a lot of investors who I think were kind of like deer in the headlights for those couple of weeks.

Can you talk more specifically about the changes you did make?

BN: As was the case with Covid, this was more of a liquidity drawdown, where people just wanted to get out of stocks and mostly everything was down materially. Such cases generally give us the opportunity to upgrade the portfolio, say by selling down auto-related names with worse balance sheets and more tariff-related exposure to buy software and service companies with better balance sheets and less tariff risk.

Is all clear, as the market seems to be saying of late?

BN: I don't know about that, but it's now more business as usual for us. We generally believe that economic forces are much stronger than political forces. In the context of tariffs, for example, if they are as bad a policy decision as many people seem to think they are, there are checks and balances to correct that. The administration might respond to stock market declines. The legislature could overrule. Courts could overrule. Mid-term elections could be at risk. If tariffs are horrible for the economy, the Republicans chance of winning the White House in 2028 would be very small.

Our assumption is that any tariff impacts will occur over the next year or two and then we assume it goes away and that our businesses are agile and resilient and will adapt. I don't mean this at all to be a political statement either direction, but history would suggest that eventually rational economics will defeat bad political policy.

Turning more to underlying strategy, describe what you primarily look for in a good investment idea.

BN: Our analysts have tremendous freedom to find ideas that they think fit our defined basic criteria: companies selling for less than 60% of our estimate of business value, managed by people who think and act like owners, and where we believe that business value, with dividends, is going to grow at least as fast as the average S&P 500 company.

Michael Nicolas: In a market where many investors spend so much of their time on predicting what's going to happen in the economy and at a company over the next 90 days, we're looking for situations where stocks appear really cheap if you're willing to zoom out a bit. Often a company's current financials don't reflect what we consider the true earnings power of the business. That could relate to latent pricing power. It could be we've recast balance sheets and income statements for investment spending that has to go through the P&L rather than onto the balance sheet. Maybe a sum-of-the-parts analysis can surface hidden value. We're also looking for unique management skill, which can be difficult for algorithms to recognize and quantify. Whatever the reason, it's up to the analyst to make the case that the economic earnings power of the business will be higher than what we're seeing today and that the market isn't adequately pricing that in.

ON LEARNING FROM APPLE:

We should always make the investment decision we think is the right one and try not to let other factors influence that.

You added Constellation Brands [STZ] to the Oakmark Fund portfolio in the first quarter. What made it interesting?

MN: Constellation is the leading imported beer company in the United States, with strong brands such as Modelo, Corona and Pacifico. The stock has sold off sharply over the past few months for a number of reasons. Its beers are produced in Mexico, so there are tariff concerns. There are worries about levels of consumer spending among Hispanic consumers, to which their brands over-index. There's also the increasing potential that regulatory changes in the U.S. might negatively impact alcohol consumption.

The stock fell to the point where we thought it traded at a significant discount to other consumer packaged goods companies with similar growth outlooks. Constellation's beer segment has consistently outgrown the industry and we believe it can further benefit from demographic tailwinds, expanded distribution and future price increases. It's by far the best performing player in the category but the market is treating it as if it's an also-ran. [*Note*: At a recent $178.20, STZ shares are 33% off their 52-week high and trade at a 14.1x consensus forward P/E.]

Was the setup somewhat similar for GE HealthCare Technologies [GEHC], a new position for you in last year's fourth quarter that you added to earlier this year?

MN: We'd been following GE HealthCare since its spinoff from General Electric in January 2023 and thought generally that was an opportunity for it to sharpen its focus, set the right culture and incentives for its specific business and, as a result, it could accelerate its growth and expand profitability. We also believe the company is well positioned to benefit as a greater portion of its products' value proposition comes from AI-enabled software and a shift toward precision care.

The stock in the fourth quarter of last year started trading down, primarily due to concerns about the business's exposure to China, to the point where it traded at a low valuation relative to other high-quality medical-technology companies and at its lowest valuation relative to the S&P 500 since the IPO. We didn't believe the long-term tariff impacts would be as pronounced as the market seemed to think, which gave us the opportunity to buy and then add to the position at what we considered a significant discount to our estimate of intrinsic value. [*Note*: Having fallen in April to near its 2023 initial offering price, GEHC shares at around $70.50 currently trade at 18.1x estimated forward earnings.]

Eight years ago [*VII*, May 31, 2017] you made the value-investing case for Alphabet [GOOG], which turned out to be a pretty good call. You still own it – please update your case for it today.

BN: As brief background, people ask sometimes about the biggest mistake I've ever made in a portfolio and they expect it to be some of the financial names we held going into the Great Financial Crisis. I always say the biggest mistake was in 2009 when Apple looked like one of our most attractive ideas, but I was afraid to own it at the position size I should have because I was worried people would think we weren't real value investors because we owned a lot of the stock. Our half position went up 30-fold over the next 12 years, so it's an understatement to say we left a lot of money on the table.

It was only a couple years later that Alphabet came along and the learning from Apple was that we should always make the investment decision we think is the right one and try not to let other factors influence that. As a result we've had Alphabet as one of our larger positions for probably a decade, essentially based on the same sum-of-the-parts story we talked about eight years ago: that the current P/E multiple was significantly overstated after correcting for the investment spending running through the company's "other bets," all the cash on the balance sheet, and for the future earnings power primarily of YouTube. We still feel that way.

MN: The risk profile of the company has increased, primarily around the impact AI could have on the core search business. It's difficult to precisely pinpoint what that impact will be, but the search business has continued to growth nicely and we generally believe Alphabet has the experience, talent and resources that put it in a good position to compete. But at today's stock price [of around $172.80], when we value the key businesses separately and adjust for cash and investment spending, we get an implied earnings multiple on search of around 10x. That's similar to banks we look at today and we think meaningfully undervalues that business.

Another portfolio company we've spoken about over the years is General Motors [GM], where the business narrative hasn't been great. How are you looking at it as an investment today?

BN: This is a very long-term holding of ours. It's been a mixed bag, but I would say we probably wouldn't own GM today if they hadn't less than two years ago made the radical switch in capital-allocation policy to devoting almost all of their excess cash flow to share repurchases. The stock today trades at about $50 per share, which is less than 5.5x forward earnings estimates. The longer the runway for internal-combustion-engine trucks and SUVs – where GM has strong positions – the better that will be for the company. But at the current valuation you're paying very little for that, and their just using cash flow to buy back shares should make this a relatively attractive investment from here.

ON RISK CONTROL:

One key element in managing risk is how you respond when your fundamental estimates turn out to be wrong.

You've started to articulate in your investor materials a more formalized "mistake management process," triggered when the business fundamentals of one of your owned companies diverges materially from expectations. What's behind that?

BN: When people ask us about risk, they're typically asking about tracking error to the index. We'll generally say we don't pay much attention to that, it's not how we think about risk. That created a perception among some clients and potential clients that we don't pay enough attention to risk, which we felt couldn't be further from the truth and we needed to address more clearly.

We judge mistakes as mis-analyzing fundamentals, not on how the stock price performs, and one key element in managing risk is how you respond when your fundamental estimates turn out to be wrong. When our estimates of business value are materially adjusted downward, the process we have in place is designed to make the path of least resistance to be for the analyst to say, "I made a mistake and we should walk away from it and move on to something I understand better." That's meant to counteract the knee-jerk reaction of the typical value manager to buy more when a stock price is down a lot. We've studied our own results enough to know that kind of knee-jerk reaction is not adding value.

Only when the analyst has unusual conviction will they go through all the review steps necessary to convince themselves and the portfolio managers this is still a good idea. Of course we still don't always get it right. One positive example that goes back a ways was Netflix [NFLX] after it announced a decline in subscribers in 2021 and the shares cratered. Our analyst was adamant the market was overreacting so we re-underwrote the idea, including meeting with management to understand better their strategy to reinvigorate growth. In the end we restored our position size and it was subsequently a fantastic performer.

Meta Platforms [META] worked the other way. Free cash flow was shrinking due to significant investment spending and the stock price fell dramatically, going below $100 in October 2022. Here we met with the CFO and felt like we were talking different languages. We wanted to talk about returns on invested capital, they wanted to talk about how big the alternate-reality universe might be in a way you couldn't quantify at all. We did keep our position but didn't restore it to its original size. That hurt when the shares went from $100 to $500.

At the end of the first quarter the 54-stock Oakmark Fund portfolio traded at an average 11.6x forward P/E and an 8.9% forward free-cash-flow yield, vs. 20.3x and 4.6%, respectively, for the S&P 500. Does that valuation gap say anything about the relative attractiveness of the investment opportunity set today?

MN: We would say that gap is unusually wide and absolutely reflects how we're thinking about the opportunity set today. We've talked a lot about the risks in the S&P 500, with concentration at the top clearly one of them. You have to go back to the late 1950s to find as much of the index made up of the top five names and, spoiler alert, those names didn't hold their weight well at all in the index after getting to that point. We also think there's clearly valuation risk – historically, forward 5-year returns from a level of more than 20x earnings are not good at all. Starting from 11-12x earnings is much more attractive. We really think now there's an unusual opportunity to build a portfolio that's cheaper and far less concentrated than the index, without having to sacrifice a ton of earnings growth to do so.

Turning to a name one might not expect to find in a value investor's portfolio, describe your investment thesis for Airbnb [ABNB].

MN: Like Alphabet, this is the type of idea that might feel out of place for a value manager like us, but a core part of our DNA has always been to look past simplistic valuation metrics to try to find underappreciated sources of value.

The company maintains an online marketplace to list, discover and book unique housing accommodations worldwide. It benefits from a strong network effect between its guests and hosts and from a dominant brand name, and we believe there is a long growth runway for it in an attractive global travel market where alternative accommodations are taking share.

The stock, however, has come under pressure due to concerns about Airbnb's heavy investment spending to broaden revenue opportunities as well as the increasing threat of a near-term travel recession. We think that's obscuring a number of levers the company has to increase revenue and margins. As comparable sites do, they can offer paid-placement opportunities for hosts on their platform, which would drive incremental high-margin revenue. We think they have considerable room to increase their "take rate" – the commission they earn on bookings – which they've purposely kept low to help build market share but the rate is now materially lower than what similar companies like Booking.com earn.

We also believe management is making the right decision with its investment spending to plant seeds for future growth, despite that squeezing margins today. Not all of these will hit, but there are natural adjacencies to open the platform to services for hosts and for guests. For hosts that might mean offers for property management, cleaning and landscaping. On the guest side that might mean trying to close the amenities gap with hotels by offering food, spa, physical training, outdoor adventure or photography services.

We assume CEO Brian Chesky fits the bill for you as a leader who "thinks and acts like an owner."

MN: Very much so. He built the business, takes an annual salary of $1 with no bonus, owns a multi-billion-dollar stake in the company outright, and has a compensation plan that will pay out $5.8 billion if the stock price hits $485 by 2030.

He's clearly playing a long game and has proven willing to trade off lower short-term profitability for what he believes is longer-term gain. He could increase margins dramatically if he spent less on R&D or increased the take rate to be more in line with peers. He's been focused on establishing market position in a giant market and considers opportunities

INVESTMENT SNAPSHOT

Airbnb
(Nasdaq: ABNB)

Business: Operates, manages and promotes an online marketplace that facilitates the listing, discovery and booking of unique housing accommodations worldwide.

Share Information (@5/30/25):

Price	**129.00**
52-Week Range	99.88 – 163.93
Dividend Yield	0.0%
Market Cap	$79.23 billion

Financials (TTM):

Revenue	$11.23 billion
Operating Profit Margin	22.2%
Net Profit Margin	22.6%

Valuation Metrics
(@5/30/25):

	ABNB	S&P 500
P/E (TTM)	32.3	23.7
Forward P/E (Est.)	30.3	22.1

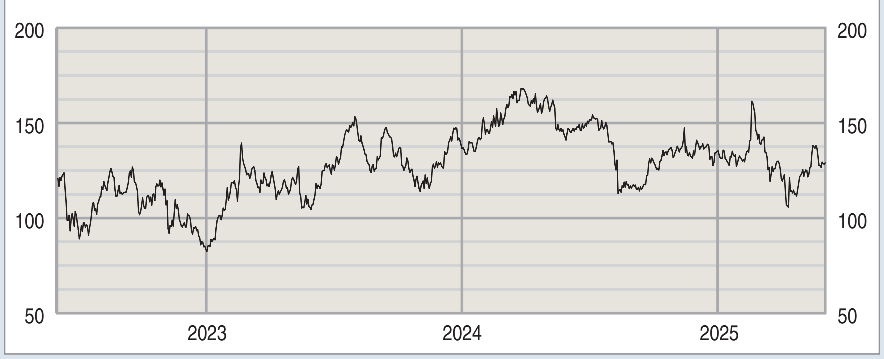
Largest Institutional Owners
(@3/31/25 or latest filing):

Company	% Owned
Vanguard Group	6.1%
BlackRock	4.9%
Sequoia Capital	3.2%
State Street	2.9%
Fidelity Mgmt & Research	2.4%

Short Interest (as of 5/15/25):

Shares Short/Float	3.8%

ABNB PRICE HISTORY



THE BOTTOM LINE

Concerns about investment spending and the threat of a travel recession are obscuring the company's long growth runway and the levers it can pull around profitability, says Mike Nicolas. The stock on his normalized estimates trades at a significant discount to the market, he says, for a company with much better growth prospects than the market's.

Sources: S&P Capital IQ, company reports, other publicly available information

to drive margins higher to be non-perishable – based on his record, we wouldn't argue with any of that.

At a recent $129, how inexpensive do you consider the shares?

MN: We're probably relatively in line with consensus in assuming the company can grow its top line at maybe twice the rate of the overall travel industry, which should grow at a mid-single-digit annual rate. The bigger call we're making is that the normal profitability of the business is far higher than what we're seeing today. Normalized operating margins we think could be in the mid-30s, around what Booking earns today.

For the potential bottom-line growth all that would generate, we think we're paying a P/E today, adjusting for the cash on the balance sheet, that is several turns below the multiple on the S&P 500. If we're right about the profitability, this is a business that would deserve a well above market multiple. That disconnect is our opportunity.

From online travel to U.S. regional banking, why are you high on the investment prospects for First Citizens Bancshares [FCNCA]?

BN: Some history is in order here. I'm old school and like to look at *Value Line* to get up to speed when an idea is first recommended. When that happened in late 2020, soon after First Citizens had announced it had agreed to buy CIT Group, there was no *Value Line* entry available. I soon learned, however, that this was an extremely well-run bank with a successful record of buying and integrating often-troubled smaller banks, many times directly from the FDIC. It had (and has) a wonderful low-cost deposit franchise in the Southeastern U.S. and an excellent reputation in servicing high-net-worth customers.

What First Citizens had more trouble doing was redeploying deposits as rapidly as it brought them in, a problem the CIT acquisition would address. CIT was never very good at gathering deposits, but it had a very good lending operation to small and mid-market businesses. We thought the deal, which was made at a discount to CIT's book value, had the potential to be very accretive.

That turned out to be the case and we were starting to assess whether our position size – we owned the stock in the Oakmark Select Fund – had gotten too big when the U.S. regional-banking troubles hit in 2023 and First Citizens was again in the news as the winning bidder for Silicon Valley Bank. Our take was that the company got a tremendous price and was more than up to the task so we thankfully kept our position in Oakmark Select and initiated a position as well in Oakmark Fund. [*Note:* Since the day before the SVB acquisition was announced, First Citizens shares are up 220%.]

MN: A big part of the story here is Frank Holding, the company's long-time Chairman and CEO. Through a combination of smartly done acquisitions and solid organic growth, he's overseen during his tenure as CEO double-digit annual growth in book value per share, 3x the pace of the average top-20 U.S. bank. SVB was

INVESTMENT SNAPSHOT

First Citizens Bancshares
(Nasdaq: FCNCA)

Business: U.S. regional bank with nearly $230 billion in assets operating primarily in the southeastern and western U.S.; acquired Silicon Valley Bank from the FDIC in 2023.

Share Information (@5/30/25):

Price	**1,848.88**
52-Week Range	1,473.62 – 2,412.93
Dividend Yield	0.4%
Market Cap	$24.37 billion

Financials (TTM):

Revenue	$9.09 billion
Operating Profit Margin	34.8%
Net Profit Margin	27.8%

Valuation Metrics
(@5/30/25):

	FCNCA	S&P 500
P/E (TTM)	10.6	23.7
Forward P/E (Est.)	11.2	22.1

Largest Institutional Owners
(@3/31/25 or latest filing):

Company	% Owned
BlackRock	9.4%
Vanguard Group	7.2%
Capital Research & Mgmt	6.1%
Harris Assoc	5.0%
J.P. Morgan Asset Mgmt	2.7%

Short Interest (as of 5/15/25):

Shares Short/Float	4.3%

FCNCA PRICE HISTORY

THE BOTTOM LINE

While still not particularly well known, the company is one of the best-managed banks in the U.S., says Mike Nicolas, with a particular strength in acquiring and integrating troubled industry peers. "We get very excited," he says, in situations like this where the stock trades in line with other regional banks despite this being a far superior business.

Sources: S&P Capital IQ, company reports, other publicly available information

in free fall when First Citizens took over and Holding and his team have done a remarkable job in stabilizing the business – which still has a very attractive franchise servicing startups and the venture capital industry – and it is now starting to grow again. This all could have just gone away. It's a credit to how well First Citizens is run that it didn't.

Trading recently at around $1,850, why do you still consider the stock attractive?

MN: The opportunity here is that the stock at 1.1-1.2x book value and maybe an 11x consensus forward P/E trades in line with other regional banks. When there's no premium for the better business – with low-cost deposits, disciplined and prudent lending, good geographies and interesting potential upside with SVB – we get very excited.

BN: The old rule of thumb says that a bank should trade at a P/E in line with its long-term return on equity. Say that's 13-14% here, which would suggest a 13-14x P/E. We think even that level, for a business with this record of book-value growth, would be an unwarranted discount to the Russell 2000 Value P/E of 17x.

We own a lot in the financial-services space and what we're hearing often is that the current U.S. administration is more interested in seeing competition against the biggest banks, the top three of which have close to 40% market share. First Citizens is #15 today. It's not at all out of the question that they'll make another large, value-accretive deal. They'll certainly be ready for the next opportunity and that's not in our numbers at all.

The last thing I'd mention is that while we're not able to take advantage of it for liquidity reasons, there's a value double-dip here. There's a B share class where the only difference between it and the A share is that the B shares get 16 votes per share instead of one. You'd think they would sell at a premium, but the B shares actually sell at an 11% discount. For small institutions or individuals it's an ideal way to invest in the company.

What do you think the market is missing in Keurig Dr Pepper [KDP]?

MN: The company was formed in 2018 when Keurig Green Mountain bought Dr Pepper Snapple Group. It's now one of the top large-scale beverage companies in North America, with dominant market positions in single-serve coffee and flavored soft drinks. Top brands include Keurig, Green Mountain, Sunkist and Canada Dry.

We actually consider soft drinks one of the more attractive categories within the consumer packaged goods industry. Market share is concentrated with a handful of rational competitors, private-label competition is almost non-existent, customer concentration is quite low, and soda still represents one of the more affordable packaged beverage options on a price per ounce basis. Keurig's brand portfolio in that market has an impressive record of volume growth and market-share gains, which we believe can continue. Their brands skew younger and toward the southeastern U.S., so the demographic trends are pretty good. They've also done a good job in rolling out successful low or no-calorie versions of their products and

INVESTMENT SNAPSHOT

Keurig Dr Pepper
(Nasdaq: KDP)

Business: North American beverage company with primary focus on soft drinks and single-serve coffee; leading brands include Keurig, Dr Pepper, Canada Dry and 7UP.

Share Information (@5/30/25):

Price	**33.67**
52-Week Range	30.12 – 38.28
Dividend Yield	2.8%
Market Cap	$45.73 billion

Financials (TTM):

Revenue	$15.52 billion
Operating Profit Margin	22.2%
Net Profit Margin	9.7%

Valuation Metrics
(@5/30/25):

	KDP	S&P 500
P/E (TTM)	30.6	23.7
Forward P/E (Est.)	16.4	22.1

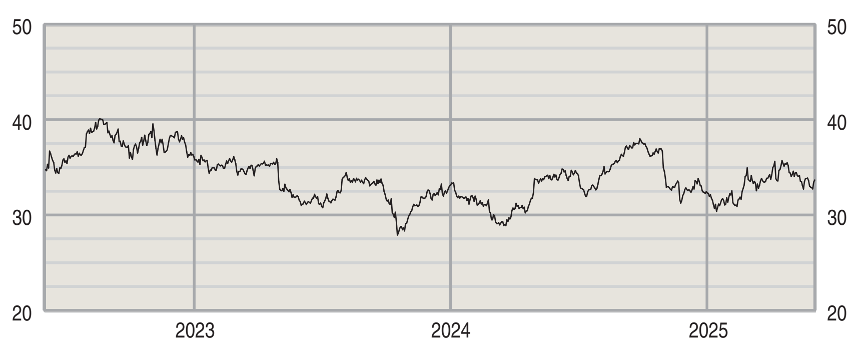
Largest Institutional Owners
(@3/31/25 or latest filing):

Company	% Owned
Vanguard Group	10.7%
JAB Holdings	9.9%
Capital Research & Mgmt	8.7%
BlackRock	7.3%
Fidelity Mgmt & Research	6.1%

Short Interest (as of 5/15/25):

Shares Short/Float	1.7%

KDP PRICE HISTORY



THE BOTTOM LINE

The company has an excellent record of volume and market-share growth in soft drinks, but investors seem more concerned about what Mike Nicolas considers to be temporary issues in its coffee operation. At the current share price he believes the coffee division, which made over $1 billion in operating income last year, is essentially available for free.

Sources: S&P Capital IQ, company reports, other publicly available information

continue to use their established brand and distribution advantages to build out offerings in faster-growing categories like bottled water, seltzers, ready-to-drink coffee and sports and energy drinks. As just one example, Keurig announced earlier this month it was buying Ghost Beverages, an up-and-coming player in the energy-drink space.

The stock has been under pressure more due to the coffee division, which makes up roughly one-quarter of the total profits today. That business has been impacted by at-home coffee consumption normalizing as people have returned to the office. In addition, the pricing for green coffee (which refers to coffee beans that have not been roasted) is at generational highs right now and as those prices are passed through it has crimped volumes. We generally think these challenges will prove transitory. Coffee popularity shows no signs of slowing and single-serve continues to increase its penetration at home, positioning Keurig to benefit as it has the largest installed base of single-serve brewers and its share of coffee-pod volumes is dominant.

How are you looking at valuation from today's price of around $33.70?

MN: The stock trades at 16.4x next year's consensus earnings, while most other peer beverage companies trade at 20x or higher. We think that's unjustified for a company that is performing as well or better than anyone in the industry. At today's share price we believe the market is ascribing almost no value to the coffee division, which earned over $1 billion in operating income last year and we think still has a very bright future.

Phillips 66 [PSX] has been in the news lately due to Elliott Investment Management's high-profile activist campaign against it. Describe why you think its shares are mispriced.

MN: Phillips 66 is an integrated midstream and downstream energy company that operates refineries, pipelines, chemical manufacturing facilities and retail fuel stations. The market seems to think of it as primarily a refiner, but we believe the majority of the company's intrinsic value comes from its non-refining business segments, which provide a more stable base of cash flow.

The refining business gets outsized attention because it's so cyclical. In 2022, a boom year for refiners, Phillips' refining division earned close to $9 billion in EBITDA. This for a company with a current enterprise value of around $65 billion. Margins in that business have since collapsed and the refining division today is losing money. We thought refining was significantly overearning in 2022 and we think it's significantly underearning today. We don't think the business is broken or going away for a long time, so generally we expect supply and demand to eventually come into better balance and that normal margins in this business should reflect historical average crack spreads. [*Note*: Crack spreads represent the price difference between refined products like gasoline and heating oil and the price of crude oil.]

With that approach toward refining, we're then able to look at the non-refin-

INVESTMENT SNAPSHOT

Phillips 66
(NYSE: PSX)

Business: Diversified midstream and downstream energy company operating refineries, pipelines, chemical manufacturing facilities and retail fuel stations mostly in the U.S.

Share Information (@5/30/25):

Price	**113.48**
52-Week Range	91.01 – 150.12
Dividend Yield	4.2%
Market Cap	$46.24 billion

Financials (TTM):

Revenue	$137.77 billion
Operating Profit Margin	0.8%
Net Profit Margin	1.3%

Valuation Metrics
(@5/30/25):

	PSX	S&P 500
P/E (TTM)	25.6	23.7
Forward P/E (Est.)	15.6	22.1

Largest Institutional Owners
(@3/31/25 or latest filing):

Company	% Owned
Vanguard Group	9.9%
BlackRock	7.3%
State Street	6.4%
Wells Fargo & Co	3.9%
Elliott Inv Mgmt	3.9%

Short Interest (as of 5/15/25):

Shares Short/Float	2.1%

PSX PRICE HISTORY

THE BOTTOM LINE

The company's market fortunes tend to vary based on the cyclical performance of its refining business, but Mike Nicolas considers its other divisions much more attractive and believes they account for the majority of overall intrinsic value. Even a 10x multiple on his estimate of normal earnings would provide "meaningful upside" from today's share price.

Sources: S&P Capital IQ, company reports, other publicly available information

ing operations on a sum-of-the-parts basis. The pipeline business collects tolls on volume going through its system and benefits from regulatory barriers to entry. It is vertically integrated into the chemical-manufacturing operation – a joint venture the company owns with Chevron – which we think has an advantaged cost position and solid growth prospects, even if it's not at a high point in the cycle today. The retail business has been steady and generates good cash flow. Altogether, including refining, management is targeting $15 billion in annual mid-cycle EBITDA. Again, that's on a current enterprise value of $65 billion.

Elliott, which earlier this month got two additional seats on the board, has been pushing Phillips to sell or spin off various of its divisions. Would you agree that's a viable path forward to unlock value?

MN: We'd rather not talk about specifics related to the activist campaign. The core of Elliott's case is that the company's conglomerate structure along with what they view as subpar refining performance is leading to substantial undervaluation in the shares. We haven't taken a public position on any of that other than to agree the shares are substantially undervalued.

How undervalued do you think the stock is at today's price of around $113.50?

MN: On our estimate of normal earnings, if the stock traded at even a 10x P/E – half the market multiple – we'd have meaningful upside from today's share price. On a sum-of-the-parts basis, we estimate the midstream and chemicals businesses together are worth the entire current enterprise value, meaning refining, retail and some other small pieces are effectively available for free.

We also like that they're returning a lot of capital. When management laid out its 2025-2027 strategic targets, that included returning at least 50% of net operating cash flow to shareholders through dividends and share buybacks. At today's valuation, we think that makes a lot of sense.

Let's talk about a couple ideas you've sold out of recently and why. Was Altria [MO], sold in last year's fourth quarter, primarily a happy story?

MN: It was a successful investment for us, but it wasn't all roses. The fundamental business performance with respect to cigarette volumes had worsened – faster than we expected – and we became increasingly concerned that the company's pricing power to compensate might become more difficult. We were able to enter the position at a cheap enough valuation that even though the fundamentals weren't up to our expectations, the cheap stock price and the significant capital return from dividends and buybacks made the investment outcome reasonably good. Buying cheap is one of the best risk-mitigation tools.

BN: One position we sold around the same time as Altria that worked out less well was Cisco [CSCO], the networking-solutions company. We initiated the position in the third quarter of 2023 when the valuation on the stock stuck out like a sore thumb relative to the tech space and to the S&P 500. We thought they were on the cusp of a turnaround and management was talking about how easy it was going to be to beat their 5% annual organic-growth targets. That turned out not at all to be the case over the first two quarters we owned the stock, and in line with our mistake-management process we met with the CEO and lost our conviction in the idea even though we'd owned it for less than a year. We concluded that there was no way we would buy it at that point – to us that's a sell.

Any thoughts come to mind around Warren Buffett's stepping-aside announcement earlier this month?

BN: Even though I've never meant him, I feel like he's been an important mentor. There has been no better teacher of the value-investing philosophy, and by his words and deeds he gave us all the freedom to think more broadly about what business value is and how that might not best be captured in the GAAP financial statements.

He has also been a fantastic role model in other ways. In a mutual fund industry that has often viewed investor communication as a necessary evil required by the SEC, we from the start have tried to model our communications after Buffett's, believing that the best shareholders are those who share your philosophy, which requires that they truly understand your process and how you think. We've always tried to emphasize communication that educates as well as informs.

He's also been a great role model in planning for succession. I'll be 67 this year and his example is one I'm trying to follow. One reason you see so few successful transitions in investment-management companies is because founders and long-time portfolio managers often keep 100% of the decision-making until they turn the lights out for the last time and say good luck to whoever comes next. That's a really bad recipe for a successful transition. Well before the time I'm ready to transition to being more of an external spokesperson and internal mentor, we have for years had people like Mike in place making day-to-day and strategic portfolio decisions. When I move on, nothing will change for them. Buffett showed us all how to do that right.

Any thoughts on Berkshire Hathaway as an investment?

BN: It's a company we admire, and we think the investment team is much deeper than just Warren and will continue to do an exceptional job. But because the business has been so well run and there's so little controversy, we've rarely seen a time when the shares were at a level we were willing to pay relative to alternatives trading at even deeper discounts. Of course that wasn't always the right decision to make, but that's generally kept us out of the stock so far. VII

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Disclosures:

AVERAGE ANNUALIZED TOTAL RETURNS (%) as of 03/31/2025

	Inception date	QTD	1 yr	3 yrs	5 yrs	10 yrs	Since inception	Expense ratio
Investor Class | OAKMX	8/5/1991	1.14	6.41	10.97	23.71	11.96	12.76	0.89
S&P 500 Index		-4.27	8.25	9.06	18.59	12.5	10.44	

Expense ratios are as of the Fund's most recent prospectus dated January 28, 2025, as amended and restated January 30, 2025, March 14, 2025 and May 19, 2025; actual expenses may vary.
Past performance does not guarantee future results. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. **Current performance may be lower or higher than the performance data quoted.** Total return includes change in share prices and, in each case, includes reinvestment of dividends and capital gain distributions. To obtain most recent month-end performance data, visit Oakmark.com.

As of May 31, 2025, the holdings mentioned above comprise the following percentages of the Fund's total net assets:

Security	Oakmark Fund
Airbnb Cl A	2.3%
Alphabet Cl A	3.7%
Altria	0%
Apple	0%
Cisco	0%
Constellation Brands CL A	1.1%
First Citizens Bcshs Cl A	2.1%
GE Healthcare Tech	1.4%
General Electric	0%
General Motors	2.4%
Keurig Dr Pepper	1.8%
Meta Platforms	0%
Netflix	0%
Phillips 66	2.5%

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Please visit Oakmark.com to view the full list of holdings for the Oakmark Fund as of the most recent quarter-end.

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Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors.

Magnificent 7 stocks refer to Alphabet Class A, Amazon.com, Apple, Meta Platforms, Microsoft, NVIDIA and Tesla.

The price to earnings ratio ("P/E") compares a company's current share price to its per-share earnings. It may also be known as the "price multiple" or "earnings multiple", and gives a general indication of how expensive or cheap a stock is. Investors should not base investment decisions on any single attribute or characteristic data point.

EBITDA refers to Earnings Before the deduction of payments for Interest, Taxes, Depreciation and Amortization which is a measure of operating income.

The S&P 500 Index is a float-adjusted, capitalization-weighted index of 500 U.S. large-capitalization stocks representing all major industries. It is a widely recognized index of broad, U.S. equity market performance. Returns reflect the reinvestment of dividends. This index is unmanaged and investors cannot invest directly in this index.

The Russell 2000® Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. This index is unmanaged and investors cannot invest directly in this index.

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Before investing, carefully consider fund investment objectives, risks, charges and other expenses. For this and other information that should be read carefully, please request a prospectus and summary prospectus by calling 1-800-OAKMARK (625-6275) or visiting oakmark.com.