ValueInvestor INSIGHT
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The Leading Authority on Value Investing

Investor Insight: David Herro

The "weight of money" in the market focuses more on expected changes in stock prices than in intrinsic values, says David Herro. Which is perfectly fine by him.

INVESTOR INSIGHT

Harris Associates
David Herro (*l*), Eric Liu (*r*)

Investment Focus: Seek companies whose ability to increase value over time appears at the moment to be overlooked or significantly misjudged by the market.

It's hard to find a value investor who doesn't cite his or her time horizon as a competitive advantage. David Herro, Harris Associates' long-time international-investing head, puts it this way: "If you manage for the short term you'll be lucky to be average over the long term," he says. "We manage for the long term to give ourselves the chance to be above average over time."

He's taken full advantage of that opportunity. The $21.7 billion (assets) Oakmark International Fund he's managed since its inception in 1992 has earned a net annualized 8.3%, vs. 5.6% for the MSCI World Index ex-US. In a highly "bifurcated" market, Herro and fellow portfolio manager Eric Liu see unrecognized upside today in such diverse areas as banking, security software, Internet services, mining and automobiles.

Morningstar's latest report on the Gold-rated Oakmark International Fund you've managed for nearly 30 years is titled, "A comeback (and cardiac) kid." What do you make of that designation?

David Herro: The key tenets of our strategy have been in place from the beginning. Invest in companies that we expect to grow per-share value over time, that are run by management teams that think and act like owners, and do so when their stocks trade at a significant discount to our estimate of intrinsic value.

We end up looking contrarian because we care about what we pay, and go to places that are undervalued as a result of the weight of market money giving up and moving on to something else. Mr. Market likes to generalize, and Mr. Market is impatient. So a company may be going through a cyclical downturn or may have macro headwinds, but Mr. Market doesn't care if the price has fallen further than expected changes in intrinsic value or if the situation will revert back in the medium to long term. It's all about the here and now. This, of course, is the opportunity for patient investors, creating an exploitable market imperfection for those who invest long term. But it also means we often invest in areas that are out of favor and can remain so for what many might consider an uncomfortably long period of time.

Eric Liu: I would also say we have a more eclectic approach than might be indicated by the "cardiac kid" label. In addition, we invest in areas that might generally be more in favor, but where we're finding extra value that we think the market is missing. These are ideas that still trade at a significant discount to our estimate of intrinsic value, but the reasons may be different than a more cyclical or macro trend.

To give an example, in the first quarter we bought Alibaba [BABA], which is clearly well known as one of the premier Internet companies in the world. One factor was price, as the shares fell 25% when virtually everything was being sold off regardless of the company or business. But beyond that, we didn't think it was being valued properly given that many of its businesses had yet to fully scale. You see some of the sell side valuing Alibaba on one-year-out earnings, but in doing that you're very likely to misvalue something like the company's cloud business, which is a leading market player in China. That business loses money today and even three years out will be far from the profitability it should eventually have. Putting a multiple on one-year forward earnings in our opinion misses a lot of value here. [*Note*: After hitting a 52-week low of $170 in March, Alibaba's shares have since increased to a recent $313.]

This we've held longer, but another example would be NAVER [Seoul: KRX], the largest Internet company in Korea with leading franchises in search, e-commerce, payments and messaging. The company is successfully growing its existing businesses, developing new businesses from scratch – like Webtoons, the #1 global platform for online comics – and managing the business to realize shareholder value. It's merging its Line Corp. Japanese subsidiary with Yahoo Japan to create one of the most promising Internet companies in Japan. It spun out its fintech subsidiary, taking in a sizable third-party investment.

As impressive as that all sounds, we were able to buy the stock in 2018 at a 14x P/E, after taking out the losses for Line, which was spending heavily to grow. There were narratives on the sell side about out-of-control spending to hire engineers. There was increased concern that YouTube's growth in Korea would hurt NAVER's search business. And Line, which is a messaging/communications business like WhatsApp or WeChat, was losing all this money. We saw none of those concerns as permanent, which allowed us to buy at what we believed was a very reasonable price. We love to invest in growth companies, we just need to make sure the entry multiple affords us an appropriate margin of safety.

Is the story on NAVER out by now?

EL: Our position size now is lower, but we still think there's material upside. The company continues to execute at a very high level and we think the Line transaction in Japan has the potential to be transformative and will create a lot of value over the long term.

You talk about investing with management that thinks and acts like owners. Is that harder to do outside than inside the U.S.?

DH: American companies, in general, have a stronger commitment to building shareholder value. But this is a critical issue no matter where you invest. We want to align ourselves with managers who are not only committed to creating value, but they're also capable of doing so. They also can't be just capable, they have to be committed. That means they understand the primary purpose of a public company is to make money for its shareholders. This is why it exists. It's not a government entity, it's not a not-for-profit. It exists to create wealth over the long term for its owners, which are our clients, looking to save for retirement, or college, or to buy a house.

Take a company like Danone [Paris: BN]. They're in a number of excellent businesses, such as yogurt, infant formula, healthy nutrition and water. But we think management has lost their way on who they're running the company for. It's fine that they care about a number of ESG [environmental, social and governmental] metrics, but these should be features of how the company operates, not its purpose. In our view they get so carried away with what they want to be that they ignore what they should be, a value-creating company to generate shareholder return. By the way, it shows up in performance and in the share price. For any time period over the past ten years, do a comparison between it and Nestlé [Zurich: NESN] and you'll see a material difference.

ON VARIANT VIEWS:

We invest in areas that might be more in favor, but where we're finding extra value we think the market is missing.

It seems like ages ago, but where you were focused as a portfolio manager when markets fell off a cliff in February and March?

DH: With the shock to the macroeconomy, step one was reviewing all of our estimates of intrinsic value to make sure they credibly reflected what was happening in the broader economy and the specific industry. Step two was then to maintain a forward-looking portfolio and try to take advantage of the significant volatility in share prices. That meant making sure the stocks with the biggest gaps between our measurement of intrinsic value and the current stock price had the most exposure in the portfolio. It's not surprising we had elevated trading in March and April as share prices were so volatile. Then, of course, we were also busy with new ideas.

Eric mentioned Alibaba as a newly created opportunity. Did the ideas tend to be more like it – a great franchise that gets cheap enough due to indiscriminate selling – or were you also investing in ideas more specifically impacted by the pandemic?

EL: There was a mix of both. Amadeus IT Group [Madrid: AMS] was and is in the eye of the storm. It's like Sabre [SABR] in the U.S., but providing the technology platform connecting travel agencies with airlines' flight inventory primarily in Europe, Asia and Latin America. It's a technology business with a very strong market position and excellent profitability, but the pandemic's impact on the travel industry obviously hit the stock very hard. We believe air travel is eventually going to come back, and while normality for the company has been pushed out a couple of years, when it does come back the potential upside in the stock – which is still nearly 50% off its pre-pandemic highs – is very attractive.

Another idea that wasn't a pandemic play but which we thought became exceptionally cheap is Fresenius [Frankfurt: FRE], which is the global leader in dialysis equipment and dialysis centers. It seems like there's been somewhat of a cloud over this industry as there have historically been high-profile cases of overcharging medical providers, at the same time as you've seen downward pressure on dialysis reimbursement rates. But our view is that this is a critical service that unfortunately as populations age and become less healthy will see increased secular demand for some time. The stigma over regulatory issues should continue to fade, and we also believe the pricing environment is poised to become much better for the company.

The stock has come back from its fall earlier in the year, but [at a recent €31.50] still trades for less than 11x earnings before interest and taxes. We think that's too low for a company with a strong market position, excellent returns on capital, and that can sustainably generate high-single-digit annual earnings growth.

It doesn't appear you added to your stake in Rolls-Royce [London: RR], another business directly hit by Covid's impact on travel. Why?

DH: This was our most impacted stock, which at one point was down as much as 85-90%. Roughly half of the business by revenue is fine, in defense and producing civil power systems. The other half – and much more than half in terms of cash flow – comes from providing engines for widebody aircraft like the 787 or the A330, which is unfortunately the weakest and probably slowest-to-return part of the travel market. We've held on to our position despite sharply cutting our estimate of intrinsic value because we think the current share price [of around 70 pence] implies that the entire business has declined as much in value as the civil-aviation business. We don't believe that's the case.

Just after the close of the third quarter the company announced a £2 billion equity rights issue as part of a £5 billion recapitalization package that should ensure adequate liquidity even if flight hours increase only moderately in 2021. We're in the process of looking at whether we want to participate.

Is the valuation divergence we're seeing today between the haves and have nots in the U.S. as prominent outside the U.S.?

EL: It's more extreme in the U.S. but we're generally seeing very bifurcated markets, with the P/E differential between growth and value at roughly double what it has been historically. As a value manager, then, it's not surprising that our portfolio has shifted more into areas that are unloved, like cyclical industrials and financials. We also have a very high percentage of the fund in Europe.

DH: We regularly track the cents on the dollar at which our portfolio companies trade relative to our measurements of intrinsic value. The overall portfolio range generally has been between 45 cents and 75 cents on the dollar. The highest was 80 cents in the second quarter of 1997 and the lowest, at 35 cents, was in March of this year. (The cheapest before that had been 40 cents in March 2009.) Today we're at just over 50 cents, which to me signifies a very attractive opportunity set.

How high today is the exposure to Europe relative to the past?

DH: We've usually had a majority of the fund in Europe, but having the exposure above 80% as it is today is at the high end of the historical range. It's purely a function of where we're finding value.

EL: How we define value is the price we're paying for the quality we're getting. There have been times in the past when David has had around 25% of the portfolio in Japan, say, but today you're paying a market multiple of 15-16x in Japan for average returns on equity that are 7-8%. In Europe you pay a similar multiple but the ROEs are 10-12%. If we're getting better-quality companies with better governance at a similar price, that's where we should be allocating money.

ON "PURPOSE":

Managers should understand the primary purpose of a public company is to make money for its shareholders.

Describe the quality you're getting for the price you're paying for European bank BNP Paribas [Paris: BNP].

DH: I would argue that European financials is the area where there is the most value today in the world, and we believe this particular name is one of the highest-quality banks in the sector.

There are several aspects to that quality. BNP has a dominant retail banking franchise, primarily in France but also in the Benelux countries and Italy. It consistently outperforms in terms of credit quality. It's strengthened its commercial banking franchises where competitors have pulled back. It's also done an excellent job in diversifying its business base to expand sources of earnings outside of interest income. That's happened through growth in areas like investment management and in selling insurance and other financial services through their branches and online. All of that is important in a low and negative interest rate environment.

At the same time, the company hasn't tried to be all things to all people, exiting riskier business lines where it has no particular advantage. Management has also been focused on transforming the cost base, hitting cost-to-income targets that are fully in line with what we would expect. Finally, while it's been a drag on earnings and returns on equity for much of the last decade, they've increased regulatory capital to above required levels. The Tier 1 capital here is almost 14%, up from 5-6% ten years ago.

The result of all this is a bank today with cost-of-funding, liquidity and scale advantages versus its smaller peers, which in a not-great economy – but off a low base – has grown its tangible book value at 5.5% per year over the last ten years.

We take it you believe management of this French company is acting like owners.

DH: We do think they're working hard for shareholders, which is evidenced by how well they've delivered on book-value-per-share growth. European banks have been forced by regulators to suspend dividends because of the pandemic, but BNP's management has been chomping at the bit to resume the dividend and continues to build excess capital that we expect to find its way back to shareholders.

How inexpensive do you consider the shares at today's €29.30 price?

DH: Tangible book value per share at the end of December was just under €70, so the current share price is less than 45% of that. This for a bank that consistently grows book value and earns a current 9-10% ROE that should be at least 11-12% on a normalized basis. Based on the last dividend paid, the dividend yield today would be more than 10%.

We believe a bank of this quality, with its balance sheet and revenue drivers, should trade at book value. And as we get past Covid and one day see some interest-rate normalization, book value can be

INVESTMENT SNAPSHOT

BNP Paribas
(Paris: BNP)

Business: Paris-based global bank offering a full range of financial services through two operating divisions: Corporate Institutional Banking and Retail Banking and Services.

Share Information
(@10/29/20, Exchange Rate: $1 = €0.86):

Price	**€29.31**
52-Week Range	€24.51 – €54.22
Dividend Yield	0.0%
Market Cap	€37.12 billion

Financials (TTM):

Revenue	€40.70 billion
Operating Profit Margin	24.1%
Net Profit Margin	18.1%

Valuation Metrics
(@10/29/20):

	BNP	S&P 500
P/E (TTM)	5.9	38.2
Forward P/E (Est.)	6.6	25.5

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Dodge & Cox	2.8%
Vanguard Group	2.6%
Harris Associates	2.4%
Lyxor International Asset Mgmt	2.3%
Norges Bank Inv Mgmt	2.1%

Short Interest (as of 10/15/20):

Shares Short/Float	n/a

BNP PRICE HISTORY

THE BOTTOM LINE
A high-quality player in what David Herro considers the most mispriced industry sector in the world, the company is well capitalized and has continued to grow its tangible book value in a challenging economic environment. He believes the stock deserves to trade at tangible book value, which would result in a more than doubling of the current price.

Sources: Company reports, other publicly available information

much higher than it is today. Given the attractiveness of the risk profile and the upside we see in the share price, this as of the end of September was our largest position.

Would BlackBerry [BB] be one of your growth-you-don't-have-to-pay-for names?

EL: We think BlackBerry is very misunderstood and overlooked by the market. People still think of this as the company that made enterprise smartphones, but over the past five years it has been completely overhauled to where now all it does is software, no hardware.

There are three main businesses. One is called QNX, which is the leading real-time operating system used for safety and infotainment systems in automobiles. It's a Unix-based system that allows for much better reliability, which has made it the de facto standard in the market, with roughly 60% market share. As the automobile continues to digitize and autonomous-driving functionality is added, revenue per vehicle for QNX should grow rapidly. When we get through the current pandemic recession we expect this business to grow at a mid- to high-teens rate for some time.

The second important business is called UEM, which stands for Unified Endpoint Management. BlackBerry was originally known for the security of its phones and that has helped it become the #2 player in offering endpoint security software for mobile phones. Endpoint security in general focuses on security management and administration, including data encryption and mitigating data loss, and the company's strongest position is in phones used by employees in regulated sectors, including government, banks and law firms. This is a more-mature business, probably growing in the mid single digits, but should generate attractive free cash flow over time.

The third big piece is Cylance, which was acquired in 2019 and competes in the rapidly growing market for next-generation enterprise security software that uses machine learning to predict security threats. Other big players in the market include CrowdStrike [CRWD], a listed company trading at around 28x sales, and Carbon Black, which VMware bought a year ago for more than 8x sales.

Other than neglect, what in your estimation is dampening the market's enthusiasm for BlackBerry?

EL: We think it's out of favor for a couple of additional reasons. QNX is tied to the automotive sector, and automotive has been hit hard by Covid. We think that's short term in nature and will come back. Another issue is that Cylance hasn't been growing as rapidly as its peers. Here we expect growth to accelerate next year with the release of new products and the benefit of heavy investment in the sales effort.

There's probably an element of investor fatigue here as well. It's no small effort to transform a business and culture as fundamentally as has needed to be done here. We are very high on the management team led by CEO John Chen, who's been in the job since 2013. He has a brilliant track record, particularly as CEO of database-software company Sybase, which ended up being sold to SAP for something like 10x the market value it had when he joined. His comp plan has very high hurdles but could ultimately be worth more than $400 million, so he's well aligned with us. It hasn't been a smooth ride at every step of the way, but we think the progress made in repositioning the company has been consistently positive and that the trajectory from here is very much up.

How do you see that translating into upside for the stock, now at around C$6.15?

EL: One way to come at it is to look at a sum of the parts, which because these are software businesses primarily uses precedent transactions on a multiple-of-sales basis. Comparable but lower-margin businesses than QNX, like Wind River and Green Hills Software, have been sold for close to 30x EBIT, so we think that business could easily be worth 4 to 4.5x sales. UEM is more mature, but if a company like Symantec can be bought for 4x sales, we don't think 3x sales is aggressive to use for UEM. For Cylance, a starting point is the multiple BlackBerry paid for it last year, which was about 7x sales. Adding in their profitable licensing business, net cash on the balance sheet and the value of net operating losses, we arrive at a per-share value for the stock of C$10 per share.

The company overall is generating low margins today because of investment spending on Cylance and the sales force, so the natural state of the margins has yet to come out. If we assume 20% operating margins for the entire business – low for software – the company today is trading at 7x normalized operating profit on an enterprise value basis. If we use a more reasonable 16x EV/EBIT, which is roughly 20x earnings, that also gets us to a share value of close to C$10.

So this is another growth business that we think today is offering a significant margin of safety. We aren't valuing the business at what we'd consider take-out value, which we'd argue is quite a bit higher. We think that further protects us on the downside.

Sticking with technology, explain why you're betting on Chinese Internet giant Tencent through South African holding company Naspers [Johannesburg: NPN].

EL: Naspers is a fascinating story, having been a newspaper company before transforming itself into a pure digital holding company, anchored as you mention by an early investment in Tencent [HK: 700]. Today there are additional investments in online classifieds, online food delivery, digital payments and online education, but most of the value here resides in the 31% Tencent stake. To be precise, after moving its non-South African holdings last year to an Amsterdam-listed entity called Prosus [PRX], most of the value of Naspers comes from its 72% ownership of Prosus, which now owns the Tencent stake.

Before we get to valuation, I'm trying to think how we might be different in viewing Tencent, which I would say is generally regarded as one of the best businesses in the world. The WeChat social network is a fantastic ad-based business. WeChat Pay is everywhere in China and also a fantastic business. Tencent has the #2 cloud-computing business in China after Alibaba. It's also a major e-commerce player through stakes in JD.com and Pinduoduo and increasingly through what they call mini-shops in the WeChat ecosystem.

INVESTMENT SNAPSHOT

BlackBerry
(Toronto: BB)

Business: Canada-based provider of cybersecurity, safety and data privacy software and systems meant for its customers to better "secure a connected future [they] can trust.

Share Information
(@10/29/20, Exchange Rate: $1 = C$1.33):

Price	**C$6.14**
52-Week Range	C$3.94 – C$8.99
Dividend Yield	0.0%
Market Cap	C$3.40 billion

Financials (TTM):

Revenue	$1.01 billion
Operating Profit Margin	(-9.4%)
Net Profit Margin	(-72.2%)

Valuation Metrics
(@10/29/20):

	BB	S&P 500
P/E (TTM)	n/a	38.2
Forward P/E (Est.)	43.9	25.5

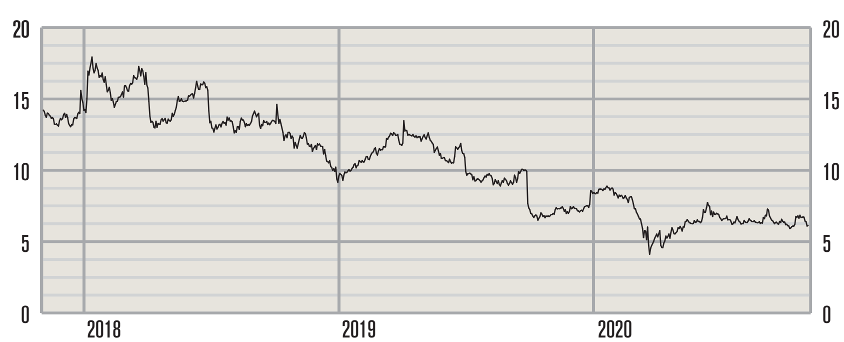
Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Primecap Mgmt	11.4%
Hamblin Watsa Inv Counsel	8.4%
Ontario Teachers' Pension Plan	3.6%
Vanguard Group	2.5%
Arrowstreet Capital	1.6%

Short Interest (as of 10/15/20):

Shares Short/Float	n/a

BB PRICE HISTORY



THE BOTTOM LINE

Having completely transformed itself from a previous hardware-centric incarnation, Eric Liu believes the company is misunderstood and isn't being recognized for how well it's positioned in attractive security-software markets. Valued on a sum-of-the-parts basis or on normalized operating profit, he believes the shares today are worth closer to C$10.

Sources: Company reports, other publicly available information

What we're probably most excited about is the company's gaming franchise, which remains roughly 40% of the business. No one has soup-to-nuts what Tencent does – in game development, publishing, live streaming, cloud technology and strategic equity stakes in companies like Epic games. That makes it what we think is the best-positioned gaming company in the world, in possibly the most attractive area of global entertainment going forward. The average mobile-phone game monetizes at around 10 cents per hour of use and the average console game is at about 50 cents per hour. The same metric for cable television is around 85 cents per hour, while live sports is more than $2. We think gaming has a significant multi-decade runway for growth and Tencent is in a strong position to benefit.

So you could access that through Tencent itself, through Prosus, or through Naspers. At today's 304,000 South African rand per share, why Naspers?

EL: It's purely a function of discount to value. We think Tencent on its own is slightly undervalued. Prosus is at closer to a 35% discount. But today on our numbers Naspers is trading at only 55% of net asset value, which reflects the widest discount we've seen in the past eight years. Coming at it another way: Tencent's stock in U.S. dollars is up close to 50% this year. Prosus on the same basis is up 30%. Naspers' shares are up only 15%. It's simply the cheapest option.

The math is pretty straightforward. Prosus' 31% stake in Tencent is worth about $210 billion at the current market cap. The other stakes we value one by one based on where they trade publicly, against relevant public comps, or against private funding rounds. The online-classifieds business isn't listed, for example, but there is an excellent comp in Advevinta [ADE], which trades in Norway. All in, we value the non-Tencent businesses at $25 billion. Add in $4.5 billion in net cash and that gets you to about $240 billion in value for Prosus, or $175 billion of value for Naspers. Naspers' market cap today is only around $80 billion, thus the 55% discount to net asset value.

I should mention here as well that we're very aligned with management, which has taken steps to unlock value in clever and tax-efficient ways. They've sold assets over time at tremendous gains and paid little tax, and we believe the Prosus deal was structured in a way that means our tax liability as shareholders will be low upon the realization of future gains. We're getting at least two exceptional management teams – at Tencent and at Naspers – for the price of one.

Returning to more of an old-world industry, describe your investment case for Glencore [London: Glen].

DH: The company has two main businesses, mining and commodities trading. The mix between the two can vary depending on commodities prices, but roughly two-thirds of annual revenue comes from mining and one-third from trading.

We first invested in Glencore in 2015 as it was overhauling its balance sheet, asset mix and capital spending. After the China-led "supercycle" commodity bubble popped, Glencore was caught with too

INVESTMENT SNAPSHOT

Naspers
(Johannesburg: NPN)

Business: Holding company for Internet, video, entertainment and media investments; largest holding is in Amsterdam-listed Prosus, which owns a large Tencent stake.

Share Information
(@10/29/20, Exchange Rate: $1 = 16.37 ZAR):

Price	**ZAR 304,046**
52-Week Range	ZAR 184,380 – ZAR 336,726
Dividend Yield	0.2%
Market Cap	ZAR 1.30 trillion

Financials (FY ended 3/20):

Revenue	$4.00 billion
Operating Profit Margin	n/a
Net Profit Margin	n/a

Valuation Metrics
(@10/29/20):

	NPN	S&P 500
P/E (TTM)	n/a	38.2
Forward P/E (Est.)	n/a	25.5

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Public Investment Corp (SOC)	16.8%
Vanguard Group	3.4%
Norges Bank Inv Mgmt	2.2%
BlackRock	1.4%
Allan Gray Ltd	1.4%

Short Interest (as of 10/15/20):

Shares Short/Float	n/a

NPN PRICE HISTORY

THE BOTTOM LINE

There are multiple public vehicles for buying into Chinese Internet and gaming juggernaut Tencent, but Eric Liu believes this is "simply the cheapest option." He says you can buy Tencent directly at what he considers a slight discount, through Amsterdam-listed Prosus at 35% off, and through Naspers at 55% less than its underlying net asset value.

Sources: Company reports, other publicly available information

much debt when commodity prices bottomed in 2015. We sold most of our stake as the share price went up over the next few years from around 70 pence to almost £4.00. Then the trade conflicts started, China began to slow down and Glencore's operating performance and share price took a significant hit. We started building back our position in 2018 and since then have added to it so that we are now the leading institutional owner of the outstanding shares.

An important part of our case is that we believe this is one of the best-placed mining companies for the evolving energy age. Four of the five top areas in which they are involved in mining are copper, cobalt, zinc and nickel, where they have scale and are generally at the low end of the cost curve. If you look at the raw materials needed for things like electric vehicles and a number of renewable-energy applications, at the top of the list would be copper, cobalt, zinc and nickel. To give just one example, the average car with an internal combustion engine today has about 80 pounds of copper in it. An electric car has closer to 300 pounds.

We also believe some of the less ESG-friendly parts of the business have more potential than is likely priced into the shares today. Glencore has a large coal business, for example, where they've said they're not planning to invest in growth or to expand assets. Most competitors are saying the same thing, but at the same time there are hundreds of new coal-fired electricity plants under construction in Asia and Africa, so the demand for coal is likely not going away as quickly as some might believe. We think the supply/demand dynamic for coal could result in strong cash-flow generation for the business for a long time.

How do you value Glencore's shares at today's £1.55 price?

DH: We value the two businesses separately. On the mining side to value reserves we use what we believe are normalized commodity prices based on prospective supply and demand. We assume economic recovery as the pandemic eventually recedes, but we don't believe we're at all making aggressive calls on either prices or volumes. If electric vehicles take off, say, we'll likely have to take up our estimates in areas like copper, cobalt and nickel. The trading business we can value more on normalized operating income, which has actually been quite resilient over time, a fact we don't think the market values as highly as it should. Overall, we think the stock is worth at least £4 per share, which is where it traded at the beginning of 2018.

I should mention management, which owns just under 20% of the stock and impresses us as consistently focused on building share value over time. They'll continue to go through the portfolio of assets and sell or buy based on what makes financial sense. The balance sheet remains lightly levered, so we would not be surprised if as soon as some of the current uncertainty is behind us that we'll see increases in dividends, stock buybacks, or both.

An investment in Germany's Daimler [Frankfurt: DAI] has been dead money, or worse, for more than five years. What's behind your optimism for it today?

INVESTMENT SNAPSHOT

Glencore
(London: GLEN)

Business: Worldwide producer and trader of commodities, with three operating segments focused on Metals and Minerals, Energy Products and Agricultural Products.

Share Information
(@10/29/20, Exchange Rate: $1 = £0.77):

Price	**£1.55**
52-Week Range	£1.10 – £2.64
Dividend Yield	0.0%
Market Cap	£18.69 billion

Financials (2019):

Revenue	$215.11 billion
Operating Profit Margin	1.5%
Net Profit Margin	(-0.7%)

Valuation Metrics
(@10/29/20):

	GLEN	S&P 500
P/E (TTM)	n/a	38.2
Forward P/E (Est.)	10.0	25.5

Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Harris Associates	5.5%
Dodge & Cox	2.8%
Vanguard Group	2.4%
Allan Gray Ltd	1.3%
Norges Bank Inv Mgmt	1.2%

Short Interest (as of 10/15/20):

Shares Short/Float	n/a

GLEN PRICE HISTORY

THE BOTTOM LINE

David Herro believes this is one of the "best-placed mining companies for the evolving energy age," with unrecognized upside as well in "less ESG-friendly" businesses such as coal. Valuing the company's mining and commodity-trading operations separately, he estimates intrinsic value at £4 per share, more than 150% above the current share price.

Sources: Company reports, other publicly available information

DH: We always say management has to have both the commitment to create shareholder value as well as the capability to do so. Two years ago we almost threw our arms up and said that Daimler as an organization seemed to possess neither. It had a leading position with Mercedes-Benz in premium automobiles globally. It was the #1 commercial truck manufacturer in the world. It had a great footprint in China. But they couldn't seem to do all that in a way that enhanced shareholder value. If we benchmarked the truck business against Volvo or the car business against BMW, Daimler was a complete flop.

Finally in the spring of 2019 they made a management change, naming a non-German, Ola Källenius, as CEO for the first time. A new CFO, Harald Wilhelm, came in from outside the company all together from Airbus. We not only liked what we heard from them upon taking over, but they actually also wanted to hear from us. The CEO sought us out and even invited me to speak at his annual management conference so that his managers could actually hear what shareholders' expectations were. We took that as an extremely good sign that at least the desire to create shareholder value was there.

And the capability?

DH: The results have been somewhat obscured by the pandemic, but we think they're taking the right steps. Layers of management have been taken out, which not only saves money but also improves the company's ability to act and react more quickly. They've simplified the product portfolio by cutting unprofitable lines. They've cut back on capital spending, are better utilizing plant and equipment and have significantly improved cost control. Earlier this month the company had to issue a profit "warning" that quarterly earnings were likely to come in well ahead of consensus Street estimates. There's a lot of work to do and the pandemic has to go away to see the full benefits of management's efforts, but we think everything operationally is very much on the right track.

How is the company positioned in electric vehicles?

DH: In Europe and Asia there are mandates for the production and sale of cars with modern drive trains, so Daimler and all the premium European automakers are on it. This is one reason the company has been sub-profitable in recent years, because of heavy investment to prepare for more stringent regulatory requirements. In the next year or two you're going to see a whole slew of new-energy vehicles from them, mostly under the Mercedes "EQ" sub brand. One thing I'd add is that the Europeans are making very nice electric vehicles. Tesla has good power management and technology, but few would laud the fit and finish of the cars. We think manufacturers like Daimler will prove to have both the technology and the attention to detail that premium cars should have.

From today's price of €44.25, what upside do you see in the stock?

DH: There are three main parts of the business that we value separately, automobiles, trucks and financial services. Financial services also includes certain joint ventures around autonomous driving.

INVESTMENT SNAPSHOT

Daimler
(Frankfurt: DAI)

Business: Development, manufacture and sale of cars, trucks, buses and vans under a variety of brand names, most prominently Mercedes-Benz, Daimler and Freightliner.

Share Information
(@10/29/20, Exchange Rate: $1 = €0.86):

Price	**€44.23**
52-Week Range	€21.02 –€54.50
Dividend Yield	2.0%
Market Cap	€47.33 billion

Financials (TTM):

Revenue	€154.82 billion
Operating Profit Margin	0.5%
Net Profit Margin	0.0%

Valuation Metrics
(@10/29/20):

	DAI	S&P 500
P/E (TTM)	116.7	38.2
Forward P/E (Est.)	10.5	25.5

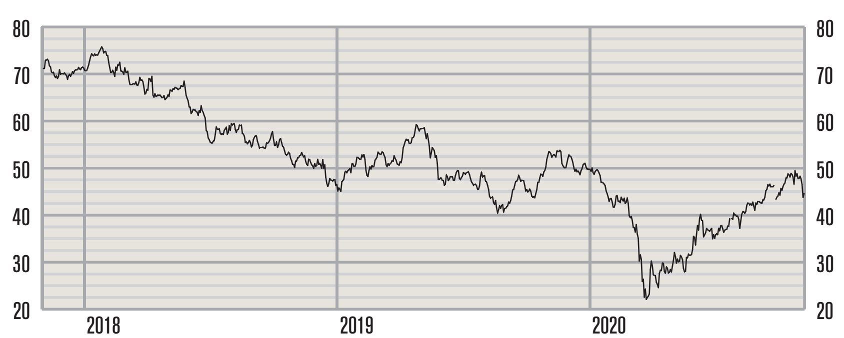
Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Kuwait Investment Group	6.8%
BAIC Motor	5.0%
BlackRock	4.5%
Bank of America	3.4%
Harris Associates	3.0%

Short Interest (as of 10/15/20):

Shares Short/Float	n/a

DAI PRICE HISTORY



THE BOTTOM LINE

Following a management change in early 2019, the company appears finally to have righted its ship operationally, says David Herro, which he expects to become fully evident once the economic environment becomes more normal. Valuing its car, truck and financial services businesses separately, he arrives at an estimated share value in excess of €100.

Sources: Company reports, other publicly available information

The valuation work for cars and for trucks consists primarily of estimating normalized levels of EBIT and then applying what we consider normal multiples given the quality and capability of each business. The finance operation is essentially a bank, so we value it on price to book value. In the end we arrive at an estimated share value in excess of €100.

The stock got as low as €21 in the early part of Covid, so it's come back nicely since then. But it still trades at less than it did at the beginning of the year, and we'd argue this is a significantly better company than it was at the start of the year.

Like many value investors, you've been finding it harder to beat the market in recent years. How is that impacting your overall mood?

DH: We always ask ourselves when we go through tough periods how much of it has been due to our misjudgment and how much to something else. When I look at the particularly tough periods we've had in 2018 and then earlier this year, by and large I don't think we've memorialized losses and believe quite strongly the investments we've held – and in many cases added to – will come back and more.

If I look in the rear-view mirror, I'd have to be pessimistic. Look at this performance gap that has opened up between growth and value. But if I look ahead, I'm quite optimistic. I'm a cyclist and I hate going up hills, but you know there's a big downhill coming. As value investors we've been trudging uphill for some time now, but the hill won't be there forever. I think the risk/reward is tilted in our favor today, so actually my mood is extremely good. VII

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As of September 30, 2020, the holdings mentioned above comprise the following percentages of the Fund's total net assets

Security	OAKIX
Advevinta	0.0%
Alibaba Group	0.3%
Alibaba Group ADR	0.3%
Amadeus IT Group	1.6%
BlackBerry	0.0%
BMW	3.3%
BNP Paribas	4.2%
Carbon Black	0.0%
CrowdStrick	0.0%
Daimler	3.9%
Danone	0.0%
Fresenius Medical Care	0.9%
Glencore	4.1%
Green Hills Software	0.0%
Naspers	2.3%
NAVER	1.0%
Nestlé	0.0%
QNX	0.0%
Rolls-Royce Holdings	0.7%
Sabre	0.0%
SAP	0.0%
Sybase	0.0%
Symantec	0.0%
Tesla	0.0%
UEM	0.0%
Volvo Cl B	1.6%
WeChat	0.0%
WhatsApp	0.0%
Wind River	0.0%
Yahoo Japan	0.0%

Portfolio holdings are subject to change without notice and are not intended as recommendations of individual stocks. Current and future portfolio holdings are subject to risk.

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

The Price-Earnings Ratio ("P/E") is the most common measure of the expensiveness of a stock.

ROE measures profitability as a percentage of the money shareholders have invested.

Book Value refers to a company's common stock equity as it appears on a balance sheet, equal to total assets minus liabilities, preferred stock, and intangible assets such as goodwill.

EBIT is a measure of a firm's profit that includes all expenses except interest and income tax expenses. It is the difference between operating revenues and operating expenses.

The EV/EBIT ratio is a comparison of Enterprise Value and Earnings Before the deduction of payments for interest and income tax expenses. It is the difference between operating revenues and operating expenses.

The MSCI World ex U.S. Index (Net) is a free float-adjusted, market capitalization-weighted index that is designed to measure international developed market equity performance, excluding the U.S. The index covers approximately 85% of the free float-adjusted market capitalization in each country. This benchmark calculates reinvested dividends net of withholding taxes. This index is unmanaged and investors cannot invest directly in this index.

The Fund's portfolio tends to be invested in a relatively small number of stocks. As a result, the appreciation or depreciation of any one security held by the Fund will have a greater impact on the Fund's net asset value than it would if the Fund invested in a larger number of securities. Although that strategy has the potential to generate attractive returns over time, it also increases the Fund's volatility.

Investing in foreign securities presents risks that in some ways may be greater than U.S. investments. Those risks include: currency fluctuation; different regulation, accounting standards, trading practices and levels of available information; generally higher transaction costs; and political risks.

The discussion of the Fund's investments and investment strategy (including current investment themes, the portfolio managers' research and investment process, and portfolio characteristics) represents the Fund's investments and the views of the portfolio managers and Harris Associates L.P., the Fund's investment adviser, at the time of this letter, and are subject to change without notice.

Before investing in any Oakmark Fund, you should carefully consider the Fund's investment objectives, risks, management fees and other expenses. This and other important information is contained in a Fund's prospectus and summary prospectus. Please read the prospectus and summary prospectus carefully before investing. For more information, please call 1-800-OAKMARK (625-6275).

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