ValueInvestor INSIGHT

The Leading Authority on Value Investing

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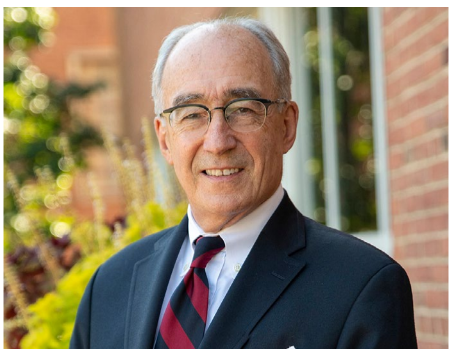
Point of Clarification

Avenir Corp.'s Peter Keefe, James Rooney and James Emanuelson explain how they curate their investing watchlist and what's on it today, how they knock managers "off the script" during company discussions, when and why they reluctantly sell, and why they see unrecognized value today in DigitalBridge, Lockheed Martin, Amazon.com and Microsoft.

INVESTOR INSIGHT



Peter Keefe
Avenir Corp.

Investment Focus: Seeks "franchise" businesses that can thrive through full cycles and whose finances ensure they're "not at the mercy of fickle capital markets."

As you might expect from an investor who's been through a number of market cycles, Avenir Corp.'s Peter Keefe is matter-of-fact in assessing today's investing environment: "There's a clarifying aspect to what's occurred over the past few months. A lot of the garbage is getting flushed out. Warren Buffett talks about seeing who's swimming naked when the tide goes out – we're confident our businesses are well-clothed and ready for whatever's next."

Keefe's penchant for finding long-lived winners has contributed to Avenir since 1990 earning a net annualized 13.1%, vs. 10.1% for the S&P 500. Today he and co-portfolio manager James Rooney are finding unrecognized value – in both new and old ideas – in such areas as digital infrastructure, software, online services and defense.

We imagine you think your approach is suited to all market environments, but would you make the case it's particularly relevant today?

Peter Keefe: Great businesses run by great managers bought at the right price are suited to any environment, but that doesn't mean the market always agrees with us. It might disagree for extended periods of time. We're trying to invest in well-managed businesses with secular growth drivers and superior economics, which should be able to grow earnings and cash flows in almost any economic environment. We're neither market timers nor economists, but it is true that turbulent stock markets can work to our advantage because excellent businesses in such markets are more likely to trade at attractive prices that offer satisfactory rates of return with a margin of safety. I wouldn't say we're overwhelmed by the number of opportunities out there today, but the search for new ideas is getting easier and more interesting.

It's been quite disorienting to try to allocate capital in a world in which capital has been essentially free. Indeterminate future cash flows are worth infinity. Perhaps Crypto and NFTs in that world make sense. SPACs trading at giant multiples of revenues and with CEOs who give you a blank stare when you talk about free cash flow make sense. This is a clarifying environment where the Fed is not going to come to the rescue and people should increasingly recognize real value in assets that generate durable, predictable and growing cash flows. We should be able to hold our own in that kind of environment.

How would you characterize your buying and selling activity in recent months?

PK: With an average holding period of more than seven years, I wouldn't say we're ever too active as buyers or sellers. We have added to some existing core holdings, especially Markel [MKL], Amazon.com [AMZN], Microsoft [MSFT] and Copart [CPRT]. With the exception of Markel – which is still up year to date – the stocks of most of these are down in price by 20-30%, making them even more interesting values. But we're also spending a lot of time on other companies on our "Best Businesses" list that are still trading materially above our estimates of fair value – even after, in some cases, declines of 50% or more.

To get a sense of what attracts you in a business, let's talk about some of those "watchlist" ideas, starting with CCC Intelligent Solutions [CCCS].

PK: We've in the past spoken about Micros Systems [*VII*, July 31, 2012], which from our earliest investments was a 100-bagger for us. It took us a while to fully appreciate it, but Micros gave us a taste of the power of a dominant vertical software business, in this case providing enterprise software and systems for restaurants and hotels worldwide.

We think CCC Intelligent Solutions is a similarly attractive business. Its software systems connect autobody repair shops with insurance carriers. There are multiple necessary points of contact between those two in the process of settling a claim, and CCC helps streamline it all in a way that gets cars off the lot and back to owners more quickly and efficiently. That's of immense value to the insurer as well as the repair shop. It has the dominant position in the market, with an installed base that includes all but two of the top 20 insurance carriers in the U.S.

In terms of what attracts us, it's an inherently high-margin business that was significantly impacted by the pandemic. Customer retention is high. There's a long reinvestment runway and a terrific, long-time CEO who is a good capital allocator. The only problem is that even with the market washout, the stock [at a recent $9] is still probably 15% away from what we'd consider an attractive-enough price. We'll see what happens from here.

How does Pool Corp. [POOL] fit your definition of a "franchise" business?

PK: I consider Pool Corp. one of the biggest mistakes I've made in my investment career. We owned it many years ago and I sold it at a price I thought was overvalued – from which it's risen probably 7-8x.

The company is by far the largest distributor of swimming-pool supplies and equipment in the U.S. If you own a pool, it's almost certain you're buying products they distribute, and you and the next owner of that pool are highly likely to continue to do so, through ups and downs in the economy. Even in foreclosure the bank will maintain the pool, as reclaiming one that's gone "green" is far more expensive than keeping it up. The critical part of the model for a company like this is that there's a very high number of suppliers and a very high number of buyers. As the dominant entity putting the two together, Pool Corp. commands relatively low prices from vendors and relatively high prices from buyers. The result is a company with sustainably high margins that is extremely difficult to compete with. That to us makes it very much a franchise business.

Probably 80% of the business relates to ongoing maintenance, but the remainder tied to pool construction means the business – and the stock – is impacted by the housing cycle. The shares have come down as concerns about housing have increased – [at $350, the stock is down 40% from its November high] – but it's still not quite Avenir-cheap. Given that the business is not undisturbed by the economic cycle, we'd prefer to buy at a trashed-out price. We don't think it's there yet.

Is the story similar for long-time market darling Adobe [ADBE]?

PK: This is another software business with powerful moats in almost all of its businesses across digital media and publishing. Students in graphic design, web design, photography, illustration, video production and video editing start from the very beginning using Adobe software, which in many cases is the industry standard. The business has almost fully transitioned to a subscription model and margins are enormous – 90% at the gross-margin level in many cases and better than 35% at the operating-margin level overall.

ON RESEARCH:

We literally try to knock managers off the Investor Relations script and force them to respond spontaneously.

There's noise from time to time that competition is picking up in some lower-end or niche applications, but the reality is that Adobe has the ability to vanquish any small competitors that are actually a threat. And the pie keeps growing. With its market positions in secularly growing areas, its ability to expand in underpenetrated markets, and its pricing power, we think the company can grow at a mid-teens rate for at least the next decade.

The stock [at a recent $368] is down almost 50% from its 52-week high and trades today at 26-27x our estimate of forward free cash flow. You could argue that based on the growth potential, buying at today's price ought to generate a market-beating return. Here we just don't have the conviction in the future growth to consider the stock a real bargain.

You've described your research into flooring retailer Floor & Decor [FND] as being at an early stage. What's your take so far?

James Rooney: The company was founded in 2000 and now operates around 160 warehouse-format stores in more than 30 states. It's all flooring, for every room in the house, and they've basically created a new retail category without any direct competitor of scale in a business where scale is a real advantage in sourcing and distribution. Revenues have grown at a 25% compound rate over the past five years and EPS from pre-Covid 2019 to last year rose almost 80%.

We spoke earlier this month with the CFO and have been impressed with how management talks about allocating capital. There's a high return-on-invested-capital requirement for all new stores. They've laid out a clear path to free cash flow generation and seem clear-headed and rational about how they plan to reinvest that free cash flow when it arrives. That's quite impressive for a company at this stage of growth, but we recognize we need more time to really get to know the business and how well management's actions match their words. The first impression has been good, but there's more to learn. [*Note*: At a recent $66.25, FND shares are off 55% from their high last fall.]

PK: It's like life. You meet someone you find attractive and interesting, but you have to get to know them better before you call them a friend. In so many meetings with companies it's very hard to throw them off the Investor Relations script. We don't want to just sit through the slide deck that's been meticulously constructed to present the business in the most favorable light. We literally try to knock managers off the script and force them to respond spontaneously. We've had refreshingly good conversations with Floor & Decor, but as Jim says, we need more time to really understand the business and match words to deeds.

Talk more about knocking managers off the script when speaking with them. What do you prefer to discuss?

PK: One company we don't currently own but know well and admire is Watsco [WSO], which distributes HVAC equipment and related parts. Recently we spent 2 ½ hours with Barry Logan, the EVP for Planning & Strategy, and it was one of the most transparent conversations we've ever had with a corporate executive. He was the fourth corporate employee hired and has been with Watsco for 30 years. While many management teams are guarded, he told us what was difficult about the business. About Watsco's disadvantages versus other distributors. What competitors they thought were the toughest. Some of the shenanigans of the people they sell to. The best conversations are when we're considered a partner, which means a real conversation about the business, the good and bad.

Back to Floor & Decor, we clearly got the sense they were enthusiastic about the company's prospects, but there wasn't any Eddie Haskell-esque promotion going on. [*Note*: For our younger readers, this is a reference to a rather disingenuous character on the 1950-60s TV show *Leave it to Beaver*.] That's important to us. If top management thinks their job is to convince us to buy the stock, we aren't at all interested. We want to talk about the nature of the business, what they find most important, what makes it hard, and what makes them tick. Some people find that refreshing. We always ask how they think per-share value is created and we'll drill down on the creation, growth and allocation of free cash flow per share until they get tired of us or – if they don't really understand what we're talking about – we get tired of them.

Do you typically have cash to invest when the time is right to invest it?

PK: Our cash level is merely fallout from the number of investable ideas we have that offer an acceptable rate of return with an adequate margin of safety. So cash naturally builds when valuations are going up, and it tends to decrease as valuations are going down. There's no tactical or strategic level of cash, it's purely organic.

Charlie Munger talks about this. One of the reasons the investment management business is so hard is because asset managers see outflows when the market goes down and inflows when the market goes up, compounding the difficulty of achieving market-beating returns. That's not an issue for a Berkshire Hathaway or Markel, where investable cash comes in every day, giving them a structural advantage over the average investment manager.

ON AMAZON:

I try hard not to be hyperbolic, but this is the one business model we have the most difficulty destroying.

So the answer to your question is yes, we typically have cash when we want to put it to work. Today the cash level across the firm is roughly 6%. That's down from where it was a few months ago, but it's not unusually high or low relative to our judgement of the opportunity set out there.

Describe what you think the market is missing in digital-infrastructure company DigitalBridge [DBRG].

PK: The company has an interesting recent history. Colony Capital in 2019 bought a private equity firm founded by Marc Ganzi and then started to transform itself – eventually with Ganzi as CEO – from a broad-based and struggling REIT into the renamed DigitalBridge, focused on digital-infrastructure assets such as cell towers, data centers and fiber-optic networks. The plan was to sell the legacy hospitality and health care assets and reinvest into digital real estate. The pandemic struck, making it a herculean task to turn Colony into DigitalBridge, but the transformation is now almost entirely complete. They are now both operators and investors in targeted end markets, using capital from their own balance sheet and from two institutional funds they've raised so far.

We have quite a bit of experience with the industry, from American Tower and other investments, and first got to know Marc Ganzi when American Tower bought an earlier company of his, Global Tower Partners, in 2013. He is a first-class CEO who knows the space as well as anyone can, which is critical to our investment case. Hundreds of billions of dollars in greenfield investment needs to be made in digital infrastructure over the next decade, and you want to back people assembling that capital and getting it invested who are true experts, with a demonstrated ability to achieve high returns. We think Marc, company President Ben Jenkins, and the high-quality managers they've attracted to DigitalBridge are the ones to bet on.

Another part of the equation is the underlying demand we expect from pension plans, sovereign wealth funds and other institutional investors anxious to put capital to work in one of the true growth markets out there. With the management team it has, we would expect DigitalBridge to attract a disproportionate amount of the new capital coming into the market. Ganzi has said he believes they can get to $50 billion in fee-earning equity assets in five years, up from about $19 billion today, which we don't think is unreasonable. They're going to have a lot of capital and a lot of opportunities to put it to work.

The stock year-to-date is down close to 45%. How are you looking at upside from today's price of $4.70?

PK: The basic valuation work is straightforward, arriving at values for the operating businesses on one side and the investment-management business on the other. We value the operating businesses by putting a private-market multiple on current EBITDA, which we expect to grow organically and through acquisition over time. For the asset-management side, we think they can reach the $50 billion goal in fee-earning assets within the next five

INVESTMENT SNAPSHOT

DigitalBridge
(NYSE: DBRG)

Business: Invests in and operates businesses across the "digital ecosystem," including cell towers, data centers, fiber-optic networks, small cells and so-called edge infrastructure.

Share Information (@6/29/22):

Price	**4.68**
52-Week Range	4.48 – 8.55
Dividend Yield	0.0%
Market Cap	$3.23 billion

Financials (TTM):

Revenue	$1.22 billion
Operating Profit Margin	(-2.8%)
Net Profit Margin	(-25.5%)

Valuation Metrics
(@6/29/22):

	DBRG	S&P 500
P/E (TTM)	n/a	20.4
Forward P/E (Est.)	n/a	16.9

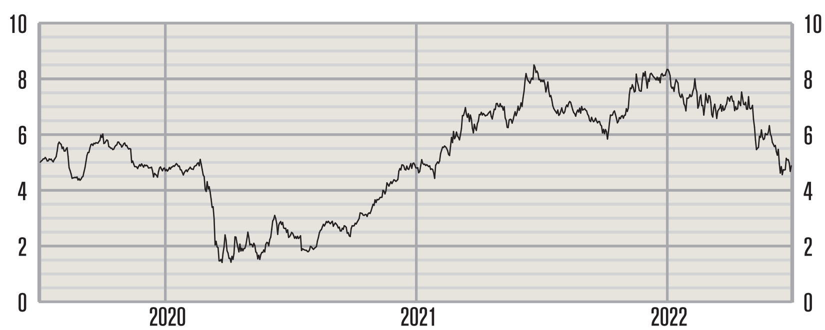
Largest Institutional Owners
(@3/31/22 or latest filing):

Company	% Owned
Vanguard Group	12.3%
BlackRock	5.9%
Baupost Group	5.1%
Capital Research & Mgmt	4.8%
State Street	3.4%

Short Interest (as of 6/15/22):

Shares Short/Float	4.1%

DBRG PRICE HISTORY



THE BOTTOM LINE
With a uniquely skilled and experienced management team, Peter Keefe believes the company is well positioned to benefit as capital flows into the massive investments needed in digital-related infrastructure over the next decade. Valuing its operating and investment businesses separately, he estimates intrinsic value at "north of" $7 per share.

Sources: Company reports, other publicly available information

years or so, and we also assume in estimating carried interest that they can get 6-7% returns on capital on their investments, which would result in a low-teens return to investors. Management is aiming for more like mid-teens investor returns.

Our estimate of current intrinsic value is north of $7 per share. We think that's conservative. Just a few months ago the shares traded above $8.50. As is the case with most of our investments, we're also expecting that intrinsic value to compound at an attractive rate as highly skilled management in an attractive end market reinvests to create shareholder value.

Describe your case for recent portfolio addition Lockheed Martin [LMT].

PK: You know in speaking with us over many years that in addition to putting emphasis on the franchise qualities of any given business, we also make a similar effort to know management, how they operate and how they think. Good businesses have a hard time being great without the right people running them.

In this case we're leaning more in our enthusiasm for the idea on the jockey than the horse. That's not to say Lockheed's defense-contracting business doesn't have a lot going for it. The F-35 fighter plane program – which accounts for about 30% of total revenues – is a fabulous franchise with an extremely long-tailed revenue stream that is unlikely to be challenged. The Missiles and Fire Control business has a number of strong programs in place and earns 14% operating margins. The competitive environments in general are quite concentrated, and the business overall has been generating returns on invested capital in the high-teens to low-20% range.

What's less appealing is the concentration of the customer base, with the U.S. government accounting for close to 75% of net sales. The business also doesn't have the growth profile we typically want to see. Defense spending tends to grow fairly reliably – and the conflict in Ukraine highlights the importance of access to the products and expertise of a company like Lockheed – but we can't really expect top-line growth over time beyond low- to mid-single-digit annual rates.

Which brings us to Jim Taiclet, who took over as CEO in June of 2020. Jim is a former U.S. Air Force pilot who ran American Tower – which has been a long and very successful holding of ours – for almost 20 years, a period in which the market cap increased from $2 billion to over $100 million. When he agreed to take the job after a couple of years serving on Lockheed's board, we were immediately interested. He's one of the best operators and capital allocators we've known, and we thought if he saw the potential to make a significant difference at the company we would probably want to join him.

We're not counting on him to fundamentally change the company or its growth profile, but we do expect him to put his stamp on how it operates. One initiative he's pushing that's interesting – relevant to his experience at American Tower – is called "5G.MIL", which is focused on improving the resiliency and security of connectivity across all battlefield assets. It's not a simple task and requires improved cooperation among the big defense contractors, but over the long term he believes it can improve the battlefield readiness of its customers as well as Lockheed's long-term position in supporting that readiness.

We also believe there's room to expand operating margins. At American Tower Jim was successful in implementing six-sigma initiatives to improve operating efficiency and effectiveness. Lockheed wasn't at all poorly managed, but there's potential for improvement and we think a fresh look under a new CEO can foster that.

How do you see all that translating into good news for the stock, which at a recent $419 has held up better than most in the market downdraft?

PK: We're penciling out $27 per share in estimated free cash flow per share over the next 12 months, so the stock trades at a 15.5x multiple on that. So as a shareholder we're getting a better than 6% free-cash-flow yield at today's price, for a business that we think can organically grow cash flow at 6-7% per year over the next five years. That should result in our getting a better than 10% return, with the optionality that Jim finds other ways we don't yet see to drive shareholder value.

On that front, were you disappointed by the U.S. government earlier this year blocking Lockheed's proposed $4.4 billion acquisition of Aerojet Rocketdyne?

PK: That acquisition came out of the blue for us, but we thought on paper it made a lot of sense. How it played out highlights that this is a heavily regulated business and things like that aren't going to be easy. We don't expect them to be easy, and the fact that this transaction didn't go through doesn't mean other even better ones won't present themselves in the future.

It's been a while since someone offered the investment case for Amazon.com. With its shares off 40% from their 52-week high, describe your view on it today.

PK: This is not a new investment for us, but as I mentioned earlier it is a core position we've added to during the market's recent disturbance.

The debate around Amazon as its AWS cloud-services business has prospered is often focused on what the retail side of the company is worth. When we first bought shares at what, split-adjusted, would be the low-$30s, we thought AWS was worth roughly $20 per share and we were getting the massive retail business – which wasn't earning any money – at a sufficiently bargain price that accounted for only one-third of the total market value at the time.

AWS is expected to generate $50 billion in operating cash flow in fiscal 2023 and we expect that to grow – conservatively, relative to history – at a high-teens annual rate. Even in a rising rate environment that's got to be worth 20x EV/EBITDA, which produces roughly $1 trillion in equity value. That's close to where the entire market cap has been lately.

So now the world's leading online retailer is even less expensive, valued in the vicinity of zero. We have a nice model that breaks everything down in detail, but we think it's important not to overthink this one. The simple case for the stock at today's price is that the retail business – which includes, among other things, the online store, the Prime membership program, the grocery business, the advertising business and the third-party fulfillment

INVESTMENT SNAPSHOT

Lockheed Martin
(NYSE: LMT)

Business: Global defense contractor that primarily focuses on high-end fighter aircraft, military helicopters, missiles and missile-defense systems, and space-based programs.

Share Information (@6/29/22):

Price	**418.89**
52-Week Range	324.23 – 479.99
Dividend Yield	2.7%
Market Cap	$111.95 billion

Financials (TTM):

Revenue	$65.75 billion
Operating Profit Margin	11.5%
Net Profit Margin	9.4%

Valuation Metrics
(@6/29/22):

	LMT	S&P 500
P/E (TTM)	18.5	20.4
Forward P/E (Est.)	14.7	16.9

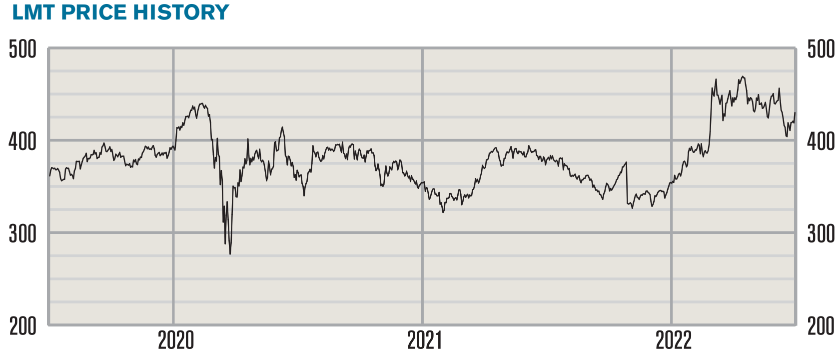
Largest Institutional Owners
(@3/31/22 or latest filing):

Company	% Owned
State Street	14.6%
Vanguard Group	8.1%
Capital Research & Mgmt	7.3%
BlackRock	5.1%
Charles Schwab Inv Mgmt	2.0%

Short Interest (as of 6/15/22):

Shares Short/Float	0.9%

LMT PRICE HISTORY



THE BOTTOM LINE

Peter Keefe believes that the current free-cash-flow yield on the company's stock plus the estimated annual growth in that free cash flow implies a better-than 10% annual shareholder return. He expects further potential upside from CEO James Taiclet – who took the reins in 2020 – "finding other ways we don't yet see to drive shareholder value."

Sources: Company reports, other publicly available information

operation – is worth substantially more than zero. International retail sales account for about a quarter of revenues but contribute no profit, which won't always be the case. You're buying at a discount a business that we believe overall in the next five years can increase operating cash flow at better than 20% per year. That's not a typical combination of valuation and growth.

I try hard not to be hyperbolic, but of all the business models we own – and we own a lot of good ones – this is the one we have the most difficulty destroying. The cloud business, along with Microsoft's, benefits from an extraordinary competitive moat and continues to press its advantage. The retail business is deeply woven into the fabric of the American consumer and the Prime program at the center of it all is a magnificent asset that can't be replicated and creates its own wind. Amazon should continue to gain share of the retail wallet in the U.S., which is pretty amazing given its presence already.

***The Wall Street Journal* ran a story recently on CEO Andy Jassy's first year on the job, describing it as "undoing Bezos-led overexpansion." What's your take on that?**

PK: I'd say we're completely unconcerned. It seems to happen regularly that the investment community is shocked and surprised by a period of heavy investment by Amazon, then it's equally shocked and surprised when that reverses and the company produces mountains of cash flow. We're in a period where people are looking around for reasons why you don't want to own Amazon. Recently, it's been the unwinding of the pandemic-related bump. We care a lot more about the relentless, entrepreneurial culture of the company and the sustaining power of the business model, all of which we think is undisturbed.

It is an issue for us that we aren't as familiar with Andy Jassy as a capital allocator, but we think the risk of unwise capital allocation is low, in no small part because Jeff Bezos is still Executive Chairman and we think he is still quite involved in running the company.

How are you thinking about valuation from today's $109 share price?

James Emanuelson: After adjusting for growth capital spending, we estimate Amazon's free cash flow in 2023 will be around $4.70 per share. That translates into a free-cash-flow multiple around 23x, which isn't cheap, but also isn't overly rich for a company that we believe over a long period can compound free cash flow at 15-20% annually. As shareholders from today's price we'd expect to benefit fully from that kind of free cash flow growth.

Is your outlook similar for fellow core holding Microsoft?

JR: This has been a major position of ours for a decade, and while we were never as down on Steve Ballmer as the market eventually was, we think Satya Nadella has done an extraordinary job as CEO since taking over in 2014. Part of that has just been a cultural shift: He's taken a company that was known as being somewhat aloof and difficult to work with and made it into one that is more willing to collaborate – both internally and exter-

INVESTMENT SNAPSHOT

Amazon.com
(Nasdaq: AMZN)

Business: Online retailer and e-commerce aggregator; largest profit contributor is Amazon Web Services, offering cloud-based compute, storage and database service offerings.

Share Information (@6/29/22):

Price	**108.92**
52-Week Range	101.26 – 188.65
Dividend Yield	0.0%
Market Cap	$1.09 trillion

Financials (TTM):

Revenue	$477.75 billion
Operating Profit Margin	4.2%
Net Profit Margin	4.5%

Valuation Metrics
(@6/29/22):

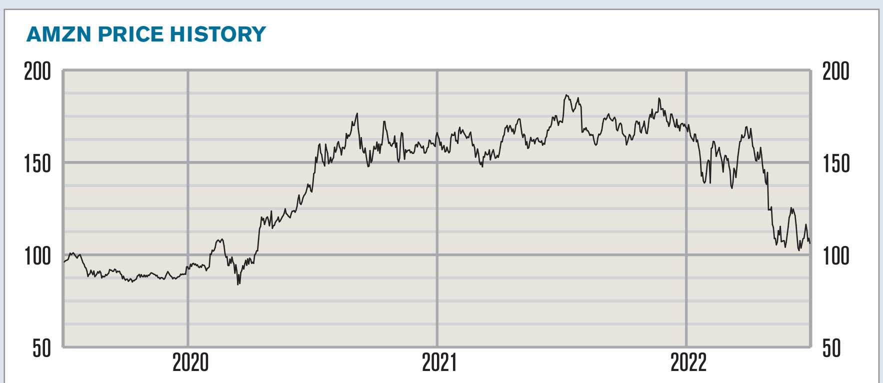
	AMZN	S&P 500
P/E (TTM)	52.5	20.4
Forward P/E (Est.)	41.4	16.9

Largest Institutional Owners
(@3/31/22 or latest filing):

Company	% Owned
Vanguard Group	6.3%
BlackRock	3.6%
State Street	3.3%
T. Rowe Price	3.2%
Fidelity Mgmt & Research	2.8%

Short Interest (as of 6/15/22):

Shares Short/Float	1.3%



THE BOTTOM LINE
Its AWS cloud-services business is worth almost the company's entire market cap, says Peter Keefe, implying a very low value for one of the world's largest and most competitively advantaged retail businesses. He expects as a shareholder to benefit in line with his estimate of 15-20% annual growth in the company's free cash flow per share.

Sources: Company reports, other publicly available information

nally – to positive effect. In many ways he quit trying to fight every battle and just focused on what they're good at, which is cloud services and consumer and enterprise software.

The businesses are generally firing on all cylinders. Most have high switching costs, high margins and ample pricing power. Azure cloud services is now a full peer to Amazon Web Services, with a hugely trusted brand and an unrivaled growth pipeline. If you're already a satisfied Microsoft customer, it's natural for you to trust it as your service provider in the cloud. Even if Azure's growth moderates, we expect it to grow at a mid- to high-teens annual rate for at least a decade.

The Office suite of products has embedded the company's software in most enterprises, and related services like Microsoft Teams have further enhanced that position. That business can continue to grow at a 10%-plus pace. Overall, it's not a stretch to say that Microsoft is one of the primary enablers of the rapid digitization of the economy, which as secular backdrops go is about as good as it gets.

From today's price of around $260, do you expect to benefit – as with Amazon – from the company's compound growth in free cash flow?

JE: We estimate the company in 2023 can earn roughly $10.70 per share in free cash flow, resulting in a forward multiple of just over 24x. Again, not cheap, but also not expensive when we expect that free cash flow to compound at least at a low-teens annual rate for the next decade.

This is another case, as Peter said with Amazon, where we don't think it's helpful to overthink it. We don't expect to be hurt by a contracting multiple and we think free cash flow can grow at 10%-plus. Those are the types of ideas we try to underwrite.

You mentioned not being active as a buyer or seller most of the time. When you do sell, what's usually behind it?

PK: When something is working well, we're conscious about not letting position sizes get extreme, but we've tried to get away from the idea of regularly "trimming." As I've said to you before, every time we trimmed Micros Systems was a mistake. When we've sold down our holding in American Tower, it's usually been a mistake. We'll still do things like that from time to time, but are very leery of cutting the flowers and watering the weeds.

JR: In other cases, we generally let our businesses compound until they don't, which usually means there has been a fundamental change in the outlook. One of our most recent sales has been Dollar Tree [DLTR], the discount retailer. We originally thought management would be able to significantly improve the results of the Family Dollar business they acquired in 2015. The shares languished for years and we came to believe that there were structural weaknesses in Family Dollar that were going to be difficult to overcome. As luck would have it, activists came in and prompted changes that the market responded quite positively to, and the stock in the fourth quarter of last year started moving up sharply. We were able to get an attractive price for it considering our

INVESTMENT SNAPSHOT

Microsoft
(Nasdaq: MSFT)

Business: Broad-based technology provider with key businesses in productivity and business-process software and systems, cloud services, operating systems and gaming.

Share Information (@6/29/22):

Price	**260.26**
52-Week Range	241.51 – 349.67
Dividend Yield	0.9%
Market Cap	$1.92 trillion

Financials (TTM):

Revenue	$192.56 billion
Operating Profit Margin	42.6%
Net Profit Margin	37.6%

Valuation Metrics
(@6/29/22):

	MSFT	S&P 500
P/E (TTM)	27.1	20.4
Forward P/E (Est.)	24.3	16.9

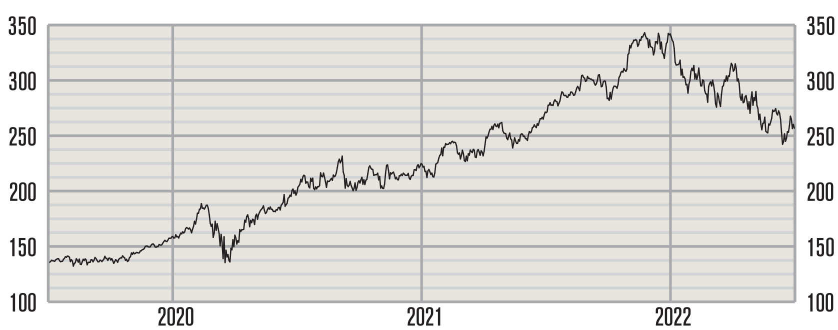
Largest Institutional Owners
(@3/31/22 or latest filing):

Company	% Owned
Vanguard Group	7.9%
BlackRock	4.5%
State Street	4.0%
T. Rowe Price	2.6%
Capital Research & Mgmt	2.6%

Short Interest (as of 6/15/22):

Shares Short/Float	0.6%

MSFT PRICE HISTORY



THE BOTTOM LINE

The company is a primary enabler of the rapid digitization of the economy, "which as secular backdrops go is about as good as it gets," says James Rooney. With its stock now trading at 24.3x his 2023 estimate of free cash flow per share, he believes shareholder returns should match the 10%-plus annual growth rate in firm free cash flow he expects.

Sources: Company reports, other publicly available information

outlook for the business long term, so we sold. We'll see whether that turns out to be right or not.

You also later last year exited your stake in pet health insurance company Trupanion [TRUP]. Did your outlook for it change as well?

PK: Trupanion fits our definition of a great business with superior economics, and we think Darryl Rawlings, the founder and CEO, is a brilliant, thoughtful guy. There were two things here. First, the stock price appreciated dramatically from our purchase price. We also couldn't get comfortable with how some of the operating metrics were being adjusted, primarily around equity compensation. It's commonly done – treating equity compensation as if it's not a real cost – but when we did count it as a real cost the fundamentals just weren't as attractive. The share price got well ahead of our estimate of fair value so we exited. [*Note*: As high at $158 in December of last year, Trupanion shares closed recently at just above $60.]

John Templeton used to talk about the importance for investors to buy at the point of maximum pessimism. We get the impression you don't think we're there yet.

PK: I do think this is a clarifying moment, where people are finding out which assets have real value and which don't. That's less disorienting for us than an environment where money is free and as a result people do dumb stuff with it.

We're still surprised at the valuations of some businesses we would love to own, where prices would have to come down quite a bit more to get to levels where we can underwrite attractive returns. There have been a couple times in my career when the market was in extremis and you almost felt sorry for the person who was selling what you were buying. We're certainly not there yet in my opinion. VII