ValueInvestor INSIGHT

The Leading Authority on Value Investing

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Investor Insight: Andrew Wellington

Lyrical Asset Management's Andrew Wellington and Matthew Mangiacotti describe how they identify "gems amid the junk," how they think about disruption threats, why they find the current equity market frustrating but not depressing, and why they see materially mispriced value in United Rentals, Global Payments, TD Synnex, Expedia and Ameriprise.

INVESTOR INSIGHT

Andrew Wellington
Lyrical Asset Management

Investment Focus: Seeks companies that have resilient, analyzable businesses when their stocks are trading in the cheapest quintile of the large-cap universe.

It was never a question for Andrew Wellington where he would focus his attention as an investor: "It may not work every day, every month or every year, but the cheapest quintile of stocks based on almost any valuation metric in any geography over a long period of time performs the best, the second-cheapest quintile the second best, and so on," he says. "Clean sheet of paper, where else would you start looking for good returns?"

With priorities set, the flagship strategy of his Lyrical Asset Management – now with $6.1 billion in firm assets – since the beginning of 2009 has earned a net annualized 14.2%, vs. 11.4% for the S&P 500 Value Index. Today he sees particularly mispriced value in such areas as equipment rental, IT distribution, payments processing, wealth management and online travel.

Your starting point in looking for ideas is what you consider the 200 cheapest of the 1,000 largest publicly traded companies. Describe why you start there.

Andrew Wellington: There have been at least a hundred academic and industry papers that show that over a long period of time the cheapest stocks have had the highest returns, whether you use price/book, price/earnings, price/cash flow, etc. So if you're going to invest in the stock market and want to generate the highest returns, where are you going to look? Are you going to look in the part of the market where outperformers are the rare exception, like the most expensive quintile, or are you going to focus on the part of the market where the average stock outperforms, like in the cheapest quintile? For us, that's a pretty easy decision.

How do you define "cheapest"?

AW: We value all companies on their current share price relative to their five-year forward normalized earnings. We have our own methodology to project five-year forward earnings from consensus estimates and the company's earnings trajectory. It's obviously only a rough estimate, but it's a great place to start. We then sort our two universes – the 1,000 largest stocks in the U.S. and the 1,500 largest developed-market stocks outside the U.S. – and at least once a month we manually go line by line through the cheapest 20% on each list.

Very often I spend a tenth of a second on each name, going "junk ... junk ... we own it ... junk ... junk ..." but then something pops up as interesting. We will then do a little desktop underwriting, using FactSet to look up things like the earnings and valuation history of the business and to review the research headlines to identify some of the investment controversies. If it still looks interesting, then it becomes a candidate for a full in-depth research review. We typically hold between 30 and 35 positions in our portfolios and our average holding period has been around seven years. So we don't need a lot of great ideas every year – this process has always produced more than enough.

You've written about the importance of being able to separate the "gems amid the junk." How do you do that?

AW: For 30 years I've been buying cheap stocks. Many have worked out and more than a few haven't, and the single most important thing that separates the successes from the failures is, "Did we estimate the future earnings about right?" We typically have a big margin of safety as value investors, so we don't have to get the earnings exactly right, but if the future earnings turn out to be, say, half of what we expected, the stock was likely not cheap enough for that to work out okay.

So how do you get the future earnings right? The common answer is to do deep research, due diligence and analysis. Of course we do that. But we've learned that "what" you analyze is as important as "how" you analyze it. There are certain company traits we've found that make it more likely we'll get the future earnings right. For example, in our experience companies that have low returns on invested capital, less than 10%, have a lower probability of working out. As a result we will not invest in any business unless we think it can generate at least a 10% ROIC, and we strongly prefer 15% or higher. That means we avoid typical value-stock industries like basic materials, regulated utilities and deep cyclicals like airlines.

In addition to our quality hurdle we also look for a trait we call "analyzability." There's almost a bravado in value investing circles to embrace the complicated and difficult. We just want to get the earnings right and we've found that it is easier to get the earnings right when it's a simpler, more analyzable business.

What tends to make something analyzable often comes down to the resiliency of the business. You're more likely to get the future earnings right if a lot of different things can happen and the company can still generate similar future earnings. If there's inflation, they raise prices and make the same margin. If interest rates go up, it doesn't matter because they don't need debt capital. Resilient businesses often are capital-light, have a high ratio of variable costs and have stable revenues. If a company has wildly volatile earnings, how much confidence can you really have in forecasting what it's going to be earning in five years?

Because we find them not sufficiently analyzable, we avoid industries like banks and pharma companies that are typically too complex or opaque. I'd also mention airlines again. In the airline industry you need everything to go right for them to make decent profits and if one thing goes wrong it's terrible. The economy's good, the weather's good, but fuel prices go up, boom. Fuel prices are low, the weather's good, but the economy's weak, boom. It's just too fragile a business for us.

We spend the vast majority of our time on deep research, but I am a strong believer that most alpha for investors comes from idea generation. You can have the best research team in the world, but if they're working on mediocre investment ideas you're inevitably going to end up with a mediocre portfolio. We've been focused from the beginning on sifting through the junk to uncover the gems and we believe we've gotten really good at finding them.

You've described three charts you pull up early on showing historical share prices, earnings and P/Es. What jumps out at you as most positive in looking at all that?

AW: We talk often about finding value hidden in plain sight. Pull up a P/E history on any stock and you'll typically find an incredibly wide range of valuation multiples over any multiyear period. As a result, very good companies with predictably growing earnings can sometimes find their way into the cheapest valuation quintile, even when nothing has gone wrong with the business. That's the prototype of our ideal stock.

I'll give you a couple quick examples. Primerica [PRI] has a straightforward business selling term life insurance mostly to middle-class families. What's different about them is that rather than keep premiums on their balance sheet to reinvest, they spend money on reinsurance to offload most of their underwriting risk. They also sell their policies using a part-time, commission-based salesforce, resulting in a sales effort with low overall cost and a high proportion of costs that are variable. They're really more of a sales organization than an insurance company.

It's a unique business model that has produced a 20% return on equity over time with excellent growth. Since the company went public in 2010 its normalized earnings have grown at better than 17% per year. You wouldn't expect a compounder like this to be valued at less than 12x forward earnings, but it is. Meanwhile the S&P 500, which has grown earnings at about 6% per year – about one-third the rate of Primerica – trades at closer to 20x earnings.

Why is that happening? Maybe the market isn't comfortable with the multi-level marketing aspect of it, but one big difference here from the more controversial product-based platforms is that salespeople don't have big upfront costs to buy inventory. There is no product inventory to buy and the only real upfront cost is to become licensed to sell life insurance. Another possible issue is that while this operates very differently from a typical insurance company, the stock is followed

Andrew Wellington

Lucky Break

After five years as a management consultant serving mostly financial institutions, Andrew Wellington in the mid-1990s wanted to shift gears into investment management when he got a call out of the blue from Rich Pzena, who was leaving the highly regarded Sanford C. Bernstein to start his own firm. Pzena agreed not to poach any of Bernstein's analysts, but had asked if he might pursue those from the firm's reject pile of job applicants – where Wellington's resume happened to then reside. "This is my calling and I couldn't imagine doing anything else," he says, "and it all got started with that one lucky break."

Luck didn't appear to be on his side when he and college friend Jeff Keswin launched Lyrical Asset Management in the middle of the global financial crises in 2008. Stocks were cratering and the economic outlook, to put it mildly, was dim. On the question of luck, however, Wellington begs to differ: "Yes, it was a terrible environment, but the opportunity cost of starting my own firm was low. What was most important was that stocks were cheap and we had nothing to lose. For a contrarian, you could argue it was the best time imaginable to get started."

by insurance analysts. Analysts can have a hard time doing good valuation work from the bottom up, so they like to rely on peer comps. When you don't have good peers to use, that can increase the likelihood something is misvalued. [*Note*: Primerica shares closed recently at around $194, up nearly 40% so far this year.]

Another position we've added this year is in F5 [FFIV], a supplier of mission-critical enterprise software that manages the flow of data across IT networks. The company over the past 15 years has compounded earnings at 16% per year and 18 months ago the shares traded at a 20x P/E, but today the multiple has compressed to less than 13x. Two things seem to be behind the fall in valuation. There's a short-term worry that we're in the weaker part of the IT spending cycle, which seems to be playing out, and there is a longer-term worry that there's some disruption threat as customers migrate to the public cloud and as the business model shifts more fully to software as a service (SaaS).

We take disruption risk very seriously. Disruption is one of the most obvious ways a company that appears cheap on current earnings can end up being very expensive on future earnings as the earnings evaporate. When it comes to disruption risk, our approach is clear cut. If a company is experiencing disruption, we won't own it. If we think the company is likely to be hurt by disruption, we won't own it. But we do own some companies where the fear of disruption may be depressing the price, but our analysis is that the business won't be disrupted. This is the case with F5.

As evidenced by the earnings performance, the company is successfully transitioning from hardware toward software and we believe it can continue to provide whatever the customer wants in a private cloud, a public cloud or – particularly in what is becoming increasingly the case – a hybrid cloud environment. In pricing F5 shares at 12.9x forward earnings, we don't think the market is getting this one right. [*Note*: As high as $249 in December 2021, F5 shares traded recently at around $161.]

On the subject of disruption, has the promise or threat of artificial intelligence impacted any of your portfolio companies?

AW: AI is a major innovation and our general take is that for the average business it's going to be like other major technological innovations like personal computers, the Internet and smartphones, enabling almost all businesses to do what they do better.

We've had two companies whose stock prices have been clearly impacted by the broader theme of AI. One positively impacted was Broadcom [AVGO], where the stock in our opinion went up way more than the positive impact of the extra AI chips they were going to sell and so we have significantly trimmed the position this year. [*Note*: While the S&P 500 over the past year is up 17%, Broadcom shares at a recent price of around $830 are up more than 80%.]

ON TRADING:

I know most firms trade around positions and claim that it adds to returns – I say show me the evidence.

On the reverse we've had Concentrix [CNXC], a top-two global provider of call center and customer experience software and solutions. The best explanation we have for the stock going down so much is that the market must think the business is going to be disrupted by AI, but our read is that AI is more a tool for them to take advantage of to distance themselves from less technology-driven peers and ultimately improve profitability. Adapting to new technology is par for the course for Concentrix, as their business model has been to migrate customers from simple solutions to technology solutions. This cannibalizes revenue at times but replaces it with higher-margin work that is also stickier, decreasing churn. We think AI in the long run will be a good thing for the company's business, not a bad thing. [*Note*: Recently trading at just over $80, CNXC shares over the past year have fallen 32%.]

You reduced your Broadcom position, did you add to your Concentrix one?

AW: Broadcom was a rare exception where we sold without selling the whole position. We typically don't trim and we never add to existing positions.

I know most firms trade around positions and claim it adds to returns – I say show me the evidence. We've looked at this issue from multiple angles and found that our position sizing has no statistically significant impact on our returns. This shocks a lot of people but the evidence is pretty compelling. It becomes clearer why the impact on returns is small when you look at it from a full portfolio perspective. Our average position size is 3%. It might seem like a big deal if we doubled a position to 6%, but doing so leaves 97% of the portfolio unchanged, and if 97% is unchanged the returns are not going to be impacted much.

Bad things can happen when you trade – trading errors, friction costs, tax inefficiency – so you should get something positive out of it if you're going to do it, and again, the evidence tells us otherwise. There are good managers with good returns that do a lot of trading around their positions. My argument is that's most likely because they picked good stocks, not because they traded.

You took a position early last year in Uber [UBER], which doesn't seem like an obvious fit for your strategy. How did it qualify as a Lyrical idea?

AW: I'm a big New York Giants fan and a big fan of their old coach Bill Parcells. He used to say in the NFL draft that if you were going to pick someone who was not the prototype – which would be, say, 6'4" and 235 pounds as a quarterback – that player better walk on water. Uber is not our prototype stock, so from a valuation perspective it had to "walk on water." When we modeled out what we thought its normalized earnings would be in five years and applied a historically average multiple to those earnings, the stock had more upside than almost anything else in the portfolio.

We refer to Uber as a turnaround that never was. Until this year the company had never produced positive earnings – so it isn't trying to get back to some former level of profitability – but our analysis of the company is similar to the work we do on a turnaround. The key question is can they hit their margin targets, and with over a third of their markets at or above those targets, and with company-wide incremental margins at or above those targets, we believe they have a clear path to getting there. The stock in our estimation didn't reflect that potential appropriately and at the current price [of around $46] still doesn't.

Talk in more detail about how you estimate a stock's intrinsic value?

AW: We define the intrinsic value of a company as 9x its five-year forward normalized earnings per share. We trust our research and analysis to make projections out five years, but no further. That doesn't mean companies stop growing after five years, we just don't believe growth rates beyond that are forecastable, so we should not pay a premium for growth beyond year five. For earnings, we model what we believe a company should earn on a normalized basis, reflecting its average growth and profitability across a full economic cycle, and without any non-recurring items or accounting distortions.

As for the multiple, we use 9x earnings five years out because that has been the median valuation of the 1,000 stocks in our U.S. universe over the past 20 years. At first 9x may seem low compared to the approximately 16x average for the S&P 500, but that's a bit apples and oranges. Our multiple is on five-year forward earnings, not current earnings. When adjusted for that time difference the two multiples are consistent, as discounting 16x for five years at 10-11%, which is the long-term return of the S&P 500, will get you to about 9x. We use the same multiple for all stocks because we've already incorporated differences in growth into our five-year earnings estimates. To put a higher multiple on higher five-year earnings would be double counting.

Describe your broader investment thesis for equipment-rental company United Rentals [URI].

Matthew Mangiacotti: Speaking first about the business, this is the largest equipment rental company in the U.S. with 17% market share, ahead of #2 player Sunbelt Rentals with 13%. Equipment rental is a secularly growing business, tied to non-residential construction spending, but beyond that benefitting from an ongoing shift away from ownership of equipment to rental. The rental market is roughly 55% penetrated in the U.S., versus places like Japan and the U.K. where it's more like 85% to 90%. In many customer use cases there are clear benefits and efficiencies from renting over owning equipment.

Scale is a significant advantage in terms of equipment availability and utilization. We think of United as more like a logistics

INVESTMENT SNAPSHOT

United Rentals
(NYSE: URI)

Business: Provider through nearly 1,500 locations in North America of rental equipment and tools used in a wide variety of commercial, industrial and residential applications.

Share Information (@9/29/23):

Price	**444.57**
52-Week Range	260.97 – 492.33
Dividend Yield	1.3%
Market Cap	$30.36 billion

Financials (TTM):

Revenue	$13.19 billion
Operating Profit Margin	28.1%
Net Profit Margin	17.3%

Valuation Metrics
(@9/29/23):

	URI	S&P 500
P/E (TTM)	13.5	20.0
Forward P/E (Est.)	11.1	19.9

Largest Institutional Owners
(@6/30/23 or latest filing):

Company	% Owned
Vanguard Group	11.6%
BlackRock	7.6%
Capital Research & Mgmt	6.5%
State Street	5.0%
Fidelity Mgmt & Research	2.5%

Short Interest (as of 9/15/23):

Shares Short/Float	4.0%

URI PRICE HISTORY

THE BOTTOM LINE

While the company is a market leader and impressive long-term earnings compounder, the market appears to overlooking it due to short-term cyclicality concerns, says Andrew Wellington. He believes the business is significantly more resilient than commonly thought and estimates the stock's fair value today at roughly 80% above the current share price.

Sources: Company reports, other publicly available information

company, where the premium is on having the right equipment in the right condition at the right place and at the right time. That's what matters most to customers. Rental spend equates to only around 2% of a project's total cost, but if you can't get working equipment when you want it, it can significantly impact the timeline. So logistics and availability are key competitive advantages that only improve with scale, which also drives utilization rates and translates in United's case into returns on capital of around 20%.

How resilient is this business?

MM: It's actually much more resilient than most investors realize. Every time historically when there's been a broader slowdown or downturn, the company has significantly reduced capital spending and its free cash flow has jumped. They have the scale to be able to cancel or postpone orders with relatively short notice, and while leaving equipment idle clearly isn't positive from a revenue standpoint, it's not particularly expensive. There are some fixed costs for things like insurance, lease payments and yard maintenance, but there aren't a lot of people involved, resulting in cash costs that are 90% variable. We consider businesses that generate more cash in a downturn to be incredibly resilient.

I'd add a couple other things. The company over the past five years has reduced its financial leverage dramatically – its cost of debt is low and net debt to EBITDA is now around 1.8x. There are also various positive secular growth drivers in the U.S., including infrastructure spending associated with the Inflation Reduction Act, the reshoring of manufacturing capacity, and the energy transition. That's going to require a lot of non-residential construction, despite what might be going on with the consumer.

Trading recently at around $444.50, how inexpensive do you consider the shares?

AW: United's earnings per share immediately prior to the financial crisis was about $3 and it has compounded since then at 19% per year. But despite that growth rate the stock currently trades at just 11x forward estimates. It seems the market is overlooking an amazing long-term earnings compounder due to short-term cyclicality concerns, and as Matt pointed out, while earnings are cyclical, cash flows are actually counter-cyclical and go up in a recession.

MM: In our five-year forecast we assume the equipment-rental industry grows about 5% per year, and that United grows another 1% through market-share gains. (We don't assume continued acquisitions as the industry continues to consolidate, but that's likely to benefit top-line growth as well.) That 6% revenue growth translates into high-single-digit annual profit growth, with potential share buybacks bringing EPS growth into the low-teens. From our estimate of current fair value after assigning our normalized multiple to the resulting EPS estimate five years out, the shares today have about 80% upside.

AW: For years this would show up on our screens at 10x earnings and we thought it was a crappy business, out of ignorance. Then it got to 5x earnings and it was too cheap to ignore. The thinking was that earnings could fall by half and it would still be cheap. The more we studied it, the more we came to appreciate the resiliency of the business and the earnings power over time. That happens in value investing. I get why people still don't understand this – we didn't properly understand it either early on.

What is the market missing in payments-processor Global Payments [GPN]?

AW: Global Payments has a phenomenal track record, with smooth, stable earnings compounding at 16% per year going back 15 years. At the beginning of 2021 the stock was over $200, they were supposed to make about $8.50 in EPS, and the P/E was nearly 25x. Two years later earnings expectations grew at 14% per year to around $11 in EPS, but the stock fell to about $100 and the P/E was under 10x.

The main concern here seems to be that the company's biggest business, facilitating electronic payments for small and medium sized merchants, will potentially be disrupted by new fintech entrants into payments processing. We did our research and concluded the disruption was unlikely.

Payments is a massive and diverse field that does not lend itself to one killer app. More likely there are hundreds of killer apps, because there are so many different types of customers with very different needs. The technology solution for McDonalds is not the same as for a smaller chain, which is not the same as for a single restaurant, which is not the same as for a food truck. The best solution for a pizzeria may be useless for another restaurant. And that's just talking about one narrow sector, restaurants. It's hard to convey just how fragmented the needs are across the universe of payments.

That speaks to the importance of Global Payments' strong position serving small and medium sized merchants across many well-defined verticals worldwide. We think this is the best part of the market, serving growing customers that are big enough to generate real volume but small enough that competitors haven't been willing or able to pour in and drive down margins. We've looked at the new entrants such as Adyen (Amsterdam: ADYEN) and Block [SQ], and while they're growing fast they just don't impact the key segments where Global Payments plays.

MM: A key part of the company's strategy is to integrate its payment capabilities with vertical-market software, either through acquisition or partnership. For example, a dental office may use a Global Payments' solution that not only processes

ON DISRUPTION:

We own stocks where disruption fear may be depressing the price, but our view is the business won't be disrupted.

credit-card payments but is also used to schedule visits, access patient health records, and process insurance claims. Management says 65% of the current business comes from such "technology enabled" formats, a share they expect to continue to grow over time, with positive impact on both client retention and margins.

The shares have recovered somewhat from earlier this year – what upside to fair value do you see from the current price of around $115.50?

AW: Overall digital-payment volume is still expected to grow at a high-single-digit rate per year, fueled by the continued shift globally away from cash to pay for things. Cash still accounts for 20-40% of total transaction volume depending on the country, so there's room for a number of industry players to stay in their niches and grow.

MM: We model 8% annual top-line organic growth over the next five years, which because incremental margins are so high translates into mid-teens EPS growth. With our valuation framework, we currently see 50% upside to fair value.

AW: Visa over the last ten years has grown normalized EPS at 16% per year and its stock trades at 25x forward earnings. Mastercard has grown earnings at 16.8% and its stock trades at 30x. These are great companies, and in some ways are clearly better businesses than Global Payments, but Global Payments over the same period has compounded earnings at 19%. That's not something you'd expect to be available at 10.4x earnings. This to us is clearly a gem amid the junk.

Why are you high on the investment prospects for technology-products distributor TD Synnex [SNX]?

AW: Our history here is that we had owned Tech Data before it was taken private in 2020 by Apollo, after which we bought Synnex as a replacement because we liked the IT-distribution business and thought its stock was comparably cheap. Then in 2021 Tech Data and Synnex merged to form TD Synnex.

Distribution businesses are simple and relatively easy to analyze and forecast. Most tech companies can't possibly have direct relationships with the vast number of end customers who want and need their products, and we think of TD Synnex as an outsourced sales organization for those tech companies. Think of how many businesses use Cisco routers – Synnex can reach them much more efficiently than Cisco could by itself. For end customers the company also adds value in helping them identify the best solutions for their particular situation in a diverse and evolving market.

One of the unappreciated elements of this business is just how low-risk it is. Virtually all of their inventory is effectively guaranteed, meaning manufacturers will take it back or pay them to hold it or discard it. If you're a regular retailer and nobody wants your stuff in inventory, you have to mark it down 80% to move it out. That's not an issue for Synnex, which is important in a business where outdated products don't hold their value very well. There has been virtually no inventory impairment over its history.

INVESTMENT SNAPSHOT

Global Payments
(NYSE: GPN)

Business: Provides technology and software that enables primarily small and midsized merchants to accept electronic credit card payments for their products and services.

Share Information (@9/29/23):

Price	**115.39**
52-Week Range	92.27 – 129.70
Dividend Yield	0.9%
Market Cap	$30.00 billion

Financials (TTM):

Revenue	$9.28 billion
Operating Profit Margin	21.5%
Net Profit Margin	8.6%

Valuation Metrics (@9/29/23):

	GPN	S&P 500
P/E (TTM)	38.4	20.0
Forward P/E (Est.)	10.4	19.9

Largest Institutional Owners (@6/30/23 or latest filing):

Company	% Owned
Vanguard Group	9.8%
BlackRock	7.1%
T. Rowe Price	4.8%
Wellington Mgmt	4.4%
State Street	4.1%

Short Interest (as of 9/15/23):

Shares Short/Float	2.3%

THE BOTTOM LINE

The wide disparity in end-market customer needs reinforces the company's strength as a leading incumbent provider of customized payments-processing solutions, says Andrew Wellington. The shares of a well-positioned company that has compounded earnings at 19% over the past ten years should not be available at 10.4x forward earnings, he says.

Sources: Company reports, other publicly available information

Investors love high margins, so this sounds like a terrible business with operating margins of 2-3%. But as with all distribution businesses that's because they're passing through the manufacturers' cost of goods, in this case with near zero risk. If you calculate margins as operating income as a percentage of gross profit – which in Synnex's case essentially represents its sales commissions – that number is closer to 45%. If this were such a bad business, normalized EPS wouldn't have compounded at 16.5% per year since 2007. That sounds like something a growth investor would find interesting, until of course they saw how cheap the stock was and were turned off by the low multiple.

Is the integration from the 2021 merger largely done?

MM: That has been a big initiative over the past two years, which is now winding down. A key element of that has been debt paydown, and the company expects within the next couple of quarters to hit its targeted leverage ratio of around 2x gross debt to EBITDA. At that point it will have a lot of cash to redeploy – we estimate on the order of $1 billion in 2024 on what is now a $9 billion market cap. That's the next leg of the story, as they're able to invest incremental cash more aggressively into M&A, dividends and buybacks.

How cheap is the stock in your estimation at today's price of just under $100?

MM: The pro-forma business over the past 20 years has had 6% annualized top-line growth, a point or two better than overall IT spending. We model mid-single-digit revenue growth over the next five years, with margin expansion, operating leverage and share buybacks driving estimated annual EPS growth of 13%. Even with no multiple expansion that would generate a good return. But there's also significant potential for the shares to re-rate. You're paying at today's price only 8.7x forward earnings – just two years ago that was 15x.

The shares of online travel agency Expedia [EXPE] are below where they traded pre-pandemic. Why are you optimistic about it when the market doesn't seem to be?

MM: This is the #2 online travel agency (OTA) behind Booking.com in traditional lodging, and it's also #2 with its Vrbo business in alternative accommodations behind Airbnb. The traditional OTA business accounts for roughly 50% of operating profit, Vrbo for 25%, and the rest comes from a business-to-business software offering that companies like American Express use to power their rewards programs. While you can book airfare and car rental with Expedia, the margins and profits are almost completely driven by lodging. From a geographic perspective, Expedia is more established inside the U.S. and Booking is stronger outside the U.S.

While the history here has been about growth through M&A, the story going forward is more about integration, efficiency and margin expansion. The company has been rationalizing a number of acquired brands to focus primarily on Expedia, Hotels.com and Vrbo. While this causes some headwinds to volume in the short term, it ultimately should create a more efficient platform in the future.

INVESTMENT SNAPSHOT

TD Synnex
(NYSE: SNX)

Business: Distributor of hardware, software and systems produced by more than 1,500 vendors to an established base of more than 150,000 end customers located worldwide.

Share Information (@9/29/23):

Price	**99.86**
52-Week Range	78.87 – 111.57
Dividend Yield	1.4%
Market Cap	$9.19 billion

Financials (TTM):

Revenue	$59.40 billion
Operating Profit Margin	2.3%
Net Profit Margin	1.1%

Valuation Metrics (@9/29/23):

	SNX	S&P 500
P/E (TTM)	14.3	20.0
Forward P/E (Est.)	8.7	19.9

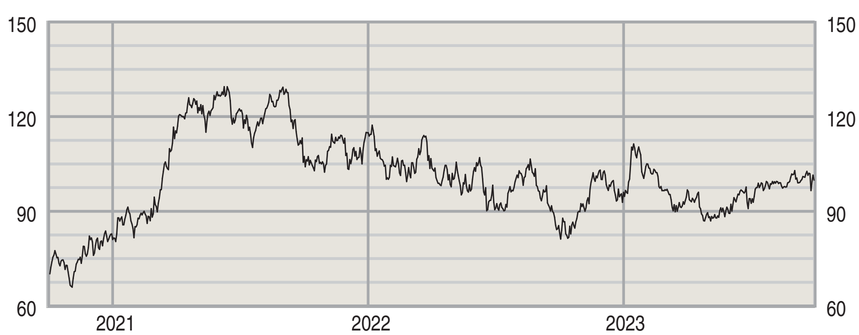
Largest Institutional Owners (@6/30/23 or latest filing):

Company	% Owned
Apollo Global	38.2%
Fidelity Mgmt & Research	7.1%
Mitac Holdings	5.8%
Vanguard Group	5.2%
BlackRock	4.6%

Short Interest (as of 9/15/23):

Shares Short/Float	3.5%

SNX PRICE HISTORY



THE BOTTOM LINE

Andrew Wellington doesn't believe the market is correctly valuing the company's low-risk business model, underlying profitability, and ability to compound earnings per share at what he estimates is a 13% annual rate over the next five years. That growth would generate an attractive shareholder return, he says, with added upside if the stock re-rates.

Sources: Company reports, other publicly available information

They've also had to invest heavily to better integrate tech platforms acquired over time. Those costs have been a headwind to margins as well, but most of the integration work is done and margins should improve going forward. Covid was terrible for the travel business in general, but one good thing coming out of it for Expedia was that they were able to accelerate a number of migration and integration projects that needed to be done.

One other interesting company initiative has been the creation of a new loyalty program that encompasses both the OTA and Vrbo businesses. That's easier to pull off as the smaller, disparate brands are wound down, and the program should pay off in higher customer retention and by driving program members directly to the app rather than coming through paid Google clicks.

People for years have talked about Google expanding its efforts in travel booking as a competitive threat to Expedia. Is that still a concern?

AW: It's still enough of a concern that we looked deeply into it, but our conclusion is that Google is unlikely to take Expedia and Booking head on as a competitor. We don't think they have the appetite to invest what's necessary to build out the partner and customer-service infrastructure to match what Expedia and Booking have built over decades. The OTAs are also top-five advertising customers for Google, making it even less likely it does anything that would harm that relationship.

This is another idea where the valuation has taken a big hit over the past two years. How attractive do you consider the shares at today's price of around $103?

AW: Even with the huge disruption to global travel due to the pandemic, over the past 15 years normalized earnings have compounded at 14.7% annually. Pre-Covid the company was earning $8 per share, and they got back to that level by early 2022 when the stock was over $200. Now they're expected to make close to $12 per share next year, but the stock has fallen by half to $103. Given the continued earnings growth progression, it's amazing to us that the shares trade where they do.

MM: People seem worried about where we are in the travel cycle, but to us that's not nearly as important as the margin expansion we see driven by cost efficiencies and incrementally higher growth from Vrbo and the B2B rewards-program business. In our model we assume mid-single-digit annual revenue growth over the next five years and that operating margins increase from 14% today to around 17%. The upside to our estimate of fair value is more than 70% above today's price.

Ameriprise Financial [AMP] is a long-time portfolio holding. Why do you still find it compelling as an idea?

AW: We buy companies because we think they're misvalued. In other words, the multiple is too low and we expect it to go up. When the multiple does not expand that's disappointing, but if we get the earnings growth we expect it still can be an outperforming stock. Ameriprise is a perfect example of this.

INVESTMENT SNAPSHOT

Expedia
(Nasdaq: EXPE)

Business: Provider of online travel agency, lodging rental, and corporate rewards-program services; leading consumer brands include Expedia, Hotels.com and Vrbo.

Share Information (@9/29/23):

Price	**103.07**
52-Week Range	82.39 – 124.95
Dividend Yield	0.0%
Market Cap	$14.78 billion

Financials (TTM):

Revenue	$12.26 billion
Operating Profit Margin	10.2%
Net Profit Margin	7.3%

Valuation Metrics (@9/29/23):

	EXPE	S&P 500
P/E (TTM)	18.4	20.0
Forward P/E (Est.)	10.1	19.9

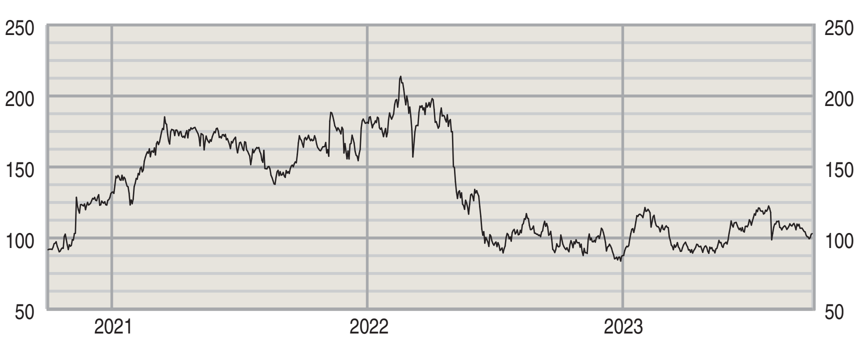
Largest Institutional Owners (@6/30/23 or latest filing):

Company	% Owned
Vanguard Group	11.5%
BlackRock	8.6%
State Street	3.9%
Artisan Partners	3.3%
Par Capital	2.4%

Short Interest (as of 9/15/23):

Shares Short/Float	5.4%

EXPE PRICE HISTORY



THE BOTTOM LINE

While the company history has been about growth through M&A, the story going forward is more about integration, increased cost efficiency and margin expansion, says Matthew Mangiacotti. Modeling mid-single-digit revenue growth and operating margins increasing from 14% to 17%, his estimate of the stock's fair value is 70% or so above today's price.

Sources: Company reports, other publicly available information

We added Ameriprise back in 2010, and since then the multiple has gone nowhere. It was around 10x back then and it's around 10x today. But the earnings have continued to grow at 13%-plus per year, which is double the rate of the S&P 500. As we've waited for the multiple to expand, the stock has still nicely outperformed due to that faster earnings growth. Growth can enable us to be patient – in the case of Ameriprise, that's 13 years and counting.

I mentioned earlier that we don't own any banks. Ironically, financial services is the largest sector exposure in our portfolio because of companies like Ameriprise. It's a wealth management and asset management firm – they don't give money out hoping to get it back, they take it in. That to us is a much better business than a bank.

MM: The wealth management business, anchored by roughly 10,000 financial advisors, accounts for roughly 65% of operating earnings. The asset management business, primarily consisting of investment firm Columbia Threadneedle, makes up another 20% of profit, and then there's a smaller retirement-annuity business that accounts for 15%.

Wealth management, which targets a Main Street, middle America customer, is the crown jewel. The driver for it is assets under management, which we think through a combination of market returns, adding new advisors and increasing the productivity of existing advisors can grow at a high-single-digit annual rate. The business is very capital-light, which results in overall company returns on equity of around 40%.

We spoke earlier about threats of disruption. How do you assess that risk here?

AW: Robo-advisors have now been around for a long time, and they can be a nice solution for people who lack the assets to be advised by a professional. But for all the talk of robo-advisors, at a certain level of wealth we continue to see that people want a human to advise them.

At today's price of just under $330, how mispriced do you consider the stock?

MM: While we believe wealth management can grow at a high-single-digit annual rate, we expect overall net income to grow slower than that, about 6% or so per year, because the asset-management business is likely to be flattish and the retirement-annuity business is in run off. Because the business is so capital-light they've been able to buy back roughly 6% of their shares annually, which would bring prospective EPS growth to closer to 12%, consistent with the history. There's also a 1.6% dividend yield.

So if the multiple stays where it is we think the stock can outperform with EPS growth alone, but we still believe the business deserves something better than the current 10.3x forward multiple. It's never re-rated much above 15x, but any re-rating of the valuation would obviously provide additional upside.

AW: This is another case where a lack of peers may help explain why the multiple has suffered. This is as pure a play on wealth management as there is in the U.S. – most of the other wealth manage-

INVESTMENT SNAPSHOT

Ameriprise Financial
(NYSE: AMP)

Business: Provides wealth management, asset management, and insurance products and services through a national U.S. network of approximately 10,000 financial advisors.

Share Information (@9/29/23):

Price	**329.68**
52-Week Range	250.88 – 358.02
Dividend Yield	1.6%
Market Cap	$33.83 billion

Financials (TTM):

Revenue	$15.08 billion
Operating Profit Margin	27.5%
Net Profit Margin	16.1%

Valuation Metrics
(@9/29/23):

	AMP	S&P 500
P/E (TTM)	15.0	20.0
Forward P/E (Est.)	10.3	19.9

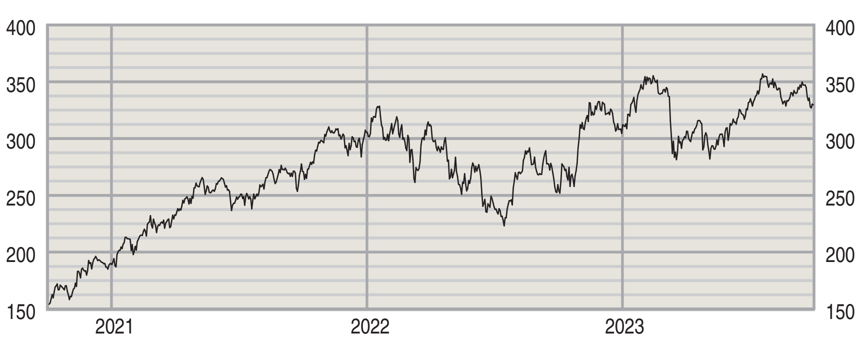
Largest Institutional Owners
(@6/30/23 or latest filing):

Company	% Owned
Vanguard Group	13.2%
BlackRock	8.4%
State Street	4.5%
Aristotle Capital	3.7%
UBS Asset Mgmt	3.2%

Short Interest (as of 9/15/23):

Shares Short/Float	0.8%

AMP PRICE HISTORY



THE BOTTOM LINE

Driven by growth at the crown-jewel wealth management business and extensive capital return, Matthew Mangiacotti believes the company can increase EPS over the next five years at a roughly 12% annual rate. There's additional shareholder upside as well, he says, were the shares to re-value above today's historically low 10.3x forward multiple.

Sources: Company reports, other publicly available information

ment peers are part of large banks – so there isn't an obvious comp. When we first bought Ameriprise it was mostly covered by life insurance analysts, and we still don't think the Street fully understands the business.

You mentioned earlier having an average holding period of seven years. Describe something you've sold recently and why.

AW: We do not target a turnover rate. We aim to buy cheap and sell fair, and over our fifteen years following that approach we have ended up with about 15% annual turnover, equating to a seven-year average holding period.

Another way to think about it is that our portfolio management consists of constantly looking at our bench of potential ideas and substituting one for a current position when we think it's significantly better. The best way for that to happen is if a stock in the portfolio goes up a lot and no longer trades at a discount to our estimate of intrinsic value. As evidenced by our turnover, that full revaluation can take some time.

We also sell things when we lose conviction, usually because something awful happens and we no longer believe in the company. An example of that over the past year would be Lincoln National [LNC], which sells insurance products mainly for retirement. After the third quarter of last year the company announced a surprise charge of over $2 billion against a book of business in which it hadn't written any policies in 20 years and hadn't taken any prior charges. That put a big hole in the balance sheet that severely impaired the company's operating and financial flexibility. After they took the charge we spent a lot of time reviewing the situation, but by the end of our analysis it became an easy call to move on to something better from the bench.

ON THE CURRENT MOOD:

I'd say our mood today is more the odd mix of frustration paired at the same time with tremendous optimism.

How would you characterize your mood as a value investor today?

AW: Our mood as investors is always swinging over time between two extremes. At one end you're happy with performance but then concerned about your portfolio because it's not cheap anymore. At the other end, you love your portfolio valuation but usually it gets that cheap after a difficult period of performance. Those are the mood swings.

I'd say today that our mood is more the odd mix of frustration paired with tremendous optimism. The frustration comes from the market behavior over the last five years or so, when for the most part the earnings of the companies in our portfolio have performed well, but the stocks have not fully recognized it. Performance has been good the last few years, but we feel like it should have been even better, if only valuations moved in line with reported fundamentals.

That is frustrating to say the least, but it's better than being depressed. You get depressed when you get the stock wrong because you got the fundamentals wrong. So on the one hand the mood today is frustration, because overall we've gotten the fundamentals right, but we haven't seen the follow through we would have expected to the stock price.

At the same time we're also tremendously optimistic. As a result of solid fundamentals not flowing through to stock prices, the valuation gap of our portfolio relative to the S&P 500 is near an all-time high. For most of the decade following the financial crisis the S&P 500 traded at a P/E premium of 25-30% higher than our portfolio P/E. Then that spread began to widen around 2017 and peaked prior to the Covid selloff in 2020. Today the S&P 500 trades at a 90-100% premium to our portfolio P/E even though the companies in our portfolio have grown earnings faster than the average member of the S&P 500. We are now patiently, and optimistically, waiting for that wide valuation spread to revert back to its historical norm.

Of course we don't let our emotions interfere with our day jobs. When we come to work every day the only thing we care about is correctly assessing the companies we own and getting their future earnings right. Markets go up and down and can be a major distraction to an investor. We don't let it distract us. If we get the earnings right, it's only a matter of time to get the stock right. That's our true north.

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As of Sept 30, 2023	1 year	5 Year	10 Year	ITD (1/1/09)
LAM – EQ (Gross)	+25.06%	+7.43%	+9.15%	+15.92%
LAM – EQ (Net)	+24.18%	+6.64%	+8.20%	+14.15%
S&P 500 Value	+22.19%	+8.41%	+9.64%	+11.42%

The S&P 500® Value draws constituents from the S&P 500®. S&P measures value using three factors: the ratio of book value, earnings, and sales to price. S&P style indices divide the complete market capitalization of each parent index into growth and value segments. Index results shown are provided for illustrative purposes only, are unmanaged, reflect reinvestment of dividends and income, and do not reflect the impact of advisory fees. Investors cannot invest directly in an index. Comparisons to indexes have limitations because indexes have volatility and other material characteristics that may differ from the composite.

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