REPRINTED FROM AUGUST 27, 2018

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Staying Disciplined to a Bottom-Up Process with a Focus on Intrinsic Value

**TONY CONIARIS** is a Partner, Co-Chairman, Portfolio Manager and U.S. Investment Analyst at Harris Associates. He is currently a co-manager of the Oakmark Select Fund (MUTF:OAKLX), the Oakmark Global Fund (MUTF:OAKGX) and the Oakmark Global Select Fund (MUTF:OAKWX). Mr. Coniaris joined the firm in 1999, previously serving as both an Associate Analyst and Research Associate at Harris. He earned a B.A. from Wheaton College in 1999 and an MBA from Northwestern University in 2005.

SECTOR — GENERAL INVESTING

**TWST: Could you please introduce yourself and tell me about your role at the firm?**

**Mr. Coniaris:** I'm Tony Coniaris, Co-Chairman of Harris Associates in Chicago. I am also Co-Portfolio Manager of the Oakmark Select Fund, Oakmark Global Fund and Oakmark Global Select Fund as well as a Portfolio Manager on many of our institutional products, both U.S. and global.

**TWST: Could you tell me a little bit about the firm?**

**Mr. Coniaris:** Yes. We are a value manager with approximately $140 billion in assets under management. Over the course of our 40-plus-year history, we have remained committed to a consistent investment philosophy and process.

**TWST: Did you want to talk a little bit about the Oakmark Funds?**

**Mr. Coniaris:** Sure. Harris Associates manages the Oakmark family of mutual funds, all of which reflect the same underlying value strategy. We buy businesses at significant discounts to our estimate of intrinsic value, that have management teams that think and act like owners — and a clear path to growing per-share value.

**TWST: Do you want to get into more detail on your investment process?**

**Mr. Coniaris:** Yes. I think it's an important differentiator for Harris Associates. We have a unique, bottom-up investment process, which means we build portfolios without regard to how the indexes are weighted. We have relatively concentrated portfolios, where the most diversified ones have roughly 50 companies. We go all the way down to 20 names or less in some of our portfolios, meaning they are more concentrated and, therefore, have higher conviction.

Our investment process among value investors is somewhat unique. When I say we look for businesses trading at significant discounts to our estimate of intrinsic value, I would really underline the word intrinsic, and you see that in our portfolios, where they look a little bit more eclectic. What I mean by that is, we don't draw arbitrary statistical lines in the sand, like we won't pay over X times book value or X times earnings, or we only buy businesses that trade at a significant discount to the overall market. Everything we do is bottom-up and intrinsic-value focused, which means that from time to time we will own businesses that are characterized as more like growth companies, where that growth is underappreciated and undervalued.

The other two filters that we put on our process are very important too. One is that we look for quality businesses, where we see a clear path to growing per-share value, essentially to avoid value traps. We have a management filter as well, where we only invest with management teams that think and act like owners, which means they do what they can to maximize per-share value over time. We look for management teams that have skin in the game. They own the stock and have the incentives to do the right sorts of things with the business. When you put all of that together, we think we can do really well for our clients over time.

**TWST: Maybe you could explain how clients benefit from some of these factors.**

**Mr. Coniaris:** They benefit because we are very different than the overall indexes. We think that's been the differentiator in our performance over time. We stay disciplined to a process where we manage relatively concentrated portfolios of significantly undervalued but quality businesses with management teams that think and act like owners.

**TWST: Did you want to highlight a stock that you find interesting right now?**

**Mr. Coniaris:** Sure. I'll highlight a couple.

**TWST: Right, one at a time.**

**Mr. Coniaris:** The first one I'd highlight is **Google** (NASDAQ:GOOG), now known as **Alphabet**. When you look at **Google**, I think it's a great example of us being truly focused on intrinsic value and not relative value, because if you look at the stock price at roughly $1,250 a share relative to its forward earnings estimate of $48 a share, it doesn't look particularly cheap at 26 times earnings.

You really have to peel back the onion to see the value in **Google**. When you do that, we believe you're paying a midteens multiple on the core search business. If you take that $1,250 share price, back out $140 per share of net cash and back out the losses that they're making on what they call "other bets," such as their Waymo autonomous driving efforts, you're paying roughly 16 times earnings for the core search business.

One also has to think harder about what YouTube may be worth. We don't believe **Google** has monetized YouTube to its full potential yet. If you take the hours viewed on YouTube and value them similarly to how public cable networks are valued, you get a value for YouTube in excess of $430 a share. Even if you use half of that, you'd be paying only a midteens multiple of earnings for the core search business.

Remember, all we did was back out the losses on other bets like Waymo. Recently, a Morgan Stanley analyst put out a long-term discount of cash flow valuation for Waymo that estimates it could be worth up to $200 per share for **Google**. So that just gives you an idea of how much value can be in some of these efforts that they're spending money on today where we don't think it's proper to value as a negative, as one would when looking at the income statement.

**TWST: Google is certainly well-known among investors. Are there any concerns among the people who are owning Google or might consider buying Google as a stock that you have seen among your clients?**

**Mr. Coniaris:** I think the toughest thing for clients to get over is a value manager paying 26 times earnings for a company. Our response to that is, again, like I said at the beginning, you have to peel back the onion to really see the true value of the business. We believe management is making rational investments on the income statement in things like YouTube and Waymo to maximize long-term value.

**Highlights**

*Tony Coniaris discusses Harris Associates. Mr. Coniaris is a value manager with a unique, bottom-up investment process. He manages relatively concentrated portfolios and isn't concerned with how indexes are weighted. Mr. Coniaris looks for businesses trading at a significant discount to intrinsic value. Because of this focus on intrinsic value, Mr. Coniaris notes that some of his investments will look more like growth companies that have underappreciated and undervalued growth. He also filters for quality companies with a clear path to growing per-share value and for management teams who think and act like owners.*

*Companies discussed: Alphabet (NASDAQ:GOOG); Charter Communications (NASDAQ:CHTR); Comcast Corporation (NASDAQ:CMCSA); American International Group (NYSE:AIG); Berkshire Hathaway (NYSE:BRK.A); Arch Capital Group Ltd. (NASDAQ:ACGL) and Marsh & McLennan Companies (NYSE:MMC).*

believe we're just beginning to see the first fruits of that integration and all of those synergies of putting these companies together. We believe over the next few years that EBITDA and free cash flow growth will accelerate as all of the spending they're doing on the income and the cash flow statements will lever into more than $30 per share of free cash flow. With the stock at $300 a share, that's just far too cheap.

Furthermore, one year ago, there were multiple offers for the company in excess of $400 to $500-plus a share. The buyers were trying to opportunistically take advantage of the synergies from these large acquisitions not being that obvious in the financials. Management turned those offers down, which were significantly in excess of the current share price because they thought they were inadequate. This gives you an idea of just how valuable we think — and this good management team thinks — **Charter** is.

**TWST: In the field that Charter is in, there's a lot of competition. There's a lot of people generating content that can be viewed either on cable TV or on the internet. How do you remain competitive in that field? How do you make sure that a lot of other companies don't come along and swipe away your audience?**

**Mr. Coniaris:** The vast majority of value is really in the broadband business, where there isn't a lot of competition locally. You're right that there is more competition on the video side, which is a much lower-margin business and a smaller component of the value.

**TWST: As far as the broadband side, you don't see a lot of competitors out there on the horizon?**

**Mr. Coniaris:** We're keeping an eye on 5G wireless competition that might emerge as a technology, but right now, we're comfortable with their competitive position.

**TWST: Did you want to mention another company?**

**Mr. Coniaris: AIG** (NYSE:AIG) is a large insurance company, in both general personal and commercial lines as well as life insurance. The reason we own **AIG** is because it's selling for 75% of tangible book value, where its peers are trading at close to a 20% premium to book value, and private market transactions occur typically in excess of 1.5 times book value. So it's significantly undervalued. The reason it's undervalued is the general insurance operations, which are not performing up to their full potential.

***"I think the toughest thing for clients to get over is a value manager paying 26 times earnings for a company. Our response to that is, again, like I said at the beginning, you have to peel back the onion to really see the true value of the business."***

**TWST: OK. Did you want to mention another company?**

**Mr. Coniaris:** Sure. Another large holding of ours is **Charter Communications** (NASDAQ:CHTR). **Charter** is the second-largest cable and broadband company in the U.S. behind **Comcast** (NASDAQ:CMCSA). It was built in May of 2016 when they merged **Charter** with Bright House and Time Warner Cable, which more than tripled the size of the company. Over the last two years, they've been integrating these businesses. We

That's where the new management team comes in with Brian Duperreault as the CEO, who has hired an A-plus cast of managers from companies like **Berkshire Hathaway** (NYSE:BRK.A), **Arch Capital Group** (NASDAQ:ACGL) and **Marsh & McLennan** (NYSE:MMC) — very well-regarded companies — to turn around the general insurance operations. We don't see any reason **AIG** can't earn an industry-like ROE in those businesses given their scale and positioning. We believe over the next few years that will become evident, and **AIG** will then be priced like its peers. If that happens, we see roughly 60% upside to a growing book value.

**1-Year Daily Chart of Alphabet**


**Chart provided by www.BigCharts.com**

**Mr. Coniaris:** There are always risks when you're investing in equities, and there are always macro risks that are identifiable and not out there. We value businesses through a cycle, meaning we account for ups and downs in their business and average for that in our valuation work. When they sell at significant discounts to our estimate of value, we buy them. Market timing based on guessing when we go into a recession is a very difficult game to play. We don't do that.

**TWST: What about particularly with the trade and tariff issues that are going on? Are there any concerns there, or does it look like these companies can work their way through whatever comes their way?**

**Mr. Coniaris:** That's a hard question to answer because we don't know what the outcome is going to be on the tariffs, but a lot of the businesses we own have withstood massive recessions, wars and other external shocks that good management teams and good businesses can navigate. That's not to say it wouldn't be aggravating for share prices if we go into a recession led by tariffs, but we don't know what's going to happen. All we can do is price quality businesses for a variety of scenarios, and when they're at a significant discount and run by good people, we will own them.

**TWST: What's been the impact so far from the whole Brexit move? Is it that these businesses largely have been able to work their way around that?**

**Mr. Coniaris:** We think they'll be able to navigate the Brexit issue.

***"There are always risks when you're investing in equities, and there are always macro risks that are identifiable and not out there. We value businesses through a cycle, meaning we account for ups and downs in their business and average for that in our valuation work. When they sell at significant discounts to our estimate of value, we buy them."***

**TWST: So you think the company can overcome some of the issues that it's had in the past regarding accounting and reorganization, those kinds of things, and turn out to be a solid investment for investors?**

**Mr. Coniaris:** Yes. **AIG** has spent 10 years cleaning up its balance sheet. What you have today is a much simpler and smaller company. The issues are very isolated in the general insurance business on the underwriting and expense side. Those are things that the new management team has a terrific wake of success doing in their prior roles.

**TWST: Some of the funds on which you work are the global funds. Maybe you could talk a little bit about some of the issues that are going on right now with global companies. Right now, you're seeing tariff issues and trade issues. How might that affect some of the companies in which you invest?**

**Mr. Coniaris:** Yes, when you look at our global portfolios, one of the most significant things that will stand out is our large position in European businesses and, in particular, European cyclicals and financials. The reason we have that position is because that's where we think a lot of the value is outside of the U.S.

**TWST: Are there some risks involved because of the possibility of tariff battles and different kinds of issues that might come up during the Trump presidency?**

**1-Year Daily Chart of Charter Communications**

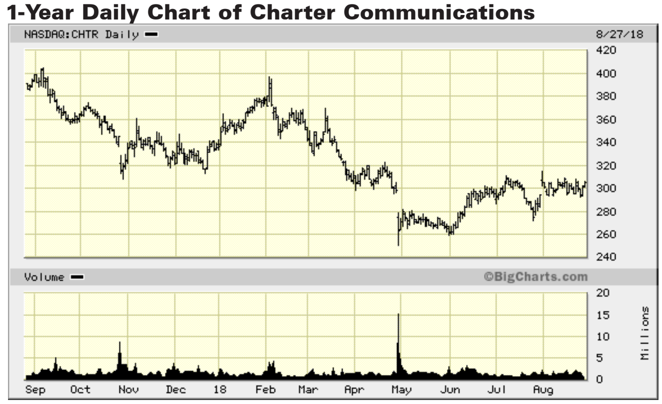


**Chart provided by www.BigCharts.com**

**TWST: Now, within Europe, certain parts of Europe are doing very well, like Germany. Do you try and take advantage of those businesses in these countries as you invest?**

**Mr. Coniaris:** We don't look at the world from a top-down perspective; we look at it from a bottom-up perspective. We spend far more time thinking about the microeconomics of a particular business than the macroeconomic outlook when we make investments.

**TWST: What would be the advantage of that? Do you think people can get a little too carried away when they're looking at the macro trends that get reported by the news?**

**Mr. Coniaris:** I do think there is a temptation as an investor to spend too much time thinking about the macro trends. We own businesses because they're selling at a discount to an intrinsic value that accounts for both good times and bad.

**TWST: Do you think it's just good sense when people put together a portfolio, be it retail investors or institutional investors, to include some exposure to global and overseas companies and funds? Why would that be?**

**Mr. Coniaris:** There's no question that having a diversified portfolio has benefits. Like I said in the beginning, we have fairly concentrated portfolios because we want to invest our clients' money in the most undervalued, well-run, quality businesses we can find.

**TWST: Changing gears a bit, when you talk with your investors, what are some of the concerns that they have about the next year or two if they look at the market and the economy?**

**Mr. Coniaris:** We always get a lot of questions on what's going on in the economy. Today, the big issue is tariffs, which we already discussed.

**TWST: In terms of those who are in their Baby Boom years or in retirement or nearing retirement, do you think that they really need to make sure that they have equities as part of their portfolios and not just invest in more fixed-income-type products?**

**Mr. Coniaris:** That really depends on the needs of the person. We believe equities are the most attractive asset class today for the long run, but every client has unique needs for income and/or capital preservation, so that's a decision for the individual.

**TWST: Do you think though that with people living longer — and somebody might retire at 65 or 70 but might live to 90 or 100 — they do need more income spread out over longer times and that the return on equity is probably going to be better than something with those very low interest rates?**

**Mr. Coniaris:** The time horizon you just provided was something like 25-plus years. So that's a sufficiently long time horizon to have equities be a component of your portfolio — in my opinion.

**TWST: Does what the Fed does impact what you guys do in terms of interest rates and whether people are going to be looking for equities or not? Obviously, if there were really high interest rates on certain bonds and government funds, more people might be investing in those than looking for equities?**

**Mr. Coniaris:** We do require a risk premium on equities relative to bonds. So to the extent interest rates go up, the discount rates we would use on equities would follow.

**TWST: In terms of what the government, either here in the United States or in Europe, can do to further encourage growth in the stock market and the economy, are there any things in particular that you'd like to see happen? I mean, there's already been a tax reform package in the United States, which has helped some companies along. Did you want to comment on that or anything that could be on the horizon?**

**Mr. Coniaris:** I think tax reform is an unequivocal positive for U.S. companies. I think the regulatory reform has been a positive for most companies. So in that sense, those are good things for U.S. businesses.

**TWST: Would you like to see some of those same things happen for companies in countries in Europe?**

**Mr. Coniaris:** Many of the European countries already have more competitive tax regimes than the U.S. had previously. So it was really the U.S. playing catch up to the rest of the world. The regulatory regime varies significantly across countries and probably isn't worth getting into.

**TWST: Do you think investors in general just need to keep their eyes on the micro level and the specifics of what you've been talking about on these stocks, as opposed to looking at maybe the hot trend that they might see from a consumer perspective or a field that might have promise? Do you have to really look at the specific company and what its financials are like?**

**Mr. Coniaris:** Every investor has different needs, and investors should really think hard about what their needs are today and what they will be over time. I think the most important step is to formulate a plan, stick to it and save more than you think you need.

**TWST: That can be hard for a lot of investors, right? There are a lot of distractions and a lot of things that come out in the news media that can sort of move them from their initial plan.**

**Mr. Coniaris:** Yes, and that's why it's so important to have a plan so that you know what to do, regardless of the environment.

**TWST: Thank you. (ES)**

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