

## Mean Aversion

Stephen Arnold, Delian Entchev and Alfred Tadros of Aoris Investment Management explain the various ways in which they try to minimize investment disappointment, why they spend so much time assessing companies' cultures, why they own only 15 stocks at a time, and why they see mispriced value in Accenture, Amphenol, LVMH, Copart and Cintas.

### INVESTOR INSIGHT



**Stephen Arnold**  
Aoris Investment Management

While the companies he targets are of particularly high quality, Stephen Arnold doesn't consider himself a growth-first investor. "Much of how we invest is really focused on minimizing the risk of disappointment," he says.

This safety-first approach has served clients of his Sydney-based Aoris Investment Management well since he started the firm in 2018. His international equity portfolio in U.S. dollars has earned a net annualized 13.6%, vs. 8.2% for MSCI's AC World Accum Index (ex-Australia).

Seeking companies with deeply ingrained cultures of value creation, he's finding opportunity today in such varied areas as technology consulting, luxury goods, outsourced business services, electric components and vehicle salvage auctions.

You make it clear in your investor communications that business quality outweighs everything else in your assessment of a company's investment prospects. Describe what quality means to you and why it's the focal point of your research and analysis.

**Stephen Arnold:** I'll start by describing our objective, which is to deliver 8-12% per annum returns over a market cycle to our investors after fees. We think the best way to do that is to own businesses that become progressively more valuable over time, and that the companies most likely to do that exhibit certain basic characteristics. They're proven market leaders in competitively stable markets. They have deep-rooted competitive advantages that allow them to constantly deliver more value to customers and gain market share. They're consistently profitable and have proven resilient over multiple cycles. The capital structure is conservative, and management reinforces a culture of long-term thinking and durable growth.

Investors often don't think enough about the fact that everything won't always go according to plan and we'll get things wrong from time to time. We believe investing only in the highest-quality businesses minimizes both the frequency and severity of disappointing outcomes, which goes a long way toward delivering better-than-average performance.

**Delian Entchev:** It might be helpful to highlight what we see as two of our key measures of success. One relates to risk and what we don't own. The other relates

to the success of what we do own.

The first measure is the number of stocks in our portfolio that perform in the bottom 20% of the market during the period we own it. While that number coming in at 20% would be considered average, in Stephen's 11-plus years running this strategy he's only had a single business that fell in the bottom 20%. With that company, S&P Global, we made very little absolute loss prior to selling it when it made a major acquisition we didn't think was a good use of capital.

We generally steer clear of companies with low returns on invested capital, high leverage, narrow business focus and high cyclicality, as well as those that are overly regulated, have opaque business models and rank poorly on ESG factors. Key sectors we avoid include banks and insurers, telecoms and utilities, pharma and biotech, and energy and mining companies. We believe the likelihood of our making an investment error is higher in all these types of businesses.

A second key measure we track is the success rate of what we do own. Across the market in any given year only about one-third of all stocks outperform the broad index, and studies have shown the same typically applies to the average investment portfolio. Since the inception of the strategy, over two-thirds of the businesses we've owned have outperformed our benchmark index over the period in which we've owned them.

**SA:** The ultimate measures of success are our absolute returns and those returns

relative to our peer group in the market. If we do well on the two metrics Delian described it's almost impossible over time for us not to achieve good absolute and relative returns. That heavily informs the sorts of businesses we favor and the sorts of businesses we avoid.

**Is there a heavy screening component to narrowing your global opportunity set?**

**SA:** We cap the number of stocks we'll own at a given time at 15. Outside of that we have a two-tier bench we call the A List and B List, each of which usually has 20 to 25 stocks at a time. These are all companies that generally meet our criteria for business quality and we're monitoring all of them closely to assess whether that remains the case. We typically have to replace 15 or so stocks per year on our bench, and we also turn over three or four in the portfolio.

**DE:** New ideas can come from any number of sources, including general reading and due diligence on companies and industries, but we do also regularly run a quantitative screen through FactSet to narrow the 50,000-company global universe down to about 250 that are in industries in which we'll invest and that meet our criteria for profitability, returns on capital, growth, balance sheet strength and liquidity.

**Of your 15 portfolio stocks today, 10 are based in the U.S. and five are based in Europe. Is that typical?**

**DE:** Our mandate is the world ex-Australia, but we typically haven't owned businesses in emerging markets, which introduce a whole host of complexities around governance, transparency, political risk and exchange-rate risk that we just don't want to contend with. While our current holdings might be narrow by domicile, we look for businesses that are internally diversified over a range of different customers, end markets and geographies. That lends itself to the consistency, resilience and durability we favor.

**Why do you own no more than 15 stocks at a time?**

**SA:** Part of our philosophy as a business is to keep things as simple as possible. Owning no more than 15 positions at a time allows us to be very demanding in all the attributes that come together to define what quality means to us. It allows us to be more discerning when it comes to the price we pay. Following 60 or so stocks closely and having to replace only three or

## ON MEAN AVERSION:

**Truly exceptional businesses can compound their competitive advantages over time more than people expect.**

four every year in the portfolio is also well within the capacity of our five-person investment team. We think we'll make better decisions if they're fewer in number and more considered.

I'd also add that we're always fully invested. We invest only in businesses we expect to become more valuable over time, so we consider having any of our portfolio capital sitting in cash as an opportunity cost. We don't think we have any edge in predicting the short-term direction in prices, so we won't have better outcomes in holding capital back in anticipation that we can reinvest at lower prices. This gets back to a word we use often, repeatability. We might be able to time the market well one out of every three times, but can we do it often enough such that it will be additive to our investment outcomes? We don't think so.

**How generally do you consider valuation?**

**SA:** We're not contrarians looking to go in the opposite direction of the market. We want to own businesses that become progressively more valuable over time, and we're confident that by being selective and patient we can find even the best of



**Stephen Arnold**

## Signal Over Noise

He started his career as a credit analyst, which Stephen Arnold considers an excellent formative experience for an equity portfolio manager: "Credit markets are a great place for investors to begin because the outcomes are asymmetric to the downside," he says. "It's good grounding in conservatism and in paying considerable attention to risk."

Arnold's grounding as an international equity investor came from nearly ten years in London, where he worked for much of that time at Goldman Sachs Asset Management under Matt McLennan, now co-head of the global value team at First Eagle Investments. After returning in 2008 to his native Australia, he became the head of international equities at wealth manager Evans & Partners prior to launching his own firm, Aoris Investment Management, in 2017.

The advantage of being a global investor based in Sydney? "I'd argue it allows us to be more contemplative, more patient, and less prone to distraction," he says. "We're not looking at the news flow and latest share-price movements because that's mostly happening while we're asleep. We can keep the signal to noise ratio high and focus on what really matters to us."

these businesses from time to time trading at or below what we believe they're worth today. That allows us to fully participate as owners in the growth in their intrinsic value through time.

**DE:** Investors can underestimate the durability of a business's growth and its ability to compound capital at attractive rates of return. You often hear investors talk about mean reversion with respect to growth, profitability and valuation. While we don't disagree with the general principle, we do believe truly exceptional businesses that have established their market-leading positions through competitive advantage can continue to compound those advantages over time more than people expect. We call that mean aversion.

Describe why information services provider RELX [London: REL] recently made the cut as a new portfolio addition in June.

**SA:** The company is best described as a content, data, analytics and decision-tool provider across end markets focused on academic research, legal research and risk and insurance. Their products and services are deeply entrenched in customer workflows, with typically leading market shares in durably growing end markets. Management has an unusually clear sense of where they're going and are focused on progressively creating new solutions for existing customer needs. All that leads us to consider the risk of a disappointing business outcome to be very low.

While the general investor perception may somewhat reflect RELX's print-publishing roots, it's a very different business today that we think is getting better. Historical annual organic revenue growth has been 4%, which we estimate at closer to 6% going forward as the company expands its suite of digital content and analytical tools. Margins should rise modestly over time. Reinvestment in bolt-on acquisitions can contribute another 2% to the bottom line per year. The dividend is 2%. That puts this in the middle of our 8-12% target return range without any change in valuation. Given that we think the stock today [at around £26.50] is priced at 15% below fair value, a closing of that discount would be additive to our return.

**You've written extensively about the importance of corporate culture in assessing**

**businesses. Describe why that is and what in particular you're looking for.**

**Alfred Tadros:** The numbers are obviously important, but they only provide part of the story. They don't tell us enough about how the historical numbers have arisen or the extent to which they'll persist in the future. Understanding corporate culture gives us insight into those types of things, which is critical in making investment

## ON STRONG CULTURES:

**The central tenets: customer centricity, healthy growth ambition, long-term thinking, and being an employer of choice.**

judgements. In our experience the central tenets of the strongest cultures are customer centricity, healthy growth ambition, long-term thinking, and an emphasis on being an employer of choice.

**Please flesh those out in a bit more detail, starting with customer centricity.**

**AT:** The best businesses put their customers first and at the center of everything they do. That translates into exceptional customer service, innovative products and services, a measured approach to pricing, and an emphasis on lowering the total cost of ownership. The result tends to be high customer loyalty and a durable ability to increase market share over time.

Cintas [CTAS], the leading provider of uniform rental services and restroom supplies to businesses in the U.S., is a great example. It offers efficient, cost-effective services that lower the total cost of operation for its customers. In pricing it focuses on the lifetime value of a customer, which may at times mean forgoing price increases or offering more flexible service terms during difficult periods – like the pandemic – when the risk of attrition is higher. This type of mindset deepens the bond with customers – retention rates are

around 95% – and bolsters our confidence in its prospects going forward.

**Healthy growth ambition?**

**AT:** To us that means focusing on growing end-markets and constantly striving to increase relevance to customers in those markets, thereby outgrowing the competition. We only invest in consistently profitable companies, but we're looking for a healthy balance between ambition for growth and operating profitability. Companies focused on aggressively increasing margins – which often just rests on cost cutting or perhaps not allowing sales and marketing expenses to rise in a way that is necessary to support a healthy rate of business growth – aren't for us. We rarely find that you can cost-cut your way to glory and that companies doing so are likely to lose ground to competitors.

Another good example from our portfolio is Amphenol [APH], a major producer of electrical, electronic and fiberoptic connectors and interconnect systems. The company has a decentralized organizational structure, with each of around 130 business units headed by a general manager with full autonomy over his or her business. The CEO of Amphenol describes its operating model as follows: "The GMs are assessed only on what they can control, but we expect high performance. Bonuses are determined by the growth in sales and operating income, with high hurdle rates that keep them looking for opportunities. We expect them to grow their businesses regardless of market conditions by seeking new customers and new product areas or adjacencies."

The company invests in R&D and manufacturing capacity to drive revenue growth while maintaining stable operating margins of 20%. The result of all this has been organic growth consistently above GDP rates and at twice the level of peers. We think that speaks to its ability to drive persistent growth going forward.

**SA:** I'd make an additional point about growth. We look for businesses growing revenue on an organic basis at a minimum

of 4% per annum over an economic cycle. Being in a growing market is not enough, we want to own companies that are consistently outgrowing their markets.

For many people 4%-plus top-line growth sounds a bit pedestrian, but we'd argue that fast-growing companies are typically in fluid markets where the long-term winner is yet to be determined and where it's very unclear whether current promise can be converted to lasting profit. We also think investors frequently underestimate the compounding power over many years of winning businesses that grow a few percent faster than average at high profit margins and reinvest capital at attractive rates of return. The median growth in earnings per share in US\$ over the ten years ending in 2022 for the top 2000 companies globally was less than 7% per annum. For our portfolio companies over that period EPS growth averaged 12% annually.

**Back to the third hallmark of a strong culture: long-term thinking.**

**AT:** Durable growth is only possible when management teams are willing to consistently make necessary investments even when payoffs may be far in the future. One of the best examples of that in our portfolio would be Accenture [ACN], the leading IT services and consulting firm. The company talks about always "rotating to the new" and has put the energy and investment necessary into areas such as interactivity, the cloud and cybersecurity to build each of those verticals from buzzwords to multibillion businesses. It's making similar investments in a number of areas, including artificial intelligence, for which it outlined earlier this month a \$3 billion initiative to build out expertise and capability in that field. There's a deep desire and commitment to always being relevant to clients, which is key to the durability of any business.

**Why do you consider being an "employer of choice" important?**

**AT:** Companies that emphasize employee satisfaction – by offering higher wages,

better benefits and more career-development opportunities – are more likely to have happy employees. Happy employees tend to be more productive, provide better customer service and are less likely to jump ship. This leads to greater customer satisfaction, higher customer loyalty, and consequently more durable businesses.

Costco [COST] is known for paying its workers well above minimum rates

## ON FOUNDER-LED FIRMS:

**We studied whether such companies have generally made better investment opportunities. Our conclusion was yes.**

and for providing full healthcare benefits and generous retirement plans even to part-time and hourly employees. It offers excellent career opportunities, promoting almost exclusively from within. In the U.S. the average employee tenure is over nine years and employee turnover is far below industry norms. We tie all that directly to the company regularly leading its peers on measures of customer satisfaction.

**Is assessing culture difficult from your home base in Australia?**

**SA:** We travel a lot to visit companies and think going to where they are matters. To give one example, a few years ago we went to Minneapolis to see the CEO of Graco [GGG], which makes industrial equipment and is in our portfolio today. We met in a conference room but after about 10 minutes he suggested we go across the road to the manufacturing facility, where you could see his whole demeanor change. He'd grown up in the manufacturing side of the business and you could see how comfortable he was in that environment and how much he knew about it. He knew everyone's name! Culturally, that's something you'd never get in an annual report, but that was really illuminating about what matters to him and to the company.

**Describe your broader investment case for Accenture.**

**SA:** The company is the world's largest information technology outsourcing and consulting firm, focused primarily on helping clients deal with change, make their operations more efficient, support their growth and modernize their IT architecture. Particular emphasis in recent years has been on the cloud, cybersecurity, e-commerce and digital marketing.

The target market is the world's 2,000 largest organizations, both public and private, for whom the company's size and breadth of services makes it the preferred competitive choice. It is about 3x the size of its largest publicly traded competitors, Cognizant [CTSH] and Capgemini [Paris: CAP]. Over 200 of its clients spend in excess of \$175 million each year with the company and 98 of the top 100 customers have been with Accenture for more than 10 years. Of new business, 70% is won on a sole-sourced basis.

As we mentioned earlier, of particular note is how well the company evolves over time to meet customers' changing needs. Long ago it made its name as the engine behind large Oracle and SAP enterprise software implementations, but that's now just one of dozens of services provided. Two years ago clients were prioritizing IT projects around working from home, today their focus may be on outsourcing to save on costs, and tomorrow it may be on artificial intelligence. Companies need help in adapting to that kind of change and Accenture has proven ready and able to provide it – from designing what should be done, to building it, and then if desired to operating it on an ongoing basis.

All this has translated into a long record for the company of growing at around twice the rate of its end markets and consistently taking market share, both measures of which accelerated through the pandemic. It does this at highly attractive and gradually rising profit margins, giving it the resources to continue to reinvest in the business to foster incremental growth. Importantly, these positive dynamics also give it a leg up in attracting and retain-



ing employees, in a business where human capital is so important.

**Before getting into specifics on Accenture, describe generally how you estimate a stock's fair value.**

**SA:** The businesses we own are all, we believe, worth a material premium to a market multiple. We start with a base multiple of 20x trailing cash earnings for an average developed-market non-financial business, and then adjust up from there for two factors. One is risk, reflecting that we only invest in businesses where the range

of outcomes is narrow and the risk of a disappointing outcome is low. The other is growth, specifically the extent to which we believe earnings before interest and taxes [EBIT] will rise on an organic basis over the next decade in excess of the 3-4% rate of growth for the average business.

We don't view valuation as an exercise in mathematical precision. In my experience, investment success will depend more on our appraisal of the business itself and management's mindset rather than on pinpoint accuracy in assessing fair value.

**With Accenture stock recently at just un-**

**der \$319, how are you looking at valuation for it today?**

**SA:** Given our assessment of the company's breadth, record of staying relevant to its clients, market position, competitive advantage, capital structure and management acumen, we consider this a low-risk business. We think it can grow EBIT at about 8% per annum over the next decade, with capital reinvestment into bolt-on acquisitions and share repurchases taking annual EPS growth to around 10%. The stock at today's price trades at a 30% or so discount to our estimate of fair value, which combined with the estimated growth in intrinsic value sets up nicely relative to our long-term return goals.

**What do you think the market is missing in Amphenol?**

**SA:** As Alfred described, Amphenol produces connectors found in any manner of applications using electricity, including mobile phones, automobiles, airplanes and IT datacenters. It has expertise in producing connectors and sensors that are used in harsh environments, where factors such as temperature, pressure, vibration and moisture place stress on the components. In general its products are used in applications where the cost of failure is much higher than the price of the component. Operating margins are consistently around 20%, speaking to the value it provides and also how efficiently and effectively the business operates.

The growth outlook across Amphenol's end markets is quite positive. In automotive it benefits from rising volumes of electric vehicles and the increase in electronics used in vehicle safety, entertainment and seating systems. In industrial markets it's seeing strong growth in areas such as renewable energy, battery production, factory automation and medical equipment. In datacenters it benefits from the ongoing investment in cloud computing and storage infrastructure from the likes of Amazon, Microsoft, Facebook and Google.

The competitive market consists primarily of one other large listed company,

## INVESTMENT SNAPSHOT

### Accenture

(NYSE: ACN)

**Business:** Provider of a wide variety of technology-related consulting and outsourcing services to large corporate and government clients in more than 120 countries.

### Share Information (@7/27/23):

<b>Price</b>	<b>318.82</b>
52-Week Range	242.80 – 327.93
Dividend Yield	1.4%
Market Cap	\$201.11 billion

### Financials (TTM):

Revenue	\$63.55 billion
Operating Profit Margin	15.3%
Net Profit Margin	11.3%

### Valuation Metrics

(@7/27/23):

	<b>ACN</b>	<b>S&amp;P 500</b>
P/E (TTM)	28.4	20.4
Forward P/E (Est.)	26.8	20.7

### Largest Institutional Owners

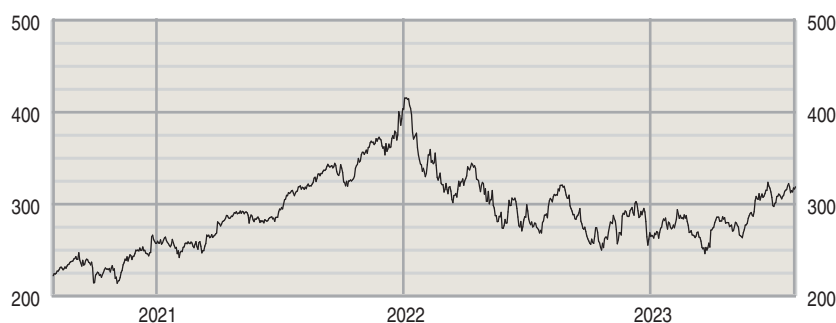
(@3/31/23 or latest filing):

<b>Company</b>	<b>% Owned</b>
Vanguard Group	9.2%
BlackRock	7.6%
State Street	4.2%
Massachusetts Fin Serv	2.4%
T. Rowe Price	1.8%

### Short Interest (as of 7/15/23):

Shares Short/Float	1.2%
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### ACN PRICE HISTORY



### THE BOTTOM LINE

The company's breadth, relevance to clients, market position and culture should translate into a level of durable growth that Stephen Arnold doesn't believe is correctly reflected in its market value. The shares currently trade at a 30% or so discount to his estimate of current fair value, for a company he expects to increase EPS at 10% or more per year.

Sources: Company reports, other publicly available information

TE Connectivity [TEL], and hundreds of smaller connector companies, many of them private, which tend to specialize in a certain industry. Amphenol because of its geographic and product breadth – and in no small part because of its decentralized entrepreneurial culture – has consistently grown at about twice the rate of the broader end market for a long period of time. The breadth of its customer base means that weakness in some product lines or industries can be offset by growth elsewhere. Over the last three years, for example, Amphenol's cumulative profit growth has been 50% higher than that

of TE Connectivity. A big reason for that is it was less exposed to production constraints in the automotive industry, where TE Connectivity derives more than 60% of its business.

Reinforcing what we said earlier, the culture of the company here is a real competitive advantage. It operates in growing markets and the general managers of each business unit are held to high standards for winning new business – from existing and new customers – by developing new products and solutions. Earnings are plowed back into organic investments and accretive M&A to fuel future growth. The

acquisition program has been very successful – Amphenol consistently cultivates relationships with family-owned businesses in an industry sector and typically pays 10-12x pretax earnings for businesses that we believe will be worth 2-3x that under Amphenol's management and stewardship. We're confident this overall playbook can sustainably drive better than market growth for many years to come.

**How are you looking at upside for the stock from today's \$88.75 price?**

**SA:** The company over the past five years has grown organically at 7.5% per annum, with acquisitions adding another 4% or so to that. For the reasons described, we think that level of growth is sustainable. There's also a 1% dividend yield.

With respect to the current fair value, given our assessment of risk and incremental growth we think the fair-value multiple on trailing cash earnings is closer to 35x. So in addition to benefitting from the compound growth in the business value, we also see upside from the discount to our estimate of fair value, now around 25%, closing over time.

**From electronic connectors to luxury goods, describe your investment thesis for LVMH [Paris: MC].**

**DE:** LVMH owns 75 leading luxury brands across five areas. Fashion and leather goods makes up half of the company's revenue, with leading brands such as Louis Vuitton, Christian Dior and Fendi. Its wines and spirits business is the largest global producer of champagne and cognac. Watches and jewelry includes the recently acquired Tiffany, as well as Tag Heuer and Bulgari. There's also a large perfume and cosmetics business and a retail division that includes Sephora and the largest operator of duty-free stores, DFS.

The breadth across brands, product areas and geographies – revenues are relatively equally split between the U.S., Europe and Asia – provides valuable balance and resilience to the inevitable ups and downs in any one area. The company also

## INVESTMENT SNAPSHOT

### Amphenol

(NYSE: APH)

**Business:** Producer of electrical and electronic connectors, interconnect systems and sensors; key end markets include the automotive, industrial and datacenter sectors.

### Share Information (@7/27/23):

<b>Price</b>	<b>88.77</b>
52-Week Range	65.21 – 90.28
Dividend Yield	0.9%
Market Cap	\$52.85 billion

### Financials (TTM):

Revenue	\$12.65 billion
Operating Profit Margin	20.7%
Net Profit Margin	15.1%

### Valuation Metrics

(@7/27/23):

	<b>APH</b>	<b>S&amp;P 500</b>
P/E (TTM)	28.9	20.4
Forward P/E (Est.)	29.8	20.7

### Largest Institutional Owners

(@3/31/23 or latest filing):

<b>Company</b>	<b>% Owned</b>
Vanguard Group	12.0%
Fidelity Mgmt & Research	9.0%
BlackRock	7.6%
State Street	4.2%
T. Rowe Price	3.4%

### Short Interest (as of 7/15/23):

Shares Short/Float	0.9%
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### APH PRICE HISTORY



### THE BOTTOM LINE

The company due to its product and geographic breadth and entrepreneurial culture has consistently grown at twice the rate of its broad end markets, says Stephen Arnold. With organic and M&A-related growth expected to drive 10%-plus annual EPS gains, he finds the shares particularly attractive at a 25% discount to his estimate of current fair value.

Sources: Company reports, other publicly available information

makes most of its products in-house and sells primarily through directly operated stores, which allows it to ensure a high standard for the quality of the products, how they're priced and the overall customer experience. The brands have rich histories that make them authentic and desirable to customers and that desirability compounds over time, making it difficult for new brands to succeed in the luxury industry.

Although the brands themselves are old, the business is far from sleepy. LVMH invests over €20 billion annually – about a quarter of sales in a given year – into

creating new products, developing engaging advertising campaigns, and refurbishing stores to keep them fresh and vibrant. The brands here also operate with a high degree of autonomy, which helps them remain agile and entrepreneurial. Typically 20-25% of revenue every year comes from brand new products, product upgrades or brand extensions.

There are advantages to scale as well, primarily through negotiating better terms with landlords, in marketing spending and in materials sourcing. The company also has the wherewithal and expertise to make and integrate significant acqui-

sitions. As one high-profile example, filling what it considered to be a gap in its watches and jewelry portfolio LVMH in 2021 acquired Tiffany, a company with a storied history but that had grown somewhat stale from underinvestment. LVMH has poured a lot of energy and money into reinvigorating the brand and it's already shown significant growth in revenue and operating profitability.

Put all this together and you have a company with a long track record of market-share gains, strong revenue growth and enviable profitability, with operating profit margins of more than 25%. We think it's an all-weather business that can continue to compound in value for many years to come.

You've written about investing in founder-led companies. Can we assume you consider that a positive here with the Arnault family owning close to 50% of the shares?

DE: We did a study on founder-led companies to determine if the conventional wisdom that such companies have generally made better investment opportunities is valid. Our basic conclusion was that the answer is yes, and we'd hold LVMH out as an excellent representative example.

Bernard Arnault, the Chairman and CEO, has built the company into the powerhouse it is today. To the extent investors worry about succession, his children in the business have performed very well in increasingly responsible positions and the company over the years has been a talent magnet on both the creative and business sides. We have no concern about the management depth across the brands to lead the company whenever Mr. Arnault eventually steps down.

We spoke earlier about long-term thinking, which is often a hallmark of family-led companies. One example for LVMH is the company's purchase of the iconic Parisian department store, La Samaritaine, in 2001. It was subsequently closed in 2005 for redevelopment and it took 16 years and over €750 million in spending before the refurbished store reopened in 2021. That's long-term thinking!

## INVESTMENT SNAPSHOT

### LVMH

(Paris: MC)

**Business:** Global sale of luxury goods in five primary segments: Wines & Spirits, Fashion & Leather Goods, Watches & Jewelry, Perfumes & Cosmetics and Selective Retailing.

### Share Information

(@7/27/23, Exchange Rate: \$1 = €0.91):

<b>Price</b>	<b>€840.30</b>
52-Week Range	€594.70 – €904.60
Dividend Yield	1.5%
Market Cap	€419.65 billion

### Financials (TTM):

Revenue	€79.18 million
Operating Profit Margin	26.5%
Net Profit Margin	17.8%

### Valuation Metrics

(@7/27/23):

	<b>MC</b>	<b>S&amp;P 500</b>
P/E (TTM)	26.3	20.4
Forward P/E (Est.)	24.1	20.7

### Largest Institutional Owners

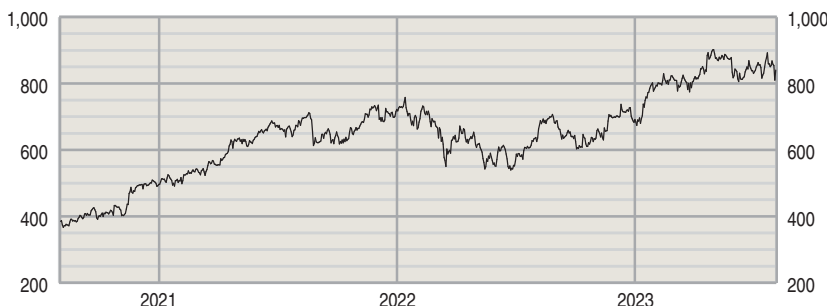
(@3/31/23 or latest filing):

<b>Company</b>	<b>% Owned</b>
Capital Research & Mgmt	2.9%
BlackRock	2.5%
Vanguard Group	1.8%
Norges Bank Inv Mgmt	1.2%
Fidelity Mgmt & Research	1.0%

### Short Interest (as of 7/15/23):

Shares Short/Float	n/a
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## LVMH PRICE HISTORY



## THE BOTTOM LINE

While its storied brands provide significant competitive advantage, the company also consistently invests heavily into keeping its products and stores fresh and vibrant, says Delian Entchev. Despite his expectation that it can grow at 10-12% annually, he believes its stock on trailing cash earnings trades at about 30% below what he thinks it's worth.

Sources: Company reports, other publicly available information

**From a current share prices of around €840, how do you see value compounding to shareholder benefit from here?**

**DE:** This is another what we consider low-risk business that consistently grows organically at 8-9% per year, with acquisitions over time adding another 2-3% on top of that. There's also a 1.5% dividend yield. For that we think today we're paying a less than full valuation with the stock trading at about 30% below what we think it's currently worth based on trailing cash earnings.

**On to the rather less glamorous business of salvage yards, explain your interest in Copart [CPRT].**

**DE:** Copart is the largest auction platform in the world for damaged passenger vehicles, primarily those that have been deemed as total writeoffs by their insurers. On a typical day it has around 300,000 vehicles for sale on its auction website and it sells over three million cars per year. The purchasers are dismantlers, who break down the vehicle and sell its parts individually, or repairers, who try to return the vehicle to roadworthy condition, maybe in an emerging market where it's easier and cheaper to repair it and return it to serviceable condition.

The salvage auction market is effectively a duopoly between Copart and its primary competitor, IAA, which was acquired in March of this year by RB Global [RBA]. Fifteen years ago Copart and IAA were of similar size, but since then Copart has steadily grown its share and it now commands close to two-thirds of the market, with double the operating profit margins of IAA.

As with any marketplace, sellers want to go where buyers are and vice versa, so auction liquidity is paramount. Over many years Copart has cultivated a substantial and growing number of overseas buyers for the cars it sells from the U.S. On the seller side it has also grown outside of its core insurance-company customer base to also serve rental and government car-fleet operators. As the participation in

the marketplace increases it becomes incrementally more attractive to both sellers and buyers, enhancing the positive network effect.

This is another example where long-term thinking and a willingness to invest in growth has allowed the company to build significant competitive advantages. Since its founding Copart has put a great deal of importance on owning the land for its salvage yards and paying up to locate them in metropolitan areas where they're in closer proximity to available cars and where approvals to locate them over time become increasingly difficult to come by.

The company has also been a pioneer in applying technology. It launched the first online auction in the industry in 1998 and over the next five years it completely shifted from physical auctions at its salvage yards to being fully online. This is more convenient for domestic buyers and makes the auctions accessible to international buyers. IAA even when the pandemic hit was still heavily reliant on physical auctions and only shifted mostly online at that point by necessity.

Finally, Copart has also been successful in building out a broader range of services that help deepen and strengthen its

## INVESTMENT SNAPSHOT

### Copart

(Nasdaq: CPRT)

**Business:** Operates an online auction platform connecting primarily insurance-company sellers of "totaled" automobiles with a large global network of potential buyers.

### Share Information (@7/27/23):

Price	88.40
52-Week Range	52.28 – 94.77
Dividend Yield	0.0%
Market Cap	\$42.21 billion

### Financials (TTM):

Revenue	\$3.76 billion
Operating Profit Margin	37.8%
Net Profit Margin	30.7%

### Valuation Metrics

(@7/27/23):

	CPRT	S&P 500
P/E (TTM)	37.0	20.4
Forward P/E (Est.)	32.5	20.7

### Largest Institutional Owners

(@3/31/23 or latest filing):

Company	% Owned
Vanguard Group	10.1%
BlackRock	8.1%
Principal Global Inv	4.5%
Capital Research & Mgmt	4.2%
AllianceBernstein	3.8%

### Short Interest (as of 7/15/23):

Shares Short/Float	1.0%
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### CPRT PRICE HISTORY



### THE BOTTOM LINE

The company's long-term thinking and willingness to invest in future growth has translated into significant market share gains in a duopoly market where scale is extremely important, says Delian Entchev. He doesn't believe its ability to compound shareholder value is well reflected in today's share price, which reflects a 15% discount to his estimate of fair value.

Sources: Company reports, other publicly available information



customer relationships. Examples of that include offering analytics software to assess repair-versus-writeoff decisions and providing various title, inspection and marketing services to limit the administrative hassle for customers.

### How would you characterize the important secular car-industry trends impacting the company?

**DE:** An important trend is that while improved safety features in passenger vehicles have reduced the frequency of accidents, the significant increase in sensors and electronics in the vehicles makes them more expensive to repair. As a result, the percentage of cars involved in an accident in the U.S. that are totally written off has increased from 10% in 2000 to around 20% today. The company expects that total loss frequency will continue its long upward trend, driving higher the number of salvage vehicles to be auctioned. The increased penetration of electric vehicles, with large and expensive batteries, may fuel further incidence of writeoffs.

### At today's price of around \$88.50, how inexpensive do you consider the shares?

**DE:** The stock today trades at about a 15% discount to our fair-value estimate. But as is typically the case, what's more important to us is how that fair value compounds over time. We think the business can grow on the top line organically at a 9-10% annual rate. EBIT margins are over 35%, as are returns on invested capital. The company has no debt and a clear culture of accountability and ownership with respect to allocating capital, so we see the potential for compounding shareholder value in a nicely growing business as quite attractive.

### Why do you expect Cintas to continue to compound shareholder value at an attractive rate as well?

**SA:** This is another business where scale matters, at the national level but even more so at the local level. National scale

helps the company service large accounts such as hotel chains that have geographically dispersed locations across the country, and it also creates better purchasing power and terms with vendors. At the local level it's a route-based business so size is a significant advantage, allowing greater route density for pickup and delivery and more productive use of laundry, warehousing and other facilities. This lowers Cintas's unit costs and makes it hard to beat on price.

This has all translated into steadily increasing market share in the uniform-rental business – which accounts for about

40% of total company revenues – and that business is 2-3x the size of its closest U.S. competitors, UniFirst [UNF] and Aramark. Cintas has also developed complementary service offerings – including cleaning entrance mats, replenishing restroom supplies, ensuring first-aid kits are full and compliant, and servicing fire-protection equipment – that can utilize the same vans and drivers. For every dollar it invests into its operating assets such as inventory and physical infrastructure, it earns roughly 6x as much operating profit as UniFirst does.

There are two primary sources of growth. One is continuing to provide ad-

## INVESTMENT SNAPSHOT

### Cintas

(Nasdaq: CTAS)

**Business:** Provides uniform rental and a variety of other facility cleaning and maintenance products and services used primarily by North American business customers.

### Share Information (@7/27/23):

<b>Price</b>	<b>504.55</b>
52-Week Range	370.93 – 518.71
Dividend Yield	0.9%
Market Cap	\$51.33 billion

### Financials (TTM):

Revenue	\$8.82 billion
Operating Profit Margin	20.4%
Net Profit Margin	15.3%

### Valuation Metrics

(@7/27/23):

	<b>CTAS</b>	<b>S&amp;P 500</b>
P/E (TTM)	38.8	20.4
Forward P/E (Est.)	35.3	20.7

### Largest Institutional Owners

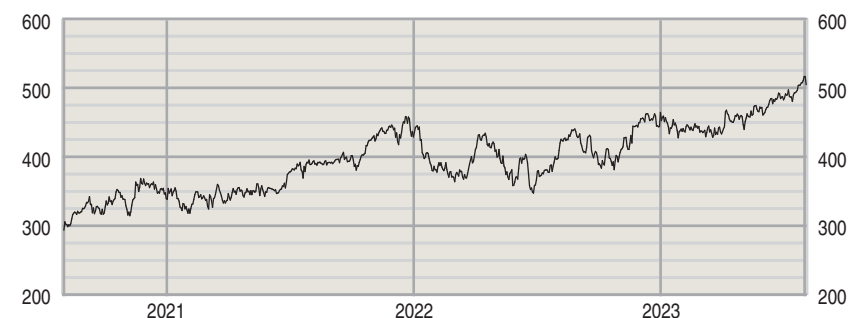
(@3/31/23 or latest filing):

<b>Company</b>	<b>% Owned</b>
Vanguard Group	10.0%
BlackRock	7.8%
State Street	3.7%
Geode Capital	1.8%
Fidelity Mgmt & Research	1.7%

### Short Interest (as of 7/15/23):

Shares Short/Float	1.4%
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## CTAS PRICE HISTORY



## THE BOTTOM LINE

Stephen Arnold believes the company will translate its competitive advantages and customer-centric focus into more durable above-market growth than the market seems to contemplate. The shares currently trade at a 10% discount to his estimate of fair value, for a business that he's expecting can compound earnings at better than 10% per annum.

Sources: Company reports, other publicly available information

ditional services to existing customers, and the second is from attracting new customers looking to outsource services that have traditionally been handled in house. The company sees particular opportunity for outsourcing in sectors like healthcare, education and government, with the effort supported by the value proposition Alfred described earlier that a scaled market leader like Cintas can offer. Total revenue has increased 7% or so annually on average on an organic basis over many, many years, two-thirds of that coming from customers outsourcing for the first time.

We mentioned the importance of the company culture, particularly the priority put on taking care of customers and building their loyalty over the long term rather than prioritizing profits in the short term. When Cintas experienced meaningful inflation in its labor, fuel and raw material costs in the last few years, it worked to secure better terms from its suppliers and to operate more efficiently rather than just passing the higher costs on to customers. In the most recent quarter it only raised prices by approximately 4%, less than the rate of inflation, while UniFirst increased its prices by nearly 10%.

**How do you see all this translating into good news for the shares, now trading at around \$504.50?**

**SA:** The stock isn't quite as inexpensive relative to our estimate of fair value, currently trading at about a 10% discount. But we're investing in a company that we believe can compound earnings at a better than 10% annual rate, driven by organic growth, a gradual increase in EBIT margins and the reinvestment of cash flow into share buybacks and the occasional acquisition. For this and many of our holdings, what the market perhaps underestimates is the durability of the growth we expect. We're confident Cintas can grow at a rate well in excess of its market and widen its competitive advantage for a long time.

**Describe something sold recently and why.**

**DE:** We exited our position in Nike [NKE] in June, as we became more concerned about the strength of its market position in some key areas. The company has gained market share over the last two years at the expense of Adidas, which has been dealing with internal turmoil and the shut-

## ON THE MACRO CLIMATE:

**We don't have unique insight into any of that ... we only want to own companies we'd describe as macro-agnostic.**

down of its fashion-based line with Kanye West. You might think as Nike owners we'd be emboldened by that, but it actually highlighted for us the fluidity with which consumer preferences can change. That made us more sensitive to the competitive threats Nike is facing in its bread-and-butter running shoe business from fast-growing brands like Hoka and On, and in China, where Nike has grown significantly but the market seems to be shifting more toward Chinese brands such as Li Ning and Anta Sports. With its growth prospects potentially challenged, we saw better uses for the capital elsewhere.

**We don't have you pegged as much of a trader, so describe why you sold your stake in industrial distributor Fastenal [FAST] early last year and then reestablished it late in the year.**

**DE:** There were two primary issues that led to our selling. One was valuation, as the stock was trading at around our appraisal of fair value. But more importantly, we had concerns about the company's ability and willingness to invest in growing its labor force in an environment of rising wage inflation. The company is famously frugal, but we thought the unwillingness to meet the current market for wages could have a negative impact on customer outcomes

and on the ability for it to grow and take share in a challenging environment.

Six months later the stock had come down quite a bit and we met with management as part of our regular overseas travels, wanting to address the personnel issues. They explained that the biggest problem in hiring had been from the disruption in college recruiting through the pandemic, and that new-hire levels were increasingly back on track. That gave us increased confidence in the growth prospects and we repurchased the shares in November at a material discount to our appraisal of intrinsic value.

**Do you spend much time worrying about the economic environment or general valuation levels in the market?**

**SA:** We don't. There are certainly challenges today in the global economy, but there always are and we don't think we have unique insight into any of that. As a result, we only want to own companies that we would describe as macro-agnostic, meaning any challenges the economic or political environment might present to their businesses won't materially damage their long-term competitive positions or earnings prospects.

With respect to valuation levels, we believe our portfolio today trades at a roughly 20% discount to our fair-value estimates. If we're right about the businesses being battle tested, resilient and durably growing, that should translate into returns over time that meet our objectives. VII