

Thinking Like an Owner

Andy Means and John Watkins of Baird Trust describe why they concluded years ago that “this time” actually was different for value investors, how they’ve learned to better let their winners run, why patience can be both a blessing and a curse, and what they think the market is currently missing in Uber Technologies, Copart, Amazon.com and Progressive.

INVESTOR INSIGHT



Baird Trust

Andy Means (l), John Watkins (r)

Investment Focus: Seek top-flight businesses run by skilled management teams that can generate high and sustainable compound growth in value over time.

Value investors often tout their long-term perspective, but rarely is that as evident in the numbers as it is for the Baird Trust Large Cap Equity strategy run by Andy Means and John Watkins. The portfolio’s annual turnover for the past 10 years has averaged less than 4%. Of the 27 stocks in it, 17 have been held for more than 10 years and 12 for more than 15 years. “It’s classic Buffett in that we’re looking at everything as if we were buying the whole company and holding it forever,” says Watkins. Means and Watkins see built-to-last upside today in such areas as ridesharing, salvaged vehicles, car insurance and online retail.

You talk a lot about the importance of risk mitigation in investing. Describe how that informs your strategy.

John Watkins: Charlie Munger often spoke about inversion as a powerful thinking tool. Applying that to investing you can ask, “How would we maximize risk?” Well, the businesses we’d own would have extreme amounts of financial leverage. They’d be unprofitable, with no foreseeable path to profitability. They’d have no discernible competitive moat and would be managed by dishonest or incompetent leaders. Then of course they’d also be excessively popular and highly priced, with little attention paid to valuation. Systematically avoiding these characteristics focuses us on mitigating risk while pointing us toward companies that can compound value at attractive rates over time.

Andy Means: Underlying our approach is the fact that great wealth creation in the U.S. is almost invariably the result of the long-term ownership of a successful business. That could be the family-run company in your town or Bill Gates at Microsoft.

We try to replicate that in a diversified fashion by holding 25 to 30 stocks of established businesses that have sustainable advantages we can identify and understand. They’re run by first-class managers who allocate capital well – protecting and growing the company’s advantages while fostering a culture focused on long-term value creation. We want to buy these businesses at a discount to what we believe they’re worth. All of that to us minimizes the risk of permanent loss while improving the odds of above-market gains.

Last summer you titled one of your market commentaries, “This Time It’s Differ-

ent, But Key Lessons Endure.” It maybe helps explain why your rendition of value investing has fared quite well against the S&P 500 when others haven’t. Summarize your arguments from that piece.

AM: We basically made the case that the modern investment era should be divided into two distinct periods: pre-Internet and post-Internet. In the pre-Internet era, many successful investors focused on reversion to the mean. They bought companies at valuations near the bottom of historical ranges and sold when valuations approached the high end in a repeatable cycle. In an economy more constrained by geography and communications, following this approach in a disciplined way worked well. People said, “Trees don’t grow to the sky,” and given the economic realities of the time that was accurate.

The arrival of the Internet changed that, breaking down geographic boundaries and expanding total addressable markets for some companies to a global scale. That reality was hard to process at first – companies able to take full advantage of this global reach could now grow faster and for longer than even the best businesses of the past. To us as investors, that meant this time actually was different. To be most successful in the Internet era we needed to focus more on durable, advantaged, high-growth businesses and then hold them for years in order to benefit from the powerful effects of long-term compounding. Trees still didn’t grow to the sky, but they could grow much taller and faster than before. That meant being less dogmatic about only investing in

stocks that were statistically cheap.

We would apply the same basic investing principles we did before, but we needed to expand our circle of competence and be open-minded about new areas. We were more open and earlier than some to the possibilities available in companies like Apple, Microsoft and Alphabet.

JW: I looked at Alphabet the other day. Its annual free cash flow as we define it was around \$17 billion when we first bought the stock in 2015. Our estimate for that over the next 12 months is over \$175 billion. We paid less than our estimate of intrinsic value in 2015, but our return on the stock since then has had much more to do with that free-cash-flow growth than the discount to intrinsic value going away.

AM: One other point I'd make is that management quality has become more important than ever because of all the disruption that goes on due to technology. You have to have managers that you believe can, in ice hockey terms, skate to where the puck is going, not where it is now. You think of Microsoft now having all these inherent advantages, but had Satya Nadella not repositioned the company for growth in the cloud – well in advance of our knowing how important that was going to be – the value created in the stock would not be anywhere near what it has been.

It's hard enough to identify these companies, let alone for a value investor to hold on to them as their shares take off. Your average annual portfolio turnover has been just under 4% for the last 10 years, so you seem fairly capable of letting your winners run. How do you do that well?

AM: Always in the back of our minds is the classic Charlie Munger quote that the worst investment mistake you can make is to interrupt long-term compounding unnecessarily. We understand that as valuations go up it makes sense to reallocate money from your winners to stocks you consider more undervalued. For us the difference is time frame. If you're looking one or two years out, you might reasonably

think a stock that's more expensive than another is less attractive based on what it might do over the next year or two. But if your time frame is 10 to 15 years and you're focused on the compounding of per-share intrinsic value, while an optimistic price today may lower your future expected return somewhat, that's much less significant over long periods. That doesn't mean there isn't a price at which we'll sell, but we don't like to sell truly great businesses as long as we believe they're truly great and are led by top-notch CEOs.

Almost all the stocks we've held for 10-plus years have gone through multi-year periods of underperformance. If you're right about the business long term, we just have to live through those and aren't confident in our ability to time getting in and out. If we do our job well on the front end, our turnover should be very low.

You cap your position sizes at around 8%. Have you ever looked to see if that's added or detracted from your performance?

AM: The rationale for that is that the world is uncertain and while we think we know a lot about these businesses and how strong they are, letting any one position get too big in the portfolio isn't prudent. Whether that's been good or bad for performance over time is a great question. My hunch would be that it's likely been a slight headwind because trimming our biggest winners has left some money on the table, but we should look into that. Regardless of what we might find, we think an 8% position-size limit is the right number for our strategy as it contributes to our risk-mitigation efforts and lets us and our clients sleep well at night.

GE Vernova [GEV] is a current top-five holding whose stock has done extremely well, of late as an AI beneficiary. How have you handled that position over time?

AM: We owned GE for many years before Larry Culp became CEO and, quite frankly, we were just wrong about it. We didn't recognize how poorly the company had been managed before he took over. After



Andy Means, John Watkins

Fast Forward

Andy Means came to value investing in a typical way for someone who's done it for some time. He grew up in Louisville and his first boss in 1981 at local financial-services firm Hilliard Lyons "was a fan of Buffett and Munger before it was cool to be a fan of Buffett and Munger," he says. "My boss said as I learned about value investing that the light bulb would go on or it wouldn't. It went on for me."

Means became portfolio manager of the firm's flagship large-cap equity strategy in 2000, which now manages around \$25 billion in assets under the Baird Trust brand name. He ran the strategy as the sole manager until John Watkins was named co-PM in 2021. Means says two heads have proven to be better than one: "Part of it is having an answer for clients wanting to know what happens if I retire or get hit by a bus," he says. "But more importantly, John grew up in the new technology era we're in – which has been driving the stock market for years – and is more knowledgeable of it and comfortable with it. Someone like me who came of age before the Internet runs the risk of getting stuck in the past. John has helped me avoid that and I learn as much from him as he does from me."

they decided to split GE Aerospace and GE Vernova we took a hard look at GEV and doubled our position at around \$130 a share. The business [selling and servicing equipment used to generate and transmit

electricity] had gone through a tough period for cyclical and self-inflicted reasons, and we believed had a long runway ahead of it under the leadership of Scott Strazik, who learned his craft under Larry Culp.

We've been consistently surprised at how much the business has improved. It had EBITDA margins inside GE of around 5% and, excluding a small wind-turbine piece, that's now closer to 20%. We have trimmed our position somewhat along the way – including as it hit 8% of the portfolio – but it's basically been a case where as we've learned more we've adjusted pretty rapidly upward our assessment of intrinsic value. There are significant barriers to competitive entry, a long tail of servicing revenues, and long-duration tailwinds from electrification and the modernization of the electrical grid. The visibility here goes out quite far – I don't know any business with a longer tailwind. As Munger said, we don't want to unnecessarily interrupt our exposure to that. [Note: GE Vernova shares closed recently at \$962, trading at a trailing P/E of 28x.]

You've owned Disney [DIS] shares for 23 years. The first 18 looked good, the last five less so. How are you processing that?

AM: I'll start by saying patience is probably our greatest attribute and it's also probably our worst attribute; it all depends on whether we're correct on the business. We've held Disney through good times and bad but believe it has the best collection of entertainment assets in the world – and the race really isn't close.

After Bob Iger returned as CEO in late 2022 he took the business through a significant transition and it is now back to hitting on all cylinders. Cash flow is much better and growing again. The balance sheet is much improved. The streaming business has gone from losing a lot of money to operating margins of 10% or so, and we see considerable upside to that. It's early to have a fully formed opinion, but we're optimistic they got the CEO transition right this time in naming Josh D'Amaro to the top job in March. He seems more technologically savvy than Iger, a

clear positive in a business like this.

Through all of this the valuation on the stock has come way down and we believe today is a terrific value relative to the assets they own. We're quite excited about what this can do over the next five years. [Note: At a recent \$105, Disney shares are down nearly 50% from their 2021 highs and currently trade at less than 14x consensus forward earnings.]

ON VALUATION:

To us buying at a discount to intrinsic value is more of a protection to the downside against fundamental mistakes.

How generally do you approach valuation?

JW: We subscribe to the view that a stock's value to a long-term owner is a function of its stream of cash flows into the future. We generally arrive at a free-cash-flow yield at today's price based on our one-year forward estimate, and then consider our prospective return to be that yield plus our range of estimates on the annual rate at which that free cash flow can grow. We don't think in precise point estimates, but want to have conviction the rate of return can materially outpace the S&P 500.

We're definitely not saying that the price you pay doesn't matter. But with our strategy and in our experience, the vast majority of our return won't come from an 80-cent dollar re-rating to a dollar. It will come from that dollar turning into \$3 or \$5 or \$20 over a 10 to 20-year period.

AM: To us buying at a discount to intrinsic value is more of a protection to the downside. If you're getting a discount, that usually means there are issues that have led to a decline in the stock price and the valuation. Buying at a discount helps protect us against mistakes in judging how quickly or easily those issues are resolved and gives us a buffer if we happen to conclude we got something fundamental wrong.

Explain your broader investment case for relatively new portfolio addition Uber Technologies [UBER].

JW: We followed Uber for a number of years before we got serious about it. We hold Dara Khosrowshahi, the CEO since 2017, in high regard and what attracted our attention was that the financials were inflecting upward while the stock wasn't.

The ridesharing business, which accounts for 55-60% of revenue, has built a difficult to challenge network effect. More drivers lead to more users, which attracts more drivers, decreasing wait times and unit costs as the business scales. Uber is typically the clear winner in the markets in which it operates. We also believe they've done an excellent job in layering the delivery business on top of mobility. They're almost the same size as DoorDash in delivery globally and we expect both delivery and mobility to continue to benefit from the rapidly growing Uber One loyalty program, which has 50 million members and has proven to improve overall customer stickiness and revenue per customer.

Describe how you developed your high regard for Dara Khosrowshahi.

JW: It's easy to forget now, but Uber was in a bad spot when he took over in 2017. Regulators disliked them. The drivers disliked them. Customers were leaving. They were losing billions of dollars. It's remarkable what he's accomplished on all those fronts since then. Early on he became an Uber driver to learn about the driver and customer experiences and what the pain points were. We love to see that level of engagement and curiosity. He's built a new culture and has been very smart allocating capital, all of which is showing up in dramatically better financial results. From hemorrhaging money when he joined, the company's operating margin last year was 12% and it earned nearly \$10 billion in net income.

How is Uber positioning itself against the expected rising tide of robotaxis?

JW: We very much agree with the strategy, which is to be the ultimate marketplace aggregator and infrastructure layer for autonomous vehicles rather than building the self-driving technology itself. Uber has an unmatched base of over 200 million monthly active users and a total of 450 million accounts with some activity. The self-driving companies can't afford for their expensive-to-make autos to sit idle, so we think Uber as an aggregator of demand is a powerful position to hold.

It is an open question how profitability on the autonomous-driving side plays out, and that's probably a reason the stock is

valued as it is. How will the new option impact volumes? How will cost savings on drivers be offset by the take rate paid to technology partners? There is uncertainty, but we believe the rollout of autonomous driving will likely take a lot longer than people expect and the longer it takes the more confident we are Uber will profitably execute its strategy. We don't think we're paying for that at today's share price.

How are you looking at upside from today's share price of around \$69.40?

JW: The stock trades at a 6-7% free-cash-

flow yield on our \$9.7 billion estimate of free cash flow over the coming year. That's an attractive starting point for a business that's growing this rapidly. Given the strength of the brand, increasing penetration and trip frequency in markets around the world, and large and growing ridesharing and delivery network effects, we estimate double-digit annual revenue growth for the foreseeable future and that free cash flow can grow at least 15% per year. That offers what we consider a pretty exciting ultimate return on the shares.

One last thing I'd say about the business is that because of the scale and now profitability, they've been able to invest more than competitors in improving technology. That's important in an operationally complex business routing drivers and deliveries. Having the best technology should be a self-perpetuating advantage.

What is the market missing today in salvage-auction company Copart [CPRT]?

AM: Copart is an example of a long-term growth company whose growth has recently stalled but we believe can return over time. It is the global leader in online auctions of cars that have been severely damaged or totaled. Roughly 80% of the inventory comes from insurance companies with cars that will cost more to fix than they're worth. Copart has the largest network of owned salvage yards and the most buyers and sellers on its global platform – over a million buyers in 180 countries – so can generally realize the most value for the insurance companies that own the cars. It earns fees from both sides of any transaction.

The industry is essentially a duopoly, with Copart and the Insurance Auto Auctions [IAA] division of RB Global commanding approximately 85% market share. The well-placed salvage yards and network effect from their highly liquid exchange are real moats and have translated into impressive growth. Copart's revenues have grown 15% annually over the past ten years and earnings per share over that period have grown at a 19% annual rate.

Over the last 18 months the business

INVESTMENT SNAPSHOT

Uber Technologies

(NYSE: UBER)

Business: Owns and operates a technology platform used primarily for the provision of consumer ridesharing and delivery services in the U.S. and major international markets.

Share Information (@9/29/26):

Price	69.36
52-Week Range	65.41 – 101.30
Dividend Yield	0.0%
Market Cap	\$141.67 billion

Financials (TTM):

Revenue	\$55.23 billion
Operating Profit Margin	12.1%
Net Profit Margin	17.3%

Valuation Metrics

(@9/29/26):

	UBER	S&P 500
P/E (TTM)	15.1	23.5
Forward P/E (Est.)	15.9	19.9

Largest Institutional Owners

(@6/30/26 or latest filing):

Company	% Owned
Vanguard Group	8.8%
Capital Research & Mgmt	7.2%
BlackRock	7.1%
State Street	4.4%
Public Investment Fund	3.6%

Short Interest (as of 9/15/26):

Shares Short/Float	2.3%
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UBER PRICE HISTORY



THE BOTTOM LINE

Given the strength of its brand, increasing ridesharing penetration in markets around the world, and large and growing network effects, John Watkins believes the company can increase free cash flow by at least 15% per year. On top of the stock's 6-7% current free-cash-flow yield, he believes that offers "a pretty exciting ultimate return on the shares."

Sources: S&P Capital IQ, company reports, other publicly available information

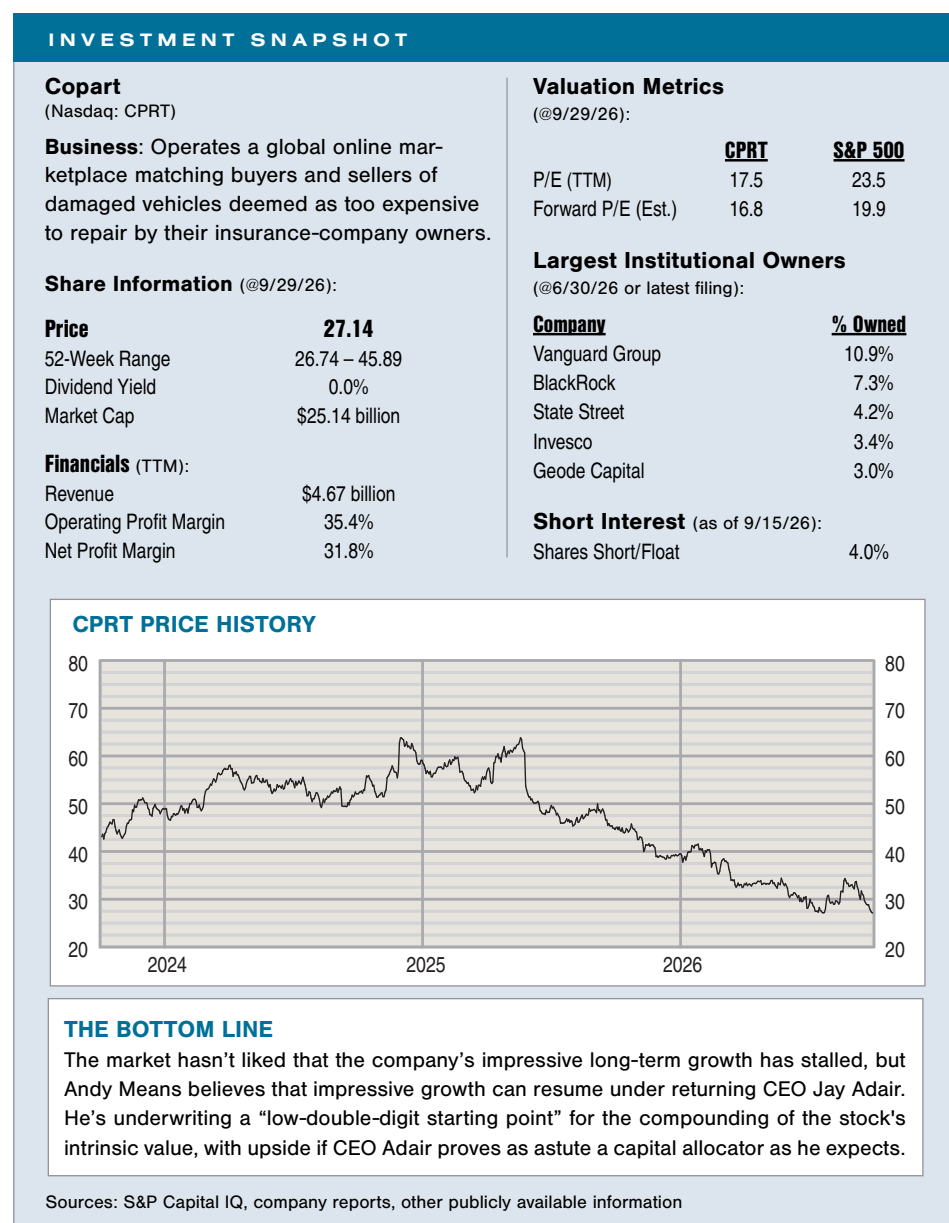
has slowed down a lot. One reason is cyclical. There has been a very “hard” market in auto insurance and as rates have gone up more people raise deductibles and go without coverage, which has led to fewer claims and fewer totaled vehicles coming the company’s way. We’re now heading into a softer market and expect as prices decline and coverage increases that the number of salvaged vehicles will come back to more normal levels.

Another issue was the loss of a significant customer, which hasn’t been disclosed but we believe it’s Progressive. IAA really cut prices in order to get that business and Copart was not willing to play that game. We agree with the decision not to chase unprofitable business, but the loss of that business combined with the cyclical issues meant the company’s unit volumes over the past year declined a bit and revenues and earnings have been kind of flat. The market hasn’t liked that and has taken what has historically been a premium valuation to a level where we decided to take a position in the shares for the first time.

There’s been a CEO change here recently that we assume you consider a positive.

AM: Very much so. Jay Adair, the son-in-law of the company’s founder, returned as CEO at the end of July. He essentially ran the company for more than 30 years as president and CEO before stepping down in 2024. He opened his first conference call back by saying Copart is a growth company and was going to get back to it.

He sees opportunity to grow the business internationally. He talks about expanding technology services offered to customers, in part by utilizing AI. The company is also aggressively expanding into “whole car” vehicle auctions that allow entities like auto dealers and rental-car companies to trade non-salvage used vehicle inventory efficiently. They just purchased ACV Auctions, which sells about 800,000 cars in the wholesale market annually, expanding Copart’s offer in what is a significantly larger total addressable market. There’s \$4.2 billion in net cash on the balance sheet (before the ACV



acquisition), so the financial resources are there to invest in growth.

Is increasing autonomous driving a risk?

AM: Improved technology in general has for some time modestly reduced the frequency of accidents, but to date that has been offset by the higher costs to repair more sophisticated vehicles. That has increasingly made it more economically attractive for insurers to salvage than repair.

I’d also mention that there are around 290 million cars in the U.S. and they’re lasting longer than ever. It will take a long

time for electric vehicles and self-driving cars to eat into that car park. The impact is something to keep our eye on, but we don’t consider it a significant threat to Copart for the foreseeable future.

The shares at a recent \$27.15 are down nearly 40% over the past year. How are you looking at valuation today?

JW: We estimate the company will earn around \$1.6 billion in free cash flow in the coming fiscal year, which results in a better than 6% free-cash-flow yield on today’s price. As they work through the two head-

winds Andy talked about, we think it's reasonable to expect revenue to normalize and get back to at least mid-single-digit annual growth. With some margin expansion, adding the annual growth we expect in free cash flow to the free-cash-flow yield gets us to a low-double-digit starting point for the compounding of intrinsic value.

That doesn't take into account the incremental value we expect to be created with Jay Adair now back as CEO. He and his father-in-law combined own about 9% of the outstanding shares and his track record in building the company gives us confidence that he can reaccelerate the growth. He's only 56 years old and says his return is not a short-term deal. If we're right about him, the IRR on the stock could be a lot higher.

You first bought Amazon.com shares in 2025 and recently added to your position. What's going on that prompted that?

JW: This is another case where it appeared all the earnings spigots were really turning on at the same time, causing profits to explode higher, but the shares were flat and starting to come down. When all the tariff news came out last year and the stock fell sharply, the stars aligned for us and we established our first position. As the business in our estimation continued to improve at a faster rate than the share price, we added to the position in March.

We love the Amazon Web Services business. It accounts for about 60% of overall operating profit and continues to benefit from massive tailwinds. CEO Andy Jassy says 85% of IT spending is still for on-premises technology versus 15% in the cloud, and that ratio is likely to flip over the next ten to twenty years. AI's rise and the importance of capturing, housing and accessing data to use it successfully should only accelerate transitions to the cloud. AWS had a head start in cloud services and maintains a very strong position, so it is a main beneficiary as that happens.

The company's retail business gets less attention from investors and we believe is very underappreciated. Amazon has what

we consider an unassailable moat in retail that's been built around scale, distribution and fulfillment. As they built that moat the retail operation for a long time was unprofitable, but in the last couple of years margins for it have turned nicely positive and we think that's just the beginning. As e-commerce continues to take share of total retail sales and Amazon takes share of total e-commerce sales, we believe this business has a very long runway of growth and margin expansion over the coming decades.

Is your opinion fully formed on Andy Jassy after his five years so far as CEO?

JW: It took us some time to conclude he was a worthy successor to Jeff Bezos, but we believe he is. Having built AWS he obviously knows it really well, but we're impressed with how he's also pushed the retail side on a number of fronts, including to upgrade its distribution network and further ramp up the speed of delivery.

We also think he's carrying on the culture of innovation established by Bezos. In addition to longer-running efforts like

INVESTMENT SNAPSHOT

Amazon.com

(Nasdaq: AMZN)

Business: Diversified global technology company operating in two primary businesses, online retail shopping and the provision of outsourced cloud-computing services.

Share Information (@9/29/26):

Price	246.67
52-Week Range	196.00 – 287.20
Dividend Yield	0.0%
Market Cap	\$2.66 trillion

Financials (TTM):

Revenue	\$775.68 billion
Operating Profit Margin	12.1%
Net Profit Margin	17.4%

Valuation Metrics

(@9/29/26):

	AMZN	S&P 500
P/E (TTM)	19.8	23.5
Forward P/E (Est.)	23.6	19.9

Largest Institutional Owners

(@6/30/26 or latest filing):

Company	% Owned
Vanguard Group	7.5%
BlackRock	6.9%
State Street	3.7%
Fidelity Mgmt & Research	3.0%
Geode Capital	2.2%

Short Interest (as of 9/15/26):

Shares Short/Float	0.8%
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AMZN PRICE HISTORY



THE BOTTOM LINE

The company's business is improving faster than its share price, says John Watkins, who estimates it can increase free cash flow through secular growth in both online retail and cloud services at a low-double-digit annual rate. On top of the current 4% free-cash-flow yield he believes that offers a prospective IRR on the stock today in the mid to high teens.

Sources: S&P Capital IQ, company reports, other publicly available information

increasing advertising sales, expanding entertainment and services through Amazon Prime, and even the grocery business, there are a number of other initiatives that could scale into real businesses – or at the very least teach them something that’s useful elsewhere. One of note would be Amazon Leo, which aims to compete with Starlink in providing fast, low-latency broadband Internet services globally. Another would be Zoox, Amazon’s entry in the all-electric robotaxi market. We don’t know what will hit or what won’t, but we highly value the ongoing focus on innovation.

One last thing I’d highlight about Andy Jassy is that he writes a fantastic annual letter. It’s detailed and insightful and he speaks to shareholders as partners in the business who he’s updating on where it is and where it’s going. We love to see that – it’s unfortunate that’s becoming more rare elsewhere.

Does the level of AI-related capital spending here give you pause?

JW: Amazon has always done a lot of capital investment, both in retail and AWS, so the numbers aren’t as jarring as they might be elsewhere. There have been many times in the past when people thought they were overinvesting and it turned out they weren’t. Given our confidence in management, we have no reason to believe the current capital spending will prove to be any different.

What type of prospective return can you underwrite today with the stock trading at around \$247?

JW: When we estimate free cash flow in a case like this we subtract from operating cash flow our best guess of maintenance capital spending but not what we consider growth capex. If we trust the capital allocator, as we do here, we don’t consider growth capex to be a drag on the business but expect it to be additive to cash flow over time.

Over the next twelve months we estimate free cash flow at about \$115 billion. That as a starting point is a 4% free-cash-

flow yield, which is at the lower end of the spectrum for us. But given the secular tailwinds and Amazon’s competitive positions, we estimate revenues can grow 10% annually, give or take, for as far as the eye can see. Assuming operating leverage on the retail side and modest margin degradation at AWS, we believe cash flow can compound at a low-teens rate per year. That would give us an IRR in the mid to high teens.

Turning to one of your longer-term holdings, describe the opportunity you see today in car-insurer Progressive [PGR].

AM: We’ve owned this in the portfolio for over 19 years and consider it a growth company disguised as a financial. People think of car insurance as a commodity-like financial business, but Progressive’s business model and data and underwriting advantages have consistently allowed it to gain market share through full market cycles and we expect that to continue. The share price has come down in anticipation of a softening of the car-insurance cycle, so we recently made a small add to our position.

We believe they simply have the better mousetrap. The company recently passed

INVESTMENT SNAPSHOT

Progressive

(NYSE: PGR)

Business: Underwrites, markets and sells auto insurance directly to consumers in the U.S.; ancillary businesses include residential-property and commercial-auto insurance.

Share Information (@9/29/26):

Price	210.52
52-Week Range	189.20 – 248.17
Dividend Yield	6.6%
Market Cap	\$122.39 billion

Financials (TTM):

Revenue	\$91.02 billion
Operating Profit Margin	16.6%
Net Profit Margin	12.8%

Valuation Metrics

(@9/29/26):

	PGR	S&P 500
P/E (TTM)	10.6	23.5
Forward P/E (Est.)	12.7	19.9

Largest Institutional Owners

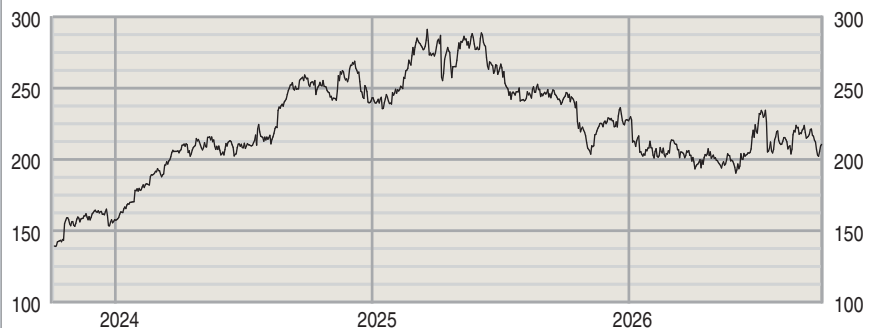
(@6/30/26 or latest filing):

Company	% Owned
Vanguard Group	9.1%
BlackRock	8.3%
Capital Research & Mgmt	8.1%
State Street	4.6%
Geode Capital	2.9%

Short Interest (as of 9/15/26):

Shares Short/Float	1.1%
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PGR PRICE HISTORY



THE BOTTOM LINE

Andy Means thinks the company has "the better mousetrap" that will allow it to continue to take share in U.S. car insurance and drive growth in other areas such as home insurance. Short-term concerns over the car-insurance cycle that are weighing on the stock aren't justified relative to the company's long-term ability to increase its book value, he says.

Sources: S&P Capital IQ, company reports, other publicly available information

State Farm to become the #1 auto insurer in the U.S., driven by a cost-effective direct-sales model that allows it to be more profitable even when offering more attractive rates. They apply the latest technology to the biggest database of information in order to better match rate to risk than competitors. They target at least a 96% combined ratio – which means four cents of underwriting profit for every dollar of premium – but consistently underwrite more profitably than that and at a better rate than peers.

The proof is in the pudding. Progressive's U.S. market share has increased from 8% in 2015 to 19% today. Over the past 10 years net premiums written and revenues have grown at 15% annually, while earnings per share are up over 24% per year. Since we've owned the stock it has compounded at a 16% annual rate, versus 11% for the S&P 500.

What do you see as primary growth drivers from here?

AM: In addition to continuing to take personal-auto market share, they're expanding as well in providing insurance to commercial fleet operators. They're selling more into the agency sales channel. But the biggest incremental growth driver is likely home insurance. It's taken them some time to bring their underwriting talent up to speed in that area, but we believe they are now there and have considerable potential in bundling home and auto policies. Households that bundle home and auto make up roughly 35% of the U.S. auto-insurance market and an even larger share of premium, because those customers stay longer and buy more. Progressive's share of that segment overall is still under 4% – and under 2% in the agency channel – against a nearly 20% share of the auto market overall. Given their proven ability to grow share in auto, we see home insurance as a real growth opportunity for years to come.

You mentioned earlier the softening of the auto-insurance market. Aren't you worried about that?

AM: While we try to avoid companies subject to very deep cycles, we own a number of businesses like this with regularly recurring “hard” and “soft” pricing markets. We generally are willing to invest through that. As long as we're convinced that through the entire cycle the business can generate the advantaged returns we're looking for, we tend to lean into a softer market rather than run the other way as many investors do. That's been the right thing to do with Progressive in the past and we expect it will be in the future.

ON THE OUTLOOK:

Many investors today appear to be grasping aggressively for high returns with little regard for the risk involved.

While the fact that policies reprice every year can hurt in a soft market, that's generally a good thing. The best companies adjust quickly and price according to current risk and return. If Florida exposure is less profitable, you can write more business in other more favorable geographic areas. If electric vehicles have different risk profiles, you can price policies on them accordingly. We think Progressive is as good and typically better at that than competitors.

How inexpensive do you consider the stock, trading at the recent price of just over \$210?

JW: We approach valuation here somewhat differently. We estimate the company's normalized, through-the-cycle return on equity at around 22%, which is well below what they've earned in the recent hard market. We then ask what earnings yield we'd be willing to accept on those normalized earnings for a business of this quality and with the type of growth potential we expect. For Progressive this is roughly 5.5%, or about 18x normalized earnings. Put the ROE and the earnings

yield together and the business should be worth somewhere in the ballpark of 4x book value.

That means we believe the stock today trading at 3x forward book value gives us a solid margin of safety, with upside on top of that coming from the fact that book value has been compounding at roughly 15% annually over the last 10 years, even after substantial dividend payments. If we're right that continues in the long term, we can be patient if the auto-insurance market in the near term is a bit weak.

You don't sell out of a position often. When did you last do it and why?

AM: The last position we closed out was Bank of America [BAC]. There wasn't a dramatic change at the company or in the industry that led us to sell, we just concluded the stock wasn't going to help us achieve our objective of outperforming the S&P 500 over full market cycles. We've owned the shares for close to seven years and over that time they compounded at close to the market return, but banks are at a pretty good part of the cycle right now and we believe the other ones we own, JPMorgan Chase [JPM] and Wells Fargo [WFC], are better positioned to help us meet our return objectives. One is run by the best banker on earth, Jamie Dimon, and the other by someone who worked under him for 25 years, Charlie Scharf.

When you've made mistakes, can you generalize about the more frequent causes?

AM: We've generally avoided making huge mistakes where we lose big on an individual investment. Our foresight isn't perfect – no one's is – but I think we've avoided that by generally not getting the business that wrong and also by being disciplined in the prices we pay. What we have done is to be too patient at times and the business just hasn't improved like we thought it might. When that drags on it may not lead to disaster, but it certainly can generate real underperformance.

JW: One example that jumps out to me

would be Pfizer [PFE]. We had owned the stock for a long time, including through Covid when they created with BioNTech one of the leading vaccines that had explosive sales growth. The company took a significant amount of the cash it made from that to buy the money-losing Seagen for \$43 billion in early 2023 in an effort to expand its oncology pipeline. That changed the nature of the balance sheet from one with heavy cash to one with heavy debt, which was one warning flag.

The bigger issue was that we were far too optimistic about the durability of the vaccine business, the revenue for which fell off a cliff. The lesson learned is to be careful after unusual periods of prosperity in assuming the outlook is more durably reset higher. We thought we were being

conservative in Pfizer's case but weren't conservative enough and exited the position in 2024 after giving back more of the previous gains than we would have liked. [Note: Pfizer shares, close to \$60 in the fall of 2021, were below \$30 for most of 2024 and recently closed at around \$28.70.]

How would you characterize your mood today as an investor?

AM: We spoke earlier about how we look to build in downside protection by buying companies with durable advantages that are run by leaders that intelligently allocate capital, while paying less for them than we believe they're worth. In environments like today when investors seem to be excited and carrying high expectations,

we think building in some protection rather than reaching for return is more important than ever.

This is not a prediction about the market's direction. We're simply observing that many investors appear to be grasping aggressively for high returns with little regard for the risk involved. We never like that tradeoff and are afraid many who are making it will come to regret it. **VII**

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