SCHARF INVESTMENTS

Port in the Storm

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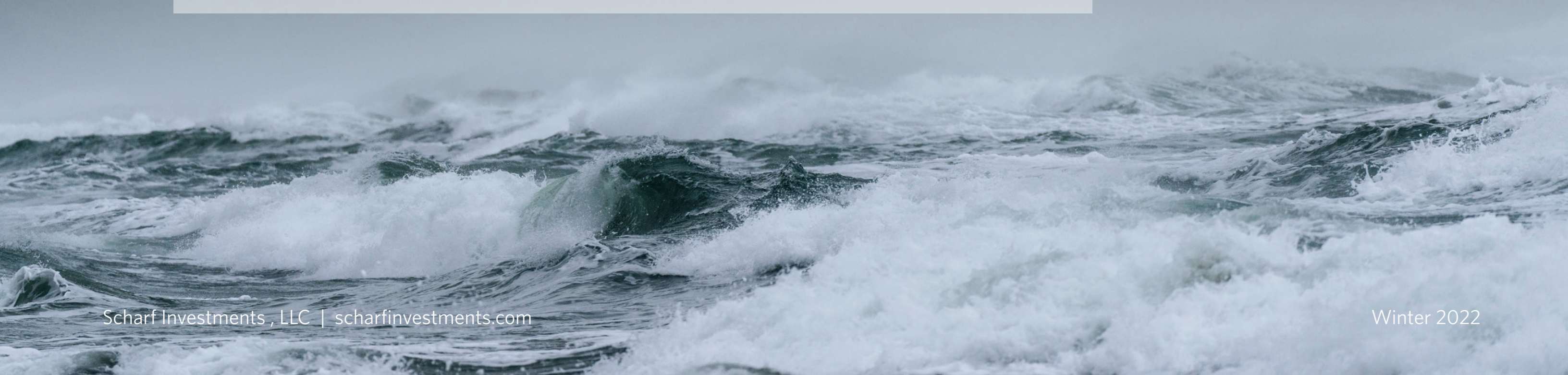
It has been an unhappy new year for risk assets. Speculative names, the type that benefited from otherworldly levels of pandemic monetary and fiscal stimulus (> 50% of GDP), are in retreat. The Nasdaq Index, laden with elevated tech stocks, has had its worst start to a year since 2008. Rivian, Bitcoin, AMC and other shiny baubles are down double digits. Investor angst ramped when the Fed released its December Federal Open Market Committee minutes, indicating an increased willingness to raise interest rates and reduce the Fed's balance sheet as early as March.

As we outlined last quarter, rising interest rates represent a real risk to long-duration assets, or securities that offer more promise than profits. The U.S. 10-year Treasury bond yield has now increased from 1.34% on December 3rd to 1.75%. While a 0.41% rise in yields might not seem noteworthy, even small increases wreak havoc on Wall Street's gilded discounted cash flow projections. Or, stated another way, a "bird in the hand" is becoming more attractive than "two in the bush."

Now is a good time to reduce exposure to speculative assets and seek shelter in higher quality stocks less predicated on stimulus largesse.

The Scharf investment process has always sought to appreciate capital with relatively lower volatility. We narrow the investment universe to a select list of stocks that we believe offer superior earnings resilience and growth, yet are priced at a 30%+ discount to our estimates. Pricing is critical because even great companies present downside. Cisco Systems was growing revenue 50% annually for five years when investors bid shares above split-adjusted $60 per share during the tech bubble in early 2000. Twenty years later, Cisco shares have only now clawed back to $62.

The combination of high-quality businesses purchased at value prices has generally translated to lower declines for Scharf portfolios when the market rolls over. It took years for many investors to recover losses following the tech bubble bursting in 2000-2002 and the global financial crisis in 2008-2009. The Scharf portfolio returned to par months, or even years, faster than the Russell 1000 Value and S&P 500 market indices.



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Global Financial Crisis

	% Drawdown from 1/1/2008 to 2/27/2009	Months Required from 2/27/2009 to Recover Drawdown
Russell 1000 Value	-52%	43
S&P 500 Index	-49%	36
Scharf Equity Net	**-39%**	**18**

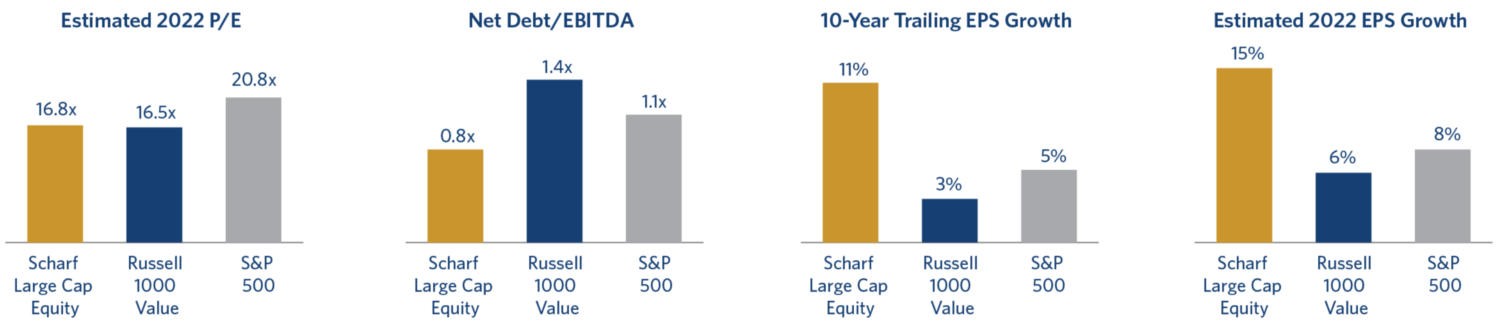
Sources: Bloomberg, Scharf Investments.

Tech Bubble Bursting

	% Drawdown from 1/1/2000 to 9/30/2002	Months Required from 9/30/2002 to Recover Drawdown
Russell 1000 Value	-22%	13
S&P 500 Index	-43%	48
Scharf Equity Net	**3%**	**0**

Sources: Bloomberg, Scharf Investments.

In periods of market uncertainly, it is important to understand: a) the market is not uniform, b) there are always investment opportunities, and c) your portfolio is comprised of high-quality businesses. The Scharf portfolio compares very favorably versus relevant market indices, comprised of the good, the bad and the ugly.



Sources: Bloomberg, Scharf Investments.

The Scharf portfolio is intentionally designed to be more resilient. We seek businesses that are more resilient. We seek prices that are more resilient. While storm clouds are brewing for the market and especially for risk assets, we feel confident that your ownership stakes offer a port in the storm.

High Quality, Sustainable Value

Following you will find the summary investment thesis for five of our high-conviction names within the portfolio. All offer the prospects for double-digit earnings growth over the next three years, and collectively are available at attractive valuations vs. the market, peers and their own trading histories.

Advance Auto Parts

Advanced Auto Parts (AAP)

- **Low Economic Sensitivity.** Consumers often delay new auto purchases in adverse economic conditions, making AAP less cyclical than the general economy. Auto purchase intentions are currently at multi-decade lows.
- **Favorable Secular Trends.** The auto parts aftermarket benefits from an aging fleet of vehicles on the road. The average age of U.S. vehicles sits at around ~12 years, and this trend has accelerated during the pandemic. The industry remains a highly fragmented one, with smaller local players ceding share to national players like AAP. Finally, ~60% of AAP's business is with mechanics (do it for me) who are taking repair share from do it yourselfers.
- **AAP's Improvement Plan.** Management has made good progress on its same store sales and margin improvement plan, and is guiding for 150-350 bps of cumulative margin improvement through 2023.

Berkshire Hathaway (BRK-B)

- **Superior Cash Allocation.** Berkshire combines one of the best records for disciplined insurance underwriting, with diversity from high quality non-insurance businesses, and rational investing and capital allocation overseen by Warren Buffett.

- **Stable & Well-Diversified.** Berkshire is a diversified, strong, safe-haven holding (with a risk profile similar to Staples/Utilities/Healthcare), which we expect to grow EPS and book value 8-12% a year.

- **Historically Cheap.** Berkshire trades at a much cheaper price/book ratio than 20-30 years ago, and for the first time in an illustrious investment career, Buffett's favorite investment has recently been Berkshire itself. Rather than making a large purchase during the pandemic, Buffett has repurchased >$50bn in company shares.

CVS Health (CVS)

- **New Leadership & Transformation; Key Assets Provide Floor.** We believe CVS' transformation can unlock value for all stakeholders. New CEO Karen Lynch, is demonstrating clear success in transitioning the company from a U.S. pharmacy/retailer to an integrated U.S. health care services firm, offering medical (Aetna) and pharmacy benefits (Caremark) underwriting and network management, pharmacy delivery and clinical care.

- **Pandemic Prowess.** Covid has reiterated CVS' competitive advantages – a huge and integrated health network, large purchasing scale and improving digital consumer platform.

- **Favorable Secular Trends.** CVS is positively levered to an aging population, increased medical innovation, closing of the health insurance gap and the rise of integrated, value-based care delivery.

McKesson (MCK)

- **Oligopolistic Pharmaceutical Distributor.** High barriers to competitive entry and the pandemic's reinforcement of the importance of McKesson's logistical capabilities support the investment.

- **Favorable Secular Trends.** McKesson is positively levered to an aging population, increased medical innovation, greater drug adherence, and shift of care outside of hospitals.

- **Opioid Overhang Improving.** While earnings have grown +8% annually the last four years, opioid litigation – as a distributor they shipped the pills - had soured investment sentiment. However, last summer ~90% of U.S. states and territories signed a preliminary Multi District Litigation settlement to set MCK's liability at $7.9bn paid over 18 years, or 10% of annual free cash flow. The stock is up over 30% since the announcement and still trades at 11x free cash flow, or a 9% yield vs. the S&P 500's 3%. We continue to monitor proceedings.

Microsoft (MSFT)

- **A Leader in Commercial Cloud & Software; Taking Share from Amazon (AWS).** MSFT's Commercial Cloud is a ~$71bn business growing 30%+ annually. Commercial Cloud consists of Office 365, Dynamics 365, LinkedIn Commercial, and Azure. All are posting strong growth and margins, but Azure is the crown jewel (~$32bn business growing at ~50% annually).

- **Long & Visible Growth Runway.** Cloud penetration is still in the 'early innings.' Goldman Sachs estimates that Cloud is only ~25 bps of global GDP currently, compared to ~170 bps for Enterprise IT spend globally. This suggests that Cloud has at least a ~7x growth runway.

- **MSFT's Other Businesses Growing.** While Cloud/Azure are the big drivers, it is important to note that MSFT has growing businesses such as Gaming, Surface, and Search (and even Windows recently).

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