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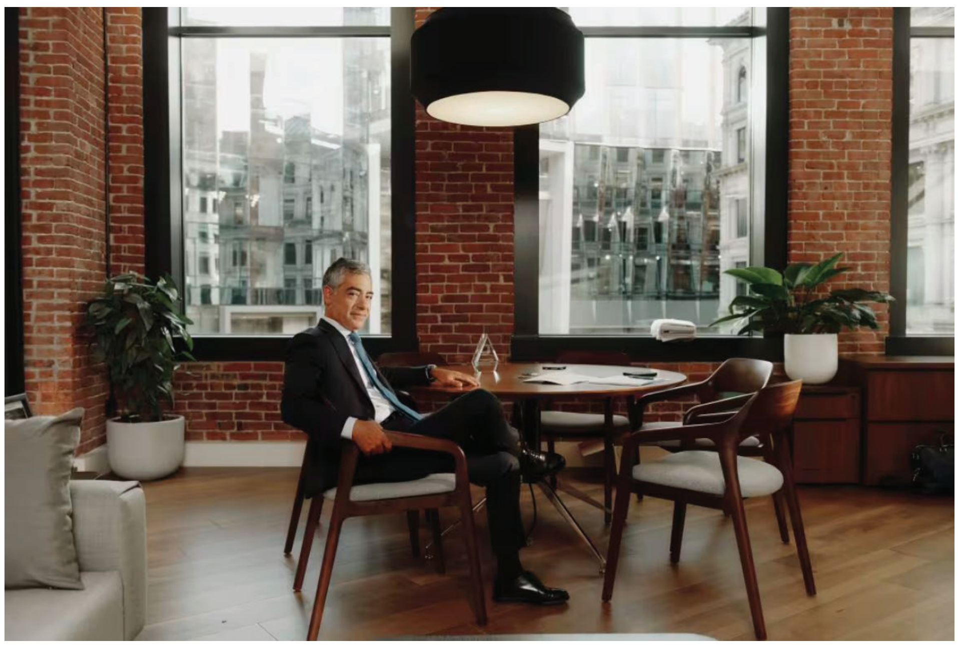
VALUE INVESTING | Q&A

This International Investing Pro Sees Value in Consumer Stocks

By Debbie Carlson



PHOTOGRAPH BY TONY LUONG

Inflation has roiled the global economy, and higher interest rates have disrupted markets. For David Samra, a portfolio manager at Artisan Partners, these headwinds create an opportunity to invest in consumer-focused companies with low valuations and long-term potential.

Samra, based in Boston, has run the $28.2 billion Artisan International Value fund since its 2002 inception, and applies classic value-investing principles—the sort espoused by Benjamin Graham and his pupil, Warren Buffett—to non-U.S. markets. Samra buys well-run companies trading at a significant discount to intrinsic value.

This past spring, the fund was named best fund over the three, five, and 10 years in Lipper's International Large-Cap Value Funds category. Samra also won Morningstar's international stock fund manager of the year award in 2008 and 2013.

Artisan International Value is up 11.7% this year, and has returned an annualized 10% over 15 years. It has also outperformed the leading international stock indexes.

Although the fund currently is closed to new investors, Samra was eager to share some of his favorite investment ideas, and his thoughts about international investing, in a recent interview with Barron's. An edited version of the conversation follows.

***Barron's:* How do you approach value investing internationally?**

David Samra: When you have slow-growth economies and a lack of venture-capital innovation, you have an asset class that lends itself to value investing. We look for a cheap stock of a good business with a strong balance sheet and a good management team. We want to invest in a business that has the ability to grow to protect us from inflation. We are generalists and are willing to look at businesses in all sectors. If there is at least a 30% expected return, then [the stock] becomes a candidate for investment in our portfolio. We never relax that 30% standard.

Give us an example of how this approach has supported returns.

We initially purchased Arch Capital Group, a property-casualty insurer domiciled in Bermuda, in 2003. The high return on equity, the retention of that capital in the business, and the reinvestment of that capital at high returns has allowed us to generate approximately a 14% or 15% compounded annual return on the security over that entire time period. There have been very few periods in which the valuation of that security became intolerably high.

What is an underappreciated nuance about international investing?

A 5% position in our portfolio is getting close to $2 billion. If we're going to commit that amount of capital, we have to ensure that not only are we getting the right risk/reward profile, but also rights as minority shareholders. In a place like France, the French system of corporate governance allows the providers of capital to exercise their rights as minority shareholders. Those rights differ from country to country, and it is important when investing outside the U.S. to be aware of those differences, because they matter.

Those rights helped you realize changes at Danone when you helped oust the former CEO. The stock is now a top 10 holding. What is so attractive about Danone?

We did a lot of work, and now they're doing all the work, which is good. They are well along in the process of reinvesting in their brands, in terms of innovation, marketing support, and better relationship management with retailers. We expect that to start to show up in volume growth and operating profitability improvement.

Danone's largest business by revenue is EDP, a milk-based business selling yogurt and derivatives. Its largest business by profitability is nutrition. The company has a strong market position in baby formula in both Europe and China. It also sells adult nutrition products. Sales of these products are growing rapidly. Danone has good brands. It also has one of the most valuable water assets in the world. It sells Evian and brands in China, Indonesia, and Mexico.

Danone trades for 15 times our estimate of this year's earnings. We believe margins are lower than they should be. Margin improvement will help the company grow faster on the bottom line than the top line. A business with these assets is worth closer to 18 or 19 times earnings.

What else excites you?

We bought Unilever in the second quarter. There's an activist involved there [Nelson Peltz, founder of Trian Fund Management], not us, who has made constructive changes. One is reducing organizational complexity in the business. Another is a focus on the largest brands in the largest markets. That will help Unilever expand its profit margin over the next couple of years, while the valuation metrics are roughly the same: 15 times earnings for what is a very a good collection of assets.

Here, too, (we believe) the bottom line will grow faster than the top line, resulting in an even more attractive multiple. Once the bad news has passed, the market will revalue the stock to a much higher multiple. The share price has lagged behind as post-Covid inflation has hurt Unilever's gross margin. Restoration of that margin will require significant prices increases, but volumes will decline. Over time, as wages catch up to broad inflation, brand value will win. Also, the stock market is focused on growth equities.

Samsung Electronics is a top 10 holding. You've held it since at least 2013. Why do you still think it is undervalued?

We see tremendous opportunity in Samsung. It isn't a company that is generally accessible to U.S. investors, although there is a Korean exchange-traded fund that has a large weighting in Samsung [iShares MSCI South Korea ETF]. Samsung has been a tremendous value creator over its history, mainly driven by memory semiconductors. It is the largest in the industry, and stands out for its technological lead in manufacturing. Its scale allows for higher levels of profitability and it has a significant amount of cash on the balance sheet.

Semiconductors go through ups and downs, especially memory semiconductors. We're coming off a period of excess supply. Profits are depressed. On a normalized basis, backing out the cash, Samsung trades at about six times earnings.

It has some faster-growing businesses, the largest of which is foundry, which is outsourced chip manufacturing. That industry is dominated by Taiwan Semiconductor Manufacturing. There is only one other source that can manufacture at the cutting edge of technology, and that is Samsung. Foundry is 10% of revenue, but the business is growing by 20% a year. There is cyclical growth in the memory semiconductor business, and secular growth in the foundry business. That should make Samsung much more valuable in four or five years.

This is a great business, with proven management that has added value, a strong balance sheet, and a cheap valuation.

What is another stock that exemplifies your philosophy of owning good companies that can grow despite inflation?

Ryanair Holdings runs the largest airline by passenger traffic in Europe, and is the low-cost producer. The company currently has a net-cash balance sheet and owns just about all its airplanes. Its CEO, Michael O'Leary, is one of the best operators in the industry. He is a large shareholder and has driven significant value for shareholders.

A case in point: During the Covid period, Ryanair used its balance sheet to place orders with Boeing to put it in a position whereby, in the next few years, it will be 50% larger by passenger traffic than before the pandemic. We bought Ryanair in September 2020.

It isn't like the airline industry is a big growth industry, and Ryanair isn't a new company. It is focusing on the fundamentals of the business, which are keeping your costs low, providing good service to customers, and providing airports with traffic. In a mature industry, this has placed the company in a position to grow at rapid rates. The stock trades at 10 times earnings.

How about a holding that has been in the news?

UBS Group is an example of a company with a good business, a strong balance sheet, and a great management team that has used the balance sheet to acquire Credit Suisse, thus creating significant value. UBS invested roughly three billion Swiss francs [$3.3 billion] to acquire assets with a book value of CHF30 billion. Some of that CHF30 billion will be spent on restructuring and markdowns of assets, but effectively, the amount of value created in that one deal was extraordinary.

This is the power of owning businesses with great management teams and strong balance sheets. This is the core of our strategy. UBS captures the power of that dynamic, and our ability to recognize it when it's happening, and then change our position sizes based on the valuation. The day the deal was announced [March 19], the share price went down. I thought, "You gotta be kidding me." But now the stock has been significantly revalued. (We believe) the investment is closer to the end of [that] process than the beginning, although we still see a 20% expected return.

Which investment challenges—or opportunities—are more prominent now than five years ago?

I'd be remiss if I didn't talk about the development of artificial intelligence, because of the amount of investment being made in just about every industry. The easiest way to [take advantage of] this is through what Samsung does—selling memory, because AI needs a lot of memory storage, along with processing power. In each and every business, we have to make sure we understand if we will be on the winning or losing side of that. Innovation has accelerated over the past decade. Now it is going to the next level. But people get excited, and sometimes push valuations up to levels that represent more risk than reward.

Thanks, David.

Disclosures—Barron's feat. David Samra (Retail)

David Samra is a managing director of Artisan Partners and founding partner of the Artisan Partners International Value Team. He is lead portfolio manager of the Artisan International Value and Artisan International Explorer Funds. This article represents the views of Debbie Carlson of Barron's and David Samra of Artisan Partners as of the date of publication and those views and opinions presented are their own and are subject to change without notice. While the information contained herein is believed to be reliable, there is no guarantee to the accuracy or completeness of any statement in the discussion. This material is being provided for informational purposes only and should not be considered as investment advice or a recommendation of any investment service, product or individual security. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

Investment Results as of 30 September 2023 (%) Artisan International Value Fund	QTD	1YR	5YR	10YR	ITD	Expense Ratio Prospectus 30 Sep 2022[1]
Investor Class: ARTKX	-3.09	31.97	7.44	6.44	11.19	1.26%
MSCI EAFE Index	-4.11	25.65	3.24	3.82	6.79	
MSCI All Country World Index Ex USA Index	-3.77	20.39	2.58	3.35	7.00	

Source: Artisan Partners/MSCI. Returns less than one year are not annualized. Investor Class inception: 23 Sep 2002. [1]See prospectus for further details.

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Carefully consider the Fund's investment objective, risks and charges and expenses. This and other important information is contained in the Fund's prospectus and summary prospectus which can be obtained by visiting www.artisanfunds.com. Read carefully before investing.

Investment Risks: The value of portfolio securities selected by the investment team may rise or fall in response to company, market, economic, political, regulatory or other news, at times greater than the market or benchmark index. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in emerging and less developed markets, including frontier markets. Securities of small- and medium-sized companies tend to have a shorter history of operations, be more volatile and less liquid and may have underperformed securities of large companies during some periods. Value securities may underperform other asset types during a given period.

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Price-to-Earnings (P/E) is a valuation ratio of a company's current share price compared to its per-share earnings.

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