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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Achieving Risk-Adjusted Returns in the Non-Investment-Grade Credit Market

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SECTOR — GENERAL INVESTING

TWST: Could you please identify yourself?

Mr. Krug: My name is Bryan Krug. I'm the founding Portfolio Manager of the Artisan Partners Credit Team. I joined the firm in 2013 and launched the firm's first non-investment-grade credit strategy in March 2014.

TWST: Did you want to talk a little bit about the firm?

Mr. Krug: Artisan Partners is a global investment management firm solely focused on providing high-value-added investment strategies to sophisticated investors. The firm has seven autonomous teams with approximately $95 billion under management as of June 30, 2016.

TWST: Did you want to talk about the philosophy of your fund?

Mr. Krug: Our team's investment philosophy is based on a few core beliefs about the non-investment-grade credit market resulting from our years investing in the asset class. First, we believe that the non-investment-grade market has cyclical, industry and company-specific dislocations, which we can exploit. Second, we believe we can find the best risk-adjusted return opportunities through fundamental credit analysis and value identification across the capital structure. Employing what we believe is a repeatable, high-conviction investment process, we believe attractive risk-adjusted returns can be achieved over a full credit cycle.

When it comes to the characteristics we look for in a potential investment, our approach to fundamental credit analysis is focused on four pillars. The first is business quality. We are attracted to companies with resilient business models and strong competitive positioning, which we believe will show profit improvement and financial deleveraging. Because we're attracted to business with high recurring revenues and low capital intensity, over a cycle, you'll likely see us overweighting areas such as software, insurance brokerage, transactions processors and health care services, and underweighting commodity-oriented and cyclical businesses.

The second pillar is financial strength and flexibility. That starts with an analysis of a company's ability to generate free cash flow and service the debt but will also consider an issuer's corporate and capital structure. Third is downside analysis. We're trying to avoid permanent capital impairment. We want to be confident the enterprise value is sufficient to support a return of invested capital in the event of default.

And then, finally, value identification is geared toward finding the best risk-adjusted return profile by looking at credit improvement potential, relative value within the capital structure and other catalysts for business improvement. And one of the things that we think differentiates our strategy is we have flexibility to invest across the capital structure, whether it be bonds or loans, based on our views of relative value.

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TWST: And did you want to highlight a company that you find interesting?

Mr. Krug: Sure, but before I do that, I think it's helpful to talk a little bit about portfolio construction because we invest according to three risk profiles, or buckets: core, spread tightening and opportunistic. Core investments are positions we view as having stable to improving credit profiles and lower loan-to-value ratios. These may be lower yielding but may also have less risk. The spread-tightening bucket consists of credits that we think have significant upside potential due to market mispricing. Opportunistic investments can be event-driven or due to a market technical.

An example of an opportunistic investment is **Williams Partners** (NYSE:WPZ), a premier energy infrastructure company in North America. Our opportunity in **Williams** came when they announced a merger with a subsidiary of **Energy Transfer Partners** (NYSE:ETP). At that time, we believed the market was discounting credit deterioration, and we believed that the bonds could have meaningful upside in a couple of different scenarios. First, the bonds have a change-of-control provision that would be triggered in the event the company merged in a leveraging transaction and the bonds were downgraded. In that situation, the bonds would be puttable back to the company at 101.

Second, in the absence of a merger, we had reason to expect that the company, as a standalone entity, would be compelled to reduce its equity dividend in order to maintain its current credit rating, and the bonds would then benefit from an improvement in financial profile. **Kinder Morgan** (NYSE:KMI), another large pipeline operator, had cut its dividend earlier this year, so we saw that as a likely scenario. We were comfortable with the potential merger risk because we were buying the bonds substantially below par and the existence of the change-of-control provision. Subsequent to our initial purchase, the merger fell through, and the company communicated that it expects to reduce or eliminate its dividend. Its bond prices responded as we would have expected in that scenario and have shown material outperformance.

Highlights

Bryan C. Krug discusses Artisan Partners, a firm that focuses on providing high-value-added strategies to sophisticated investors. Mr. Krug's investment philosophy is based on core beliefs about the non-investment-grade credit market. He believes the market has dislocations that can be exploited and the best risk-adjusted returns can be found through fundamental credit analysis. When analyzing a potential investment, Mr. Krug focuses on four pillars: business quality, financial strength and flexibility, downside analysis and value identification, which looks at credit improvement potential, relative value and catalysts for business improvement. Using a repeatable, high-conviction process, Mr. Krug constructs his portfolio by investing according to three risk profiles: core, spread tightening and opportunistic. Companies discussed: Williams Partners LP (NYSE:WPZ); Energy Transfer Partners LP (NYSE:ETP); Kinder Morgan (NYSE:KMI); VEREIT (NYSE:VER) and First Data Corp. (NYSE:FDC).

An example of a core holding would be **VEREIT** (NYSE:VER), which is a real estate investment trust, or REIT. The company brought in a completely new management team that is focused on deleveraging and portfolio repositioning. Previously, the company had poor corporate governance, a very aggressive M&A strategy and a dividend policy that was dependent on incremental borrowings. The new management team has come in and improved the corporate governance, sold assets to delever the balance sheet and now has a dividend that we believe can be sustained. The company, in our opinion, has a better balance sheet than it did when it was an investment-grade credit. And we don't think we're paying much for the optionality of a potential ratings upgrade.

TWST: And with a real estate investment trust, what are some factors that could impact them — things like interest rates, who becomes President, what might happen to the market in general?

Mr. Krug: If you look on the debt side, what REITs want to do is lower their weighted average cost of capital to be competitive so they can buy additional assets and have a higher multiple relative to their peers. One component of that is maintaining an investment-grade balance sheet, which gives you a lower cost of debt financing. On the equity side, they tend to trade more with interest rates, and obviously, the bonds have some interest rate sensitivity too, but on the equity side, they tend to be bond proxies.

TWST: So what the Fed does may not have too much of an impact?

Mr. Krug: Correct. Our investment case is company-specific, as opposed to making judgments as to what the Fed may or may not do in upcoming meetings.

TWST: Did you want to mention another company?

Mr. Krug: Our largest position in the portfolio is **USI**, an insurance broker. The company has materially delevered its balance sheet over the last two and a half years through organic growth combined with some modest M&A activity. We like the business's cash flow stability. In terms of insurance brokerage, we think it's a mission-critical service. The free cash flow is strong, and that has allowed the company to delever and also provide a fair amount of enterprise value cushion, because we think the business is worth close to two times the value of the debt. And as we look forward, we think the owners will likely either recapitalize or potentially sell the company in the next 12 months or so.

1-Year Daily Chart of Williams Partners LP

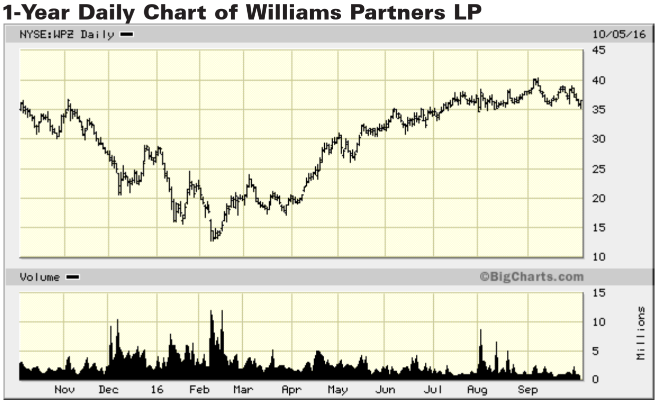

Chart provided by www.BigCharts.com

TWST: And from what I understand, they're not just focused on narrow areas, like some insurance companies, but they seem to be involved in things like property and casualty and employee benefits and other things?

Mr. Krug: Correct. They're very broad.

TWST: Why is that a good thing?

Mr. Krug: It allows you to offer full solutions to your customers. So you can offer property and casualty, you can offer directors' insurance, you can offer employee benefits, and it results in greater penetration within your existing base. We view that as a good thing.

TWST: Did you want to mention another company?

Mr. Krug: Another top-10 holding is **First Data** (NYSE:FDC), a transaction processor. The company continues to benefit from the secular trend toward credit and debit usage and away from cash. That's been a theme that's been going on for well over a decade, but it still continues. The company is focused on deleveraging. It is in a public form as opposed to being privately held. The company's got stable, predictable cash flows; low capital intensity; strong enterprise value coverage; and we think the company will continue to deleverage the balance sheet as its business continues to perform.

TWST: And they are involved in such things as e-commerce and security and fraud, and those seem to be growth areas.

Mr. Krug: They are growing a little bit. They're not showing parabolic growth, but growth is predictable, and what we like more is its predictability as opposed to its growth.

TWST: And that would be a benefit — as opposed to some of their peers in these industries — the predictability?

Mr. Krug: They are the largest in their peer group. Scale does have some benefits for sure, and so we think that's a distinct advantage. But generally, if you look at the sector that they're in, there tends to be a high degree of predictability. I think the early investors like to pay for that predictability in terms of their earnings stream.

TWST: As people look to the elections that we're having and to the Brexit vote that recently took place in Britain, are these concerns for investors?

Mr. Krug: I think the Brexit vote proved to have a short-lived impact on markets, and a lot of that, I think, was driven by increasingly accommodative central bank monetary policy. Going forward, I'm less concerned about who may or may not win the U.S. election and more concerned about potential changes in monetary policy by the central banks.

TWST: What challenges might exist in the high yield asset class that investors might face?

Mr. Krug: One concern would be central bank policy. How does the unwind of central bank balance sheets end up happening. It's an unprecedented level of activity in terms of asset purchases. The other concern, which is always out there, is: Will there be a recession that will result in a profitability decline of our companies and consequently increased default rates? Increased default rates are not currently priced into the market, in our view.

TWST: Do you get a sense of what the Fed might be doing in the next year?

Mr. Krug: I think the Fed has wanted to raise rates. However, either the economy domestically has not grown as much as they would have expected or macro factors outside of the U.S. have been deemed too volatile. So I think we've seen, historically, there's a desire to raise rates — to allow the Fed to have more options in the event of a recession — but it just hasn't come to fruition. You saw one official rate rise in December 2015, the first since 2006. We'll see how things go going forward, but it's a little unpredictable as to what can happen. But in general, it wouldn't surprise me if they're able to accomplish less than they hoped for, as has been the case in the last eight years.

TWST: Thank you. (ES)

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Bryan Krug is the lead portfolio manager for Artisan High Income Fund. This article represents the views of Bryan Krug as of the date of publication and those views and opinions presented are his own. Artisan Partners is not responsible for and cannot guarantee the accuracy or completeness of any statement in the discussion. This material does not constitute investment advice or a solicitation of any specific investment product or service. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation. Prospective investors should consult their financial and tax adviser before making investments in order to determine whether an investment will be suitable for them. This is not an offer for any mutual fund mentioned other than Artisan High Income Fund.

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 calling 800.399.1770. Read carefully before investing.

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For the purpose of determining the Fund's holdings, securities of the same issuer are aggregated to determine the weight in the Fund. The holdings mentioned above comprised the following percentages of the Fund's total net assets as of 30 Sep 2016: Williams Cos Inc 4.7%; Kinder Morgan Inc 1.3%; VEREIT Inc 4.3%;USI Inc 5.9%; First Data Corp 2.8%. Securities named in the Commentary, but not listed here are not held in the Fund as of the date of this report. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

Non-Investment Grade refers to fixed income securities with lower credit quality. **Free Cash Flow** is a measure of financial performance calculated as operating cash flow minus capital expenditures. **Put** is an embedded option giving the holder the right, but not the obligation, to demand early repayment of the principal. **Par** represents the level a security trades at when its yield equals its coupon.

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