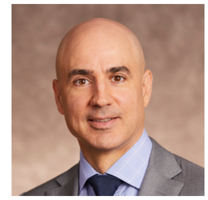
PORTFOLIO MANAGER
Viewpoints

May 2019

Not All PEs Are Created Equal

A Discussion with Artisan Partners Global Value Team portfolio manager Daniel J. O'Keefe



Daniel J. O'Keefe
Portfolio Manager

26 Years Investment Experience

Value investing is out of favor. That may be a gross understatement. Growth has outperformed value in 8 of the past 10 years—2011 was a dead heat, and value bested growth in 2016 only to trail by a relative 14% over the next 2 years. According to some measures, growth stocks trade at a nearly 50% premium to their value counterparts. That should be cause for some optimism from the value crowd as such extreme disparities tend to sow the seeds of their own undoing. That said, we saw growth premiums stretch as high as 100% during the dot-com era.

We must admit that we don't spend much time worrying about this. We focus on the economics, not the machinations of the market per se or which way the winds of popularity blow. Economics endure and ultimately prevail.

So in this market of massive growth premiums, what is for sale in the value bin? Two industries stand out as "cheap" in today's market: automotive and semiconductor, both full of companies trading at 10-ish times earnings or less, and both operating in cyclical industries. We have committed significant capital to the latter but almost none to the former: Samsung Electronics, the world's largest memory semiconductor manufacturer, is our largest holding in the Artisan Global Value Strategy; and NXP, the world's largest analog semiconductor company is also a top-10 holding. Why does one industry interest us so much more than the other?

Comparing Samsung against its leading counterpart in the automotive industries is an interesting exercise in *not all PEs are created equal.*

Exhibit 1: Not All PEs Are Created Equal

	Equity Value	Debt	Cash	EV	EV/EBITDA	EV/EBIT	PE	FCF	ROE
Samsung Electronics[1]	281,473	—	(95,680)	185,793	4.5X	3.9X	9.2X	37,470	21%
Toyota Motor[2]	21,781	19,348	(13,720)	—	—	—	8.4X	882	13%

	Industry Structure	End-Demand Growth	Credit Dependency	IT Disruption	Elasticity
Samsung Electronics	Three players	High	Modest	Beneficiary	High
Toyota Motor	Too many to count	Zero real	Very high	Victim	Low

Source: Team estimates, as of 31 March 2019. [1]Korean Won. [2]Japanese Yen.

Cyclicality explains why they both appear cheap, as the market often fixates on what is right around the corner rather than what is farther up the road. But the similarities largely end there. Samsung has more than a quarter of its market cap in net cash. Toyota, like most auto original equipment manufacturers (OEMs), has a balance sheet that is difficult to really disentangle and an enterprise value that involves a lot of judgments. It has no net debt at the manufacturing business but massive debts at the financing subsidiary. It's effectively a bank with a manufacturing business attached. This is true of most auto OEMs.

We note what we consider the main differences and similarities in Exhibit 1. We won't go through them all, but we can summarize. Samsung is the leader in an oligopolistic market that should grow strongly as the need for memory and computing power burrows deeper and deeper into the fabric of our economy. Toyota is the leader in an industry plagued by chronic overcapacity, with little-to-no real long-term growth and facing significant challenges due to electrification and autonomous driving. We don't mean to pick on Toyota: It's a well-run company, and one of the best auto manufacturers in the world. It's just in a very difficult industry.

The question of which one you would rather own is, at this point, a rhetorical one. As always, we are open to persuasion. But the comparison serves a further purpose—one that brings us back to our earlier observation about growth and value. Sometimes the comparison of growth versus value is a false one.

Around here we often say that growth is a characteristic and value is a judgment. It's our job to apply that judgment to an investment case with all its characteristics and determine whether there is good value. And we always prefer to invest in companies that have growth. Granted, companies experiencing what seems like perpetual, uninterrupted growth often get very high multiples that push them out of reach for value-oriented investors such as ourselves. There seems to be a lot of that going on these days. But not all growth is uninterrupted; it can be cyclical as well with each downturn and upturn ultimately higher than the last.

We believe this will be the case with Samsung. And with a modest multiple on currently depressed profits, we think it offers the very attractive prospect of not only a higher multiple but a higher earnings level, as well. Not all PEs are created equal, indeed.

Top 10 Holdings (% of total portfolio)

Samsung Electronics Co Ltd (Korea)	4.7
Arch Capital Group Ltd (United States)	3.3
NXP Semiconductors NV (Netherlands)	3.3
Citigroup Inc (United States)	3.3
Expedia Group Inc (United States)	3.3
ABB Ltd (Switzerland)	3.3
Cie Financiere Richemont SA (Switzerland)	3.3
Facebook Inc (United States)	3.3
Allergan PLC (United States)	3.2
DENTSPLY SIRONA Inc (United States)	3.2
TOTAL	34.3%

Source: Artisan Partners/FactSet (MSCI). As of 30 June 2019.

For more information: Visit www.artisanpartners.com

Investment Risks: 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 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. Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal. These risks, among others, are further described in Artisan Partners Form ADV, which is available upon request.

This summary represents the views of the portfolio manager as of 31 Mar 2019 and is subject to change without notice. Security examples are for informational purposes only and are not representative of the entire portfolio. There is no guarantee that investment within the securities mentioned will result in profit. While the information contained herein is believed to be reliable, there is no guarantee as to the accuracy or completeness of any statement in the discussion. This material is for informational purposes only and should not be considered as investment advice or a recommendation of any investment service, product or individual security.

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Growth and value equity returns are based on the performance of the MSCI ACWI Growth Index and MSCI ACWI Value Index, respectively, as of 31 Mar 2019. Past performance is not indicative of future results. The MSCI ACWI Growth Index measures the performance of large and mid-cap securities with growth characteristics from constituent countries in the MSCI All Country World Index. The MSCI ACWI Value Index measures the performance of large and mid-cap securities with growth characteristics from constituent countries in the MSCI All Country World Index. MSCI All Country World Index measures the performance of developed and emerging markets.

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