# Artisan International Small-Mid Fund

QUARTERLY
Commentary

Investor Class: ARTJX | Advisor Class: APDJX | Institutional Class: APHJX

As of 30 June 2022

## Investment Process

We seek long-term investments in high-quality businesses exposed to structural growth themes that can be acquired at sensible valuations in a contrarian fashion and are led by excellent management teams.

### Investing with Tailwinds

We identify structural themes at the intersection of growth and change with the objective of investing in companies having meaningful exposure to these trends. Themes can be identified from both bottom-up and top-down perspectives.

### High-Quality Businesses

We seek future leaders with attractive growth characteristics that we can own for the long term. Our fundamental analysis focuses on those companies exhibiting differentiated and defensible business models, high barriers to entry, dynamic management teams, favorable positions within their industry value chains and high or improving returns on capital. In short, we look to invest in small companies that have potential to become large.

### A Contrarian Approach to Valuation

We seek to invest in high-quality businesses in a contrarian fashion. Mismatches between stock price and long-term business value are created by market dislocations, temporary slowdowns in individual businesses or misperceptions in the investment community. We also examine business transformation brought about by management change or restructuring.

### Manage Unique Risks of International Small- and Mid-Cap Equities

International small- and mid-cap equities are exposed to unique investment risks that require managing. We define risk as permanent loss of capital, not share price volatility. We manage this risk by having a long-term ownership focus, understanding the direct and indirect security risks for each business, constructing the portfolio on a well-diversified basis and sizing positions according to individual risk characteristics.

## Team Overview

Our team is intellectually curious about the world and how it is changing. Each team member is passionate about small company investing and discovering businesses with meaningful and open-ended growth opportunities.

### Portfolio Management

Rezo Kanovich
Portfolio Manager

## Investment Results (%)

| As of 30 June 2022 | QTD | YTD | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Inception |
|---|---|---|---|---|---|---|---|
| | | | | Average Annual Total Returns | | | |
| **Investor Class: ARTJX** | **-17.19** | **-27.75** | **-29.21** | **3.31** | **5.43** | **7.13** | **10.03** |
| **Advisor Class: APDJX** | **-17.14** | **-27.68** | **-29.08** | **3.46** | **5.54** | **7.18** | **10.06** |
| **Institutional Class: APHJX** | **-17.15** | **-27.68** | **-29.03** | **3.55** | **5.67** | **7.27** | **10.10** |
| MSCI All Country World ex USA SMID Index | -16.63 | -22.16 | -22.41 | 1.44 | 1.95 | 5.57 | 7.67 |
| MSCI All Country World ex USA Small Cap Index | -17.55 | -22.92 | -22.45 | 2.94 | 2.55 | 6.22 | 8.50 |

Source: Artisan Partners/MSCI. Returns for periods less than one year are not annualized. Class inception: Investor (21 December 2001); Advisor (4 December 2018); Institutional (12 April 2016). For the period prior to inception, each of Advisor Class and Institutional Class's performance is the Investor Class's return for that period ("Linked Performance"). Linked Performance has not been restated to reflect expenses of the Advisor or Institutional Class and each share's respective returns during that period would be different if such expenses were reflected.

| Expense Ratios | ARTJX | APDJX | APHJX |
|---|---|---|---|
| Semi-Annual Report 31 Mar 2022[1] | 1.29 | 1.13 | 1.04 |
| Prospectus 30 Sep 2021[2] | 1.31 | 1.15 | 1.07 |

[1]Unaudited, annualized for the six-month period. [2]See prospectus for further details.

**Past performance does not guarantee and is not a reliable indicator of future results. Investment returns and principal values will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than that shown. Call 800.344.1770 for current to most recent month-end performance.**

## Market Environment

Global equities continued to experience high levels of volatility and finished Q2 with decisively negative returns, leading to the worst first half of the year in two decades. The Russia-Ukraine war has been the central disruptor of the market. Significant effects include higher overall risk premium, swings in the energy market stemming from Russia's control of resources, and food inflation with grain export constraints. Our portfolio is not overly impacted by the tightening cycle, but rising inflation is curbing consumer spending. US stocks have shed $9 trillion thus far in 2022 as investors sold on concerns over global growth and the Federal Reserve's ability to manufacture a soft landing while attempting to rein in inflation. Central banks across the world, with the notable exceptions of China and Russia that cut interest rates and Japan that maintained ultra-low interest rates, are picking up the pace of rate hikes. Developed nations are raising rates to fight inflation, and emerging economies are following suit to defend their currencies. The spread between value and growth stocks continued to widen in the quarter, with the MSCI ACWI Value Index outperforming its growth counterpart by 1,558 basis points YTD. Non-US small- and mid-cap stocks delivered negative returns across all sectors. The largest laggards within the index were materials and information technology, which both finished down more than 20%.

It goes without saying that the macro-economic environment has changed dramatically in the past year. However, the importance of maintaining a long-term orientation and understanding the through-cycle profitability of a business remain key tenets of our investment approach. Many people think about the international small- and mid-cap universe as presenting trading opportunities around a source of volatility. Our approach could not be more different. We think of the opportunity set solely as a place to identify smaller companies that have the potential to become the large companies of tomorrow. Typically, it is difficult being a small company; the vast majority of them stay small forever or disappear. They face large powerful competitors, operate in regulated industries, don't have resources to invest in R&D and cannot attract or retain the right leadership talent to drive their organizations to the next level. However, there are a select few that are led by highly driven and capable people, have intellectual property, strong brands and know-how to build sustainable winners. We look to be long-term owners in such high-quality businesses and, ideally, find stocks we can own well beyond our initial five-year underwrite as the business evolves with its opportunity set. Wonderful businesses are rarely available at attractive prices, so we look for opportunities to acquire them in a contrarian fashion in times of adversity, or perceived adversity. We are sensitive to the prices we want to pay for these companies, seek differentiated insights on their business models and look for inflection points in their journeys that are misunderstood by the market, leading to future value.

Our job is to separate the signal from the noise and remain thoughtful about the quality and valuations of our holdings, relevance of our themes, and the portfolio's diversification. Over the past two years, the market has swung between extremes, from exuberance and willingness to pay sky-high multiples for meme stocks and blank-check SPACs, to broad-based pessimism with little regard for company fundamentals. The selloff has been indiscriminate and pronounced, particularly in certain market segments such as technology and health care. This top-down trend behavior creates opportunities, as it ignores the disparity in quality or the fact that management actions can drive wildly divergent outcomes in both the near term and long term. This point holds especially true for smaller-capitalization companies, which are often nimbler than their large-cap counterparts.

In many cases, the market is not recognizing investment cycles. Strategic buyers, however, continue to value businesses on normalized margin assumptions and look for situations of dislocation. Companies that have continued to invest through the turbulence of the past few years are now entering a period of operating leverage. This dynamic is often missed in current stock prices.

For example, let's examine Kornit Digital, an IP-protected leader in the digital transformation of the apparel industry that enables key structural shifts toward automation, the near-shoring of garment manufacturing and less production waste. In Q1, Kornit reported year-over-year revenue growth of 32% but a slowdown in ink consumption growth due to lower garment production in the merchandising market. Over the course of Q2, sales of new printer installations showed signs of slowing, signaling customer caution about a forecasted macroeconomic slowdown. The reaction in Kornit's stock has been dramatic, now pricing in not just a deep consumer recession but a fundamentally broken business. Kornit's shares are back to a price not seen in over three years and recently crossed under our original 2019 entry point. Since the start of 2019, Kornit's business has transformed meaningfully. Not only has the market completely forgotten about the promise of on-demand manufacturing, but the stock now trades as if Kornit will be running off its installed base for the next five years without selling any additional equipment. In reality, the installed base of high throughput printers has doubled, ink consumables revenue is up 70%, and customer relationships have continued to expand. In tandem, Kornit's overall revenue and earnings have doubled, and its cash position has more than quintupled to $734 million on a $1.4 billion enterprise value. Throughout this period, Kornit has also kept its commitment to R&D, and the result of this effort includes another meaningful product launch in 2023—one that will increase automation in printer operation and is a significant positive development for increased throughput. In addition to its cash hoard, Kornit has no debt and the ability to self-fund growth, shielding it from rising financing costs and the need to tap capital markets. Our extensive diligence effort goes beyond the management team and includes conversations with trade publications, industry consultants and direct contact with numerous end customers. This work continues to affirm our conviction in Kornit's business progression.

The most exhilarating aspect of our work, and what has the potential to drive investments returns that supersede a market cycle, is the ability to uncover small businesses that will one day be large leaders in their respective industry. For those of you that attended our talk at the Artisan Investment Forum in May 2022, you heard us discuss business transformations—how dynamic businesses evolve with their opportunity set and make long-term oriented decisions throughout cycles. Examples included:

1) NICE, a business our regular readers will know well, which has gone from a hardware business focused on contact centers to a SaaS provider to today an increasingly AI-enabled upstream management decision tool across multiple sprouting business lines.

2) CAE, a maker of flight simulators for the aviation industry that has transformed from a manufacturer to a services business to an emerging software provider.

3) ConvaTec, a UK medical device maker that has evolved from being a leader in ostomy to also having strong market positions in continence care, infusion devices for insulin pumps and wound care. ConvaTec's product offerings are expected to grow over the next 30 months and have higher margins and prices in large, structurally growing markets.

These businesses are on a journey. The path from small capitalization to much larger is rarely easy and never occurs in a linear fashion. Transitions take all shapes and various timelines. Sometimes the bump in the road is self-inflicted, and many times shifting market conditions can present new challenges. As investors, we are comfortable being patient when the business model quality is unimpaired and we are aligned with the right management team. In the case of Kornit, we are confident the future is bright, and we are comfortable looking past the market's short termism.

## Performance Discussion

Our portfolio modestly trailed the MSCI ACWI ex USA SMID Index in Q2. Security selection in the industrials sector was the largest detractor from relative returns. Other sources of relative drag included selection in the consumer discretionary sector and an overweight to technology. However, our tech positions outperformed those in the index and resulted in flat relative returns in the sector. Positive relative returns in materials, where our structural growth oriented portfolio is underweight, and health care partially offset areas of underperformance.

On an individual security basis, Wolfspeed, Jet2 and RS Group were notable detractors. Wolfspeed manufactures silicon carbide wafers for the next generation of power semiconductors, which improve the range and efficiency of electric vehicles (EVs). When considering the unit economics of the EV transition versus increasing an EV's range by 40% in an elevated gas price environment, Wolfspeed's value proposition is clear. Recently reported quarterly revenues reflected temporary logistics issues as a result of lockdowns in China, but its ability to secure design contracts with tier-1 suppliers and OEMs has not been impacted. Demand for power devices—particularly for electric vehicle production—is accelerating and still in the early stages. To meet increasing demand and to secure its position as an industry leader, Wolfspeed opened a new device manufacturing facility in April—the largest SiC facility in the world. We have confidence in the ability of Wolfspeed's management team to successfully navigate the evolving opportunity set.

We initially purchased shares of online travel agency Jet2 during the depths of the COVID-led travel shutdowns. The company used its balance street strength to play offense during the height of the pandemic as more leveraged competition faltered. Jet2 has meaningfully renewed its fleet, strengthened relationships with its hotel partners and acquired 40 additional landing slots at key airports, significantly enhancing its value proposition and positioning it to see significant market share gains. Shares sold off on near-term concerns that supply side inflation (fuel, hotels, staff, etc.) and a consumer spending squeeze will challenge margins and partially offset Jet2's higher pricing and bookings in fiscal 2023. We believe in Jet2's resilience and its ability to continue growing market share in a risk-minded manner.

We have been long-term investors in RS Group (formerly named Electrocomponents), a global omni-channel provider of product and service solutions for designers, builders and maintainers of industrial equipment and operations. Historically, RS Group distributed primarily electronic components in the UK. Today, the business is transitioning to a more global orientation and an evolved focus toward maintenance, repair and operations (MRO) solutions, which are inherently less cyclical. RS Group has also substantially digitalized its business and has taken steps to mitigate issues around the shortage of components and supply chain bottlenecks plaguing the industry amid record-strong demand backlog. The stock price currently reflects worries about cyclical pressures on the business, which we are carefully observing. Our conviction, however, remains in place as RS Group has demonstrated clear pricing power and success in its journey to more meaningful value creation.

In terms of top contributors to Q2 performance, health care holdings Legend Biotech and Lantheus led the way. In light of the significant share price declines in biotech at large over the past year, we are having success finding meaningful, idiosyncratic opportunities in this vast universe. Legend's Carvykti (cilta-cel), now approved in the US and EU, is a best-in-class B-cell maturation antigen-directed therapy in relapsed/refractory multiple myeloma, and we believe the potential for use in earlier treatment settings is likely. We're optimistic about Carvykti's long-term sales potential and are encouraged by its Johnson & Johnson partnership focused on expanding manufacturing capacity to support a sales target of more than $5 billion. Legend also has a robust pipeline of innovative cell therapies, including its newly approved drug application to treat gastric, esophageal and pancreatic cancers. Legend originated from a Chinese company but has strengthened its US-based leadership team with the new CFO, global

head of R&D and general counsel roles. The Chinese biotech industry has evolved from a services business with little R&D to an area of true innovation on a global scale.

Lantheus is a pioneer in medical imaging and has a pipeline of radiotherapeutics, PET imaging agents and small molecule therapeutics in oncology and cardiology. Shares outperformed on a successful launch of PYLARIFY®, a PET imaging agent that is becoming the standard of care for prostate cancer. Lantheus also had strong sales of DEFINITY®, an imaging agent for echocardiograms. Looking forward, FDA approval for in-house manufacturing of DEFINITY® should meaningfully expand gross margins, and an improving product mix should boost profitability.

HomeServe and Gaztransport Et Technigaz (GTT) were also strong contributors to performance. HomeServe has two main business units: Home Expert—similar to Angie's List in the UK—and its legacy business of home repairs/homeowner's insurance. HomeServe's businesses are highly profitable, and the company has successfully expanded into North America. Canada-based private equity firm Brookfield Asset Management is acquiring HomeServe in a cash offer of £12 per share, implying an enterprise value of £4.7 billion and a material premium to the share price. We have exited the position after more than three years of ownership due to the significant share price appreciation on the announcement.

GTT is an IP-intensive developer of cryogenic membranes for the transport and storage of liquefied natural gas (LNG) and a supplier of electrolysers used to produce green hydrogen with industrial scale potential. LNG and hydrogen are structurally important sources of energy amid the world's transition to energy that is cleaner and more secure. While recent geopolitical conflicts have slowed this shift in the near term, long-term demand for LNG is very supportive, with new vessel orders increasing for current projects, new projects on the horizon and an industrywide effort to increase shipyard capacity. GTT's patented IP creates a barrier to entry, and its continued focus on improving membrane technology helps to sustain its competitive advantage. The company is highly profitable via the licensing of its technology, which creates a circumstance where the company can grow revenue with virtually no additional cost.

## Perspective

While the market swings from unbridled optimism to pessimism, companies are transitioning, orienting themselves for future success and making investments for growth. While the public market often gets caught up in sentiment, valuing businesses on the latest trailing number or near-term event at the trough of an investment cycle, there are thoughtful strategic buyers in the market that focus on long-term normalized profitability.

Today there is an abundance of capital to fund deals, and savvy players are trying to take advantage of lower valuations to acquire quality companies they believe will enhance their long-term prospects. Deals worth more than $10 billion are up 12% in the first six months of 2022 versus the same period last year. A number of our health care companies, ranging from bioprocessing to biotech to life sciences and tools to providers and services, as well as companies in the video gaming industry and other areas have recently been the subjects of acquisition or were speculated of being approached. We do not comment on speculation, but we are confident there is a lot of value in the portfolio.

Volatility and macroeconomic headlines will likely continue to dominate the market in the medium term. In Q2, we accelerated portfolio activity amid the heightened market volatility, as well as resumed travel and participated in more frequent in-person meetings. This is a dynamic market, and by remaining patient, thoughtful and long-term oriented we should be able to continue to identify well-positioned businesses in which we believe we can compound returns over multiple years. We are in the privileged position to have an investment universe ripe with innovation and promise, and we are hard at work to uncover the leaders of tomorrow.

**For more information:** Visit www.artisanpartners.com | Call 800.344.1770

**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 800.344.1770. Read carefully before investing.**

**Current and future portfolio holdings are subject to risk. 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 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. Growth securities may underperform other asset types during a given period.**

MSCI All Country World ex USA SMID Index measures the performance of small- and mid-cap companies in developed and emerging markets excluding the US. MSCI All Country World ex USA Small Cap Index measures the performance of small-cap companies in developed markets and emerging markets excluding the US. MSCI All Country World Growth Index measures the performance of companies in developed and emerging markets with higher forecasted and historical growth rates. MSCI All Country World Value Index measures the performance of companies across developed and emerging markets that exhibit value style characteristics according to MSCI. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

This summary represents the views of the portfolio managers as of 30 Jun 2022. Those views may change, and the Fund disclaims any obligation to advise investors of such changes. 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 Jun 2022: Kornit Digital Ltd 1.5%, Nice Ltd 4.0%, CAE Inc 2.0%, ConvaTec Group PLC 2.3%, Wolfspeed Inc 1.4%, Jet2 PLC 1.5%, RS Group PLC 1.8%, Legend Biotech Corp 1.4%, Lantheus Holdings Inc 1.2%, Gaztransport Et Technigaz SA 1.4%. 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. All information in this report, unless otherwise indicated, includes all classes of shares (except performance and expense ratio information) and is as of the date shown in the upper right hand corner. This material does not constitute investment advice.

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**Return on Capital (ROC)** is a measure of how effectively a company uses the money (borrowed or owned) invested in its operations. **Enterprise Value (EV)** is a measure of a company's value. A **special purpose acquisition company (SPAC)** is publicly listed company formed for the express and sole purpose of raising capital via initial public offering in order to acquire a separate, existing company at a later date. **Operating Leverage** is a measure of how revenue growth translates into growth in operating income.

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