Artisan International Explorer Strategy

QUARTERLY
Commentary

As of 31 December 2023

Investment Process

We seek to invest in high-quality, undervalued businesses that offer the potential for superior risk/reward outcomes. The investment universe is generally non-US equities with market caps below $5 billion.

Undervaluation

Determining the intrinsic value of a business is the heart of our research process. Intrinsic value represents the amount that a buyer would pay to own a company's future cash flows. We seek to invest at a significant discount to our estimate of the intrinsic value of a business.

Business Quality

We seek to invest in companies with histories of generating strong free cash flow, improving returns on capital and strong competitive positions in their industries.

Financial Strength

We believe that investing in companies with strong balance sheets helps to reduce the potential for capital risk and provides company management the ability to build value when attractive opportunities are available.

Shareholder-Oriented Management

Our research process attempts to identify management teams with a history of building value for shareholders.

Portfolio Management


Beini Zhou, CFA
Co-Portfolio Manager


Anand Vasagiri
Co-Portfolio Manager

N. David Samra
Managing Director

Investment Results (% USD)

			Average Annual Total Returns				
As of 31 December 2023	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception[1]
Composite — Gross	**12.18**	**22.42**	**22.42**	**8.63**	—	—	**15.65**
Composite — Net	**11.61**	**20.33**	**20.33**	**6.55**	—	—	**13.41**
MSCI All Country World ex USA Small Cap Index	10.12	15.66	15.66	1.49	—	—	7.92

Annual Returns (% USD) Trailing 12 months ended 31 December

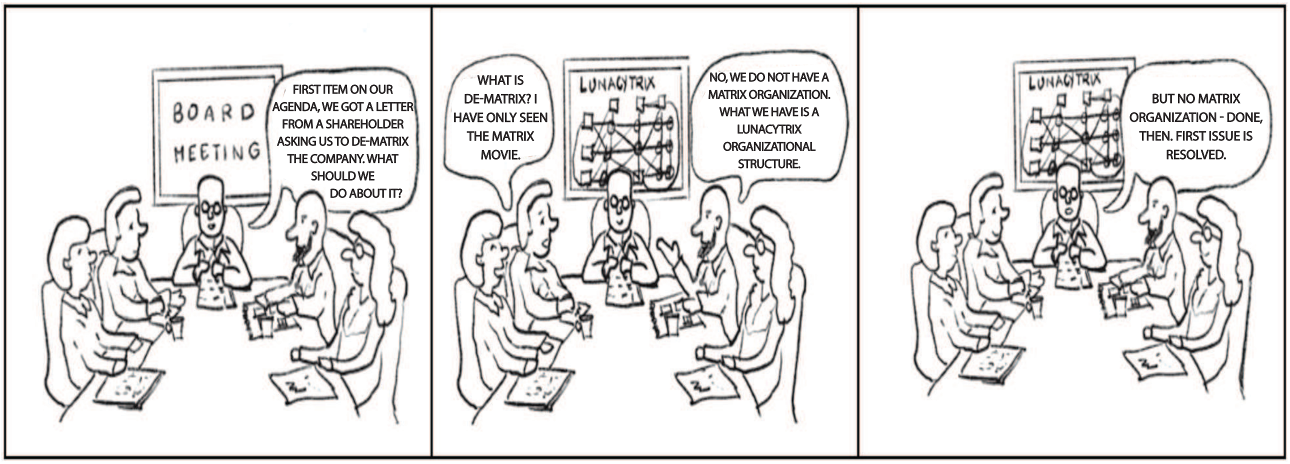
	2019	2020	2021	2022	2023
Composite — Net	—	—	**18.38**	**-15.08**	**20.33**

Source: Artisan Partners/MSCI. Returns for periods less than one year are not annualized. [1]Composite inception: 1 November 2020.

Past performance does not guarantee and is not a reliable indicator of future results. Current performance may be lower or higher than the performance shown. Composite performance has been presented in both gross and net of investment management fees.

Investment Risks: 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 near the back of this document, which should be read in conjunction with this material.

The Matrix



Source: Artisan Partners. Written and illustrated by Anand Vasagiri.

This quarter, we wrote a private letter to the board of a portfolio holding urging it to cut costs, reduce staff in its bloated headquarters and devolve responsibilities to the business unit level. This cartoon captures how we imagined our letter would be received by the board. However, we were pleasantly surprised. Shortly after we sent the letter, it announced a major restructuring program in line with what we had advocated.

Over the years, we've come to appreciate the power of a decentralized organization: a lean HQ that pushes down decision-making as close to the front line as possible. This stands in sharp contrast with organizations with a big HQ often run in a so-called matrix structure along products and geographies. We've found successful investments in both types of organizations, but based on our years of experience, we've seen a disproportionate amount of long-term value creation in decentralized organizations. We believe the reason can be distilled into one word: accountability. People need to be held accountable in all organizations. Sounds obvious, right? Yet, you'd be amazed how many businesses we've come across are hindered by people who hide behind bureaucracy and titles to evade responsibilities while pointing fingers at colleagues. A decentralized organization doesn't guarantee accountability, but a culture of accountability is naturally nurtured when business unit heads take responsibility for their respective unit's profit and loss end-to-end.

We didn't fully appreciate this organizational factor a decade ago, but we should have once one of us attended Warren Buffett's annual shareholder meeting in Omaha for the first time in 2010. Buffet's Berkshire Hathaway is the poster child for a decentralized organization hidden in plain sight.

Decentralized organizations are not a dime a dozen. Nonetheless, by kissing a lot of frogs over the years, so to speak, we've uncovered more and more decentralized organizations across all kinds of industries. During our most recent trip across Europe this December, we happened to meet with two businesses run in a decentralized fashion: a Dutch industrials business and a German IT reseller business. It's probably no coincidence that both have been long-term compounders of both their business and their share price.

If only there were an easy way for investors to screen for decentralized organizations. On second thought, the lack of such a screening tool plays to our advantage. It's hard to truly grasp the nuances of this organizational factor unless one visits the company and meets eye-to-eye with lower division leaders as well as C-level management on its premises. Our extensive travels enable us to add value by uncovering such well-run, off-the-beaten-path organizations with great alpha-generating potential in the years ahead.

What We Bought and Sold in the Quarter

We were more active on the initiation front this quarter, given the big market drawdown in October followed by a sharp rally the last two months of the year. We initiated three names in the quarter—one in Japan and two in the UK. We're still in the process of patiently building our position in the two UK names at the right price, so we'll leave them undisclosed at this time.

In Japan, we initiated a position in Osaka-based Kansai Paint, the second-largest paint business in the country and a major producer globally. The paint industry can be broadly classified into three end markets: auto, industrial and decorative. Kansai has a meaningful presence in all three, albeit with different emphases in different countries. It typically takes decades to build a paint business. But once well-established at scale, the business tends to have good pricing power since customers, both businesses and consumers, are often brand loyal. That loyalty is driven in part by a distribution channel moat, especially in decorative paint, that's hard for new entrants to crack.

Roughly 40% of Kansai's profits come from the domestic market, close to half from the rest of Asia and the remaining from Europe and Africa. With a relatively mature domestic market, it's focused on overseas markets to drive growth. The crown jewel of the company's global portfolio is arguably the 70%+ stake in listed Kansai Nerolac Paints, India's third-largest paint company. The Indian subsidiary accounts for nearly 30% of total profits. The country's low per-capita paint consumption, compared to many other countries, presents a long growth runway for an established local player like Kansai Nerolac.

Notwithstanding all the positive attributes we've mentioned thus far, Kansai's management team's decisions in recent years have made us believers. The previous management team had spread the business across too many areas. Profits stagnated as a result. After being promoted to the top executive role four years ago, the current president immediately started to retrench and close unprofitable assets and business lines, including a sale of its headquarters and idle land on the balance sheet. On the other hand, it bought back close to 10% of shares outstanding last fiscal year. Kansai's most recent attempt to sell its South African paint business to Akzo Nobel at a good price was, unfortunately, blocked by the local regulator due to antitrust concerns. The attempted sale nonetheless revealed a lot about management's capital allocation intentions.

We bought shares at around mid-teen times earnings in the quarter. The earnings multiple might not seem cheap, but we believe there is substantial room to improve operating margin in the coming years from the current ~8% level.

We were equally active on the sell side, exiting three positions this quarter.

We sold Japan-based Horiba, a position held since portfolio inception, as its share price hit our estimated intrinsic value target. Ostensibly classified as a measurement instruments business for the auto industry, close to 100% of profit has come from semiconductor production equipment in recent years. The share price soared after its latest earnings announcement showed the semiconductor business delivered robust results. Though it was trading at no higher than a low-teens P/E, we were afraid it had reached peak earnings. This is a good illustration that we never go by publicly reported P/E to make valuation calls.

We also sold NexTone, another Japanese company. NexTone manages music copyrights on behalf of songwriters and composers. It collects royalty payments and distributes them to artists. They're the only competitor to a quasi-government player that used to be a monopoly. It's successfully gained market share against the incumbent in recent years thanks to nimble execution in the booming music streaming market. Perhaps sensing a potential slowdown in music streaming, NexTone bought a money-losing business that it claims will enable expansion into adjacent areas of the music industry. We cannot interpret the purchase as anything other than poor capital allocation. We sold the position upon the deal's announcement. It was one of the portfolio's worst performers last year. It's worth noting that we actually trimmed the name by about half a year ago when its share price had done well and approached our estimated intrinsic value target.

Lastly, we sold UK-based Oxford Biomedica at a loss. It provides one of the key delivery mechanisms for gene and cell therapy as a CDMO (contract development and manufacturing organization). The company is a pioneer in what it does, with significant intellectual property and process know-how. It was not immune to last year's biotech CDMO industry downturn, with rising interest rates leading many biotech customers to pull back spending. We were not too concerned over this as we believe secular demand in CDMO remains. In fact, the new CEO, who arrived about a year ago, quickly repositioned this business as a pure CDMO by getting out of a proprietary drug pipeline. We applauded this move at the time. Late last year, however, despite current manufacturing facilities being materially underutilized, it announced a deal to buy a French manufacturing plant that is also underutilized and losing money. We (again) regard this deal as poor capital allocation.

How management allocates capital is so important to us that we decided to exit Oxford Biomedica as well as NexTone. It's also worth noting that neither of them was a big position in our portfolio to begin with.

Top Contributors and Detractors

We outperformed our benchmark by about 180bps this quarter and by almost 500bps for the full year.

Our top two contributors in Q4 were Glenveagh Properties and Despegar.com.

Glenveagh is one of Ireland's largest homebuilders. It reported good first-half earnings toward the end of the previous quarter, which likely gave rise to the positive share price performance toward year end. Easing investor concern about rising interest and mortgage rates in the quarter likely further boosted sentiment toward this sector. The company continues to execute superbly, and we expect it to deliver substantial growth this year given their solid development pipeline and a severely undersupplied market. Already one of our top positions, we added to the position materially early in the quarter, before the year-end rally.

Despegar.com is one of the largest online travel agencies in Latin America. Think of it as the Expedia of the region. It reported good earnings in the quarter and forecasted full-year numbers surpassing its pre-COVID peak. One month later, toward year end, management upgraded its full-year earnings guidance given its robust order book. The share price reacted positively as a result. Trading at around 1X revenue, its share price remains undervalued, in our opinion.

Our bottom two detractors in Q4 were Luxfer Holdings and Impro Precision Industries.

Luxfer is a UK-based specialty engineering materials maker. It primarily operates in two metal categories—magnesium and zirconium—where it's the dominant player in certain niche end markets globally. Its magnesium alloys, given their lightweight, strong and heat-resistant properties, are used in diverse end markets, including aerospace, oil/gas, industrials and medical device/health care applications. Its zirconium alloys are used, for example, in catalytic converters for the automotive industry to control emissions. Historically, it enjoyed around 17% after-tax ROI, which is very respectable for an industrials specialty materials business. In the past year or so, however, as inflation started to kick in, it struggled to push up pricing to pass through rising raw materials costs. Management has blamed long-term contractual agreements signed some years earlier. However, we suspect its relatively new CEO, who was promoted a year and a half ago, has not been aggressive enough in demanding fair pricing from customers. At the same time, one of its smaller business lines has been suffering losses recently due to aggressive Asian competition in Europe. The company's weak earnings have persisted for a few quarters, leading management to substantially lower its full-year outlook this quarter. In light of all this, the board has announced a strategic review of the entire business with all options on the table. We welcome this announcement. We added to the position this quarter; it trades at a high single-digit P/E based on earnings power, and we believe the issues are cyclical rather than structural in nature.

Impro is a Chinese industrial precision components maker listed in Hong Kong. We commented on this name last quarter as it was one of the top contributors then. It specializes in a manufacturing method called casting. If you're familiar with Precision Castparts, which is owned by Warren Buffett's Berkshire Hathaway, then you can loosely consider Impro as the Precision Castparts of China. No fundamental news surfaced this quarter, as far as we can tell, other than its founder/CEO, Mr. Lu, continuing to accumulate shares. He now owns more than 70% of the business. Buying shares around the current price, at ~7X P/E, is "a commercial decision," he once said to us. We wish more CEOs out there could think like him.

For the full year, our top two contributors are Despegar.com and Glenveagh properties, which happen to be the same as this quarter.

On the other hand, our bottom two detractors are NexTone and Luxfer holdings, and we've commented on both earlier in the letter.

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 and less developed markets, including frontier markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations. 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. These risks, among others, are further described in Artisan Partners Form ADV, which is available upon request.

Unless otherwise indicated, the Artisan Strategy characteristics relate to that of an investment composite or a representative account managed within a composite. It is intended to provide a general illustration of the investment strategy and considerations used by Artisan Partners in managing that strategy. Individual accounts may differ, at times significantly, from the reference data shown due to varying account restrictions, fees and expenses, and since-inception time periods, among others. Where applicable, this information is supplemental to, and not to be construed with, a current or prospective client's investment account information. References to individual security performance relate to a representative account in the composite. Individual holding periods may differ.

For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the Strategy. The holdings mentioned above comprised the following percentages of a representative account within the Artisan International Explorer Strategy Composite's total net assets as of 31 Dec 2023: Glenveagh Properties PLC 8.2%, Despegar.com Corp 7.1%, Impro Precision Industries Ltd 2.7%, Luxfer Holdings PLC 1.5%, Kansai Paint Co Ltd 1.5%. Securities named in the Commentary, but not listed here are not held in the portfolio as of the date of this report. Totals may not sum due to rounding.

ESG assessments represent one of many pieces of research available and the degree to which it impacts holdings may vary based on manager discretion.

Attribution is used to evaluate the investment management decisions which affected the portfolio's performance when compared to a benchmark index. Attribution is not exact, but should be considered an approximation of the relative contribution of each of the factors considered.

If applicable, contribution is calculated by multiplying a security's weight by its in portfolio return daily for the period and has been derived from a transaction-based methodology. Net contribution has been calculated by 1) deducting the related Composite's net return, which has been reduced by the highest model fee, from the greater of either of the portfolio's gross contribution total or the Composite's gross return, to determine a "model fee" applicable to managing the representative account's portfolio, 2) weighting that model fee based on each investment's average weight during the period; and then 3) deducting the weighted model fee from each investment's corresponding gross contribution to arrive at the net result. Return attribution identifies relevant factors that contributed to the portfolio's results, but is not exact, nor representative of actual investor returns due to several variables (e.g., security pricing, cash flows, the deduction of fees and expenses, etc.), and therefore should be examined in conjunction with performance of the portfolio or Composite during the period. Artisan will promptly provide further information on the methodology used or the performance of the account from which the individual security returns were extracted upon request.

Net-of-fees composite returns were calculated using the highest model investment advisory fees applicable to portfolios within the composite. Fees may be higher for certain pooled vehicles and the composite may include accounts with performance-based fees. All performance results are net of commissions and transaction costs, and have been presented gross and net of investment advisory fees. Dividend income is recorded net of foreign withholding taxes on ex-dividend date or as soon after the ex-dividend date as the information becomes available to Artisan Partners. Interest income is recorded on the accrual basis. Performance results for the Index include reinvested dividends and are presented net of foreign withholding taxes but, unlike the portfolio's returns, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the indices.

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. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

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