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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Seeking Capital Appreciation Through Business Value Compounders

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SECTOR — GENERAL INVESTING

TWST: To begin, just tell me a little bit about the fund; I know it's fairly new. And what was the emphasis for starting the fund? What was the approach? What was the philosophy?

Mr. Kaufman: The Fund is new, but I managed a developing world strategy at Thornburg, which launched back in 2009, and managed that portfolio for five years until I left to join Artisan.

Back in 2009, it was a difficult period in the capital markets in general, and for emerging markets in particular. Emerging markets were down 50% in 2008, and a lot of actively managed strategies in the emerging markets were down not only about 50%, but 60-70% even, and my fundamental starting point was that it is difficult to compound your way out of that sort of result.

And so our approach to long-term capital appreciation in the emerging markets embeds the importance of compounding and our approach to capital appreciation seeks to do a better job of mitigating the volatility of returns along the way. And so those two distinct aims are really the two bedrocks of our strategy.

TWST: Why don't you talk about the compounding assets first?

Mr. Kaufman: I'll introduce you to a term that we call business value compounding, which is really a summary of our approach to long-term capital appreciation in emerging markets. Now, you'll hear terms and statements like earnings drive share prices over time. We wouldn't disagree with that statement, but business value compounders are more robust companies that embed the importance not only of point-to-point growth but the manner in which that growth is achieved. And so we spend a lot of time thinking about whether companies are financially sound, whether they're free-cash-flow generative, what their capital structures look like.

We also spend a lot of time thinking about business models, about the cyclicality of the companies that we invest in. We're not averse to cyclicality per se, but we want companies that have the staying power to continue to invest during periods of competitive change or economic downdraft because we want that underlying earnings power to be growing. We want the compounding to continue even during the adverse periods.

And so we really focus on those two aspects in our pursuit of business value compounders — financially sound, free-cash-flow generative companies and companies with certain business-model durability. There is one last point of emphasis I would make with respect to business value compounders, which is, we invest in companies of a domestic-demand orientation. We believe that domestic demand is the essence of the emerging-markets story.

And when we look at the composition of the MSCI Emerging Markets Index, we think it's suboptimal in some ways. The Korea component of the MSCI Emerging Markets

Index is 15%; the Taiwan component of the MSCI Emerging Markets Index is another 13% at the moment. We might be 5% invested in those two countries combined versus, say, 28% for the index. There is nothing inherently wrong with Korea and Taiwan, per se, but we think it's fair to characterize those as Western-facing markets, and we don't believe investors should be focused on the emerging markets because they wish to play, for example, export recovery in Europe in 2016.

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We believe that domestic demand and the low penetration of basic goods and services is the essence of the emerging-markets story. And so we try to tweak our opportunity set a little bit away from exporters, away from those Western-facing places. So that could mean an investment in a company like **Unilever** (NYSE:UN), where about half of the profits are in emerging markets like Indonesia, India, and Latin America, but it could be a company that doesn't have the majority of its profits in the emerging markets, but it's economically tied to an emerging market.

Delphi (NYSE:DLPH) is a company that we invest in that has a very nice position in China as well as in future automation of cars. We view that business model as a lot more durable than, say, a unit-driven business model in the automotive sector, where we could invest instead in a pure play in China. And so we're really willing to be flexible about domicile to access the underlying domestic demand in the emerging markets, and we want to make sure that we're adhering all the while to the underlying importance of business value compounders, and emphasizing capital structures and business models as we go.

TWST: And then, the other part of your approach?

Mr. Kaufman: The other part of our investment process is our approach to mitigating volatility at the portfolio level, which we would summarize as holistic. And the reason that I use the word holistic is because generally any portfolio that you might invest in is going to have a degree of sector diversification; any portfolio that you might invest in is going to have a degree of country diversification, and we, of course, offer that too.

But I think what makes our approach to mitigating volatility distinct is, we try to identify and manage additional dimensions of risk, and I'm going to highlight two. One is our differentiated correlation profile, and one is our differentiated currency profile. And we believe that by identifying and managing those additional dimensions of risk, we can deliver a volatility experience for our clients that is robust, and that positions our portfolio to outperform over the long term.

So let me talk a little bit about each of those two dimensions — the differentiated correlation profile and currency profile. On the correlation side, the MSCI Emerging Markets Index has about 65% in large-cap stocks. There is nothing wrong with large-cap emerging-markets stocks, and any portfolio is going to need a degree of liquidity in it, and we seek to provide that as well, but the nature of our large-cap stocks is a little bit different than the nature of the large-cap stocks in the MSCI Emerging Markets Index. And that's because we've typically had between 15% and 25% of our portfolio in companies that are not based in emerging markets but economically tied to emerging markets.

And why is that important? It's important because, over the long run, what's going to determine the investment success of a company like **Unilever**? What's going to determine the investment success of a company like **Kansas City Southern** (NYSE:KSU), which is a Class I railroad in the United States with 55% of its profits in Mexico? Well, in the long run, what's going to determine the success of those two investments is, for **Unilever**, its footprint

Highlights

Lewis S. Kaufman discusses the Artisan Developing World Fund. Mr. Kaufman's approach to long-term capital appreciation in the emerging markets places importance on compounding business value as well as mitigating the volatility of returns. When it comes to evaluating investments, Mr. Kaufman's goal is to find companies that are business value compounders. He looks at a company's capital structures, how financially sound the company is and if the company is generating free cash flow. He also focuses on a company's business model. Mr. Kaufman wants companies that continue to invest during adverse periods and emerge stronger than their competitors. Companies discussed: Unilever N.V. (NYSE:UN); Delphi Automotive plc (NYSE:DLPH); Kansas City Southern (NYSE:KSU); Gazprom PAO (OTCMKTS:OGZPY); HDFC Bank Limited (NYSE:HDB); ICICI Bank Ltd. (NYSE:IBN); and Magnit PAO (MCX:MGNT).

in India, Indonesia and Latin America; for **Kansas City Southern**, it's going to be, to a large extent, the success of its railroad business in Mexico.

But over shorter-term periods, what we've experienced is, a lot of these companies might be able to transcend MSCI emerging-markets fund flows better than the average

1-Year Daily Chart of Delphi Automotive plc

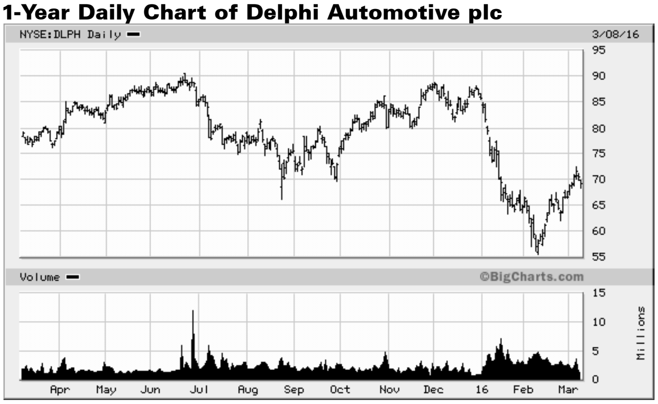

Chart provided by www.BigCharts.com

1-Year Daily Chart of HDFC Bank Limited

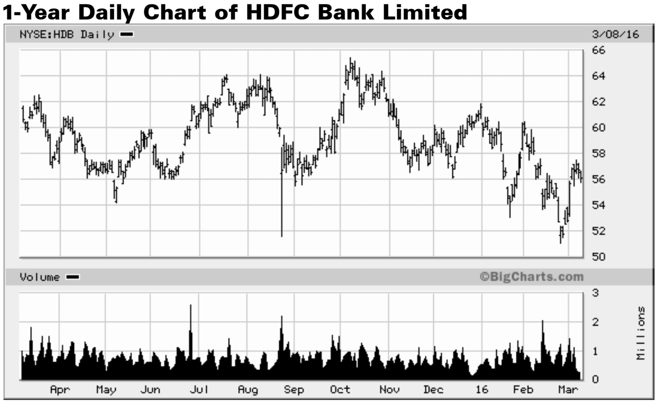

Chart provided by www.BigCharts.com

constituent in the MSCI Emerging Markets Index. So for example, you'll see in adverse periods for the market a company like **Gazprom** (OTCMKTS:OGZPY), which is very much pro-energy, pro-cyclicality, behave just the same as a company like **HDFC Bank** (NYSE:HDB), which is sort of the antithesis of **Gazprom** in the sense that India is a country that probably benefits from lower oil prices. So here are these two disparate investments that really shouldn't perform together in any way, and yet, when the fund-flow tide turns on emerging markets, they tend to perform in lockstep.

We believe the large-cap companies in our portfolio, in the long run, are going to perform economically like emerging markets. But over the short term, these companies might behave differently than the average company in the MSCI Emerging Markets Index. That's a critical distinction because it gives our portfolio a source of liquidity that's different than the Index.

And how does that translate in real life? Well, generally speaking, it may mean that we have a source of liquidity in the portfolio that we can use to fund other investments that might be out of favor in adverse periods. It could mean that we have a source of liquidity that enables us to meet a redemption without having to sell stocks that we don't want to sell. And in the final analysis, I believe the most important aspect of this is that it puts us in a position of strength—it puts us in a position to be buyers of last resort rather than sellers of last resort. That is my overall summary of our differentiated correlation profile.

A differentiated currency profile is a second distinct aim. When you look at the MSCI Emerging Markets Index, currency has contributed 7% on average to return for the

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dollar-based investor over the last 10 years. Now, just to be clear, that is the absolute value of the currency movement in the MSCI Emerging Markets Index on an annual basis for a dollar-based investor. Now, I think 7% is a lot, and I want to mitigate that volatility.

The traditional way that most managers of international equities will mitigate currency volatility is through hedging. But in my opinion, there are two shortcomings to hedging in this particular asset class. The first is, hedging is not necessarily cost-effective in the emerging markets. And why is that? Well, we're not talking about the euro or the yen. These are countries with negative deposit rates, countries where you are literally being paid to implement a currency hedge.

For the currencies that we're going to be concerned enough about to want to hedge, currencies like the Brazilian real, the South African rand, the Turkish lira, etc., these are typically currencies that are going to cost you more than 10% a year to hedge. That's a pretty high cost, a pretty high hurdle rate to jump over, and I think that's an important consideration before implementing a hedge in these and other currencies.

A second consideration is that we're in the business of repeatable processes, and ultimately, currency hedging is no different than buying and selling stocks. You have to make an initial investment decision to place a hedge on, and you need to make a second investment decision in terms of when to take a hedge off. It is incumbent upon the portfolio manager to have a repeatable process for implementing that hedging strategy if he or she is going to do so. I believe that's difficult. If you don't have a repeatable process, sometimes you get hedges right and sometimes you get them wrong.

So what we try to do instead is focus on a cost-effective and repeatable approach to mitigating currency volatility. And how do we do that? There are essentially three aspects to our approach. The first is, we try to identify currencies that are externally vulnerable. How do I define the word vulnerable? Well, we're looking for countries that first and foremost have current account deficits that are significant and that need to be funded with foreign capital. I would define foreign capital as foreign stock and bond flows, as distinct from foreign direct investment.

Why is that important? You have these two currencies--the renminbi and the riyal--that have been relatively fixed or managed in the past and therefore have not had a ton of empirical volatility. But most objective observers would agree that these two currencies do have a degree of underlying vulnerability. We are not concerned with backward-looking empirical volatility, but rather forward-looking volatility. So our framework for identifying externally vulnerable currencies gives us a great reference point for assessing fixed and floating exchange rates.

And the final step in our approach to managing currencies, having assessed the underlying vulnerability, and having made a projection about future currency volatility, is to implement the concept of hurdle rates in the individual investments that we make. Now, does that mean we'll never make an investment in an externally vulnerable currency like the Brazilian real? No, it doesn't mean that. What it means is if we anticipate high future currency volatility, we want to be compensated for the risk of that high future currency volatility.

"Now, I want to make one more distinction, which is, we're not concerned so much about historical volatility. We're not so much concerned about empirical volatility. We're not backward-looking. We're not saying, 'Oh! The South African rand has been volatile in the past; it's going to be volatile in the future,' because we're in the business of dynamic assessments."

And the reason that we focus on that is because underlying vulnerability leads to a second phenomenon, which I would summarize as volatility — in other words, the extent that a currency is externally vulnerable, the extent that a currency has a large current account deficit that needs to be financed with foreign stock and bond flows. The reality is, foreign stock and bond flows are fickle. The market gives, and the market takes away. In risk-averse periods, the market takes away, and what you'll see is, as that foreign capital is removed, you experience currency volatility. And so we use our assessment about the underlying vulnerability of currencies as measured by the dependence on foreign capital to make a projection about future currency volatility.

Now, I want to make one more distinction, which is, we're not concerned so much about historical volatility or empirical volatility. We're not backward-looking. We're not saying, "The South African rand has been volatile in the past; therefore it's going to be volatile in the future," because we're in the business of dynamic assessments. We're in the business of forward-looking assessments. And that's a very powerful distinction because it gives us a framework for approaching not only floating exchange rates like you would see largely with the South African rand, the Russian ruble, the Brazilian real, but also for managing fixed-exchange-rate regimes or managed-exchange-rate regimes, like the Chinese renminbi or the Saudi Arabian riyal.

TWST: Let's move on then and talk about some of the individual holdings in your fund. Your largest position is HDFC Bank.

Mr. Kaufman: HDFC Bank is one of the handful of largest private banks in India. Let's take a step back and talk about the private banking sector in India. Back in 1995, the government owned 100% of the banking sector through state banks and made a decision to privatize the sector by handing out its first wave of banking licenses, and there were four licenses in 1995 handed out. The two that emerged with the most prominent positions over the next 10 to 12 years were **HDFC Bank** and **ICICI Bank** (NYSE:IBN). And as a group, I believe that the private banks had gone from 0% market share to about 22% market share by 2007. I think that market share number stands at about 30% today, and so the private banks have been market share gainers through this period.

Now, **HDFC Bank** is a unique company. They have a very distinctive and simplistic approach to the banking business. They're not looking necessarily to be the most aggressive or service the widest range of products. I think what they are really looking to do is stick to their core niche in retail banking. While other banks in India, on the eve of the global financial crisis back in 2007, strayed a bit from their core competencies, **ICICI** notably so, **HDFC Bank** continued to focus on its core strategy.

ICICI Bank ran into a bit of difficulty with the global financial crisis and had to retrench on its branch expansion during that period. **HDFC Bank** continued to invest in branches, and when the economy recovered in 2010 to 2011, it was able to grow at a very favorable rate. **ICICI Bank**, on the other hand, lowered the effective speed of its growth. That is a pattern that has continued since that time, and what we've had over the last several years in India is another period of economic weakness and problems for the state banking sector in particular that continues to struggle with a very significant nonperforming loan component.

HDFC Bank, much as it did on the eve of the global financial crisis, has continued to invest, and I would highlight two areas in particular it's continued to invest in: its branch footprint, and digital banking. And those are two really important things to do when you are talking about a country of a billion people where those investments can bring the next 100 million people into the banking sector for the first time.

So as the economy has stabilized a little bit in India, those investments for **HDFC Bank** have begun to bear fruit. On the other hand, **ICICI Bank** continues to struggle with problems, this time in its corporate loan portfolio, while the Indian state banking sector continues to struggle with problems in its loan portfolio, **HDFC Bank** in recent quarters has put up between 25% and 30% growth in its retail lending portfolio in a relatively high-quality way.

And so we like **HDFC Bank** because it's a play on low-credit penetration in India, but we like **HDFC Bank** because it's the essence of what we would describe as a business value compounder. It's a company that has the business-model resilience to continue to invest during adverse periods in the business cycle and emerge from those periods stronger than its competitors. So I think **HDFC Bank** nicely captures the essence of what we define as a business value compounder.

TWST: Let's move on to Magnit, another large position in your portfolio.

Mr. Kaufman: We're often asked if we have a view on oil prices. I have some views; but I'm not sure that I can execute on those views in a repeatable way. And so we're happy to approach oil exposure by identifying businesses that we believe are going to compound business value through a market cycle. Oil prices are going to ebb and flow. Rather than investing in the physical commodity themselves, again we prefer to invest in companies that are compounding that business value under the hood.

Magnit is a great example of that. By way of background, Magnit is a multi-format retailer in Russia. Do we own **Magnit** because we are bullish on oil prices of the commodity cycle? No. Do we own **Magnit** because we're bullish on Russia or reform in Russia or capital markets developments in Russia? No. Do we own **Magnit** because we're bullish on Russian consumption? No.

What we like about Magnit is its business model. They have three formats: a convenience-store format, a hypermarket format and a cosmetics format. Their dominant format is the convenience-store format. That's an important distinction, because in contrast to most of their competitors who focus on the hypermarket segment, which is a big-box format that's capital-intensive and requires a lot of investment upfront, **Magnit's** dominant format is the convenience-store format.

Why is that important? It's important because, when you are a hypermarket company, the business model is essentially, if you build it, they will come. And so what you've seen from a lot of the Russian retailers that focus on the hypermarket sector is they built it, but customers aren't coming. And so they borrowed a lot of money to build these big stores with a lot of inventory, with big parking lots, with expensive rental bills, with a lot of employees that have to be knowledgeable and are expensive to train.

Magnit has instead mostly continued to stick to its knitting in the convenience-store format. That format is smaller, it has a smaller number of SKUs, which means that you get leverage over your suppliers, and you might be able to generate a certain amount of working capital as you grow, as distinct from having to invest in working capital as you grow. So despite a very high rate of growth, **Magnit** is financially sound and free-cash-flow generative. They might have a few employees in their store, but these are typically lower-level employees that don't have to be well-trained. Maybe their primary function is to stock shelves. Maybe there is a parking lot in a **Magnit** store, but it's a smaller parking lot, not as expensive to construct or maintain, etc.

So what **Magnit** does for you as an investor is two things. Number one, it gives you the ability to participate in the penetration opportunity for modern trade in Russia. These are essentially bigger, brighter, cleaner stores that sell modern products that meet certain health and quality standards. **Magnit** gives you the ability to participate in that modern retail penetration opportunity, but in a manner where you worry less about the capital structure or financial stability of the company.

We want to avoid levered companies that have to issue equity in order to shore up their balance sheets during adverse times. We believe these types of situations impair capital in a permanent way. For **Magnit**, which has a focus on the convenient-store format, we believe you take that risk off the table because **Magnit** is generating free cash flow as it grows.

The second thing is **Magnit** represents the essence of a business value compounder. In contrast, competitors are struggling, and trying to deal with the legacy of having built big hypermarket stores, and having to get their balance sheets in order against the backdrop of a weak environment in Russia, which has impacted consumption, the ruble and purchasing power. **Magnit** is a company that continues to invest in its store footprint in the regions. It's a company that continues to invest in its logistic system, which gives it a good cost advantage and scale advantage and distribution advantage versus its competitors. It's continued to invest in the development of its cosmetics and beauty format, which has much higher margins than even its convenience-store format and is likely to contribute to the cash generation of the company over the medium term.

So **Magnit**, in our view, is a great example of a company that's getting stronger during this period instead of weaker. And ultimately, if and when oil prices recover, we'll get some exposure to that too, but through a business model that is compounding value in a higher-quality manner than a company whose growth is entirely dependent on oil prices.

TWST: Thank you. (JM)

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Lewis Kaufman is the lead portfolio manager for Artisan Developing World Fund. This article represents the views of Lewis Kaufman as of the date of publication and those views and opinions presented are their 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 Developing World 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 visiting www.artisanfunds.com. 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 discussion of portfolio holdings does not constitute a recommendation of any individual security. These holdings comprised the following percentages of the Artisan Developing World's total net assets as of 31 Dec 2015: Delphi Automotive PLC 2.1%; HDFC Bank Ltd 4.0%; Kansas City Southern 2.6%; Magnit PJSC 3.1%; Unilever NV 2.2%. The portfolio holdings mentioned are subject to change and the Fund disclaims any obligation to advise investors of such changes.

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