ValueInvestor INSIGHT
June 28, 2024
The Leading Authority on Value Investing

Recovery Mode

Sarah Ketterer and Ellen Lee of Causeway Capital describe why cyclical stocks play well to their approach, the upside they find in nuts-and-bolts operating restructurings, the extent to which AI has become an important element in their investment cases, and why they see mispriced value today in Samsung Electronics, Reckitt Benckiser, Kering and Alstom.

INVESTOR INSIGHT

Causeway Capital
Sarah Ketterer, Ellen Lee

Having focused much of her career investing outside the U.S., Causeway Capital Co-Founder and CEO Sarah Ketterer is as enthusiastic as ever about the opportunity in international equities. "Non-U.S. is like one giant value market," she says. "What makes 2024 different is that now more management teams and boards truly care about their share prices. That makes our job easier."

Ketterer's approach has more than stood the test of time. Causeway now manages $48 billion and its flagship International Value strategy – which accounts for roughly 75% of assets under management – has since inception in 2001 earned a net annualized 7.6%, vs. 5.8% for the MSCI Europe, Australasia and Far East Index. Its Global Value strategy that started in the same year has returned 9.9% per year, vs. 8.4% for the MSCI All Country World Index.

Targeting companies facing cyclical challenges or those undergoing some sort of operational restructuring, Ketterer and co-Portfolio Manager Ellen Lee see mispriced value today in areas such as consumer products, semiconductors, luxury goods and rail transportation.

Most of Causeway's assets today are in international strategies. Was that the original idea or does it just reflect where you're finding the most opportunity?

Sarah Ketterer: That was the original idea. We were the former international equity team of Hotchkis & Wiley, so we only knew non-U.S. investing. Ironically, the first big client to hire us asked us for a global strategy, so from the outset we had to also figure out how to cover U.S. stocks.

As for where we're finding opportunity, I would argue non-U.S. markets today are generally mispriced. The focus has been on the U.S., more narrowly on U.S. technology, and even more narrowly on artificial intelligence. So much of the rest of the world's equity markets are languishing, even as corporate governance has gotten better than it's ever been. That makes it a fascinating time, full of opportunities.

While we talk about "international" and "global" strategies, fundamentally we think less about our portfolios from a listing perspective than we do where revenues are generated. Our Global Value portfolio exposure by listing as of the end of March was 46% North America, 23% U.K., 20% Europe (ex-U.K.), 6% emerging markets and 5% Asia Pacific. By revenue, however, the exposure was 40% North America, 29% emerging markets, 16% Europe (ex-U.K.), 8% Asia Pacific and 6% U.K. MSCI's All Country World Index also exhibits a gap between listing and economic exposure, with 67% in North America by listing, yet only 48% by revenues.

Companies going through some sort of industry cyclicality tend to populate your portfolios. Describe why that's the case.

SK: Cyclical stocks, which are more prevalent in non-U.S. markets, play well to our strategy. When the companies are headed to the bottom of an economic or product/business cycle, investors don't want anything to do with them and their shares can be priced as if this is how it's going to be forever and an upturn will never happen. As value investors, if we believe the current underperformance isn't the norm, we can find attractive disconnects between the underlying intrinsic value and the current price.

Ellen Lee: Diageo [DEO] would be a good current example. It's a global leader in premium spirits and the question around the stock today is whether the downturn in its business is due to a normal destocking after a period of rapid growth through Covid, or whether it signals some sort of permanent change in consumer drinking habits. If habits have fundamentally changed, its shares [at a recent $127] might be appropriately priced at an historically low level of just over 14x forward earnings.

Based on our research we don't believe that's the case. Distributors who during Covid hoarded inventory because supply was so low naturally destocked when de-

mand moderated. Diageo itself in a period of rising interest rates wanted less capital tied up in inventory. While those have short-term impacts, we don't believe end demand for spirits – particularly at the more premium ends of the market where Diageo plays – has changed, meaning the industry and company should return to historical levels of steady growth. If that's the case, earnings will improve and the stock is likely to re-rate from today's level.

Another representative example would be Canadian Pacific Kansas City [CP]. We consider the industry structure for rail in North America to be positive and expect the business to benefit as global supply chains evolve. We also believe the company is uniquely well managed, which is an advantage in a high-fixed-cost business with a premium on operating efficiency.

Last year and continuing into this year volumes have disappointed for Canadian Pacific and others, in large part due to the type of destocking I mentioned earlier for Diageo happening across multiple industries. We think that's very much a temporary phenomenon, so in the first quarter took advantage of the cyclical downturn to establish a position in what we consider an excellent, well-managed business. [*Note*: CP shares at a recent $79 are at the same price at which they began this year.]

You also gravitate toward companies going through some sort of operational restructuring. Why do you find that fertile ground for ideas?

EL: We believe some of the greatest share-price improvements can come when managements are extracting one small profit improvement after another, say, from wringing out supply-chain inefficiencies, or better managing variable costs, or innovating to capture pricing power. We think that's especially true – as is arguably the case today – in periods when earnings growth otherwise is more likely to slow and valuations are more likely to compress. The execution risk of a company regaining prior levels of profitability may be lower than the risk that it can achieve higher and higher levels of growth.

The valuations of companies in recovery mode generally appear expensive using current earnings or cash flows. Maybe they've also had to reduce or pause capital return to shareholders. That can leave them neglected by growth and value investors alike, which helps create the opportunity if our fundamental research concludes earlier than others that the upside is more promising than expected.

Tell us about your experience with Rolls-Royce [London: RR] in this regard.

SK: We owned Rolls-Royce prior to the pandemic as well, but it has been one of our top-weighted holdings since the end of 2020. The investment thesis has basically stood on two legs, one cyclical and the other based on operational restructuring.

We think it's a great business, one of three primary competitors (along with GE Aviation and Pratt & Whitney) in a global market for jet engines that has extremely high barriers to competitive entry. Covid obviously devastated the business, and the cyclical element of the thesis was that the company would survive and thrive as engine flying hours and the demand for wide-body airliners – its primary market – eventually recovered and continued to expand at above-GDP rates. That maybe sounds straightforward, but it was somewhat terrifying early on when the company in 2020 had to go through a rights issue to shore up its balance sheet.

At the same time it was dealing with the pandemic, management was also trying to overhaul the business in a variety of ways, including improving contract pricing, dealing with manufacturing issues with one of their engines, and cutting overhead costs. As unfortunately is often the case, this effort wasn't going fast enough or far enough and it took until new CEO Tufan Erginbilgic took over at the beginning of 2023 to start seeing results. We knew him from a prior role at BP – where he had turned around the company's global downstream business – and thought he was the kind of hard-driving manager the company needed to fix what he called a "burning platform" when he arrived.

Ellen Lee

Well Traveled

If one key to a successful career as an international equity analyst and portfolio manager is adaptability, Ellen Lee comes by the trait honestly. She was born in Seoul, but her father's job as an engineer with Korean Air meant the family spent three years each in Anchorage, Alaska and Los Angeles before she returned to Korea at 14 for high school and college. "My kids would probably kill me if I told them we were moving at that age," she says. "I didn't think that much about it and always had confidence I could do it."

That confidence was well placed. After several years as an investment banker in Asia, Lee returned to the U.S. to earn an M.B.A. from Stanford, joining Causeway Capital in Los Angeles after graduating in 2007. For her final interview she was given a Vodafone annual report and ten detailed questions, the answers to which were then discussed in a group meeting including Causeway founders Sarah Ketterer and Harry Hartford. "It was all about analyzing the business and company from the bottom-up," she says. "That was exactly what I wanted to do." Still the firm's lead analyst in the consumer and utilities sectors, Lee became a co-portfolio manager of its fundamental equity strategies in 2015.

The shares have come back strongly from their lows, which we believe is mostly due to the cyclical recovery in the industry. [*Note*: Below 50 pence in August 2020, Rolls-Royce shares traded recently

at around £4.55.] We think the market hasn't yet fully recognized the potential upside from the restructuring improvement, so this is still our largest position in our international and global portfolios. There's a lot of upside in ideas like this with both cyclical and restructuring components if you catch them when despondency levels are at their highest.

How would you describe your current take on investing in China?

EL: There is a lot for investors to be concerned about in China. Middle-class consumption remains challenged, the property market is distressed, and exports in many industries are weak. In areas like for-profit education, we've seen how changing government regulation can devastate companies' prospects.

Our general view is that while all that is true, there are specific opportunities in certain nationally favored industries such as electric vehicles, battery technology, green energy, semiconductors and high-end materials. There are strong consumer discretionary businesses with excellent franchises focused primarily on China that have derated well beyond what we think their business fundamentals warrant. Even some of the best-known Internet companies are so inexpensive that we're finding the risk/rewards very attractive at today's valuation levels.

Tencent [Hong Kong: 700] would be a good example. The company has the dominant "killer app" in China in WeChat. It has a global gaming platform with a very sticky user base. In winner-take-all and winner-take-most markets, this is one of the more attractive Internet platforms out there. For that part of the investment case we didn't have a lot of debate.

Where there was a lot of debate was around whether the shares at one-third the multiple they used to trade gave us enough margin of safety. Where we came out – here and with some other similar Chinese examples – is that the value proposition, even adjusting for China-related risk, is too attractive to ignore. One compromise is that we keep the position size smaller than it would be independent of the country risk. [*Note*: Tencent shares at around HK$375 trade at 16x estimated forward earnings and nearly 50% below their five-year high in early 2021.]

Causeway has been a pioneer in applying data science and other quantitative methods to its investment and portfolio management processes. To what extent do you see new AI tools as an additional asset?

SK: I think there's real potential for productivity gains, in particular around going through large amounts of information and providing summaries. As an example, we have detailed notes on our research into companies going back to when the firm was founded. There's a lot of accumulated knowledge there about industries and companies that we think AI tools can allow us to more quickly access, process and summarize. It's still early days, but we're actively working on adding tools that allow us to use all that information in a way that's additive to our current research.

ON ARTIFICIAL INTELLIGENCE:

There are certainly cases today where we believe there is an AI angle that the market is not fully recognizing.

Looking outward, is AI an increasingly important element in your investment cases?

SK: There are certainly cases where we believe there is an AI angle that the market is not fully recognizing. A good example of that would be Samsung Electronics [Seoul: 005930], which is one of our largest holdings. Here we expect that extremely high demand for high-bandwidth memory semiconductors used in AI data centers is going to accelerate the cycle for memory chips and give it a steeper trajectory for longer than ever. That should benefit Samsung's memory semiconductor business to an extent we don't believe is represented in the current share price.

There are also cases where we believe the market is overreacting to an AI threat. For a company like Concentrix [CNXC], which provides call-center and customer-experience software and solutions, the market is saying run, don't walk away from the stock, apparently out of concern that what it provides to help companies better communicate with customers is going to be replaced by AI. We've found almost nothing about their business that makes us think that is going to be the case. With the stock [priced recently at $62.75] trading at 5x next year's earnings, we think the market is handing us a high-quality, well-managed company with a pretty consistent earnings stream with a very, very large margin of safety. Our target multiple for the stock is closer to 9x.

EL: I'd mention in this context Cognizant Technology Solutions [CTSH]. It is one of the leading IT services providers in the world, employing more than 300,000 people and generating nearly $20 billion in annual revenue. Here also there's concern AI is going to incrementally make some of the services they provide obsolete and even that certain currently outsourced functions will be brought back in house because of the highly proprietary nature of company-specific AI applications. Based on our research in the field, we expect for some time that AI will be more of a revenue driver for Cognizant as companies need expert help in how to utilize and deploy it. If we're right, we would expect the company to generate low to mid-teens earnings growth over the next few years and for the shares to re-rate at least somewhat from today's level. [*Note*: At a recent $67.75, Cognizant shares trade at 14.5x consensus estimated forward earnings.]

Describe in more detail your investment case for Samsung.

SK: This is a position we've owned for almost ten years that we have opportunistically sized up and down given where we believe we are in the cycle. It's a giant com-

pany, in semiconductors, personal computers, peripherals, monitors, televisions, home appliances and telecom equipment. The biggest profit driver, accounting for around 40% of total revenues, is related to memory semiconductors.

The memory semiconductor business is known for its massive capital costs and boom-and-bust cycles, but has generally consolidated into three dominant suppliers, Samsung, SK Hynix (which we also own), and U.S.-based Micron Technology. Pandemic disruptions and subsequent inventory overstocking made this past cycle the most volatile we've seen in some time, but the three big players in the market have shown more supply-management discipline this time than in the past. There will always be cycles driven by timing mismatches in supply and demand, but we believe industry consolidation has made response times faster and that cycles are becoming shorter and less volatile.

As supply and demand for traditional end markets like PCs and smartphones continues to balance, we're obviously seeing a surge in technology investment related to AI. Most capital is being directed toward AI servers used to train large language models. These servers consist of graphics processing unit (GPU) chips from Nvidia and Advanced Micro Devices, a central processing unit (CPU) chip from Intel or AMD, and many high-performance dynamic random-access memory (DRAM) chips known as high-bandwidth memory (HBM). HBM chips are critical for GPUs to ingest and process vast amounts of data with minimal latency. SK Hynix and Micron hold the dominant market share in HBM, although we expect Samsung to catch up by Q4 of this year.

We believe we're still in the early stages of the AI-server infrastructure build, as the computing power required for AI model training is doubling every three to four months. Memory chips from Samsung support this accelerated compute intensity, and we believe they are an important bottleneck in AI expansion. We think demand for AI-related memory can grow at better than 70% per year for at least the next five years.

This alone is great news for Samsung, but AI investment should be a positive for it in other ways. Shifting of manufacturing capacity to high-bandwidth memory away from standard memory chips is limiting the supply of the more standard products Samsung also makes, putting upward pressure on those chips' prices. We also believe increasing AI capability in consumer products like mobile phones, laptops and refrigerators – where Samsung should be a leader – can drive another long-term sales cycle for those products as well.

We consider Samsung a complete and unabashed beneficiary of generative AI, but the market in its enthusiasm for chip companies like Nvidia just isn't getting it.

How inexpensive do you consider the shares at the current price of around ₩81,500?

SK: This is a capital-intensive business so we think valuing it relative to book value is an appropriate approach. Book value per share at the end of 2023 was close to ₩60,000, and we expect that by 2026 as profits turn up to be closer to ₩79,000. Our base case at that level would be for the shares to trade at 1.5x book.

INVESTMENT SNAPSHOT

Samsung Electronics
(Seoul: 005930)

Business: Global manufacturer of semiconductors – the primary profit driver – mobile phones, TVs, computer peripherals, household appliances and telecom equipment.

Share Information
(@6/27/24, Exchange Rate: $1 = ₩1,388):

Price	**₩81,600**
52-Week Range	₩65,800 – ₩86,000
Dividend Yield	1.8%
Market Cap	₩539.63 trillion

Financials (TTM):

Revenue	₩267.11 trillion
Operating Profit Margin	9.2%
Net Profit Margin	7.4%

Valuation Metrics
(@6/27/24):

	005930	S&P 500
P/E (TTM)	28.1	24.0
Forward P/E (Est.)	11.8	22.3

Largest Institutional Owners
(@3/31/24 or latest filing):

Company	% Owned
National Pension Service	6.4%
BlackRock	4.9%
Vanguard Group	3.1%
Norges Bank Inv Mgmt	1.8%
Fidelity Mgmt & Research	1.3%

Short Interest (as of 6/15/24):

Shares Short/Float	n/a

SAMSUNG PRICE HISTORY

THE BOTTOM LINE

The market is missing the extent of the AI-related upside for the company as demand for its high-bandwidth memory semiconductors explodes over the next five years, says Sarah Ketterer. As profits increase, she expects book value per share to nearly equal the current share price by 2026 and that the stock then would deserve to trade at around 1.5x book.

Sources: S&P Capital IQ, company reports, other publicly available information

It's also worth mentioning that the company has been increasing capital return to shareholders, committing to return 50% of its free cash flow through buybacks and dividends. The policy is re-evaluated every three years, but we consider it a positive and expect it to continue.

What's going on in Reckitt Benckiser's [London: RKT] business that makes it interesting to you today?

EL: Reckitt is a global branded consumer-products company focused on hygiene, health and nutrition. Hygiene includes brands like Lysol and Woolite. The health-related brands include OTC drugs like Mucinex and sexual well-being products like Durex. Nutrition is mostly infant formula, the primary brand being Enfamil. The revenue split is roughly 40% hygiene, 40% health, and nearly 20% nutrition.

What originally attracted us to the company pre-Covid was an operational restructuring that involved reinvesting margin in product innovation and marketing to drive more sustainable growth. This is common in consumer-products companies, and if well-executed and supported by strong brands – as is this case here – the effort can have a positive impact on the level and predictability of longer-term growth that is originally obscured by the initial investments being made.

A number of things have complicated the story since. Sales of Lysol and other hygiene products spiked during Covid and then came back down in its aftermath. Sales in the infant-formula business took off when the main competitor in the U.S., Abbott's Similac, went through a product recall and plant shutdown. Then in late-2022 the architect of the operational reset, Laxman Narasimhan, left to become the CEO of Starbucks.

If all that wasn't enough to create uncertainty about the fundamental trajectory of the business, in March a jury in Illinois ordered the company's Mead Johnson division to pay $60 million to the mother of a premature baby who had been fed Enfamil baby formula and died of a disease called necrotizing enterocolitis (NEC). The argument was that the company had "failed to warn" of the risk of NEC. There are a number of similar cases pending in the U.S. and the stock fell 15% – losing $7 billion in market cap to a decade-long low – after the verdict was announced.

So now there are two essential elements to the investment case. The first is that despite the lack of clean comps we believe the company is delivering on the operational turnaround and will hit their annual top-line growth guidance of 4-6%. We also expect that growth to prove more sustainable than was previously the case.

The second element revolves around the litigation risk. Reckitt believes it's not at fault and has appealed the latest verdict. We've done a lot of work on this subject as well and think the company has a strong case. There's no science that proves infant formula causes NEC, and even the NEC Society – the non-profit promoting research, advocacy and education about the disease – says there's no linkage. That doesn't mean in a tort system like we have in the U.S. that we can be at all certain about how the litigation plays out, but we do believe that any ultimate liability will be significantly less than the decline in market value from the announced award.

INVESTMENT SNAPSHOT

Reckitt Benckiser
(London: RKT)

Business: Manufacture and sale of branded consumer products in hygiene, health and nutrition categories; well-known brands include Lysol, Clearasil, Durex and Mucinex.

Share Information
(@6/27/24, Exchange Rate: $1 = £0.79):

Price	**£43.52**
52-Week Range	£41.03 – £60.06
Dividend Yield	4.4%
Market Cap	£30.41 billion

Financials (TTM):

Revenue	£14.61 billion
Operating Profit Margin	21.8%
Net Profit Margin	11.2%

Valuation Metrics
(@6/27/24):

	RKT	S&P 500
P/E (TTM)	19.1	24.0
Forward P/E (Est.)	13.5	22.3

Largest Institutional Owners
(@3/31/24 or latest filing):

Company	% Owned
BlackRock	8.5%
Vanguard Group	4.8%
Flossbach von Storch	3.7%
Massachusetts Fin Serv	2.9%
Morgan Stanley Inv Mgmt	2.7%

Short Interest (as of 6/15/24):

Shares Short/Float	n/a

THE BOTTOM LINE

The operational reset that initially attracted Ellen Lee to the company's stock has been complicated by intervening events that she expects to resolve in a way that will eventually highlight the operational improvement being realized. A company with this growth potential, she says, should trade at closer to a 17-18x P/E rather than less than 14x today.

Sources: S&P Capital IQ, company reports, other publicly available information

How are you looking at valuation from today's share price of around £43.50?

EL: The stock trades today at less than 13x our estimate of 2026 earnings and pays a 4.4% dividend. With operating leverage and stock buybacks, our base case is that earnings per share can grow at 7% to 9% per year. A steady-Eddie consumer-products company growing at that rate would typically trade at 17-18x earnings. We don't know when all the noise dies down, but even assuming our worst-case scenario around litigation, the margin of safety in the stock today is quite attractive.

From consumer products to luxury goods, describe why you're high on the investment prospects for Kering [Paris: KER].

EL: This like Rolls-Royce is a combination of organizational restructuring and cyclical turnaround. The company has a portfolio of luxury brands including Saint Laurent, Bottega Veneta and Balenciaga, but by far the dominant and strongest brand is Gucci, which today accounts for close to 50% of total revenues. The geographic footprint is pretty well diversified, with just over 40% of the business in Asia Pacific (including Japan), and just under 30% each in North America and Europe.

The operational reset revolves primarily around Gucci. After a tremendous initial run under creative director Alessandro Michele, the brand started to lose its uniqueness in the market and the company last year ended up replacing Michele with Sabato de Sarno, who used to be the top designer for Valentino. His charge, which we think makes sense for what had become a €10 billion annual revenue brand, is to establish a more classic, timeless style that is not as aggressively fashion-forward. The line is not fully turned over, with maybe 20% of the product in stores now consisting of de Sarno's first collection that launched last September.

In addition to the style reset, the company is revamping and upgrading the merchandising organization to put increased emphasis on more sophisticated differentiation in the products and how they're sold across channels, customers and countries. They're also looking to enhance operational efficiency in the supply chain after a period of rapid growth. Some of these things we were surprised weren't already in place, but that they're being addressed increases the likelihood that the brand revamp is successful. Given the huge profit warning last quarter we're not there yet, but we believe we're close to the trough now for Gucci.

Another investor concern is increasing pessimism about spending on luxury goods as consumer sentiment has cooled somewhat after Covid, especially in China, which is now the largest market for such products. It's not surprising to us that we've seen some cyclicality in these markets, but we believe the long-term demand in China – and in other developed markets for that matter – from increasingly affluent customers for aspirational luxury goods of well-known brands is still fully intact. The luxury-goods market has been growing 6-10% per year and we think that's sustainable.

Kering shares at a recent €342 are off nearly 60% from their 2021 highs. How are you looking at upside from here?

INVESTMENT SNAPSHOT

Kering
(Paris: KER)

Business: Design, manufacture, marketing and sale of luxury apparel and accessories worldwide; top brands include Gucci, Saint Laurent, Bottega Veneta and Balenciaga.

Share Information
(@6/27/24, Exchange Rate: $1 = €0.93):

Price	**€341.75**
52-Week Range	€299.20 – €546.80
Dividend Yield	4.3%
Market Cap	€41.89 billion

Financials (TTM):

Revenue	€19.57 billion
Operating Profit Margin	21.3%
Net Profit Margin	15.2%

Valuation Metrics
(@6/27/24):

	KER	S&P 500
P/E (TTM)	14.0	24.0
Forward P/E (Est.)	19.3	22.3

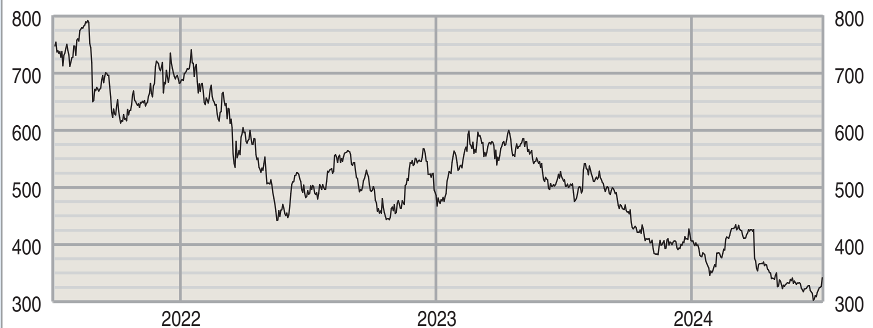
Largest Institutional Owners
(@3/31/24 or latest filing):

Company	% Owned
Baillie Gifford	5.0%
Capital Research & Mgmt	3.4%
BlackRock	2.5%
Vanguard Group	2.3%
Norges Bank Inv Mgmt	1.3%

Short Interest (as of 6/15/24):

Shares Short/Float	n/a

KER PRICE HISTORY



THE BOTTOM LINE

The market appears to be overly pessimistic about the turnaround prospects for the company's flagship Gucci brand and about the overall health of luxury-goods spending, says Ellen Lee. She believes earnings can roughly double by 2026 from their trough level this year, which with no change in valuation would result in attractive upside for the stock.

Sources: S&P Capital IQ, company reports, other publicly available information

EL: We need to see a sharp recovery from Gucci for the stock to work. At the peak the company overall was earning close to €30 per share, which we think this year bottoms at around €17 per share. With the Gucci rebound we think is possible and some operational improvements, we're estimating EPS in 2026 in the mid-€30s and then growing solidly from there. We don't have to assume any re-rating – the shares today trade at about 19x consensus forward earnings – for that to result in an attractive return. It's always difficult to get the timing right in these types of ideas, but we expect patience to be rewarded.

Explain what you think the market is missing in rail-equipment manufacturer Alstom [Paris: ALO].

EL: The company manufactures locomotives, freight cars, passenger cars and related signaling and other infrastructure used in high-speed and local rail transportation. This is another idea – again similar to Rolls-Royce – where things went from bad to worse after we established our position, but we now believe the righting of the ship is closer at hand.

We like the industry backdrop. With governments worldwide promoting the energy transition and move to lower-carbon emissions, there's considerable investment being made into rail networks. In places like Europe that's driven more by passenger rail, while in North America it's more tied to commercial rail and upgrading logistics networks. Increased investment overall should benefit an industry leader like Alstom.

An important part of the story here is Alstom's 2020 acquisition of Bombardier Transportation, which had a reputation as a chronic bad actor in the global industry. The bad news was that the company had to inherit all of Bombardier's poorly conceived contracts, but we generally like the setup when an already fairly consolidated, capital-intensive industry loses a prominent bad actor. There's a workout period as the old contracts turn over, but there should be a more rational and profitable competitive dynamic going forward.

While we expected the workout period here to take time, the company surprised the market and us last October in announcing negative net cash flow in excess of €1.1 billion in the first half of last year. The acquired contracts were even worse than expected and there were other negative impacts from customers delaying projects, cutting back on inventories and slowing down payment schedules. It was a full-blown crisis that ultimately required a €2-plus billion debt-reduction plan involving layoffs, selling non-core assets, eliminating the dividend and – completed earlier this month – an equity rights issue at €13 per share that we participated in. We never thought the business was broken, but the balance sheet was and we now think the repair work on it is done.

What's the case today for the stock at a recent €15.50 price?

EL: We estimate Alstom by 2026 can generate €1 billion in annual free cash flow, which against today's market value translates into a free cash flow yield in the mid-teens. That's attractive in and of itself, but as the focus shifts to the operating business and its improved prospects going

INVESTMENT SNAPSHOT

Alstom
(Paris: ALO)

Business: Manufacture and sale of locomotives, freight cars, passenger cars and related signaling and other infrastructure used in high-speed and local rail transportation.

Share Information
(@6/27/24, Exchange Rate: $1 = €0.93):

Price	**€15.51**
52-Week Range	€10.05 – €26.78
Dividend Yield	0.0%
Market Cap	€7.15 billion

Financials (TTM):

Revenue	€17.62 billion
Operating Profit Margin	2.6%
Net Profit Margin	(-1.7%)

Valuation Metrics
(@6/27/24):

	ALO	S&P 500
P/E (TTM)	n/a	24.0
Forward P/E (Est.)	9.7	22.3

Largest Institutional Owners
(@3/31/24 or latest filing):

Company	% Owned
Caisse de Depot et Placement	14.5%
Causeway Capital	7.8%
Bpifrance	6.3%
Bank of America	4.5%
BlackRock	4.2%

Short Interest (as of 6/15/24):

Shares Short/Float	n/a

ALO PRICE HISTORY

THE BOTTOM LINE

The company is coming through a crisis requiring multiple efforts to repair its balance sheet, says Ellen Lee. With that work largely done, she expects investor focus to shift toward its strong position in an attractive market and its ability, she believes, to generate annual free cash flow by 2026 that is a mid-teens percentage of the current market cap.

Sources: S&P Capital IQ, company reports, other publicly available information

forward, we would expect the shares to re-rate as well. We're the second-largest shareholder here and believe the company has gotten now to the place it needs to be for that to happen.

Describe a position you recently sold and why you sold it.

EL: One in my coverage area is Alimentation Couche Tard [Toronto: ATD], the Circle K convenience store company. This originally attracted our attention three or so years ago when we thought the risk to its convenience store/gas station business model from the ongoing adoption of electric vehicles was overly priced into the stock. We also thought the company had considerable room and the right plan to increase same-store sales growth. That was all going fine until the latest quarterly earnings, when it became clearer that improving same-stores sales had more to do with rising fuel margins in an inflationary environment than anything else. That contradicted our thesis and we decided to take a pause here and reallocate the capital elsewhere.

You should always think your strategy is right for the times, but would you make the case that's particularly true today?

SK: Value as a strategy did just fine until central banks got as aggressive as they did with monetary expansion, bringing down interest rates to close to zero in the U.S. and negative in Europe and Japan. If discount rates approach zero, longer duration stocks with higher growth rates are generally more appealing. Grounded as we are in valuation, that's been a high hurdle for value investors.

Since March of 2022 interest rates have gone up and we think they are going to stay relatively high. Governments haven't shown the discipline to cut back on spending and central banks can't shrink balance sheets very much without upsetting the financial system. To us that means inflation remains a threat and interest rates as a result are going to be higher.

An environment of greater volatility, brought about by efforts to bring inflation under control, should benefit active managers. And a greater focus on valuation now that money isn't free should favor managers with a value-oriented, long-term investment approach. Check back with me then, but I think a year from now people will be asking questions about the viability of value investing much less often. VII

Important Disclosures

To determine if a Fund is appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's full or summary prospectus, which may be obtained by calling 1-866-947-7000. Read it carefully before investing.

Risk Disclosure

Investing involves risk including loss of principal. There is no guarantee that the Causeway Funds will meet their stated objectives. In additional to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Investments in smaller companies involve additional risks and typically exhibit higher volatility.

This communication expresses the portfolio managers' views as of the date it was created and should not be relied on as research or investment advice regarding any stock or sector. These views and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass.

Causeway Funds are distributed by SEI Investments Distribution Co, (SIDCO), 1 Freedom Valley Drive, Oaks, PA 19456, which is not affiliated with Causeway Capital Management LLC.