I Still Think There's Potential for a Second Step at ABB

David Samra, lead portfolio manager of the Artisan International Value Fund, explains why he believes the Swiss industrial conglomerate could benefit from further reorganization. He also comments on his positions in Holcim, UBS and Richemont – and explains why he is calling for a complete turnover of the Board of Directors at Novartis.

The Market | Christoph Gisiger

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English Version

Few people understand the international equity markets on a fundamental basis as deeply as David Samra. He heads the Artisan International Value Fund, which manages more than $33 billion in client assets. His investments include significant positions in Swiss blue-chip companies.

In an in-dept conversation with The Market NZZ, the expert in finding undervalued companies talks about his investments in Switzerland, on which he likes to comment in public. ABB is one of his fund's core positions. He is impressed by the operational improvements of the industrial conglomerate, but still thinks that a further reorganization could create value for shareholders.

Mr. Samra also shares his view on other positions like Holcim, Richemont and UBS. Furthermore, he explains why he avoids Roche and instead favors Novartis where he calls for a total turnover of the Board of Directors, starting with the chairman.

Stocks have lost some of their luster in recent weeks. How do you experience the current market environment as a value investor?

David Samra: Over a shorter time-horizon, market noise can dominate signals and influence perception. But over a longer time horizon, the quality of good businesses with competitive advantages, strong management teams and healthy balance sheets will likely shine through. That's why value investing often requires patience and taking a long-term perspective. Our time horizon is measured in years, typically over three to five years.

Your international value fund holds several Swiss blue-chip companies. What's your investment approach for opening a position?

DS: As a diversified industrial manufacturer, ABB was – and obviously still is – a conglomerate with many different business lines. If you went through these business lines and compared them to competitors, their

profitability was much lower. The previous management would make a lot of excuses, but they were never really able to execute. Therefore, I have to give ABB chairman Peter Voser a lot of credit. After taking charge, he recognized the shortcomings and successfully implemented a new operational philosophy to drive profitability.

What makes this philosophy stand out?

DS: In this context, it's also important to point out that a lot of influence came from the Swedish contingent with the Wallenberg family as a large shareholder. They have restructured a number of companies, using a certain management philosophy where responsibility is devolved down into the individual divisions. This approach empowers divisional leaders and directly ties their compensation to the operating performance of their units – and that happens down to all levels of the organization, from the divisions we see in the earnings release to the individual operating units. The results are fantastic: ABB's operating margins went from 11-12% up to 16-17%. Notably, this impressive increase in profitability coincided with improvements in both market share and the underlying businesses' growth rates.

ABB's progress is reflected in the impressive performance of the share price. How do you feel about the departure of CEO Björn Rosengren, who's stepping back from his position at the end of July?

DS: We will miss him, but ABB remains in good hands. Mr. Voser's continued tenure as chairman ensures strong corporate governance. Morten Wierod, who takes office as CEO in early August, brings a proven track record. Having joined ABB in 1998 and serving on the executive committee since 2019, he possesses an in-depth understanding of the company where he led the electrification business and before that the motion business area.

After you started your position in ABB in late 2014, you called for a fundamental reorganization. Since then, the group has divested three major units and plans to spin-off the e-mobility division as well. In your view, what are the next strategic steps?

DS: The e-mobility business is small, so I don't spend a lot of time worrying about it. But I still think there's potential for a second step. There's enough scale inside ABB, and several businesses could stand on their own. But to be clear: Given how well things have gone, I'm not pushing the company to do something they're not interested in doing.

What could such a second step look like?

DS: Electrification is a prime example. It possesses the capability to thrive as a standalone business. There are other ways to unlock value as well. One way would be to create two separate parts of ABB: one part that's focused on factory automation, potentially combined with electrification. The other part could then focus just on component manufacturing. But again: Things are running really well right now. ABB developed a great culture which has changed the dynamic of this company, and it's still happening. It's not done. So let's just let this run for a while and see where we go; maybe we even get to 20% operating margins.

Novartis, another core position in the Artisan International Value Fund, has also undergone a thorough reorganization in recent years. Where does the company stand today?

DS: We've been involved with Novartis for around fifteen years now. A lot happened during that time: They sold the animal health business, the vaccine business, and the OTC pharmaceuticals business. Furthermore, they spun off Alcon, and recently they've spun off their generics business Sandoz. So we've been there through the whole thing, and today the business is running quite well.

What's the upside looking ahead?

DS: Vasant Narasimhan is an incredibly talented CEO. However, Novartis' historical conglomerate structure has limited its operating profitability compared to its peers. So looking ahead, not only should we get good 3-5% top line growth over the next few years, but also achieve significant margin expansion. Operating margins should climb from the high 30s to the low 40s – and I just think that's not yet priced in. To sum it up: Novartis boasts exceptional leadership, improving profitability with growth potential, and a very strong balance sheet. Historically, such a combination has been a powerful driver of returns.

An important aspect of investing in pharma stocks are payouts to shareholders via dividends and stock buybacks. What do you expect from Novartis in this respect?

DS: We like Novartis' capital allocation policy. After they sold their stake in Roche, we spent a fair amount of time discussing with the company how that capital might be used. I think they made a very good decision – especially at the valuation at the time – to buy a significant amount of their own stock and use mainly free cash flow and a little bit of that capital for bolt-on acquisitions. To me, that's a very sensible way to run the company.

Against the backdrop, do you see any further need for major changes?

DS: I definitely think there needs to be a total turnover on the board of directors, starting with the chairman. The current board has not been focused on the right things in the interests of the minority shareholders. It's effectively been the CEOs of the company that have pushed Novartis' strategy in the right direction.

Investors who are vocally critical of a company's strategy are often perceived as agitators. What do you think of such allegations?

DS: In my view, there's some underappreciated power in having a reliable long-term shareholder on your register. Somebody you know and you can have an honest, true dialogue with; not about what you're going to earn the next quarter, but a long-term dialogue on where the business is going. I think that's valuable and it may prompt people to think about the business in a different way.

Why aren't you invested in Roche? The shares are trading at a significant discount compared to peers.

DS: It comes down to corporate governance. Roche is a public company, yet they have super voting rights for the founder's family. This is bad corporate governance which makes it very difficult for somebody who's allocating large amounts of capital. Such structures are archaic, and it's time for them to go. It should be one share one vote, and Roche should be subject to the type of normal capital markets pressure like other companies such as Novartis, which is performing. But I'm not trying to pick on Roche specifically, because there's a whole bunch of Swiss companies that still have multiple share classes and super-voting shares. Schindler is another example.

Another position in your portfolio is Holcim. Why are you betting on the Swiss building-materials giant?

DS: Due to another one of our holdings, we were sort of casual observers of the company for many years. Neither Holcim nor Lafarge was run well. Holcim was managed better, but that wasn't saying much. But in 2017, somebody had the great idea of recruiting Jan Jenisch as CEO. Around that time, the company also appointed Géraldine Picaud as CFO, who is an outstanding executive and now the CEO at SGS. So we bought the stock immediately. Not only was this a massive upgrade to management, but the valuation was highly attractive too.

Meaning a clear case of an undervalued company?

DS: Yes, that's the essence of value investing: acquiring a fundamentally strong business with new, capable leadership at a discounted valuation due to a temporary decline in margins or some sort of calamity. That was the situation with Holcim at the time. The new management caused a revolution; similar to what happened at ABB, although not exactly the same. Holcim underwent a radical restructuring, virtually eliminating its corporate headquarters. They run the company in a very decentralized, but controlled way.

What are the prospects for the company today?

DS: Holcim was over-diversified geographically. If you look at the company today, they've largely solved that problem. Furthermore, they've done a succession of very good deals, which is hard to replicate. Today, Holcim still has some emerging markets assets that are probably going to be sold. The largest is China, and they may also sell their assets in the Philippines. The problem is, you can't get a bid on a Chinese asset right now. But I think that those assets will largely be sold at some point.

Now, Holcim wants to spin off its business in North America and float it on the US stock market in 2025. Is this the right strategy?

DS: The way the leadership is deciding to reorganize the business is a little bit of a surprise. But I understand why they're doing it. The US is still carbon sensitive, but it's growing and less carbon sensitive than Europe. In Europe, volumes have been going backwards dramatically for the last few years. It's been made-up for by price, and price will continue to go up because of carbon costs. So you definitely have a different dynamic here: There is a growth part of the business, which is the US, and then there is a value part, so to speak, which is going to be the non-US assets.

Which of these two parts is more attractive?

DS: We can make decisions on what we're going to do with the two pieces once we see what the valuations are and what the management structure is. If you look at the management structure, Mr. Jenisch has some fantastic people that he's put in over the last few years. So we're not worried about what the leadership will look like once this separation happens.

You mentioned the difficult situation in China earlier. How do the persistent slump in the Chinese economy and growing geopolitical concerns affect the valuation of a luxury goods group like Richemont?

DS: Economies go up and down, and China's situation is no exception. Obviously, there's the geopolitical risk with China that doesn't exist in some of Richemont's other large markets. In general, the geopolitical aspect of the Chinese question is one that is extremely broad in terms of its implications. But honestly, I have way bigger problems than Richemont if we have a geopolitical issue in China.

Why?

DS: Richemont has a strong balance sheet with a net cash position. They own all their brands, and they control their retail channels. If, for some reason, they had to pull out of China, that would be very painful and their profits would certainly go down. But the company would survive and prosper everywhere else.

To conclude, let's talk about UBS. What factors led you to invest in the shares of the Swiss bank?

DS: We started getting involved a few years after the global financial crisis. At that time, bankers weren't held in very high esteem and the regulatory structure started to tighten up dramatically. In this environment, we were able to buy UBS below book value. It some time, but book value kept on building, and eventually the share price did very well. Going into 2023, UBS was trading at a premium, so we had sold most of our stock. But then, with the collapse of Credit Suisse, UBS was able to buy $30 billion worth of assets for around $3 billion. Of course, there's restructuring charges and some write-downs, so call it $20-25 billion worth of assets. But the value that was created on that transaction was enormous, so we rebuilt our position size almost immediately.

Since then, the share price went up by around 60%. How much room for upside is left?

DS: I want to see them finish the integration, dispose of the excess assets, generate capital, and return that capital to the shareholders. Those are the basics, but essentially it comes down to asset retention and asset growth in the wealth management business. Moreover, UBS still has an issue in the United States they have to resolve. I don't really see a clear path, and I don't think that they see a clear path on how to solve this issue.

And where do you see the most potential for growth?

DS: Outside of the United States, given their market position, their strong balance sheet, and now less competition, UBS should be able to grow their underlying assets. They should achieve a significantly higher profit margins post the Credit Suisse transaction compared to pre-transaction. In other words, following the merger, the profitability of the non-US business should be meaningfully higher than before the takeover because of the larger scale of the combined business.

Investment Results as of 3/31/24 (%) Artisan International Value Fund	QTD	1 year	5 year	10 year	Inception	Expense Ratios (Gross/Net) Prospectus 30 Sep 2023[1]
Investor Class (ARTKX)	4.38	16.28	11.19	7.22	11.65	1.26%
Advisor Class (APDKX)	4.44	16.44	11.35	7.36	11.72	1.12%
MSCI EAFE Index	5.78	15.32	7.33	4.80	7.40	
MSCI All Country World ex USA Index	4.69	13.26	5.97	4.25	7.52	

Source: Artisan Partners/MSCI. Class inception: Investor (23 September 2002); Advisor (1 April 2015). For the period prior to inception, Advisor Class performance is the Investor Class's return for that period ("Linked Performance"). Linked Performance has not been restated to reflect expenses of the Advisor Class and the share class's returns during that period would be different if such expenses were reflected.[1] Net expenses reflect a contractual expense limitation agreement in effect through 31 Jan 2025. See prospectus for further details. Includes estimated expenses for the current fiscal year.

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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.

David Samra is the lead portfolio manager for Artisan International Value Fund. This article represents the views of Christoph Gisiger of The Market and David Samra as of 19 April 2024 and those views and opinions presented are their own. Artisan Partners is not affiliated with The Market. The views and opinions expressed are based on current market conditions, which will fluctuate, and those views are subject to change without notice. While the information contained herein is believed to be reliable, there is no guarantee to the accuracy or completeness of any statement in the discussion.

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Clarification: The Artisan International Value Fund held 27 million shares of UBS as of 31 December 2022.

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