Artisan International Explorer Strategy

QUARTERLY
Commentary

As of 31 December 2024

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 2024	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception[1]
Composite — Gross	**-3.18**	**7.32**	**7.32**	**4.47**	—	—	**13.58**
Composite — Net	**-3.94**	**5.89**	**5.89**	**2.66**	—	—	**11.55**
MSCI All Country World ex USA Small Cap Index	-7.66	3.36	3.36	-1.46	—	—	6.80

Calendar Year Returns (% USD)

	2020	2021	2022	2023	2024
Composite — Net	—	**18.38**	**-15.08**	**20.33**	**5.89**

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.

Euphoria, Naming Games and Playing Ostrich

With the S&P 500® Index around 6,000, its Shiller adjusted P/E sits north of 37, a level only reached during the dot.com bubble (ignoring the COVID-impacted blip), even higher than the peak in the roaring twenties. Just this data point may lead some to conclude that the current macro environment is great or about to become great.

However, both prior periods (1929 and 1999) are not good company as an indication of subsequent equity market performance. Granted, index composition is different this time around, but it is never a strict apples-to-apples comparison. We now have more tech platforms and virtual monopolies skewing the index composition and performance, while in the past, the index was more broad-based. The press is touting another stellar year of performance of the S&P 500® Index in 2024; however, the big gap in performance between the market cap-weighted (24.8%) and equal-weighted (12.9%) indices comprising the same 500 companies highlights selective euphoria.

The underlying market conditions are not that rosy. The Institute for Supply Management's manufacturing PMI, a benchmark for industrial activity, still indicates that conditions for industrial companies are in contractionary territory. Germany and Italy are facing the risk of another recession as their manufacturing sectors contract significantly. France's and the UK's budget deficits continue to inch up, the pain of inflation in Japan is now palpable, and China's economy and consumer sentiment are dour enough for the government to offer a loan program to support equity purchases. The fact that oil prices remained subdued despite the events in the Middle East makes us wonder if it is a sign of weak global demand. But if we avoid looking at the full dataset, including through-the-cycle numbers, maybe it gets better. We have yet to learn this ostrich-like trick adopted by some fintechs and market participants.

Consumer financing is old, but buy now, pay later (BNPL) is new and fashionable. BNPL applications allow cash-strapped consumers to defer payments on purchases. These apps proliferated when there was over $15 trillion of negative interest rate debt, and lenders' cost of capital was ultralow. Today, the merchandise volume on these platforms exceeds $300 billion. It should not be a big surprise that BNPL is popular with young, lower income adults, a cohort traditionally considered higher credit risk. According to the US data, BNPL users seem to have a much higher delinquency rate across products. Despite this fact, the self-reported credit losses by some BNPLs are almost as low as higher quality, asset-backed lending to borrowers with prime credit scores.

We have also recently noticed a new naming trend gaining traction in the industry. Much like the artificial intelligence (AI) craze, where simply labeling something as AI is enough to draw in the masses, the term "private" now seems to have a similar effect. Public equities outside of big US technology names are not interesting at all, even with single-digit dividend yields and double-digit earnings yields. However, private equity (PE), even if focused on staid, old industrial companies and charging hefty fees, is the place to be. Never mind that the PE industry's cost of capital has gone up as interest rates normalized post-COVID. Public debt is blah, but private debt is the hot new thing. While that is not a space we dabble in, its growth has broader implications for the markets and the world.

The private credit market is currently estimated to be $2 trillion to $3 trillion, and McKinsey estimates the addressable market for private credit could be more than $30 trillion in the US alone, more than tenfold growth from such a large absolute base!

We understand that regulatory oversight swings like a slow pendulum over time. After the financial crisis, regulators globally clamped down on capital requirements for banks, reducing the returns for banks in a belated attempt to make the system less fragile. As some lending gradually moved to private markets that were not burdened with the same capital requirements, the regulatory capital arbitrage automatically improved returns. This capital flight has the potential to boost the money supply through the money multiplier effect, as the private credit market has no reserve requirement. We have seen at least a part of this movie before in the late 2000s, and these trends make the world inherently more fragile.

Our concerns may not matter if the credit cycle is dead and credit costs stay subdued. After all, didn't we slay inflation in the decade before COVID-19 and again last year? Why can't we add business and credit cycles to that list? But, at a time when US household debt excluding mortgages inched to an all-time high of nearly $5 trillion, aggregate delinquency rates inched up in many categories, and seriously delinquent loan balances increased 50% YOY in 2024.

"Extend and pretend" only works for a while. A report released by the Federal Reserve Bank of New York last quarter found that banks extended and pretended their impaired commercial real estate mortgages, leading to credit misallocation and a buildup of financial fragility. In parallel, according to the Financial Times, defaults in the global leveraged loan market—the bulk of which is in the US—recently picked up to 7.2%. Calling something fintech or private and playing ostrich may attract more capital, but it is unlikely to defy the basic economics of the business and underlying cycles in the long run.

We are dating ourselves here a bit, but we also remember a time when the myth of "Internet traffic doubling every 100 days" was widespread and used to justify everything from lofty company valuations to billions of dollars in capex spent for underwater cables as the markets bought into the "you can never have enough bandwidth" narrative. However, Schumpeter's creative destruction process continued, and technological advances could multiply bandwidth faster than the rate at which demand could increase. After the dot-com crash, by some estimates, only 2.7% of the installed fiber capacity was being used. Even today, we continue to enjoy the benefits of some of that dark fiber. But valuations matter, and sky-high valuations eventually matter even more. When something is priced for more than 1,000% annual growth, even 100% growth looks underwhelming and destroys a lot of value. We are reminded of these instances when we look at the current expectations for AI and think about the potential glut of graphical processing units (GPUs). Similar to the dark fiber situation 25 years ago, in the long run, society will benefit from a glut of GPUs, yet in the meantime, many investors might lose their shirts.

Lastly, we are acutely aware of the headlines on policies that may be implemented by the new US administration later this month. At the same time, there is a lot of noise and confusion about the policies and their implications for the US and the rest of the world. We plan to discuss the implications in future letters once we can look past the rhetoric and have more clarity on the actions.

Our clients may wonder how we can eke out any returns in these market conditions and how we think about equity selection and the underwriting process in this environment.

First, equity performance is not uniform across the world; the US equity market's performance has not carried over to other countries. Some emerging parts of the world are trading at valuation discounts last seen in the 1970s. Valuation discounts are one of the many reasons companies are getting pushed to move their listings to the US. We also view such actions with great skepticism, and we will likely cover the topic in another letter. For now, note that the US performance is not reflected in the rest of the world.

Second, we are benchmark-agnostic, bottom-up investors who are macro-aware. We are not aiming to give "exposure" to our clients and our capital. We stay away from companies with business models that do not make sense to us or whose valuations appear unattractive across a range of potential scenarios. And we constantly try to gain insights from our travel and research to update our worldview. While we see no dearth of stocks at optically cheap multiples, we focus on finding durable and anti-fragile business franchises.

For all the risks we have highlighted already, we remain disciplined in our underwriting process and the prices we are willing to pay as we assess more scenarios in analyzing each company. Price matters, as not every company can grow to become a virtual monopoly. We also continue to have an active absolute return bias and emphasize capital preservation.

All of this is a long-winded way of saying—we see what is going on, but we are happy to stick to our knitting and our process, to protect and compound our capital, even if that means relative underperformance in some periods.

What We Bought and Sold in the Quarter

We initiated two new positions in the quarter.

We bought U-Blox, a fabless semiconductor chip business in Switzerland whose core business is designing satellite positioning chips. It has around 30% of the global market share as a leading player, with particularly attractive shares in the auto and industrials end markets. Think of autonomous driving cars, lawnmowers, factory robots or drones. They all need satellite positioning chips to determine their precise positioning relative to the environment. We believe this is an attractive segment of the overall semiconductor chip market, where leading players should grow by double digits over time and have double-digit margins. However, U-Blox's margin has eroded substantially over the past 8–10 years to single digits as it invested hundreds of millions of R&D dollars into cellular connectivity, an adjacent or what we consider non-core area, which masked the true double-digit profitability of its core positioning chip business. Because of this poor capital allocation decision, we passed on this idea more than three years ago but continued to follow the name.

The company changed its CEO in early 2023. The new CEO announced plans to stop development in non-core areas and to focus on its core business. In addition, a Europe-based semi-activist investor, whose interests we believe are aligned with ours, became its top shareholder with a board representative in the past year. In the meantime, the business suffered and posted losses in 2024 as there was a big channel inventory correction on top of weak demand from the auto end market. Its balance sheet remains liquid with a solid net cash position. After staying on the sideline for close to four years, judging that all the pieces we were looking for are now in place, we pulled the trigger this past quarter. We believe we're paying little more than 10X normal net earnings for its core positioning chip business.

We also bought Sabre, an auto insurance company in the UK. It's a small, niche player in the country with only a 1%–2% market share. What's remarkable about this company, however, is that it has arguably the country's most profitable auto insurance business by a wide margin. Its combined ratio, a key operating metric for the industry (think of it as one minus operating margin), was in the mid-70s over many cycles while the entire industry was barely making any money. This is because Sabre has very conservative pricing policies. Specifically, it carefully picks its spots by targeting niche customer segments with specific risk profiles, such as sports car drivers within a particular age range, that industry peers tend to ignore.

Usually, our complaint about property and casualty insurance businesses is how they chase market share in a more competitive market with relaxed underwriting standards at the expense of profit. Remarkably, Sabre has not suffered from this. We believe it had the opposite problem—a lack of growth historically while being conservative to a fault. This seems to be changing as management just announced a plan to reach a compound annual growth rate (CAGR) for profit of 10% over the medium term. It plans to leverage data and technology to price policies at a more granular level than is currently done by the market, identify more mispriced risk pools in other larger cohorts and expand its addressable market without compromising on its underwriting discipline or returns on risk capital. It might seem as easy as turning on a switch, but we were told that the company has been working behind the scenes on its back-end technology/software side for a couple of years to lay the groundwork for this newly unveiled growth strategy.

Given Sabre's excess capital position, it's been paying out all of its net income in regular and special dividends. Its current total yield is close to 10%. We view this investment as offensive and defensive—if its growth materializes as planned, it should get re-rated with a higher multiple from what is currently less than 10X net earnings; if not, we won't be too disappointed collecting a 10% annual dividend along the way.

Top Contributors and Detractors

We outperformed our benchmark by ~400bps this quarter and by ~250bps for the full year.

Our top two contributors in Q4 were Despegar.com and Care Ratings.

Despegar.com is one of the largest online travel agencies in Latin America. Think of it as the Expedia of the continent. It's a big position we've owned since inception. It reported good earnings in USD in the quarter despite local currency depreciation. Its share price reacted positively.

Bigger news came toward the end of the year when its board approved an all-cash takeover bid of $19.50 per share from Prosus, a South Africa-based investment holding company that has a big food delivery operation in Brazil. We had already trimmed the position substantially in the quarter before the bid surfaced, but at a price that was not much below the bid price. We believe the bid price from Prosus more or less fairly values the business. We're always happy to see validation of value in a company we own from an independent third party. We expect to sell our shares when the deal closes unless a higher bid surfaces down the road. Despegar was the biggest contributor not only for the quarter but for the full year as well.

Care Ratings is the second-largest credit rating agency in India. It is equivalent to S&P and Moody's in the US. Credit rating agencies play a critical role in the proper functioning of a credit market—they judge the creditworthiness of credit securities, such as bonds or bank loans. They effectively give stamps of approval to credit issuers, like banks or corporates. Institutional investors have little appetite to purchase an unrated credit instrument. The Indian market is dominated by three players—CRISIL (controlled by S&P), ICRA (controlled by Moody's) and Care. We consider it a great business because it has a huge barrier to entry with a high return on capital.

Care reported good earnings in the quarter, contributing to its positive share price performance. Although still too early to be certain, some of the initiatives the current CEO, Mehul, put in place after assuming the role in 2022 seem to have started bearing fruit, especially in regard to turning around its advisory and analytics businesses. Borrowing a page from S&P's successful advisory business strategy, Mehul and his team leveraged the CARE brand to offer complimentary value-added services to its existing client base. Care also made a bold foray into the sovereign ratings space, hitherto served only by international ratings companies, all the while keeping a laser focus on costs. All these efforts enhanced company profitability without requiring much capital, thereby boosting an already envious return on capital. We've trimmed the position substantially in the quarter as its valuation discount has narrowed significantly.

Our bottom two detractors in Q4 were M&C Saatchi and Alten.

M&C Saatchi is a UK-based advertising agency. This should be a familiar name to those who regularly read this quarterly commentary, given it's one of our top positions. To quickly recap, the new chairwoman, who arrived in the summer of 2023, immediately embarked on a major cost and personnel restructuring exercise, which we believed was overdue. She also effectively brought in a new CEO in May 2024. Since then, its cost base has been right-sized, and its profitability has been greatly restored; it reported encouraging 1H24 numbers in September. No fundamental news hit the wire during Q4, as far as we can tell. Its share price fell by a low-double-digit percentage in USD terms this quarter, with a share price drop in GBP terms and GBP depreciation against the USD, each accounting for roughly half of the overall decline. It became our top detractor due to its high-single-digit position sizing.

Alten, headquartered in France, is one of the world's biggest outsourced R&D engineering services providers. For example, if Volkswagen were to approach Alten for development help on a next-generation electric vehicle (EV) platform, it would assign a team of engineers to work closely with the auto company. We've owned this name since inception. It also showed up as one of the worst detractors back in Q2 2024 and was, in fact, the worst detractor for the full year.

After running at a double-digit CAGR for three straight years after COVID-19, revenue started to decelerate toward late 2023. At the beginning of 2024, management had expected continuing, albeit more moderate, growth for the full year in its auto and aerospace segments, which account for almost 20% and 15% of revenue, respectively. But growth didn't pan out as the year progressed. Airbus continues to be plagued by post-COVID supply chain woes, and German automakers are in dire straits in the face of fierce competition from the rapidly rising Chinese EV makers. As a result of weakness primarily from these two end markets, it had to lower its full-year organic revenue growth target more than once through the year.

We believe the headwinds it faces are temporary, and its business model has no structural weaknesses. Most importantly, the company is run by an owner-operator whom we highly respect and who's still the largest shareholder with a close to 15% stake. Its valuation has come down to 12X what we believe is trough net earnings expected in 2025 with a net cash balance sheet. We used the share price weakness to add to our position.

For more information: Visit www.artisanpartners.com

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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 2024: M&C Saatchi PLC 8.3%, Alten SA 4.9%, Despegar.com Corp 4.0%, u-blox Holding AG 1.9%, Sabre Insurance Group PLC 1.4%, Care Ratings Ltd 1.2%. 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. S&P 500® Index measures the performance of 500 US companies focused on the large-cap sector of the market. S&P 500® Equal Weighted Index gives each constituent the same weight in the index, versus the market weighted index where bigger companies hold a larger share of the index. S&P 500® Market Cap Weighted Index measures the performance of 500 US large-cap companies, weighted by their market capitalization. The index(es) are unmanaged; include net reinvested dividends; do not reflect fees or expenses; and are not available for direct investment.

This summary represents the views of the portfolio manager as of 31 Dec 2024. Those views and portfolio holdings are subject to change and Artisan Partners disclaims any obligation to advise investors of such changes. The discussion of portfolio holdings does not constitute a recommendation of any individual security.

Free Cash Flow is a measure of financial performance calculated as operating cash flow minus capital expenditures. **Shiller Adjusted Price-to-Earnings (P/E)** is a valuation ratio that compares a company's current share price to its inflation-adjusted earnings over the past 10 year, smoothing out short-term fluctuations. **Price-to-Earnings (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings. **Dividend Yield** is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. **Earnings Yield** (which is the inverse of the P/E ratio) is the company's per-share earnings divided by its current share price. **Normalized Net Earnings** are earnings that are adjusted for the cyclical ups and downs over a business cycle, net of all expenses. **Operating Margin** is a measure of profitability equal to operating income divided by revenue. **Risk-adjusted Return on Capital (RAROC)** measures the profitability of an investment while taking into account the associated risk. **Current Yield** is the annual income (interest or dividends) divided by the current price of a security. **Return on Capital (ROC)** is a measure of how effectively a company uses the money (borrowed or owned) invested in its operations. **Compound Annual Growth Rate (CAGR)** is the year-over-year average growth rate of an investment over a period of time. It is calculated by taking the nth root of the total percentage growth rate, where n is the number of years in the period being considered.

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