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## WCM INVESTMENT MANAGEMENT

Interview

### **ANDREW WIECHERT** **Portfolio Manager & Business Analyst**

Andrew's primary responsibilities are portfolio management and equity research for WCM's global value strategies. Prior to joining WCM in 2007, Andrew began his investment career in 2006 at BNY Mellon Wealth Management. Andrew earned his B.S. in Economics and Management Science from the University of California, San Diego, where he graduated with honors.

### **DREW FRENCH** **Portfolio Manager & Business Analyst**

Drew's primary responsibilities are portfolio management and equity research for WCM's global value strategies. Drew's investment career began when he joined WCM Investment Management in 2013, first as Portfolio Associate, and later as Marketing & Communications Manager. Drew earned his B.A. in Communication from the University of California, San Diego.

### ***Could you give our readers a bit of background on WCM?***

**Drew:** Absolutely, Rupert. WCM is a 76-person investment management firm based in Laguna Beach, CA. We manage ~\$107 billion in assets (as of 31 December 2021), predominantly focusing on institutional client relationships. Our primary goal is to generate long-term, sustainable excess returns for clients through a culture of innovation, close alignment of employee incentives with client objectives, and a flat power structure that fosters meritocracy and critical debate. To this end, we strive to mitigate risk for our clients, focusing our attention on downside protection, low volatility, and low turnover.

The firm was founded in 1976, but we didn't adopt our institutional focus until the current management team bought out the original founder in the late nineties. The single most important lesson we learned during our transformation from a \$200 million RIA to \$100 billion institutional asset management firm is how critical a role corporate culture plays in the success of an organization. We have been incredibly intentional about building a culture focused on our core values of having fun, showing gratitude, and serving others. We believe it's people that ultimately drive results, so we want to foster a culture that empowers our people and encourages them to think different and get better. We have also



been committed to passing down equity to the next generation of investors and leaders at the firm. Today, over 50% of our employees have an equity stake in the firm, and we have 11 principal owners with an equity stake of 1% or more.

Our Global Growth Equity Team is responsible for the majority of our assets under management, managing strategies across international, global, and emerging markets. My co-PM, Andrew Wiechert, and I are responsible for WCM's Global Value Equity enterprise, along with Sachin Kashyap, a business analyst dedicated to our team.

### **Why do you believe your approach differs from that of other value-focused funds?**

**Andrew:** You know, Rupert, I'm confident that there isn't another value manager approaching markets the same way we are here at WCM. Back when we launched Focused International Value in 2011, we approached the market with the belief that international indices are structurally inefficient, and that we could exploit these inefficiencies from several angles.

First, we believe our portfolio possesses a significant structural advantage. If you look at the benchmarks outside the US—and this is especially true in emerging markets—they're filled with basic commodities, poorly run banks, and utilities. It's our firm's view that as emerging-economy consumers gain higher disposable incomes, they will do what developed-economy consumers have done for decades: expand their use of technology, seek out higher quality, branded consumer goods, and demand more comprehensive healthcare. Fortuitously, our bottom-up process for identifying great investments naturally leads us to emphasize discounted, high-quality businesses in these same sectors (e.g., consumer, technology, health care, and niche

industrials). In other words, our process drives toward the sectors and industries benefitting from where the world is headed. This means our portfolio not only looks materially different than the benchmark, but that it also stands to meaningfully benefit from the global, emerging middle class. This positions our portfolio in front of a multi-decade tailwind, where the sources of real value creation will come from the sectors we emphasize. This is in stark contrast to many traditional value funds, who tend to bargain hunt in more cyclical sectors or industries that tend to be facing long-term headwinds. To be clear, we don't believe value investing needs to be—or should be—a sector bet on these typically lower-quality subsections of the market.

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**Second, and more importantly, we believe our process has a significant stock-selection advantage. This derives from our framework for identifying successful businesses that we can purchase at discounted-entry points. While we know valuation is critical to identifying investments with the best risk/reward profiles, we are also convinced that quality wins over time.**



identifying investments with the best risk/reward profiles, we are also convinced that quality wins over time. And while our front-end valuation discipline certainly produces an attractive opportunity set, we believe our focus on identifying businesses with strengthening competitive advantages (“economic moats”) and superior corporate cultures is what truly propels the probability of outperforming over the long-term. Moreover, we believe pairing our valuation discipline with our long-term time horizon and our emphasis on quality ends up highlighting unique businesses that are easily overlooked by other investors. We believe there is a false dichotomy between value and growth investing that has been growing over the past several decades. As both camps become more entrenched in their way of investing, we believe our process allows us to exploit the growing opportunity set in between.

Third, and perhaps most importantly, we believe we have a temperament advantage. This derives from our efforts to build a culture at WCM that fosters humility, absence of fear, audacious / different thinking, and continuous learning. As we’ve done that, we’ve come to believe that a culture which attracts and keeps the best people is not only important to the success of our firm, but that it is important to the success of any organization, and, in particular, to the businesses we want to own. Ultimately, it is great people that keep a business squarely in front of the important “tailwinds”, and it is great people that nurture the competitive advantage to grow year after year. We think that building these concepts into our own culture and into our process is why our small team has exhibited the judgment and temperament necessary for long-term success.

***You say you start the idea generation process with a “series of quantitative***

***screens.” Could you offer our readers some idea of the sort of metrics you’re screening for in this initial step?***

**Andrew:** There might be some doubts about this after the last 10 years or so, but we believe valuation is absolutely critical to the risk/reward profile of any investment, and we believe that price is going to be a much more important factor for returns in the next 10 years than it has been in the past decade or so. This belief is why we’ve always put valuation at the front-end of our process, as it ensures that we’re fishing in the right pond—e.g., the top three deciles of the most undervalued stocks in the non-US universe. That said, we don’t think there is anything magical about our screening process. By design, they are incredibly simple and focus only on the factors we think best represent value across all sectors and industries.

Our initial criterion consists of simply eliminating companies with a market cap less than \$2 billion. This initial step alone reduces the entire non-U.S. universe to about 2,000 names.

Our secondary set of criteria consists of a simple six-factor screen that ranks the remaining international universe based on:

- Valuation (P/E, P/B, P/CF, Dividend Yield);
- Financial strength (Price/Net Assets); and
- Relative strength (EPS estimate revisions).

This screen limits our universe to ~600 names for consideration. Our next step, we would argue, adds the most value to the “narrowing” process, and to our subsequent returns. This step includes seeking businesses with:

- Favorable and long-term economic tailwinds;
- High or rising return on invested capital (“ROIC”). This suggests the presence of an



economic moat;

- Low or no debt. We don't have a precise standard on this but generally speaking, we use a net debt/EBITDA threshold of about 2.5x;
- High or rising operating margins;
- History of consistent and sustainable earnings, revenues, and free cash flows; and
- Relative price strength.

This set of hurdles narrows the universe to a very manageable list of ~200 names. From this narrowed universe, we are actively following ~100 names for consideration.

From this list, we construct a portfolio of 40-50 high-quality businesses that we believe are attractively valued, are supported by long-term tailwinds, are growing their competitive advantages, and are aligned with superior corporate cultures.

Lastly, the final portfolio is diversified not just across sector, industry, country, currency, and revenue, but also across our own distinct sub-categorizations—our traditional, transitional, and opportunistic value profiles. While growing economic moats and superior corporate cultures are barriers to entry for all three of these profiles, the criteria we seek beyond these factors will depend on the value profile we assign to the company. For traditional value, we primarily seek strong operators with more predictable earnings and free cash flows. For transitional value, we are primarily looking for signs of inflection points in the business (e.g., a narrative shift, product mix shift, or cultural turnaround). Ultimately, we believe these names have the potential to transition from value names to growth names during our holding period. Lastly, for opportunistic value, we are seeking high-quality businesses that experience

a short-term period of what we believe to be unjustified multiple compression, thereby giving us and our investors a deeply discounted entry point.

***Companies that pass the first screen are subjected to your “fundamental analysis.” You place particular emphasis on long-term tailwinds and competitive advantages. How do you assess if a company’s competitive advantages are sustainable?***

**Drew:** We would actually take this one step further, Rupert, and suggest that a sustainable competitive advantage isn't enough for us. We are actually looking for companies where we can make the case that the competitive advantage is growing relative to its peers, and importantly, that the corporate culture in place is aligned with the business strategy and will allow the company to continue growing its moat over the next 5-10 years.

The distinction between a growing moat and a sustainable moat is crucial. After all, competitive advantages aren't static, and every company is either getting stronger or weaker relative to its peers. We believe that understanding the direction—or trajectory—of the competitive advantage is critical to understanding business quality, avoiding value traps, and ultimately aiding downside protection.

When you think about the typical value investing playbook, investors are guided to:

- Find a wide moat business that's optically cheap based on price metrics, then apply rigorous discrete modeling—e.g., discounted cash flow (“DCF”), sum of the parts (“SOTP”), dividend discount—to uncover the business's intrinsic value.
- Apply a margin of safety to this intrinsic value to minimize downside risk.



- If the business is trading at enough of a discount to its intrinsic value, it's a buy.
- Set your price target to the intrinsic value and sell once this target is reached, or go back and adjust your model to justify continued ownership.
- Rinse and repeat.

Effectively, this approach encourages investors to seek companies trading at 60 cents on the dollar, then sell them at a profit when their stock prices reach their intrinsic values. This price-centric approach operates independently of time-horizon, and forces investors to sell their winners. And as you're selling your winners, how many of your 60-cent dollars are actually on their way to becoming 40 or 30-cent dollars? This dynamic inevitably forces investors into "value traps", which we believe can be avoided through by taking a long-term approach, along with an understanding the trajectory of a company's competitive advantage.

There are several ways to assess moat trajectory, but often the best indicator of a strengthening competitive advantage is finding a company positioned to grow its ROIC over

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the next 5-10 years. In fact, if you look at any broad international index (e.g., MSCI ACWI ex US) on a rolling 5-year basis across every time period since its inception, there is a one-to-one correlation between the delta in ROIC and stock performance, where the companies with the strongest positive ROIC deltas dramatically outperform the broader market, while the companies with the weakest (or negative) ROIC deltas substantially underperform.

And if our fundamental analysis suggests that a company is enhancing its various moat sources (i.e., switching costs, intangible assets, network effect, cost advantage, efficient scale), we believe this will often show up as growth in its ROIC over time.

Once we've uncovered a business with a strengthening economic moat, we need to have confidence that its moat will be able to continue to grow for the foreseeable future. Ultimately, we believe this all comes down to corporate culture, which is really just an extension of our moat trajectory analysis.

**Andrew:** WCM has focused on culture analysis for almost two decades. It's an area that's often overlooked, but where we think we have a massive competitive advantage, given that it is incredibly subjective, difficult to measure, and nearly impossible to model.

When we assess a company's culture, we are trying to understand the DNA of the business. Who drives decision making? What are the incentives in place to promote the behavior necessary to drive forward the company's strategy and grow its competitive advantage? We are trying to understand whether or not the company's culture is aligned with its competitive advantage, if the culture allows for adaptable decision making to adjust to unforeseen challenges, and if the culture is strong enough to be pervasive and consistent across the entire company.



We conduct our culture work from a variety of angles, from onsite due diligence visits and meetings with executives, to scuttlebutt research through expert networks where we speak with former employees, competitors, and supply chain partners. While the direct dialogues with management are always insightful and useful, we find a greater deal of value in our conversations with former employees, which tend to be better insights into what's actually happening within an industry and the innerworkings of a company.

**What sort of tailwinds are you looking for as an indication of a firm's longevity?**

**Andrew:** The most important indication of a firm's longevity is the adaptability of its corporate culture. We believe an adaptable culture is the ultimate margin of safety for a business. We may not be able to predict the next challenge that a business will confront, but our understanding of a company's adaptability helps us assign a probability to how successful a business will be taking on new and unforeseen challenges.

From a more traditional tailwind perspective, our long-term approach to investing—paired with our high-quality emphasis—guides us toward multidecade themes such as the proliferation of wealth in the emerging middle class, aging populations, software eating the world, automation, e-commerce, electrification of everything, conspicuous consumption, and trends in health & wellness... to name a few.

**You're looking for firms that are in the "midst of becoming dominant, industry-leading companies." What sort of markers are you looking for in a company at the beginning of this journey?**

**Andrew:** I think this is an area where we have one of our strongest competitive advantages, Rupert. Companies that tend to meet this definition in our portfolio are categorized as what we call "transitional value" companies. These are businesses we believe are underappreciated by both the value and growth investor alike. These companies tend to live in a veritable "no man's land"—too optically expensive for the deep value investor, but with too much hair on them for a growth investor. Within this subsection of the market, we are hunting for companies experiencing an inflection point that will allow the businesses to accelerate the growth of their economic moats, typically through a catalyst such as a product-mix shift, a narrative shift, or a cultural turnaround. As these companies inflect and begin to grow their economic moats, we believe their investor bases will inevitably shift from more traditional value investors to growth investors. Along with this shift, we ultimately expect to see multiple expansion: a subject typically considered taboo in the world of value investing.

**Drew:** I think a company like Royal DSM is a great example of this. DSM likes to call itself "the biggest company you've never heard of," which at a ~\$30 billion market cap is probably true today. DSM is a Dutch chemicals company, specializing in human and animal nutrition. The company works to grow yields for farmers across both developed and emerging markets through value-additive vitamin premixes for animal feeds, provides science-focused nutrition solutions for human consumption in various end markets (e.g., eubiotics), and works to bring innovative solutions to market to drive forward its goals of enriching people, planet, and profit. In effect, DSM functions as an outsourced R&D provider for various industries. For example, if Nestlé wants to update the nutrition profile of its infant formula, it will go to DSM to



blend the formula with the correct protein, vitamin, fat, and specialty ingredient (e.g., human oligosaccharide) premix. In this scenario, Nestlé's role is more of a branding company than it is a manufacturer, leaving DSM responsible for the taste and nutritional content of the final product.

Now, this wasn't always the case at DSM. DSM began as a coal mining company before beginning its decades-long journey as a petrochemicals business. It wasn't until the 2000s that DSM began to transition away from petrochemicals and into more specialized materials production, inevitably moving into the nutrition market. This transformation was guided by former CEO, Feike Sijbesma, who restructured the business to focus on the higher-growth, higher-margin nutrition market. Just a decade ago, nutrition accounted for less than 40% of DSM's revenues. Today that number has doubled to 80%, with the spin-off of the remainder of DSM's materials business likely to happen in the near future. Along with a refocus of strategy on stronger

parts of its business, Sijbesma also refocused the company's culture. The sales team was completely overhauled, with an emphasis placed on end market specialization. This allowed DSM to function more of a trusted consultant to its end clients as opposed to a commoditized chemicals provider. R&D spending was more than doubled. EBITDA margin became a KPI at the front and center of DSM's incentive structure, and corporate headcount was nearly halved.

In the late 2010s, DSM's cultural turnaround began yielding fruit, the product mix continued to shift into higher growth markets, and a narrative shift began to form within the investment community as DSM began to transition into a pure-play on nutrition. This transition led to a shift in the investor base, as the incremental investor was no longer the value fund looking at DSM as a cyclical commodity company, but rather a growth investor looking for a high-quality, defensive growth pure-play. DSM became a structurally better business that was no longer being compared to the likes of BASF and Covestro, but rather to Chr Hansen and Novozymes. Along with this came a period of robust multiple expansion.

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**Andrew:** This transitional value bucket of our portfolio is typically our largest overweight, historically representing 50-60% of the portfolio. It's also a subsection of the market where we think our position within WCM is an incredible competitive advantage, given our cross pollination with our Global Growth Equity Team. I mean, there aren't many value investors that work alongside world-class growth investors. We believe this team structure gives us an intimate understanding of what drives a successful long-term growth investment, helping us uncover potential future growth stories while they are still in the early innings of their transition.





**Do you tend to concentrate on a select few ideas or manage a well-diversified portfolio?**

**Drew:** The answer is both, Rupert. As mentioned, we believe having a focused approach to investing is critical to achieving outsized excess returns. This is why we run a concentrated portfolio of 40-50 of our best ideas. That said, we believe that having a properly diversified portfolio is important to consistency in returns.

Andrew mentioned earlier that we don't believe value investing should be constrained to traditional "value sectors." We think this narrow approach explains the rollercoaster ride that a lot of the deep value managers have been on over the last fifteen years. Of course, when those strategies work, they go gangbusters, as we're seeing in today's environment. We simply prefer a more holistic approach to value investing that provides consistency and downside protection in a multitude of environments. This is why our portfolio is diversified not just across sector, industry, country, currency, and revenue exposure, but also across the three types of value mentioned earlier: transitional value, traditional value, and opportunistic value. We believe this high-quality, holistic approach explains a lot of the consistency we've seen in our portfolio over the last decade.

**Could you provide an example of an investment that offers an excellent example of your strategy in action?**

**Drew:** I think Getinge AB is a great example. Getinge is a Swedish medical technology company that specializes in acute care therapies (critical care, cardiopulmonary, cardiovascular), life science (sterilization & cleaning, transfer bags, bioreactors), and surgical workflows (operating room equipment, IT workflow systems, infection

control solutions). More than a third of Getinge's sales come from the US hospital system.

**How did you first discover the business?**

**Andrew:** Getinge is a name that had shown up on our radar off and on over the course of the past several years, but it had been plagued by failed turnaround efforts for the better part of a decade, and we never quite had the confidence they'd be able to right the ship. Getinge had been cobbled together from years of acquisitions without a focus on operational optimization, and there was an incredible amount of redundancy in its portfolio. The business had been centralized to the extent that leaders of each business unit didn't understand their own end-markets (e.g., the head of its life science business unit was being run by a person with a cardiovascular background). This led to lackluster sales and low customer confidence. To make matters worse, the company struggled with quality control issues—inevitably leading to a consent decree in 2015 that crippled Getinge's balance sheet.

After three CEOs in as many years, Mattias Perjos took the job in 2016 and focused on operational efficiency, streamlining the portfolio, decentralizing the business, cleaning up bad actors, and aligning management with shareholders by making sure management owned shares in the company. Additionally, Getinge's acquisition of the bioprocessing company, Applikon, proved to be a homerun that gave Getinge a new platform for growth.

All of this helped us gain confidence that a cultural transformation was underway, and that Getinge should be able to increase its competitive advantage. In September 2020, the pandemic had catalyzed the last piece of Getinge's turnaround, since they were able to



utilize heightened ventilator sales to remove the overhang from its consent decree and dramatically improve its balance sheet.

**What first attracted you to the company -- how does it fit into the strategy?**

**Drew:** We think investors are correct to be skeptical about turnaround stories—especially companies like Getinge who have had a long history of disappointing shareholders. However, if a company is actually able to get it right, we have seen that these turnarounds can offer some of the greatest opportunities for investors to compound wealth. Nearly without exception, we have seen that corporate culture is inevitably what determines the success, or failure, of a turnaround. We believe our nearly two decades of developing a playbook on culture—specifically, our focus on the cultural attributes that drive returns—gives us a massive competitive advantage in our ability to invest in turnarounds. This is ultimately what led us to Getinge. If you look at Getinge today, the company is undergoing

a narrative shift, having already improved its quality controls, increased its operational efficiency, and streamlined its portfolio. It's also well-positioned to improve its product mix and expand its recurring revenues, leading to margin expansion and ROIC growth.

Particularly in life science, Getinge is already the leader in sterile transfer solutions (i.e., controlled vaccine distribution), a top player in sterilization equipment, and a growing player in the high-margin market bioprocessing market—an industry growing at 2x the rest of the Group. While bioprocessing pits Getinge against some fierce competition (e.g., Danaher, Merck KGaA, Sartorius, Thermo Fisher), the company is pursuing a more niche market of fully configurable reactors, limiting its direct competition with larger players. Getinge is targeting more aggressive M&A in this space, as well as tackling the single-use bioreactor market.

**Andrew:** As Getinge continues to grow its life science business, we expect to see increased recurring revenues from consumables, particularly as the company enters the single-use reactor market. Peers such as Danaher and Sartorius derive 65-75% of bioprocessing revenues from consumables, whereas Getinge's consumables revenues represent <30% of sales. This leaves significant room for increased visibility and improving margins—even before even taking into account the future replacement, maintenance, and consumable needs of Getinge's installed base of high-quality ventilators.

This is a classic example of a company that fits in the transitional value bucket of our portfolio, as we believe the cultural turnaround at Getinge fueled a product mix shift that is beginning to lead to a narrative shift that will attract incremental investments from growth-focused investors.

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***When did you first buy/at what valuation?***

**Andrew:** We purchased Getinge in September 2020 when it was trading around 19x forward earnings.

***What was the price target? How did the story play out?***

**Drew:** This is my favorite question, because we don't really use price targets. We fundamentally don't believe in ascribing a price target to our investments, as we believe price targets are, at best, derived from false precision, and at worst, can encourage short-term thinking and portfolio turnover that can limit the effects of long-term compounding.

So if we don't use price targets, what is our sell discipline? Our discipline is quite simple. We sell a position:

- If the company's moat shows signs of deterioration, or we can no longer make the case it is expanding;
- If we find a more attractive name in a similar industry; or
- If leadership loses its way and the culture is challenged.

We will trim if the portfolio weight becomes excessive (~4-6%), or if the valuation looks less attractive. This was the reason for our trim to Getinge in June 2021.

In the case of Getinge, our thesis remains intact, and we will continue to hold company until any of our sell criteria are met.

***It would also be interesting to know if there's has been an investment that originally ticked all the boxes but did not ultimately work out. What initially attracted you to the business? What was the valuation? What went wrong?***

**Andrew:** I think a great example of this is

our recent sale of Royal Philips, considering it's a good counterpoint to Getinge. Based in the Netherlands, Philips is a name most people are somewhat familiar with, given its previous products in the consumer electronics market and its dominant position in electric toothbrushes. However, it wasn't these businesses that caught our attention, but rather Philips' move toward becoming a pure-play healthcare company specializing in diagnostics, sleep devices, and connected care.

We initially bought Philips in May 2017, as the company was divesting its lighting business. It was at this time that Philips began signaling a move toward a pure-play healthcare business. Eventually, this part of the thesis came to fruition in 2021, when Philips announced it was selling its domestic appliance business and focusing solely on healthcare going forward.

Unfortunately, Philips is a company who had been plagued with quality control issues in the past, having received a consent decree from the FDA in 2017 for its Automated External Defibrillators ("AEDs"). At the time, we thought its increasing focus on healthcare and management's heavy investments into quality control would ameliorate those issues over time. Then in June 2021, Philips issued a recall of its DreamStation CPAP due to the possibility of foam degradation from heat, humidity, or the use of unapproved cleaning materials. Aside from potentially years of litigation and overhang around the business, more digging has revealed a broader potential for quality control issues within Philips.

Since our sale in December 2021, Philips has now raised its provisions for its pending litigation, which indicates that this may be the canary in the coalmine for further issues with additional products for Philips in the future. Our suspicion today is that the firm



INTERVIEW

## ANDREW WIECHERT & DREW FRENCH | WCM Investment Management

overextended itself and slipped into its old habits by letting quality control slide as the company focused on growth, all while concurrently trying to balance the divestiture of its consumer electronics business. ▼



## WCM INVESTMENT MANAGEMENT

### **Can you provide a brief overview of the Belgian conglomerate and how it makes money?**

**Drew:** D'Ieteren Group SA is a Belgian family business consisting of four core pillars: 1) Belron (50.01% ownership) is the largest vehicle glass repair and replacement ("VGRR") and advanced driver assistance systems ("ADAS") recalibration service business in the world, operating under such brands as Safelite, CarGlass, and AutoGlass; 2) D'Ieteren Automotive is the exclusive importer of VW vehicles in Belgium (including Audi, Lamborghini, Skoda, etc.). Additionally, D'Ieteren Immo is the captive real estate business which effectively owns and leases property for D'Ieteren Automotive; 3) Moleskine is a producer of fashionable journals and accessories; 4) TVH Parts (40% ownership) is the global independent leader of aftermarket parts for the materials handling, construction & industrial, and agricultural sectors.

### **How did you come across the idea?**

**Andrew:** This was a name that entered our screens in 2019. Only a year prior, private equity ("PE") firm Clayton, Dubilier, & Rice ("CD&R") had acquired a 40% stake in Belron, one of D'Ieteren's core assets. The D'Ieteren family had acknowledged it hadn't been successful in optimizing the business since its original acquisition date in 2007, particularly from an efficiency and cost reduction standpoint. In this first year, CD&R was successful in cutting capex in half, which motivated Belron's management team to find its own operational stride. The stock was still trading cheaply—around 12x NTM P/E—but we could see the business beginning to inflect

under the guidance of CD&R. We purchased the stock in September 2019.

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**The group owns the multi-franchise car dealer D'Ieteren Automotive, car glass supplier Belron, notebook manufacturer Moleskine and real estate business D'Ieteren Immo. How do these companies fit together? Also, which is the most promising business in your view, and how do you see its growth playing out over the next five to 10 years?**

**Drew:** To be honest, Rupert, there are no real synergies between these businesses. I think TVH is actually a compelling business model, as this business is able to connect the aftermarkets of some attractive, niche end markets to incredibly specialized parts makers and distributors using its proprietary software database. The Automotive/Immo business is a fairly decent business as well, given its ability to force the consolidation of downstream dealerships to protect margins. Still, this is a low-margin business that is facing stagnant



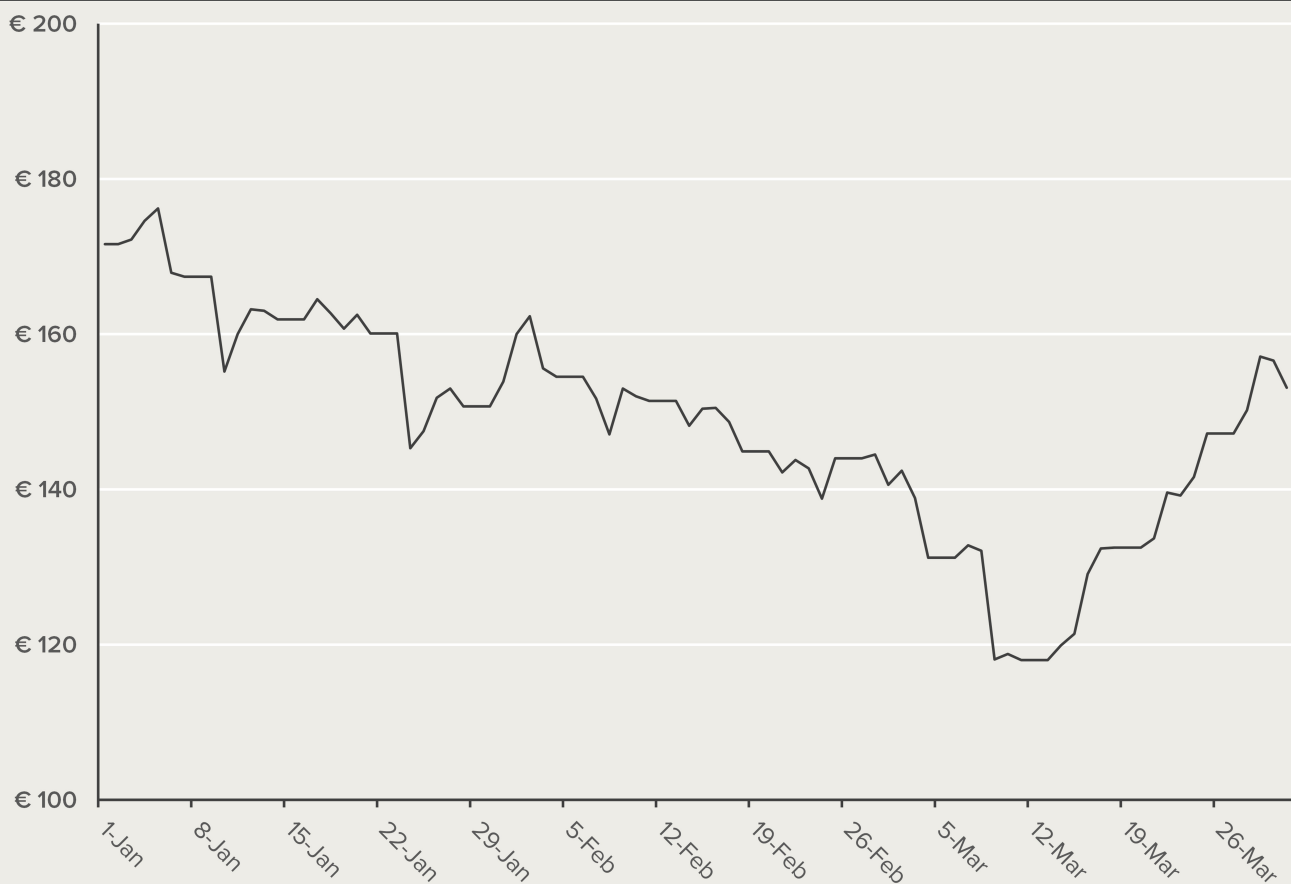
## D'IETEREN GROUP (DIE-BE)

growth and a product mix headwind from EV penetration, leading to declining aftermarket revenues. Moleskine is marketed as a turnaround story, but in all honesty, it's not a business we are excited about and we would actually love to see removed from the portfolio. It's worth mentioning that the firm has also entered into conversations to acquire Parts Holding Europe ("PHE"), another aftermarket parts distributor for the automotive sector.

That said, the story for D'Ieteren is 100% all about Belron. That's actually the beauty of the Belron story: It's one of the best businesses we've ever encountered, and it's been hiding in plain sight for years behind the D'Ieteren holding company.

D'Ieteren owns just a hair over 50% of Belron, with the remaining 50% split between PE firms (CD&R, Hellman & Friedman ("H&F"), BlackRock, GIC), Belron management, and the Lubner family (Belron's founding family). To be clear, Belron is a niche service provider that strictly focuses on windshield repairs and replacements. This is a high-margin service, especially compared to many of the narrow-margin auto repairs that get absorbed by collision repair shops. Belron dominates its competition in every market it has entered, particularly in the US, where Safelite (you may know the jingle, "Safelite Repair, Safelite Replace") is the preferred VGRR provider for 95% of auto claims (70% of Belron's total revenues). This has led to unrivaled scale

### Stock Information | DIE-BE (Year-to-Date Price as of 31 March 2022)





benefits for Belron, both in glass procurement and enhanced capabilities. Belron has efficient scale in an industry where competitors are either unwilling, or unable, to incur the costs to deepen their capabilities. Furthermore, Belron's brand recognition and unparalleled network of service centers have made the company the "go-to" glass repair provider for both end-consumers and insurance companies alike.

What makes the Belron story so compelling is growth in ADAS. ADAS includes everything from adaptive cruise control and traction control to traffic signal recognition and forward collision warnings. Today, these systems operate via sensors in the windshield in tandem with cameras, radar, LIDAR, and on-board computers. This means when car windshields need to be replaced, these ADAS systems will also need to be recalibrated. This is a high-margin add-on service for Belron, which has grown both operating profit margins & ROIC from 6% to 15% as calibrations have increased from 70k to ~2mm over the past five years. Remember, the number of sensors in an automobile has grown from effectively zero to more than 70 today. ADAS calibrations have increased from less than 1% of all replacement jobs five years ago to ~25% today. We see that number rising to above 50% of jobs in another five years, on its way to 70-80% by 2030. Growth in margins, sales, and ROIC should continue to be robust as ADAS complexity continues to grow. In the next 10 years, it wouldn't surprise us to see both operating margins and ROIC in the high-20s to low-30s.

***Do all of these businesses meet your target for owning dominant firms and industry-leading companies?***

***Drew:*** Again, just being honest, but I think Moleskine is arguably the poster child for the antithesis of what we are looking for in a

business. While some of the other businesses I think add value to the D'Ieteren portfolio, this investment is 100% about the Belron business.

***The D'Ieteren/Périer family still owns 58.5% of the group's equity. Does this considerable insider ownership concern you? What is management's track record of creating value for shareholders?***

***Andrew:*** Given the nature of this investment, we actually see insider ownership as a positive. Despite Drew's tongue-in-cheek comments on Moleskine, we view the D'Ieteren family as strong stewards of capital. Like many family-owned businesses, management has told us that the family's objective is to leave a better business for the next generation than the previous, giving the company a long-term mindset. This is positive for our investment in Belron, as it gives us confidence that the family will continue to support its crown jewel and not dilute the business with additional capital allocation decisions such as Moleskine. The family's

***The family's sale of 40% of Belron to CD&R in 2018 is also a positive indicator that the family is interested in results, not power. There is a clear division of labor between the chairman, Nicolas D'Ieteren, and CEO, Francis Deprez (no board seat). It is also worth noting that out of the 11 board members, four are independent.***

**D'ETEREN GROUP (DIE-BE)**

sale of 40% of Belron to CD&R in 2018 is also a positive indicator that the family is interested in results, not power. There is a clear division of labor between the chairman, Nicolas D'leteren, and CEO, Francis Deprez (no board seat). It is also worth noting that out of the 11 board members, four are independent. Importantly, management has a clear investment philosophy to invest in large markets underpinned by sustainable growth trends, scalable business models, strong management, and the ability for D'leteren to be the lead shareholder.

Notably on the Belron side of things, a former director at CarGlass described Belron's "clear leadership focus," "customer orientation," and "strong, caring culture" as the company's greatest competitive advantages relative to its peers. Additionally, management's focus on operational efficiency continues to help drive operating margins.

**How have you approached valuation, and what is your price target for the stock based on current fundamentals?**

**Andrew:** A business like D'leteren is typically valued using SOTP, given its structure as a holding company. Generally, we think SOTP is almost always a flawed exercise which assumes that the sum of the parts must always equal the whole. Given our focus on finding businesses with growing economic moats, we would argue we're typically looking for businesses where the  $1 + 1 > 2$ .

Of course, basic SOTP analysis is a useful way to understand what expectations are baked into the current price. It's worth noting that in July 2021, H&F, Blackrock, and GIC agreed to buy 13% of Belron, valuing the business at €21 billion. This made D'leteren's 50% stake in Belron worth substantially more than D'leteren's entire market cap at the date of the sale. With the 2021 IPO of the

Cary Group—the largest VGRR company in Scandinavia with an additional footprint in the UK and Spain—the market saw its first pure-play comparison company. While Cary is earlier in its growth cycle, it will likely never even begin to compete with Belron in terms of size and scale, nor does it benefit from the same insurance-dominated market that Belron enjoys in the US. That said, Cary is trading for 38x NTM P/E today, while Belron trades at <20x NTM P/E based on its mark-to-market price of €21 billion.

Assuming: 1) the spot price of Belron from the recent CD&R transaction, 2) the purchase price of TVH Parts from D'leteren's original transaction, and 3) the announced purchase price of D'leteren's pending PHE acquisition; basic SOTP analysis shows D'leteren is trading at just over a 70% discount to its implied market value today. This is roughly in line with Cary Group's valuation as a pure-play peer comparison, given Belron represents ~85% of D'leteren's operating income. However, this point-in-time analysis misses is the longer-term growth trajectory of the Belron business, which is astronomical. Factoring in the expected growth of Belron, its improving margins, its strengthening ROIC profile, and the tailwind behind ADAS should lead to a much larger valuation than what traditional SOTP can account for. Perhaps more importantly, this is a business where we are already seeing an inflection in the investor base, as the recent PE deal has shown a glimpse of the growth potential in the Belron business. We see future rerating opportunities for D'leteren as the incremental investor continues to shift toward growth.

**Drew:** There is a reason that during one of our conversations with CD&R, one of the partners told us: "This is the best business I've seen in my entire career. As a GP, we rolled out about \$1 billion of carried interest into the vehicle





holding Belron ownership. Belron is single-handedly the largest position in every partner's portfolio." Amen to that, brother.

***How do you think the intrinsic value will develop over the next decade --what is the moat trajectory?***

**Drew:** I think we are just scratching the surface on the value that Belron will create over the next decade. The global ADAS market has doubled in size every five years since 2015, and the move toward connected

***In the short term, there is a case to be made that rising inflation and gasoline prices will lead to a decrease in miles driven, thereby decreasing VGRR volumes. However, because Belron's revenues are primarily generated through insurance claims, the company is mostly shielded from any declining trends in consumer purchasing power.***

vehicles, EV, and autonomous driving will continue to drive forward growth. Additionally, while increased ADAS and autonomous features could impact the claim volumes passing through collision repair shops, these improvements should not impact the need for glass repairs and replacements, which tend to be completely correlated with miles driven and road conditions.

Additionally, Belron is working to make inroads into emerging markets, which are much further behind in their ADAS growth curves. This will

allow Belron to extend its growth curve and increase its scale advantage even further.

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For D'Ieteren as a Group, we see a positive capital allocation trend in such acquisitions as TVH Parts and PHE, as the firm seems to have found its North Star with complementary businesses in correlated industries. D'Ieteren is the acquirer of choice for many family-owned businesses who are looking to partner with a family-focused firm that is less aggressive and hands-off than a PE firm, and we believe this will work in D'Ieteren's favor within its recent acquisition targets.

***Is there anything that could cause you to revisit your valuation of the business and growth outlook?***

**Drew:** There are really two things: 1) If we were to see a meaningful change in Belron's core business model, be it through changes to its monopoly over US insurers or disruptive technologies that meaningfully lessen VGRR volumes or decrease recalibration costs, or 2) if we see D'Ieteren accelerate M&A in unattractive businesses, thereby diluting our stake in Belron. ▲▼



## WCM INVESTMENT MANAGEMENT

***The second pick is FUJIFILM Holdings Corp. Can you give a brief overview of how this firm makes money?***

**Andrew:** Tokyo-based FUJIFILM Holdings, Inc. (“Fujifilm”) is a Japanese conglomerate that operates in the following business segments: Business Innovation (35%), Healthcare (26%), Materials (26%), and Imaging (13%). Within Business Innovation, the firm focuses on business and office solutions, primarily manufacturing and selling printers, copy machines, and production systems. Healthcare is focused on medical systems and diagnostics, contract development manufacturing organization (“CDMO”), and life science. Materials is comprised of resins and functional materials across electronics and displays, industrial products, and graphic communication. Imaging is Fujifilm’s legacy camera business, focusing on professional DSLR and consumer camera equipment such as its Instax cameras.

**Drew:** I’ve also heard Instax cameras go great with beards, hip clothing, and craft beer. Just saying.

***The camera and drug maker might seem like an odd choice to some investors considering the competitive nature of these two sectors. Why did the firm initially appear on your radar, and why did you decide to dig further?***

**Andrew:** Fujifilm is a name that had popped into our screens several years ago, but we didn’t get interested in the company until mid-2020 when we realized how critical the CDMO industry was going to be to the biopharmaceutical value chain going forward. Just to extrapolate on this, CDMOs are critical enablers of the growth in the

biopharmaceutical market, helping the industry bring to market everything from small molecule pharmaceutical drugs to the complex biologics going into mRNA vaccines and both cell and gene therapies. These companies are outsourced R&D providers who have climbed the value chain to become not just contract manufacturers for biopharmaceutical companies, but also trusted, end-to-end consultants that help these companies co-develop and bring their final products to market.

***We ended up purchasing the stock in January 2021 after we became comfortable with Fujifilm’s dedication to expanding its healthcare franchise. The stock was trading at ~16.5x NTM earnings at the time.***

I remember we did our work around Fujifilm in tandem with our Global Growth Team’s analysis on Lonza and Wuxi Biologics at the time, which is common for our firm. We on the value side tend to work closely with the growth team, and our 360-degree approach to research means we tend to uncover and share ideas that arise from our work on a specific industry, theme, or region.

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***How does the business stack up to your goal of finding companies with long-term tailwinds and competitive advantages?***

**Drew:** Fujifilm is another example of a transitional value company where we think its ability to create long-term value is essentially hiding in plain sight. On the surface, Fujifilm looks like just another Japanese conglomerate; however, the company has shown more adaptability than its peers, leveraging its film processing technologies and expertise to build a world-class healthcare business. Fujifilm has been intentional about the shift in its business strategy, reinvesting cash flows from other business segments to expand its healthcare portfolio. As the healthcare business grows, particularly in its CDMO enterprise, we expect to see improved business quality and margin expansion. We also expect to see persistent rerating opportunities as Fujifilm transforms from a stodgy photo/printing IT company to a high-quality CDMO and medical technology giant.

Fujifilm is going all in on its CDMO business, already establishing itself as the fifth largest CDMO in the world. This is a highly fragmented industry growing in the low double digits, with high barriers to entry and regulatory switching costs. Importantly, Fujifilm is working to provide the fastest turnaround times in the industry—already #1 in antibody drugs. This is a competitive advantage compared to the more established players such as Lonza, whose customers explain tend to be much slower moving. Additionally, Fujifilm's current and planned capacity are primary in the US (Texas & Boston) and Europe (Denmark via its acquisition of Biogen's biologics site), which defends the company against reshoring concerns. This could also allow Fujifilm to be a beneficiary of any fallout that comes from the continued trade war between the US and

***In addition to CDMO, Fujifilm's recent purchase of Hitachi's health care business makes Fujifilm a one-stop-shop for medical institutions, as Fujifilm now offers MRI, CT, medical IT, endoscopy, and in vitro diagnostics solutions. Hitachi's product suite should also benefit from Fujifilm's artificial intelligence capabilities, leading to AI-supported diagnoses.***

China, particularly as it relates to any long-term impacts to relations with Wuxi Biologics. Importantly, Fujifilm's cash cow Business Innovations segment offers the company ample resources to continue to build capacity and acquire other players in a consolidating industry.

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***How do you see growth in the fast-growing drug ingredients business playing out over the next decade? How do you see the group's growth evolving over the next decade and how does this factor into your valuation?***

**Drew:** At the end of the day, we are betting that Fujifilm's product mix will continue to shift



**Stock Information | 4901-JP** (Year-to-Date Price as of 31 March 2022)



toward healthcare. If you go back a decade ago, healthcare sales only represented ~12% of Fujifilm's total revenues. Today that number is ~26%, with CDMO representing ~5% of sales. The firm's medium-term plan is guiding for healthcare to represent 32% of sales by 2023, and we can see healthcare sales reaching more than 50% of sales by 2030. Assuming a growth rate for Fujifilm's CDMO business of 15% through 2030, this business could represent more than 15% of Fujifilm's total sales in less than a decade. Additionally, life science is expected to more than double over the same period. With operating margins at 20-25% for CDMO and 25-30% for life science, it's easy to pencil in ROIC growth into the low-double digits—up from ~7% today.

As this mix shift plays out, we also expect to see a narrative shift take shape within the market. Today, Fujifilm is still being compared

to IT peers such as Canon, Kinoca Minolta, and Xerox. As Fujifilm's healthcare business becomes its dominant source of revenues, the narrative of Fujifilm as a document solutions company will shift to reflect Fujifilm's position as a leader in medical systems, CDMO, and life science. Moreover, we wouldn't be surprised to see Fujifilm have its GICS sector reclassified from Information Technology to Healthcare. This should bring continued opportunities for multiple expansion.

Ultimately, this means our thesis critically hinges on Fujifilm's adaptable corporate culture. The thesis completely falls apart if Fujifilm determines it wants to reinvigorate its cash cow consumer electronics business.

**Andrew:** Fortunately, Fujifilm has a storied history of adaptability. Until the digital age sent the photo film market into a death spiral

**FUJIFILM HOLDINGS CORP (4901-JP)**

in the mid-2000s, Fujifilm had risen to the top of the industry to share a virtual duopoly with Eastman Kodak. While Kodak was unable to pivot its strategy away from its razor-and-blade model in film, Fujifilm was able to navigate this challenge by applying its technological knowhow in film production to new industries with long-term tailwinds (i.e., healthcare and materials). Former CEO, Shigetaki Komori, has ingrained a culture of adaptability and innovation into Fujifilm. From Komori: “No matter how good business is, you have to foresee and prepare for a coming crisis... a CEO—really any top-level manager—is responsible for thinking about the future, twenty or thirty years ahead, or even more, to ensure that the company survives and thrives.” Now that Komori has retired, Teichi Goto will carry the cultural torch. Goto has reiterated Fujifilm’s plan to continue to drive capital from its cash cows into the healthcare business, and he has demonstrated his commitment to this plan through Fujifilm’s recent expansion of its CDMO capacity, as well as the purchase of Hitachi’s diagnostics enterprise. Given Goto’s background on the healthcare side of the business, as well as his focus on ROIC targets by segment, we believe he is the right choice to continue to grow Fujifilm’s moat in healthcare.

***Do you think the market is missing something with the camera business?***

**Andrew:** As far as business quality, we don’t think the market is missing anything within the camera business. It’s not interesting as a standalone business. What we do think the market is missing is the fact that Fujifilm is intentionally using its legacy camera and document businesses as cash cows to fund its future as a healthcare powerhouse. Our opinion is that the market tends to focus too heavily on the conglomerate discount with Fujifilm, given the proclivity for many older

Japanese companies to sacrifice business quality for diversification. Fujifilm is clearly not running that same playbook today.

***What’s your current estimate of intrinsic value for the stock?***

**Drew:** Again, we don’t assign price targets to our investments, and given this is an opportunity with a long right tail, we don’t think traditional DCF modeling is appropriate to capture the longer ends of that tail where most of the value will be. If you look at the at the opportunity in front of Fujifilm in terms of its ability to organically grow its sales, operating margins, and ROIC—as well as the rerating opportunity we expect to see via its shift into a healthcare company in an attractive and fast-growing subsection of the market—we think the upside potential for Fujifilm is massive. Today, Fujifilm is trading only one turn higher than legacy peers such as Canon and Konica Minolta, but is trading at 60 cents to the dollar compared to companies like Thermo Fisher, Catalent, Danaher, and Sartorius. This is even more stark compared to CDMO pure plays, such as Lonza and Wuxi, where Fujifilm is

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trading at less than 40 cents to the dollar.

Now of course, some of that discount is absolutely justified, given where Fujifilm is in its transition today. That said, we would expect to see Fujifilm's peer group shift toward higher quality healthcare names in the diagnostics, CDMO, and life science space. Basic SOTP would guide Fujifilm into a mid-to-high-20s multiple in the next 5-10 years. This doesn't account for the growth in both the top and bottom lines, higher-quality recurring revenues, a strengthening economic moat, the emerging narrative shift, or a shifting investor base.

Safe to say, we think the future is bright for Fujifilm.

**Considering the competitive forces in both the drug and camera sectors, how will you evaluate the strength of the company's competitive advantages going forward? Is there anything you will be looking out for to signify a deteriorating moat?**

**Andrew:** Given our mix-shift thesis, our biggest focus area will be on Fujifilm's corporate culture. Goto has embraced the culture of adaptability and innovation that Komori ingrained in Fujifilm's DNA, but we need to watch for red flags that Fujifilm will get in its own way as it shifts into healthcare. M&A into areas outside of healthcare, or poor capital allocation within the healthcare segment are all items to watch.

If we look out five years at how our investment would have failed, our premortem looks something like this: Within CDMO, Fujifilm was unable to compete with Lonza in Europe and Patheon (Thermo Fisher) and Catalent in the US. Industry consolidation ended up working against Fujifilm, who wasn't able to form partnerships with the best players in

key markets. While most of Fujifilm's CDMO capacity is built in Europe and the USA, it was lumped into the same category as other APAC players by biopharmaceutical companies that began reshoring production in the aftermath of the pandemic, trade wars between the US and China, and the Russian invasion of Ukraine. Additionally, the biopharma market did not meet forecasted growth expectations due to waning interest in cell and gene therapies, leading to falling growth rates and overcapacity. Fujifilm failed to make the shift into the razor-and-blade consumables market, leaving it exposed to more cyclical equipment sales. This took Fujifilm's eye off the ball in its other markets, leading to quality control issues. It became clear that Fujifilm was not able to navigate these issues without Komori at the helm, leading to poor capital allocation decisions and further moat trajectory stagnation.

**Is there anything else readers should know about the group's prospects?**

**Andrew:** No, I think that covers it.

**Drew:** We appreciate the time, Rupert!

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