THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Global Manager Favors Europe for Strong Quality, Governance and Management



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SECTOR — GENERAL INVESTING

TWST: What differentiates Brown Advisory, including in terms of investing in newer strategies like Sustainable International Leaders, which you manage?

Ms. Agnihotri: I would start by saying that Brown Advisory as a firm is very focused on delivering the best value for our clients.

The mindset of the firm is very long term, so they tend to invest in newer strategies. They have patience to see how that goes, but it's done in a very methodical way, looking at what our clients want. So, it's really driven off of that, and that's how my strategy came about — there was a need for an ex-U.S. global strategy — and that's what led to starting the strategy.

Another thing I would say is that many of our strategies are focused on investing in good businesses for the long term, so that our own investment horizon in many of our strategies is aligned to Brown Advisory's own way of looking at investing.

TWST: You mentioned your strategy being ex-U.S. global. What else would you add in terms of its investable universe and the criteria you focus on when evaluating potential investments?

Ms. Agnihotri: The universe is global ex-U.S. I'll start off with the philosophy, and then how that relates to the criteria.

I believe that investing is an inherently probabilistic activity, and we want to maximize our chances of getting it right. In order to do that, I think that there are businesses with a specific set of characteristics which we think will outperform the market. Those would be businesses with strong competitive advantages, or moats, that generate high returns on capital and generate strong free cash flow. So, those would be some of the starting qualitative and quantitative criteria.

We're also looking for strong management teams. Typically, these sorts of businesses generate high returns, and the management is responsible for deploying a lot of it, whether they pay it back to shareholders or they create future growth options. So, it's quite important for the management to have an excellent track record.

We wait to purchase these businesses at attractive prices, because ultimately the price that you pay will determine your return, irrespective of the quality of the business, to some extent.

And so, if you put all that together, the average company in the portfolio will grow its free cash flow between high single-digit to low double-digit annually. There might be companies at the higher end of that. In our experience, exceptionally strong businesses can continue to grow the value of their business at that rate, typically far beyond the typical time horizon of most investors, and that's what helps us to generate attractive compounded returns.

TWST: You just gave us a sense of how you define "good businesses." What about the "sustainable" and "leaders" part of the strategy name?

Ms. Agnihotri: In terms of thinking about sustainability, the starting point is that we want to invest in businesses that are a part of the solution, not the problem. And by that, what I mean is we're not looking to exclude a particular industry, but really looking at risks and opportunities for companies from a sustainability perspective and seeing if they are best positioned.

So, it's more dependent on the individual companies. For example, we have quite a few industrial holdings, and many of them, whether it's **Airbus** (OTCMKTS:EADSY) or **Safran** (OTCMKTS:SAFRY) in the aerospace industry, whether it's **Atlas Copco** (OTCMKTS:ATLKY) in industrial compressors, they typically provide more energy-efficient products for their own end customers.

So, they might be in an area such as aerospace, or **Atlas Copco** might be selling to several industries, but they're actually helping their own customers be more energy efficient, and that's giving them a competitive advantage in the marketplace.

We definitely have a preference for those sorts of companies. That's more on the opportunity side of sustainability. But we also think about risks, and I would say that in the global ex-U.S. universe, risk is quite important.

Of course, we talked a little bit about management, but if you go beyond the management, there are different countries we are dealing with where the governance, the role of regulators or other stakeholders, could be different from what we are used to in the U.S. or Western Europe. So, those are some considerations on the risk side.

Another would be if there is a risk of declining consumption in certain markets. If we think about alcohol, is there a risk that there might be moderation, and what does that mean for the businesses that we invest in, to give you an example.

We invest in the global alcoholic beverages leader **Diageo** (NYSE:DEO), which, in addition to their strong portfolio of brands, has an unparalleled distribution network in their major markets. The company focuses on drinking better, not more, which positions them well as their customer base across developed and emerging markets has focused on better quality alcohol over a long period of time.

Diageo has additionally invested in the low- and no-alcohol category, which can leverage the same distribution network should it become a bigger trend over time, albeit we appreciate that the economics would be different.

We've sold businesses that we thought were overvalued. Sometimes an investment can get to the higher end of what we expect, in which case we might hold it in a smaller position size, but sometimes, if the valuation reflects the full potential of the business, we've had to sell out. That's always a difficult decision, because these are typically really good businesses.

I sold out of a Swiss specialty chemicals business called **Sika** (OTCMKTS:SXYAY) earlier this year. It's still on my "buy" list if it becomes available at a better price.

TWST: There are many macro issues that can pose risk, such as geopolitical tensions, the global economy, inflation and monetary policies around the world. How do you evaluate and factor those into investment decisions and your ongoing portfolio management?

Ms. Agnihotri: I'll start by saying that we are fundamental, bottom-up investors, so we really evaluate each company on a case-by-case basis. That said, the type of business models we invest in should be relatively resilient, so they would typically hold up well in different macroeconomic environments, and they would gain share through difficult times.

"Because the companies we're looking at have some sort of a competitive advantage, they're typically able to pass on inflation to their end customers. It might be with a lag, or it could be immediately, but generally their economics tend to remain fairly stable through different environments, or if they have a downturn, it may be a short-lived sort of cyclical issue, and we are able to see through that."

These factors limit the risks for **Diageo** from lower consumption over the next five to 10 years.

The second question you had was on the leaders. It's not necessarily always the number one player by size or market share, but the company should be among the best in the industry in terms of their competitive position, profitability, and execution, and I would say that I look at those metrics over multiple cycles and through a number of years to make that assessment.

TWST: You mentioned a few minutes ago looking for companies at attractive prices. Tell us more about the role that valuation plays in your investment decisions, including exiting positions.

Ms. Agnihotri: To start off with, I believe that stock prices over the long term reflect the compounding of the intrinsic value of the business per share. So, I think it's quite important to be able to estimate the intrinsic value per share, and then assess it with respect to the current price to see what sort of returns we would generate.

The way we do that is we focus on valuation over five years and beyond, because that's the typical investment horizon. We look at free cash flow, because the generation of free cash flow is what would drive the increase in intrinsic value over time. So, that's how we would think about that valuation piece.

In terms of entering and exiting positions, we're quite keen to be disciplined in entering new positions at attractive valuations, because certainly over a shorter period of three years or four years, the price that you pay matters much more. Over the long term, it's much more the economics of the business, but I think you still have to balance those two things.

Paying a too-high price for a great business can be a risk with the way we think about investing. We definitely want to manage and limit that risk, so we want to be keen to protect our downside when we enter a new investment through not overpaying for it.

If you think about **LVMH** (OTCMKTS:LVMHF), the leader in global luxury, they tend to go through difficult times when there is a weaker outlook for consumer discretionary, but those periods don't last very long. Whenever the industry comes back, typically they've gained share.

That is similar to other sorts of businesses we own. There are industrials that we own which tend to have an aftermarket component, like **Safran**, a French engine maker in the aerospace industry. They have significant aftermarket cash flow from engines that need to be serviced. They sell engines, and then they get cash flow from servicing these engines, and that tends to be a little more resilient. It definitely gets impacted by the macro, but it would be more resilient.

Because the companies we're looking at have some sort of a competitive advantage, they're typically able to pass on inflation to their end customers. It might be with a lag, or it could be immediately, but generally their economics tend to remain fairly stable through different environments, or if they have a downturn, it may be a short-lived sort of cyclical issue, and we are able to see through that.

Beyond that, I would say that having a portfolio means that you are automatically diversified, you are exposed to different cycles. We invest in India, Indonesia, Brazil, Japan, and many of them have domestic drivers of the businesses that we invest in that could be very different from what's happening in Europe or in the U.S.

There are definitely companies we own which have a lot of global exposure, but then there are certain businesses that have more domestic exposure, and so they won't necessarily be moving in the same economic cycle.

On geopolitical risk, again it's very much a case-by-case analysis of the opportunities and risks. If you look at the semiconductor industry, we sold out of **Taiwan Semi** (NYSE:TSM) when the geopolitical risk started rising in 2022. When the risk went up, we

couldn't assess if there was a greater risk of military action by China and Taiwan, and so we sold out at that point.

We still have some semi exposure. We still own **ASML** (NASDAQ:ASML), as an example, which plays into a similar secular trend, but they're not based in Taiwan, they're based in the Netherlands, so we think they would be potentially less impacted.

So, it's limiting exposure in certain cases, but also thinking of opportunities that might arise. Like with the U.S. trade tensions with China, does that create opportunities for Mexico? But it would be very much bottom-up in terms of, if we come across an investment that benefits from that or faces the risk, we'll evaluate it.

TWST: Are there particular areas where you're currently overweight, where you're seeing better opportunities, whether in terms of geography or sector or both?

Ms. Agnihotri: We are overweight Europe in general as a region. That's where we've found a really good combination of very strong quality of businesses, great governance, great management teams, and we've found interesting enough valuations.

Similarly, we are overweight in emerging markets financials. We've found that is an area where there are strong secular tailwinds. Many of the financials benefit from rising consumption in emerging markets, and they tend to be cheaper than the consumer names in those markets.

TWST: On the flip side, are there areas you're especially cautious about, underweighting, or avoiding altogether?

Ms. Agnihotri: It's never been an approach of limiting exposure to or excluding any particular area of the market. But in terms of geography, since the inception of the portfolio we have been underweight emerging markets overall, and underweight China and Japan.

The reason for that is that it's just been harder to find businesses that meet all the criteria that we're looking for; either it's the government piece that we don't end up being comfortable with, or if everything checks out, it's typically the valuation that has led to that underweight.

TWST: Tell us about a few investment ideas — they could be top holdings or just stocks that you're particularly enthusiastic about. Why are they attractive and a good fit for the strategy?

Ms. Agnihotri: One of the companies that I'm very excited about is **Deutsche Boerse** (OTCMKTS:DBOEF), which is a leading financial market infrastructure provider in Europe. They own the largest derivatives exchange in Europe, they are a leader in custody and settlement, and they've been growing their data and analytics business and building out an investment management solution piece, which includes software, index data, and also risk and analytics.

I think they are quite well positioned to continue to grow in Europe. They have been growing their earnings between 10% to 15% for a long time. They've been quite disciplined on their capital allocation.

Also, they don't tend to trade at a very expensive level. Because they are an exchange that is technically qualified as a financial, they tend to trade not as expensive as your typical data and analytics company. We think it's well positioned by business quality, but also because of the valuation.

Another idea is **HDFC Bank** (NYSE:HDB) in India. It's the leading private sector bank in India. I think that retail credit penetration in India remains quite low.

This is a bank that used to trade as one of the most expensive banks in the world a few years ago. But they are in the midst of integrating a merger with their parent company, and I think there are a few short-term issues which have spooked investors — not being able to grow deposits in one quarter, or not growing as fast as the other banks, which I don't think is a bad thing at all for a bank.

This is a company we've known for a long time. They've had a really disciplined credit underwriting history, very focused on returns, and I think that the problems they're facing with the merger are more temporary than permanent. It's also a merger within the same parent group, so I don't think it would be as challenging as people think.

I think that's what has led to a compelling valuation, so I'm quite excited to see how that works out.

TWST: Your strategy, as we noted at the beginning, is relatively new. You just marked three years since inception, and that's certainly been a three-year period with a lot of volatility in the markets and the world. How have you performed relative to your benchmark over those years? And, looking ahead, what are you doing today to best position the portfolio?

Ms. Agnihotri: Yes, you're right, it's been a very volatile time. We are in line with the benchmark before fees, but have slightly underperformed after fees. The strong performance in industrials, which has been a big overweight, was offset by underperformance in financials within emerging markets, which is an area we've been familiar with for a long time and I do believe will turn around.

There is definitely a preference for quality, and we have seen a de-rating of some of those businesses in the time since we launched the fund. At the same time, I would say that we've taken advantage of the volatility to buy some really great businesses that we've added to the portfolio at really good prices.

I think we've actually upgraded the quality of the portfolio and added more valuation protection, so I think that positions us well going forward.

TWST: Is there anything else you think readers should know about the strategy, about you and your colleagues, and your approach to investing?

Ms. Agnihotri: We are very focused as a team on self-improvement. We gather together quite often to discuss how we can improve the process. Think of incremental improvement. We work with an external behavioral consultant who provides us with feedback on our trades in terms of the decision-making. Is there a particular bias? How can we address that?

We also read a lot, about different companies, but also about different industries and about some of the great investors as well as history, philosophy, behavior science books.

So, reading widely and looking at external feedback, not just from what we are seeing within the actual stock market price reaction to our decisions, but also getting feedback from the behavioral consultants — I would say that makes us quite different.

TWST: Thank you. (MN)

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The portfolio information is based on a representative Sustainable International Leaders account.

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