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Atlantic Investment's Concentrated Approach Yields Strong Returns

Signal from Noise will occasionally use a Question & Answer format, as we run across portfolio managers with investment themes and stock ideas relevant to our subscribers. It's our intention to familiarize you, if briefly, with the views of successful money managers, some you might have read about, but, more importantly perhaps, some you might not have

This week's Q&A was conducted recently with Alexander Roepers, who owns and runs the New York City-based Atlantic Investment Management, which began operations in 1988. Alex has been at the helm the entire time and expanded the scope of investment from the US to include eventually international assets. As you'll see below, Atlantic Investments has strongly outperformed over the long term, even with a few hiccoughs. Alex has been dubbed the "Gentleman Activist," for his generally non-hostile and cooperative approach to persuading underperforming companies to change their ways.



Pic: Alexander J. Roepers, Founder &
Chief Investment Officer of Atlantic
Investment Management

Q: Describe briefly the history of Atlantic and its funds and your general investment stock picking approach.

A: Atlantic Investment was founded in 1988. I call our approach concentrated disciplined value investing and we prospect in a carefully defined universe of \$1-20 billion industrial/consumer products/services companies, employing private equity-like due diligence and a strict buy/sell discipline focused on low multiples of cash flow, dynamic position sizing and the use of constructive shareholder activism.

By 2003, following considerable success in our US-focused, long/short and highly concentrated long-only funds, we initiated the same approach to look at investments outside the US. From 2004 onward, we have been equally active in Western Europe and Japan and from 2008 in Asia ex-Japan. Currently, our AUM stands at \$1.6 billion with the majority of capital deployed in our Cambrian Global strategy, which is a long-only best ideas strategy with 15-18 investments. In addition, we have our original flagship Cambrian US strategy as well as smaller regional long/short equity funds for the US, Europe, Japan and China.

Q: How does this method distinguish itself from more conventional methods?

Clearly, one difference is our concentration of capital on high conviction investments (just 6-7 positions in our flagship strategy), which allows for private equity-like, deep due diligence. Secondly, our narrow mid-cap universe excludes tech and banks. Additionally, our global approach enables the selection of the most attractive companies in our preferred sectors anywhere. Atlantic Investment also distinguishes itself with our true value buy/sell discipline and our "liquid" constructive shareholder activism (allowing us to trade positions at all times, while actively pushing our agenda for shareholder value enhancement). All this sets us apart from other more conventional value managers.

Q: What has been Atlantic's long-term historical performance and what was it last year.

A: The Cambrian US strategy has a net CAGR of 13.5% since inception 28 years ago for a net cumulative return of 3,063% versus 1,234% for the S&P 500. Last year, Cambrian US strategy was up 16.3%. Cambrian Global strategy was up 13.6%.

In 2019, we had positive attribution on virtually all of our core positions globally. We had two positions that suffered setbacks during the year and each ended down 30%. Through active position sizing, we managed to achieve positive attribution on one, DXC Technology (DXC), and materially reduced the adverse attribution of the other, O-I Glass (OI), which is performing well in 2020 to date.

Q: What are the five stocks in your portfolio that you believe could give the best return in 2020 and why?

1 O-I Glass (OI US, \$13.38), with \$7.2 billion in revenues, is the world's largest manufacturer of glass containers. Recent positive developments include the January 6th announcement that OI found a way to ring-fence and bring finality to its legacy asbestos liabilities. Just now, the company reported solid Q4-2019 results, with 2020 earnings and free-cash-flow guidance as expected. Importantly, OI reduced net debt by over \$1 billion in H2-2019.

For 2020, we see OI's free-cash-flow of over \$300 million amid lower capex, no asbestos-related payments and improved working capital. OI's operational review should lead to further right-sizing its North American manufacturing footprint, which should yield substantial savings in H2-2020 and beyond. Of note, as a result from our constructive engagement with OI's management and board, the company also just announced that it will replace two board members, as we had pushed for in a 13D filing, including the appointment of our candidate. We believe the refreshed board will help OI achieve improved shareholder value over time. Our 12-18 month price target is \$26/share, or 8x 2020e EBITDA, reflecting conservative assumptions.

2 DXC Technology (DXC US, \$29.78) is a leading \$19.6 billion US-based independent provider of end-to-end IT services. This company came about through the merger of Computer Sciences Corporation and the Enterprise Services unit of Hewlett-Packard Corp. After significant cost-cutting, growth slowed and troubles began. A new CEO, Mike Salvino, a 22-year veteran of Accenture, was appointed in September last year. He has made strides righting the ship and announced plans to divest three units, representing a quarter of DXC's revenues, to repay debt and buy back shares.

Further, he has brought in new top management and is driving for improved service quality and business growth. We are confident in his ability to turn DXC back to profitable growth. Meanwhile, DXC's value is supported by its sum-of-parts value as well as its strong client list of long-standing blue-chip customers and proprietary IP. DXC just announced earnings and is delivering against its March ending FY2020. The company is on track to generate more than \$5 billion from the disposal of non-core assets, highlighting the valuation discount for the remaining business. Our 12-18 month price target is \$56/share, based on 12x FY2022e EBITA.

3 G4S (GFS LN, £2.01) is a \$10 billion UK-based global security company offering guarding and monitoring as well as cash processing and transport services. G4S is set to report full year results in March, when we believe the focus will be on an update regarding the separation of the Cash Solutions business. We continue to view G4S as a compelling special situation with strong downside support due to its low valuation on solid earnings, a dividend yield of 5% and strong upside which we believe can be

unlocked through its current strategic review process, including a sale of the Cash Solutions unit or through a takeover. Our 12-18 month price target of £3.20/share is based on 13x 2021e EBITA and is supported by our sum-of-the-parts analysis.

Company/Ticker	Industry	Price	Mkt Cap (\$mm)	2020 YTD Return
O-I Glass Inc / OI US	Metal & Glass Containers	\$13.38	\$2,082	12.2%
Dxc Technology C / DXC US	IT Consulting & Other Services	\$29.78	\$7,556	(20.8%)
G4S Plc / GFS LN	Security & Alarm Services	\$2.62	\$4,061	(7.7%)
Capri Holdings L / CPRI US	Apparel, Accessories & Luxury	\$28.19	\$4,211	(26.1%)
Koito Mfg Co / 7276 JP	Auto Parts & Equipment	\$42.41	\$6,818	(8.6%)

Source: FS Insight, Bloomberg, As of 2/18/20

4 Capri Holdings (CPRI US, \$28.19) has \$6.0 billion in sales from three iconic brands, namely Michael Kors, Versace and Jimmy Choo. Its shares, along with other luxury companies stocks, declined sharply in January amid the coronavirus related sell-off which disproportionately impacted consumer/China-exposed sectors. CPRI just reported solid Q3-2019 revenues and indicated that the coronavirus crisis will reduce its Q4-FY2019 sales and earnings, as was expected by now.

Importantly, all categories of the Kors brand grew except for watches, which now represent less than 5% of brand revenues. In addition, the company provided a preliminary cost synergy estimate of \$100 million in 2021. CPRI has repaid \$500 million of debt YTD and repurchased \$100 million shares, a sign of confidence in its free-cash-flow generation. CPRI trades on 7x FY2019 EPS, which we believe ignores the company's \$600 million annual free cash flow generation and earnings growth potential. Our price target of \$65/share is based on 12x FY2021e (ends March) EV/EBITA. (Capri was the subject of a separate SFN on Dec. 4, 2019.)

5 Koito Manufacturing (7276 JP, ¥4,660) is a \$7.7 billion Japanese automotive lighting equipment-maker. The stock performance was adversely affected by general concerns over a slow recovery of the global auto market and trade friction. Despite flat industry growth, we believe Koito should be able to maintain mid-single digit topline growth, supported by increasing high margin LED/ADB (Adaptive Driving Beam) penetration and market share gains.

Koito has been gaining market share with its largest customer, Toyota Motor, providing all the LED headlamps for Toyota Prius and Lexus brand cars globally. Profit margins are expected to widen due to the top-line growth and better mix. Upside catalysts include earnings and valuation multiple recovery as well as increased and/or special dividends. Our 12-18 month price target is ¥8,100/share, based on 10x FY2021e (ends March) EBIT.

Thanks, Alex.

Prior "Signals"

Date	Topic	Subject / Ticker	The Signal
2/12/20	Stock	Casper Sleep (CSPR)	Casper Stock Might Not Let You Get a Whole Lot of Sleep
2/5/20	Stock	Arch Coal (ARCH)	After Sentiment Plunge, Arch Coal Stock Looks Inexpensive
1/29/20	Sector	Healthcare	Healthcare Looks Inexpensive; Some Healthy ETFs to Play
1/22/20	Stock	Spirit Airlines (SAVE)	Why Spirit Airlines Shares Could Take Off in 2020
1/15/20	Market	4Q19 EPS Season	Market to Focus on SPX EPS Growth after 4Q19 EPS Season
1/8/20	Stock	Alibaba (BABA), Tencent (700 HK)	Alibaba, Tencent Look Attractive on Strong Growth Potential
1/2/20	Stock	2019 Report Card	Signal From Noise 2019 Picks: 74% Win Rate, Beat SPX
12/26/19	Market	Stock Market 2020	2020 Could Be the Year "Animal Spirits" Return to Equities
12/18/19	Stock	Ulta Beauty (ULTA)	Ulta Beauty Shares Whacked 35%; Stock Looks Cheap
12/11/19	Market	UK Stock Market	Conservative Election Win Should Boost Lagging UK Stocks
12/4/19	Stock	Capri Holdings (CPRI)	Capri Holdings Recovery, Makeover Could Send Stock Higher
11/27/19	Style	Value	When a Value Stock Is a Value Trap
11/20/19	Stock	Aaron's (AAN)	Roughed Up Aaron's (AAN) Stock Looks Undervalued
11/13/19	Stock	Bed Bath & Beyond (BBBY)	Bed Bath & Beyond Fixable; More Best Buy Than Blockbuster
10/30/19	Stock	GH Pharmaceuticals (GWPH)	Undeservedly Caught Up in the Volatile Marijuana Stock Fad

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