the market NZZ

INTERVIEW

"I Expect that Novartis Will Be Able to Improve its Margins Up to Peer Levels"

David Samra, lead portfolio manager of the Artisan International Value Fund, explains why he is investing in the Swiss pharma giant. He talks about his positions in Holcim, UBS and ABB – and explains why he believes in the turnaround of the chocolate manufacturer Barry Callebaut.

Christoph Gisiger | 04.04.2025 (English version)

US President Donald Trump is keeping the world on edge. His harsh tariffs on imports are rattling financial markets. The invincibility of tech giants such as Apple, Nvidia and Amazon are suddenly being questioned. Capital is flowing out of US stocks into international markets, especially into Europe.

This trend aligns with David Samra's investment strategy. As head of the Artisan International Value Fund, which oversees approximately $37 billion in client assets, he has substantial investments in Swiss stocks. He also holds several German companies.

"ABB has made significant efforts to establish local manufacturing, which has paid off," David Samra.

One of the names in his portfolio is chocolate producer Barry Callebaut. "The surge in cocoa prices has jolted all of the manufacturers out of complacency about the supply chain. This creates an opportunity for Barry," says Mr. Samra. "In a couple of years, if cocoa prices start coming down, people could look at this company in a very different way, potentially leading to a much higher multiple."

In an in-depth interview with The Market NZZ, the seasoned value investor also shares his thoughts on the regulatory debate surrounding the Swiss banking giant UBS, explains why he still sees upside for the pharmaceutical group Novartis, what he likes about the German chemicals distributor Brenntag, and what he is looking out for regarding the split-up of the building materials group Holcim.

International equities saw significant gains in the first quarter, while the US stock market, driven by the dominant tech sector, went through a consolidation phase. Will international equities continue to outperform?

David Samra: We will see. Obviously, the US stock market had appreciated significantly over the last couple of years, and a lot of that appreciation was condensed in a few equities. Those companies are great businesses, but we believe the market accelerated past their earnings growth. Outside the US, markets have done just fine, rising along with earnings growth. Now, there's some excitement in European stocks, generated by Germany spending between $500 billion and $1000 billion. Depending upon where and how quickly this money will be spent, that should provide a backstop to GDP growth and help certain companies grow their earnings.

How do you navigate this environment as a value investor?

DS: Honestly, I don't find valuations that compelling. There is no visible distress anywhere which is usually where value investors get excited. Generally speaking, I don't think non-US equities were undervalued. In the past few months, the market was driven by sentiment, rather than growth in earnings. Looking at a company like Hensoldt or other defense contractors, their share prices have gone through the roof. So now, you have to wait for earnings to show up.

You're holding Hensoldt in your smaller International Explorer Fund for international specialties. What's the reasoning behind this position in the German company?

DS: We got involved several years ago when the valuation was much lower. The company was operated reasonably well, and we saw some operating improvement that could come through. Since then, the stock has performed fantastically well. The valuation has been pushed way above where we thought it could get to on its own. But now, Hensoldt has a customer who's eager to spend, and the valuation reflects this.

A counter-example is Barry Callebaut, where the valuation has decreased significantly. You own the stock in your International Value Fund. Why do you bet on the Swiss chocolate manufacturer?

DS: Historically, Barry's gourmet business drove growth, with higher profitability and margins. However, a quality issue at one of the company's manufacturing facilities was a wake-up call, prompting a CEO change and a shift in focus to the non-gourmet business. There, they made a key discovery: with the right investments, which hadn't been made in years, they could not only improve quality but also lower costs. This puts them in a position to earn better margins and, because costs go down, offer their larger customers the ability to outsource more of their production. That's a big addressable market, given that only 10% of chocolate manufacturing is currently outsourced.

However, the surge in cocoa prices has complicated the turnaround plan.

DS: Yes, rising cocoa costs have made sourcing much more difficult, jacking up costs around working capital, which introduced significant volatility to the share price. Typically, when the price of a commodity surges, consumption declines and production increases. However, boosting production –securing better crops in Africa or Latin America – is a time-consuming process. As a result, lower demand is hurting Barry's business, while the supply side lags behind, dependent on factors like weather which adds complexity. It may take a year or two for the supply chain to adjust. But once it does, cocoa prices should normalize, revitalizing chocolate consumption and alleviating working capital pressures.

How would this impact the company's valuation?

DS: Barry's enterprise value is $10 billion, and we believe operating profit could approach $900 million over the next few years, even if cocoa prices stay where they are. This assumption includes cost savings from the strategic investment program and the working capital burden of current cocoa prices, which would likely be passed on to customers, since it's a cost-plus business. Hence, at a minimum, we believe Barry should deliver a stable performance. But if they're able to provide a compelling offer to their customers and get them to outsource more of their manufacturing, the company could grow for many years. Today's valuation is not reflecting that opportunity.

What gives you confidence that this strategy will pay off?

DS: The surge in cocoa prices has jolted all of the manufacturers out of complacency about the supply chain. This creates an opportunity for Barry, providing secure supply and trying to drive more variable cost into the P&L of the customer. Also, we believe Peter Feld is a fantastic CEO. He is spending a lot of time with customers and is investing aggressively in the company's manufacturing capacity. In a couple of years, if cocoa prices start coming down, people could look at this company in a very different way, leading to a much higher multiple.

Yet, Barry Callebaut's debt has risen significantly due to higher cocoa prices. How do you cope with the risk that liquidity issues could derail the turnaround?

DS: We have been pleasantly surprised about the company's access to capital at very cheap rates. They don't have an issue in this regard, and we would be willing to be supportive of the company if they needed capital.

Besides Barry Callebaut, your portfolio also includes Swiss blue chips UBS, Richemont, ABB, Novartis, and Holcim. Which of these stocks is currently your top focus?

DS: In general, I'm pretty optimistic. Richemont is doing fine. You're waiting to see what happens to the general consumer, especially with the US stock market going down. Meanwhile, Holcim is getting ready to break into two pieces. That's a well-run company, so there's no controversy there. The biggest concern is UBS, where uncertainty surrounding capital requirements and their timing is weighing on the share price.

How do you perceive this issue from an international perspective?

DS: It gets very complicated, but large global banks like UBS typically are only required to provide enough capital in each country where they operate to back their local business activities in that country. So normally, regulatory frameworks allow for flexibility, permitting banks to use borrowed funds to meet some of these capital requirements. However, the Swiss regulators are deviating from this international norm by demanding UBS put in equity capital in Switzerland to back their foreign subsidiaries. The number is big: it's $20billion, which will drag down the company's return on equity and hinder its competitiveness.

However, UBS's balance sheet is almost twice as large as Switzerland's GDP. Therefore, regulators must ensure that the bank is prepared for a crisis.

DS: It's important to note that UBS' largest subsidiary is its US business. That's where most of this issue resides. I don't think Switzerland is taking the right approach because the banks' US operations consist mainly of wealth management which doesn't take much risk: you're basically taking in client assets; maybe you're making some securities loans or some mortgage loans, but they're all very highly secured.

Still, similar arguments were made in the case of Credit Suisse, and UBS needed a bailout in the Global Financial Crisis. Shouldn't we make sure this never happens again?

DS: The issues associated with Credit Suisse are pretty well-documented, and there's a lot of blame to go all the way around. In the US, we had First Republic Bank and other financial institutions that went bust and the regulatory process worked. What I'm saying is it takes two to tango; the regulatory process has to work effectively and the bank has to operate prudently. Also, we should not fail to recognize the fact that UBS put its reputation and shareholders at risk by taking on Credit Suisse.

That said, the takeover of Credit Suisse also opened up a historic opportunity for UBS. Today, shareholders are benefitting from the merger, aren't they?

DS: Of course. It's always about risk and reward: UBS took significant risk, and you're not going to take that risk unless there's a potential significant reward. But mind you, money is a commodity: if one bank offers an interest rate of 1% on your account and another bank offers 2%, you'd choose the bank with the higher rate, unless there's some high risk of failure. Customers typically go where they can get a better deal. That's why UBS can't persist at a low ROE because people like me will go to the management and say: We are unwilling to pay you to earn an 8% ROE. That's unsustainable; you have to change what you're doing.

You are known for being a constructive and long-term-oriented investor. In your opinion, what would be a reasonable solution to make sure clients see UBS as a safe and reliable bank?

DS: I understand that this is a deeply politicized issue, but if the regulatory structure results in onerous capital requirements, UBS' valuation gap compared to "best-in-class" peers like JPMorgan or Morgan Stanley will widen. So ultimately, you can imagine them spinning off the domestic Swiss bank and redomiciling the rest of the organization, the parent bank, somewhere else, maybe in the UK or in the US. That way, the regulatory structure may normalize and they can get their ROE back up. But this would be highly disruptive for a major bank like UBS, and likely cause some level of disruption for Switzerland as well. But if the regulatory framework proves reasonable and UBS can deliver a competitive ROE, in our view, there's no reason that valuation gap shouldn't narrow over time.

Let's switch to Holcim. As mentioned, the building materials group is spinning off its North American business as a separate US-listed company. Which part is more attractive?

DS: It all depends on where the shares trade. Generally speaking, volume growth in Europe is expected to be slower, and the added risk is that volumes have been declining for years, resulting in substantial excess capacity. That capacity should exit the market given the carbon costs that are being imposed, but there's uncertainty around this. As a result, I suspect the European business will trade at a lower multiple than its US counterpart, where the industry doesn't necessarily have that issue.

And what factors are you consider to assess the North American business?

DS: The US operation has some unique strengths. The roofing business that CEO Jan Jenisch has put together is poised for volume growth, driven by the desire to reduce energy costs. Holcim's operating margins in this business are below those of its closest peers, suggesting room for improvement over time. The aggregates business, although smaller, is highly valuable, while the cement business will be one of the largest, if not the largest, in North America, including a significant Canadian presence. The market's appreciation for the cement business remains to be seen, and given that aggregates businesses typically command higher multiples, the question is what valuation the stock will trade.

Another Swiss industrial company among your holdings is ABB. How is the electrical engineering group positioned in an environment with trade wars and rising tariffs?

DS: ABB has made significant efforts to establish local manufacturing, which has paid off. The stock performed very well over the past few years, leading to a substantial valuation increase. As I mentioned in my Q4 shareholder letter, with a forward-earnings multiple of more than 20, it's challenging to argue that ABB remains significantly undervalued. That's why I'm not surprised the stock is trending sideways.

In our previous interview a year ago, you said that ABB still has scope for further strategic restructuring. What's the current status in this regard?

DS: We initiated our position in 2014. At that time, ABB was an overly diversified, poorly run conglomerate. It required three CEOs to achieve the turnaround, resulting in a business that performed better than we had thought possible. The key driver of the stock has been the increase in operating margins. Additionally, buybacks have reduced the number of outstanding shares by more than 19%. That's why I also emphasized that ABB is operating well in its current form and that I don't think something's going to change anytime soon – and that's fine, one of the hallmarks of value investing is patience.

Why don't you own Siemens? Isn't that the ultimate value play in that industry group?

DS: Siemens does a lot of different things, so the "conglomerate discount" has yet to be eradicated. They do these half-split-ups, listing portions of their medical technology and energy businesses. What's the point of that? It's almost as if the management and the board or perhaps Germany's codetermination system doesn't allow for proper structures to allow companies to operate independently and efficiently. Just look at what happened at ABB: once the discount was eradicated, operating margin went from 12 to 18%.

Another company that has eradicated the conglomerate discount is Novartis. The eye care division Alcon and the generics business Sandoz were successfully spun off. What's the investment case now?

DS: I believe margins in the core business are still subpar. Furthermore, the company faces a significant patent expiration this year for Entresto, their top-selling heart failure medication. However, with promising growth from new drugs like the breast cancer therapy Kisqali, Novartis should be able to maintain stable revenue or achieve modest growth despite the patent loss. Once we're through this somewhat anemic period, I suspect and expect that the company will be able to improve its profit margins up to peer levels which are in the low forties.

A year ago, you advocated for a complete overhaul of the Board of Directors, starting with the Chairman. What do you expect from the new Chairman Giovanni Caforio?

DS: Let's see how it goes. As the CEO of Bristol Myers Squibb, he made a very large deal with the acquisition of Celgene that yielded disappointing returns. We all learned our lessons throughout our history, myself included. Novartis' past, particularly under Daniel Vasella, served as a cautionary taleof poor capital allocation. Even under current CEO, Vasant Narasimhan, results of acquisitions clearly have been mixed. Hopefully, the cumulative knowledge leaves Novartis to be careful about the way they allocate capital going forward.

Compared to Novartis, Swiss competitor Roche has outperformed recently. Do you regret not owning the stock?

DS: Being in the investment business for more than thirty years, I have an enormous number of errors of omission. But if you're asking about regrets, Novo Nordisk would be the one in the pharma space. Roche still has the same corporate governance issues it had the last time we spoke. Plus, our scope extends far beyond Switzerland, so this is a very narrow comparison.

So let's wrap up with Brenntag. Why do you invest in the German chemicals distributor?

DS: The company has two opportunities to create value: First, profitability has been hindered by cost issues. Hence, we need leadership there that is tighter on cost. With some operational improvements and perhaps a few fill-in acquisitions, margins can be lifted. Second, the company has two distinct distribution platforms: Essentials for commodity-like chemicals and Specialties for specialty chemicals. Splitting these businesses could yield two benefits: sharper focus and potentially a higher valuation for the specialty segment.

Thomas Reisten will take over as CFO in early April, and CEO Christian Kohlpaintner is set to depart by year-end. What are your expectations for the incoming management team?

DS: With the right leadership, there's significant potential. Also, having Kuehne Holding, the investment fund established by Klaus-Michael Kuehne, as co-shareholder is a great plus. We've known the folks there for a long time and have a lot of respect for the way they operate. We also like chairman Richard Ridinger, Lonza's former CEO. So we believe everybody is focused on the right thing: improving the economics of the business. With an undemanding valuation and a solid balance sheet, Brenntag meets all of the criteria we're looking for in an investment.

Carefully consider the Fund's investment objective, risks and charges and expenses. This and other important information is contained in the Fund's prospectus and summary prospectus, which can be obtained by calling 800.344.1770. Read carefully before investing.

David Samra is the portfolio manager for Artisan International Value Fund and the Managing Director for Artisan International Explorer Fund. This article represents the views of Christoph Gisiger of The Market and David Samra as of 4 April 2025 and do not necessarily represent those of Artisan Partners. The views and opinions expressed are based on current market conditions, which will fluctuate, and those views are subject to change without notice. While the information contained herein is believed to be reliable, there is no guarantee to the accuracy or completeness of any statement in the discussion. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation. Artisan Partners is not affiliated with The Market.

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