THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Analyzing International Equities for ROI and Life Cycle

**MASAKAZU HOSOMIZU** is a Partner and Portfolio Manager of RMB Capital Management LLC. He joined the firm in September 2013 as a Portfolio Manager. In his role, Mr. Hosomizu directly oversees the firm's international equity investments, engaging in a disciplined research process that includes both qualitative and quantitative analysis, which is supported by regular research travels for meetings with companies and their management teams. Prior to joining RMB, Mr. Hosomizu spent eight years with Coghill Capital Management and held various roles within Nomura Securities Company, the largest brokerage and investment banking firm in Japan. He earned his bachelor's degree in law from The University of Tokyo, his MBA in finance and accounting from The University of Chicago, and is a CFA charterholder.

**SECTOR — GENERAL INVESTING**

**TWST: If you wouldn't mind, start by telling us a bit about RMB Capital's business, your overall investment philosophy, and what differentiates your research and investment management.**

**Mr. Hosomizu:** First of all, talking about RMB Capital, the firm was founded in 2005 by a team of wealth management advisers at UBS in Chicago who started their own business for high-net-worth individual clients. At the same time, they started an asset management business, which is one of the unusual things about RMB. We have in-house, institutional-level asset management services and products for those high-net-worth clients, as well as the institutional clients outside of the wealth management clients. That's the team I belong to.

Unlike the traditional wealth management firms, we provide more sophisticated, institutional-quality investment products in equities and fixed income. I am in charge of the international equities, specifically for equities benchmarked to EAFE. I also have a couple of Japanese equity products within the firm. In terms of the team for international equities, I am a portfolio manager, and we have six sector analysts and one country-specific analyst who covers Japan.

Our analysts are experienced researchers, including myself, and have around 20 years of experience in the financial industry on average. Our team is a very, I would say, seasoned fundamental analyst team, which is a very strong point nowadays in this industry. Even though our international equity product, which is in a mutual fund form, has only three years of track record, we have very strong investment experience, as well as the 20-plus years of research inventory in the form of the research reports across countries and sectors.

In terms of the investment philosophy, we are very strong believers in active management, even though in the real world, passive investment is getting more and more share. We do believe in active management based on fundamental research analysis, and we are stock pickers and prefer standout companies in a diverse universe, especially in the international space where there are so many companies to pick from — large cap, midcap, to small/medium-cap names. It's an interesting space.

Our portfolio is relatively concentrated. We usually have 40-plus names in a portfolio, and this is consistent across products. We have U.S. equities, international, and then Japan specific, but all products are characterized as concentrated, based on fundamental research and stock picking. We like high-quality companies. I know there are many definitions for "high quality," and definitions really vary, but we like a company which has consistent return on investment — ROI — especially cash flow-based ROI.

We call those companies compounders — compounding capital given from the equity holders, and the managements who are excellent in compounding the capital over years with a great track record. We also like the executive managers who are excellent in allocating the capital — allocating more capital to growing businesses, high-ROI businesses, and shrinking assets in low-ROI-generating businesses. It is easy to say, but in reality not all executives are doing this, so it is a point we focus on when we are making investment decisions.

And one characteristic when we are looking for companies is life cycle as well. In our view, companies are growing from venture-type stages and they're growing in size, in businesses, and entering their golden age. Some companies stay in the golden age for a long time, some companies decline in their business and eventually get into trouble, or some companies come back from the trough and make a turnaround to come back to the high-ROI stages again. We are looking at life cycles of individual companies and we try to identify attractive companies in terms of the life cycle as well. Those are the key aspects when we are looking at investment ideas.

**TWST: Would you like to talk a little bit more in depth about one of the firm's specific international strategies or funds?**

**Mr. Hosomizu:** We have the RMB International equity mutual fund. We launched this mutual fund in December 2017, so it's just turning three years old. This product initially started under a different team, but about one-and-a-half years ago, myself and a new team took over the product. Since then, we've added a more organized, systematic way to look at the individual companies, as well as the portfolio construction and the risk management.

In addition to investing in the compounders and focusing on their life cycle, we have a proprietary research platform, developed over two decades, that houses all of our fundamental research, contains our proprietary valuation model, and includes more than 30,000 different data points. It's a very powerful tool.

If you enter a ticker, you can see all the historic cash-based ROI figures and how the companies are run under CEOs and how their business has been growing as a whole and by individual business lines, and how the market is expecting the company's ROI going forward. We can see the gap between the company's actual track record in terms of their ROI and how much ROI and growth are implied in the current stock price. If the market's expectation is lower than the track record and the outlook, it'd be a great investment opportunity. We know the company is great and the stock is mispriced. It is a reverse engineering of investment ideas in stock pricing. That's how we look for the companies.

Then we talk to the management about what they're thinking of the business and the outlook, and if we identify a gap between the current stock price and the fundamental intrinsic value, it's a good sign to invest in them.

This tool is especially powerful in international equities, where the universe is so large and very diverse. In countries where the business cultures are different, and more importantly, the accounting standards are different, such as Europe and Japan/Asia, the basic financial analysis is very time consuming. We automate the basic financial accounting analysis part so that we can focus and spend more time on the fundamental research, including interviewing executives, researching industry, etc. This is our strategy in terms of financial analysis.

**TWST: In what you noted is a large universe of stocks, are there any particular themes or trends that stick out for you, especially in terms of good opportunities, whether by sector or industry or geographic market?**

**Mr. Hosomizu:** One of the biggest trends is the equity valuation gap between the U.S. and international. Historically, especially in the past 10 years, U.S. equities outperformed international equities. It's been very consistent. But if you stretch out the history, in the past 20 years, 30 years, or even 50 years, it's always going back and forth. The U.S. outperformed for five to 10 years at some points, but afterwards international equities outperformed.

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Currently, we see a huge gap between the U.S. and international equities in terms of the valuation, and at some point we believe the U.S. equities — some of the sectors, especially tech industries, are very stretched in valuation — will revert to the other way. That's a very top-down viewpoint, but we do think international equities will come back. If you look at the next decade, that will be a big, interesting shift in the equity market.

Within the international equities, of course there are many unique, high-quality companies, compounder businesses, but at the same time, Japan looks very interesting, too. It's not because I'm from Japan, but Japan has very unique history of corporate governance improvement recently since 2013.

Even though historically Japan is low in capital efficiency — either in ROI or ROE — they've been introducing a lot of corporate governance measures such as having more independent directors, having committee systems to nominate CEOs and decide compensation for executives, more stock options, stock-based compensation, more shareholder returns, etc., which the U.S. and European companies went through in the past 10 years or 20 years. Japan is, at this very moment, going through the reform, and we are very curious to see how Japanese companies will evolve and be like European or U.S. equities.

**TWST: What do you see that you're cautious about?**

**Mr. Hosomizu:** In terms of the equity valuation, U.S. equities, especially the tech industry, look very stretched. But the stretched valuation is seen across the world. As you see, central banks have been pumping money into the market for many, many years, and liquidity-wise, it's been so

### Highlights

*Masakazu Hosomizu discusses his criteria when analyzing international equities for RMB Capital Management LLC. He defines high-quality companies as those having consistent ROI, especially cash flow-based ROI. He tries to identify companies that are attractive in terms of life cycle as well. The team uses internally developed software tools for individual company analysis, portfolio management, and risk assessment, which Mr. Hosomizu says is especially useful in international equities, where the universe is so large and diverse. Mr. Hosomizu notes a valuation gap between U.S. and international equities, with U.S. equities outperforming international equities over the past 10 years. However, given historical patterns, he expects a shift in the other direction.*

*Companies discussed: Credit Suisse Group AG (NYSE:CS); Rentokil Initial plc (OTCMKTS:RTOKY); Rollins (NYSE:ROL); Terminix Global Holdings (NYSE:TMX) and Murata Manufacturing Co., Ltd. (TYO:6981).*

stretched as well. Some companies in some specific sectors are very stretched, like growth companies, growth stocks. At the same time, the value names are very undervalued. So, as you saw in November, the value/growth rotation, when rotation happens the shift could be stronger than ever.

Volatility is going to be larger than ever in the stock market history. That's one caution point, and we are very cautious of that in our portfolio construction. If you chase the growth names only, when rotation happens in the valuation, especially when the value names are coming back to regular valuation, you'll be losing a lot, and vice versa. So we are very cautious about building our portfolio from this viewpoint as well.

They generate ROI of 20% to 30%, which is very high, and the great thing is the pest control business, fortunately or unfortunately, is not going away. As far as human history persists — it will last almost forever. So this is a very exciting business, a high-compounding business, a sustainable business, and a growing business, and we see this as a kind of golden age business, very strong positioning and in a great lifecycle stage.

In terms of the valuation, the gap has narrowed since we invested in this company a couple of years ago. But because **Rentokil** is based in the U.K. and covered by European analysts, not by U.S. analysts, there is always a valuation gap between the two U.S. competitors, **Rollins** and **Terminix**, and **Rentokil**, where **Rentokil** is slightly discounted to the other players even though they are in the same field, same competitive situation, and the same high-return-on-capital businesses. So this investment has an aspect of a cross-border arbitrage opportunity.

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**1-Year Daily Chart of Rentokil Initial plc**

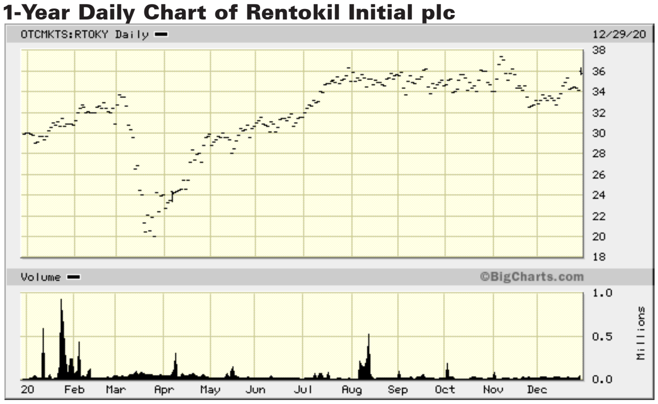


**Chart provided by www.BigCharts.com**

**TWST: Would you tell us about a couple of stock ideas — top holdings or current favorite investment ideas — and what is attractive about them?**

**Mr. Hosomizu:** Sure. One is a company called **Rentokil Initial** (OTCMKTS:RTOKY). It's a commercial pest control company in the U.K. Sounds like a very plain-vanilla business, but it is a very strong and a high-quality compounder in its golden age return of capital. It's based in the U.K. and they have, of course, strong exposure in Europe, but at the same time they are one of the top three players in the U.S., which is the largest pest control market in the world.

They have about 10% market share in the U.S., after two competitors in the U.S.: **Rollins** (NYSE:ROL), which owns **Orkin**, and **Terminix** (NYSE:TMX). Those two players take 20% of the market in the U.S. each. But surprisingly, **Rentokil**, which is a U.K.-based company, takes the third position with a 10% market share.

An interesting aspect of this pest control business is it's a very fragmented market, where lots of small regional operators exist. It is a consolidation story for large companies like **Rollins**, **Terminix** and **Rentokil**. These top three dictate 50% of market share, but the other 50% is dominated by very tiny, usually family-owned businesses, and **Rentokil** is aggressively buying regional, small businesses to take market share, while making these local, small, family-owned businesses more efficient in operation. It's like a platform; they're providing a platform for the local businesses, and growing steadily in the U.S. market.

I'd say our strength in the research team is that we have industrials and consumer sector analysts who look at the U.S. companies as well, and they know those three companies in the U.S. and Europe to identify the valuation gap.

**TWST: Is there another idea you'd share?**

**Mr. Hosomizu:** Another company is a Japanese company called **Murata Manufacturing** (TYO:6981). It's an IT hardware company. They manufacture multi-layer ceramic capacitors — called MLCCs — which are tiny ceramic capacitors used in communication hardware like mobile phones or base stations of a mobile phone network, and any electronic gadgets, IoT gadgets, everywhere in the world. **Murata** is the world's number-one player of the MLCCs.

Actually, the key Japanese makers dictate approximately 60% of the market share in this MLCCs market, and **Murata** takes about one-third of the global market. **Murata** focuses on the high-end MLCCs, so when mobile carriers extend their 5G network —which is a growing market right now — they need **Murata's** MLCCs, not in thousands, but in millions of the tiny capacitors. And unless they can procure **Murata's** ceramic capacitors, they can't build any 5G networks or manufacture smartphones or any other electronic gadgets. It is a rare and very strong positioning in the growing tech market.

They generate high single- to double-digit ROI, and growing at a double-digit pace in the foreseeable future, so this is a great compounding business as well. Even though the company is a relatively old company, about 70 years old, in terms of the business profile — high margin, high ROI and double-digit growth — we see the company as a venture-like business which is growing rapidly with a high margin. It's a very attractive business.

**TWST: This interview will be published in January, so we'll be in the new year, and I am wondering, as year-end earnings reports and calls get underway, what will you be looking for in earnings announcements and outlooks for 2021?**

**Mr. Hosomizu:** I believe most of the companies are expecting a better year in 2021. Obviously in 2020, especially the manufacturing industry had a very tough time in terms of supply chain disruption. Of course, some companies benefited from the COVID-19 pandemic. But most of the businesses were impacted adversely, more or less.

**1-Year Daily Chart of Murata Manufacturing Co., Ltd.**

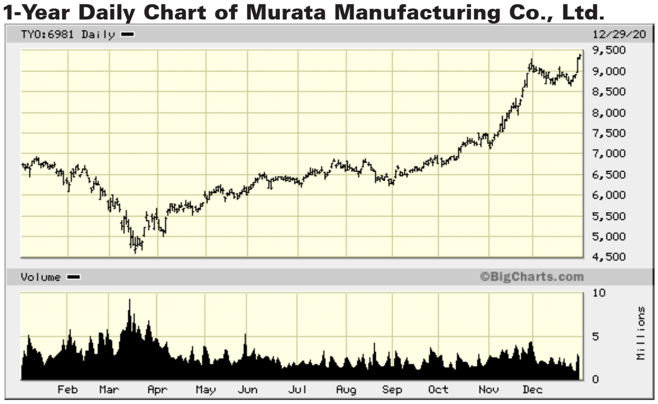


**Chart provided by www.BigCharts.com**

Even **Rentokil**, which is benefiting in general from the COVID-19 pandemic for the sanitization demand of the office spaces in the U.S. and Europe, initially had negative growth at the very beginning of the pandemic because they had to shut down their business for a certain period of time. But in 2021 those operations will be in full swing as things get normalized, and still there's a lot of demand from COVID-19. It will impact the long-term equity story, as well.

**Murata** is the same. They had some minor disruption in its production lines because of COVID-19, but their long-term business is very solid. The 5G story, for example, is a long-term story to build a network across the world, and electronic gadgets, and overall demand for ceramic capacitors is very strong, and the double-digit growth for the next, I would say, five to 10 years is almost guaranteed. It's a very powerful equity story for **Murata**.

I would expect those companies will have more bullish and more upbeat outlooks in 2021.

We do invest in the consumer side as well, and some of them were disrupted in 2020, but here is the same story — as the COVID-19 situation stabilizes and the economy normalizes, these businesses will be back on track and will be compounding the capital of shareholders again.

**TWST: Are there any other big picture or macro issues that are top of mind for you?**

**Mr. Hosomizu:** Other than COVID-19, probably the U.S. government change is, not necessarily an issue, but a big change, especially for international equities. We are still analyzing how the presidential shift will impact the international market, especially around the U.S.-China trade tension and other political things, how the new Biden government treats the U.S. economy and taxes, or other regulatory issues such as around the health care industry as well. But in general, we are very hopeful for 2021.

**TWST: Do you want to wrap with some final thoughts or advice?**

**Mr. Hosomizu:** Nothing to add, but again, our strength is in our long research experience, cross-sectional experience and our equity research analyst expertise, both in industry and geographic exposure. We are very excited to enter 2021.

**TWST: Thank you. (MN)**

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The Fund invests in foreign securities which may be less liquid, subject to currency-rate fluctuations, be in areas with political and economic instability, and be subject to less strict regulation of the securities markets. These risks are greater for investments in emerging markets.

As of 12/31/20, Rentokil Initial PLC (RTO LN) comprised 3.50% of the Fund holdings and Murata Manufacturing Co. Ltd. (6981 JP) comprised 2.59%. Holdings are subject to change and are not recommendations to buy or sell any security.

Return on Investment (ROI) is a performance measure used to evaluate the efficiency of an investment or compare the efficiency of a number of different investments. ROI tries to directly measure the amount of return on a particular investment, relative to the investment's cost. Return on equity (ROE) is considered a measure of the profitability of a corporation in relation to stockholders' equity.

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