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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Using Scenario Analysis to Look at a Company's Range of Outcomes

WARREN KOONTZ JR., CFA, is Managing Director, Head of Value Equities and a large-cap value Portfolio Manager at Jennison Associates LLC. Earlier, he was a portfolio manager at Loomis, Sayles & Company for diversified and concentrated value strategies. Earlier, he was a senior portfolio manager at Comerica Bank. He also worked for three years as Chief Investment Officer for The Jeffrey Company, a private investment firm. He began his investment career in 1984 at the Public Employees' Retirement System of Ohio as a securities analyst and later became an assistant investment officer. He received a B.S. in finance and an MBA from Ohio State University.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Koontz: We are very much a fundamental manager, with deep research skills and insights that are shared across our investment teams. Our portfolios are constructed with high-conviction names, high active share, and portfolios across the firm are constructed from a bottom-up orientation.

TWST: And could you tell me a little bit about your approach to value investing at the firm?

Mr. Koontz: We look at the underlying fundamental value of companies, the intrinsic value of companies. And we are using scenario analysis to look at a range of outcomes. The most likely outcome is our base-case scenario. This base-case scenario is our estimate of intrinsic value or the target price of our companies. We also look at a reasonable downside scenario, which we feel is just as important as our base case.

We are long-term investors and our turnover in our value portfolios tends to be fairly low, around 25% in any particular year. This implies a four-year outlook in our scenario analysis. Our intent is to look for a 2-to-1 upside-to-downside ratio. That is a stock that has manageable or smaller downside in relation to the upside as our investment thesis plays out and the underlying intrinsic value is recognized. If you put the 2-to-1 ratio into numbers, on average, we look for 20% or so upside with 10% or so downside.

Additionally, we think about this upside-to-downside ratio as a way to think about risk. If a stock has more risk than average, we will demand more than a 2-to-1 ratio. Conversely, if a stock is a stable cash flow generator in the consumer staples sector, as an example, we may require less than a two-to-one upside-to-downside ratio.

TWST: And why does that approach make sense now with what's going on in the market and the economy?

Mr. Koontz: I think it has always made sense. First of all, I've been a value investor for 33 years. I've always taken a longer-term approach in analyzing the market. A longer-term approach is even more important now given the large and short-term horizon of flows into ETFs and systematic funds through factor investing. These large, short-term flows create wonderful opportunities for a longer-term value approach.

In my view, many of these flows have no regard for valuations and prices; therefore, they can drive stock prices well away from the company's intrinsic value. Of course, these flows can drive prices to undervalue companies or to overvalue them. Obviously, as a value investor, we are looking to add to the companies the market is undervaluing or ignoring and move away from the companies the market is overvaluing or crowding into. And so these short-term fund flows, which have become a large portion of the daily volume, create wonderful opportunities if you're a long-term, high-conviction, fundamentally research-based firm.

TWST: You mentioned some areas that are being ignored. Did you want to give an example?

Mr. Koontz: The areas that I would say that were ignored recently came to light with the presidential election. These ignored areas are the economic-sensitive industries, like industrials, materials and energy stocks. Of course, you can also say that financials had been ignored for periods of time over the last decade. These industries mentioned are very prominent areas for value investors. Eventually, there is some catalyst that allows that undervaluation to be recognized and the market moves in that direction.

The financial sector is an area that we have had a substantial exposure to over the last year. We have witnessed a substantial rally after the presidential election with the idea that more economic stimulus would improve the economy and accelerate the Federal Reserve's pace of interest rate increases. Of course, we have been battling a decade or more of declining interest rates, which has been a tremendous headwind for the banks and created very attractive valuations as investors were apprehensive.

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With the perception that the economy would move at a faster pace, the market's attitude changed dramatically toward the financial sector. This is a very good example of the dislocations of the large and short-term nature of recent fund flows. As the attitude changed substantially after the election, fund flows have moved quickly back toward buying financials. Even after the run up, I think financials are very attractive.

TWST: And did you want to mention a stock that you find interesting now?

Mr. Koontz: Yes, **Bank of America** (NYSE:BAC) is one that is very interesting. It is a beneficiary of rising rates. And you are still able to buy this at about 11 times earnings, which looks very attractive relative to the broader market at 17 times earnings. Another attractive aspect you have is the policy environment. If the Trump administration is backing away from some of the more onerous legislation or policies, that should help reduce banks' cost structures. That's certainly helpful. **Bank of America** is a large position in our portfolios, and we still see a plenty of upside. We think, given the move up in the stock, the downside is a bit larger than it was but still manageable.

Highlights

Warren Koontz Jr. discusses Jennison Associates LLC. With a bottom-up approach, Mr. Koontz's portfolios are constructed with high-conviction names and high active share. He uses scenario analysis to look at a stock's range of outcomes. Mr. Koontz uses the base-case scenario to estimate a company's intrinsic value. He also looks at a reasonable downside scenario, which Mr. Koontz believes is just as important as the base case. In addition, Mr. Koontz is a long-term investor and his portfolios have a very low turnover. In general, he looks for a 2-to-1 upside-to-downside ratio and sees the ratio as a way to think about risk. If a stock has above-average risk, Mr. Koontz will require more than a 2-to-1 ratio.

Companies discussed: Bank of America Corp. (NYSE:BAC); Flex Ltd. (NASDAQ:FLEX); Nike (NYSE:NKE); FMC Corp. (NYSE:FMC); Tesla (NASDAQ:TSLA); Viacom (NASDAQ:VIA) and CBS Corporation (NYSE:CBS).

TWST: And what about Bank of America do you think investors may not realize that is important for them to know about the company?

Mr. Koontz: In my view, their consumer bank is underappreciated. If you think about what they are, with the addition of **Merrill Lynch**, they are very good at offering a banking client a broad range of products. These range from credit cards, brokerage and wealth management services to basic banking like auto and mortgage loans. So they have offered a very good breadth of product, which I think that's not fully recognized. In a better banking and rising rate environment, I think these businesses can provide improving returns.

TWST: And do you think they will benefit, like a lot of financial institutions, if there's some regulatory reform with Dodd-Frank and some of the other regulations?

Mr. Koontz: Yes, certainly they could. I don't think we are going back to the banks of old, before the financial crisis, where they took undue risk by trading for their own book. They are certainly going to be more regulated and better capitalized than they were then. However, when you think about the amount of regulation and the amount of reporting that has to be done now, it does create and has created an overhang and an increased cost structure. If we have better definitions of bank regulations and less regulations, this should increase the amount of capital that can be returned to shareholders.

TWST: Could you explain a little bit about its nationwide footprint?

Mr. Koontz: Well, as you know, it's hard to not see a **Bank of America** branch in any city across the U.S. That is undoubtedly helpful to the consumer banking business, as we discussed earlier. However, the banking environment is also becoming more online-oriented. This will further their nationwide reach. They have been beefing up their technology and beefing up their online services, and this trend will continue. This can allow them to reduce the number of branches, like many banks, but their nationwide reach will continue to be quite large relative to other banks.

TWST: Do you think that they'll do well if small or medium-sized businesses start to expand, and will that provide opportunities for Bank of America?

Mr. Koontz: Yes. As the economy continues to grow, and at perhaps a faster pace, small and medium-sized businesses can benefit. Small and medium-sized businesses can enhance commercial and industrial loan growth. Also, if President Trump follows through with less regulation on businesses across sectors, this should also help smaller businesses. A better business environment can help **Bank of America** as well as most of the banking industry.

TWST: So do you want to bring up another company?

Mr. Koontz: Yes. There are probably two companies that I like that are a bit off the beaten path. One is a tech company. The name is **Flex** (NASDAQ:FLEX), formerly known as **Flextronics**. This is a company that people may remember that concentrated on design and engineering in the technology space. But they have done an extremely good job of expanding their total addressable market beyond just technology companies. They have increased their growth trajectory as they have expanded capabilities to design and manufacture products for industrial, medical, aerospace, defense and automotive companies. And so the shift in revenue is from a highly competitive traditional technology industry to a much larger market.

1-Year Daily Chart of Bank of America Corp.

Chart provided by www.BigCharts.com

rapidly is the growth of electric vehicles.

While there is quite a bit of lithium out there, the particular lithium that they need for batteries is much harder to manufacture. **FMC** has strong lithium manufacturing capabilities to produce this higher-grade lithium required for companies such as **Tesla** (NASDAQ:TSLA). **FMC's** lithium earnings have grown at over 200% over the last four quarters. We believe that its lithium business will double by 2020. So what used to be an asset that generated only 5% of **FMC's** earnings, we believe it is on its way to generating midteens by 2020 and possibly higher should they decide to further expand their lithium business. This high growth business, of course, is a higher multiple business than their ag business.

Speaking of ag, it has been a rough time in the industry. Farm incomes are down, commodities are weak, and inventories of crop control products have been high. In my view, **FMC** has had the correct approach to the ag cycle. They have focused on maintaining price and forcing destocking of products such that when the cycle returns, they should be in very good shape with a solid pricing structure, manageable inventory levels.

So they are managing through a tough ag market, and they have ramped up their lithium capabilities. We believe as lithium grows and the ag cycle turns, earnings for **FMC** can grow substantially into 2020. Again, remember when I talked originally, we use a long-term horizon, and certainly, this is within our time horizon.

"But with the substantial growth in their lithium business with the growth of electric vehicles, it has now morphed into a lithium play. Ag still is the majority of their revenues and earnings, but that's changing rapidly, and the reason it's changing rapidly is the growth of electric vehicles."

To give you an example, they have recently won a contract with **Nike** (NYSE:NKE), the athletic shoe company. **Flex** will take **Nike's** shoe design and develop the manufacturing capabilities and deliver to **Nike** the finished product. Another contract that **Flex** has mentioned is with **Bose**, the speaker and audio company. As **Flex** expands it markets, we see this continuing to revalue the company. Lastly, as a value investor I should mention that the valuation is very reasonable. It is only selling at about 11 times next year's earnings.

TWST: And theoretically, Flex could go into a lot of different sectors in the economy. And if they're working on sneakers, there are all sorts of fields with which they could end up getting involved.

Mr. Koontz: That's right. And that's the real story of this company. It's really transforming and providing design and manufacturing capabilities across a broader global spectrum.

TWST: And did you want to mention another company?

Mr. Koontz: The other company I would like to talk about is **FMC Corporation** (NYSE:FMC), which is an agricultural materials company. Many people will remember **FMC** as an agricultural play with a small lithium business. But with the substantial growth in their lithium business with the growth of electric vehicles, it has now morphed into a lithium play. Ag still is the majority of their revenues and earnings, but that's changing rapidly, and the reason it's changing

1-Year Daily Chart of Flex Ltd.

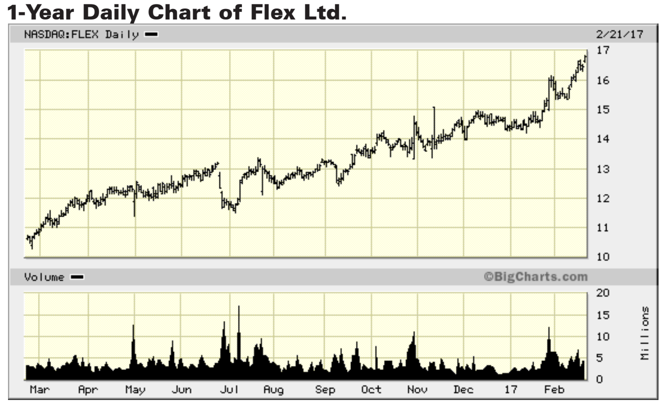

Chart provided by www.BigCharts.com

TWST: And especially with their agriculture business, they're very much a global company as opposed to one that operates more in North America. Maybe you could talk a little bit about that.

Mr. Koontz: Yes, they are a global company. A few years ago, they acquired a company in Europe called **Cheminova**. **Cheminova** has great products but not very good distribution. **FMC**, on the ag side, had decent product but very good distribution. So when you put these two operations together, as they did in 2015, you have very good products and a very good global distribution system. It has been a very good combination that allowed them to better manage through the tough ag downturn.

TWST: And did you want to mention the final company?

Mr. Koontz: I think the final one I'll mention is in the media space, and it is **Viacom** (NASDAQ:VIA). **Viacom** changed their CEO within the last few months. The boardroom melodrama played out publicly, as it has involved some issues around the controlling holder, Sumner Redstone. But in the end, the new CEO, Robert Bakish, has been a very good choice. He has articulated a very good strategy for a turnaround.

The new strategy is really to focus resources on six flagship and four reinforcing brands. These flagship brands include Nickelodeon, Comedy Central, MTV and BET — to name a few. The focus of the resources will be to turn the ratings through better programming. They have shown early signs of ratings improvement but still have a long way to go. The other positive aspect that you have is a good advertising environment. This will be very helpful as the new CEO turns the ratings and is able to attract more advertising dollars.

Lastly, **Viacom** has fairly high leverage. As better cost control and focused spending combine with increasing ad revenues and the elimination of a stock buyback program, the balance sheet should repair fairly quickly over the next couple of years. So with a new management team, a new strategy and a very attractive valuation, the stock has started to perform much better.

TWST: And I understand that the company explored a merger between Viacom and CBS? Is there a possibility that more mergers or acquisitions could be on the table for them at some point?

Mr. Koontz: The merger discussion was a result of a request from the Redstone family, which owns both a majority of voting shares of **Viacom** and **CBS** (NYSE:CBS). It was reviewed and decided it was better for them to stay separate. As a result, the **Viacom** board then named Bakish as CEO to lead the company. As mentioned, the early signs are positive, and the stock has started to rebound.

I would say from **Viacom's standpoint**, there probably will not be a lot of merger or acquisition activity as they work to improve their balance sheet. Currently, they are about over four times levered. As the leverage reaches a much lower level, there is a possibility mergers and acquisitions could occur, but for now, I think they will just concentrate on righting the ship rather than adding more crew in the boat through acquisitions.

TWST: And it appears that the brands that they're focusing on, a lot of them are household names so that certainly could be a benefit to them.

Mr. Koontz: Yes, household names and certainly brands prevalent across all cable systems. Related to this, CEO Bakish has mentioned that he would like to improve and deepen distributor partnerships. Under the previous management, these relationships had been strained. Bakish will focus on cultivating strategic partnerships to reposition the flagship brands, rather than viewing these relationships as transactional. This approach will be very helpful.

TWST: And changing gears a little bit, when you talk with investors and people who follow the market, when they look at 2017, are there certain concerns you think that they're having, and what would your responses to those be?

Mr. Koontz: While there are concerns, investors are fairly optimistic. If President Trump delivers on some aspects of tax reform and can lessen some of the regulations that are perceived to be overbearing, that could be positive for the markets. I think the market has a bit of angst as to whether we have come too far too fast. So far, investors like the discussions around tax reform and regulation, but they will need to see concrete actions from Congress in the coming weeks. There has also been some concern around President Trump's protectionist comments. Obviously, investors would not believe a trade war with China will be beneficial.

TWST: And by approaching it through value investing, is that a way to prevent from losing out on a too-fast response to investing?

Mr. Koontz: As I mentioned earlier in our discussion, we construct our portfolios from the bottom up, one stock at a time. I also mentioned that we focus on the intrinsic value of our holdings through our scenario analysis. While we have an opinion on the macro environment, we are more interested on the impact that a move in the broader market or economy has on individual stock prices. While the Trump presidency has positively impacted the market, we are still pleased with the vast majority of our holdings and how our portfolio is positioned. Said another way, even if the market has come too far too fast, we believe our focus on the upside and downside scenarios is a very appropriate guide with which to navigate the current market environment, or any market environment.

With that said, we have trimmed and sold some individual holdings in this rally, as they have obtained our target prices, and have reinvested the proceeds in other attractive stocks. When investors run up a holding to our target price, we like to be a provider of liquidity and avoid what may be a crowded trade. A crowded trade is rarely an underappreciated stock. Finding underappreciated stocks is a key objective of our value investment process.

TWST: Thank you. (ES)

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