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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in Competitively Advantaged Companies with Strong Managements

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SECTOR — GENERAL INVESTING

TWST: Please give us a snapshot of Luther King Capital Management, a bit about the company's history and business today.

Mr. King: Luther King Capital Management was founded in 1979 by Luther King, after he had served for nearly a decade at Lionel D. Edie. He stepped out on his own to establish a firm here in Texas. The initial clients were from the Fort Worth and Dallas area. The requests from initial clients were for him to establish a firm based in Fort Worth and to focus on the investment research as opposed to marketing.

So for the first 10 years, there was no name on the door, no cards were distributed, and it was really a referral-based platform of investment professionals that focused solely on research and portfolio management as opposed to allocating disproportionate resources to sales and marketing. So that was the genesis, and from there, a lot of the culture that underlies the firm has remained the same.

It started off as principally equity but quickly in 1980 started the balanced strategies, incorporating fixed income as countercyclical components into the portfolios. Then, in 1981, established the fixed income strategy itself. In 1986, established our first partnership, which was an all-cap partnership that created a vehicle for outside investors to not just invest in large-cap core but also to capture other parts of the market through a multicap portfolio.

From there, we continued to lay down additional strategies, and the firm has continued to grow, adding a mutual fund complex in the early 1990s, which incorporated and introduced the small- and eventually smid-cap strategies as well as mutual funds for the core, fixed income and balanced strategies. Then, in the mid-1990s, we established our independent research team, which were dedicated publishing analysts for our own consumption that supported all of the strategies that had been started through the years.

We've continued to grow over the past 25 years since that research team was established, and we've added, in addition to the small and smid, private equity, which we've done for many years on a case-by-case basis but now have an institutional effort in private equity. We have accordingly added an investment team and analysts specific to that division. We've added three offices: expanded in Dallas and added offices in San Antonio and Austin.

Most recently, we started the international strategy, which began in 2015. And we've continued to grow that, initially incubating it for the first five years with internal capital and then starting to actively introduce the strategy to prospective clients during the last 12 months. We started a mutual fund in May of 2019 after we had established a relevant track record in an LP format.

The firm has hit a record of $19.6 billion in assets under management at the conclusion of the last quarter. And we have a robust professional staff of approximately 52 investment professionals, total employees of 85, and in those 52 investment professionals, including 32 CFAs, 31 MBAs and seven CPAs, with a combined experience of 1,257 years of investment experience.

TWST: What would you say most characterizes the firm's overall investment approach and philosophy, and how does that translate specifically to the international equity strategy?

Mr. King: The investment philosophy has been very consistent throughout the many decades of our existence, and really, it comes from fundamental bottom-up research into each company and industry. Our analysts look for competitively advantaged companies with strong managements, with better-than-industry and better-than-broader-market growth prospects, with investment capital returns that also exceed not only our cost of capital but also their peers. With strong managements, they can allocate the internal shareholders' capital generated through earnings back into growth at these attractive rates of return.

It's a pretty basic approach from that standpoint — invest in the company and invest in the management. Then, let them compound the capital with lowest frictional costs incurred with taxes by effective capital allocation and compounding in attractive marketplaces. Typically, that means that we have higher quality of earnings and cash flow dynamics. We typically prefer to have modest amounts of leverage. We want the companies to earn their cost of capital through operational strength and not financial leverage.

We're typically a low-turnover and high-active-share firm. We've found that throughout our history, and also many studies support this as well, higher-active-share and lower-turnover managers have a higher incidence of positive alpha throughout cycles. That is a recipe that we follow and believe in.

Typically, our core portfolios are about 40 to 50, maybe up to 55 names, with the tendency to use the whole market-cap spectrum within the portfolio. Our portfolios typically, even in the large-cap space, fall squarely in the middle of the large-cap core box, if you will, but on an aggregate level. That doesn't mean that we don't try to find good ideas that are in the down cap range, either mid or smaller large caps that have great runways to continue to grow before the law of large numbers really starts to stand in their way.

How does this translate to international? Companies have the same business models irrespective of marketplaces, and when we started the international strategy, the concept was to use the same analyst team to review companies that would be competitors of the domestic companies. They just operate in a different domicile, oftentimes competing in similar end markets from a geographic and product standpoint. This brings a great amount of background and experience into a review of a new set of securities in industries and companies, many of which we already know.

A good example would be our consumer staples analyst who covers **Estee Lauder** (NYSE:EL) and was already familiar with **L'Oreal** (EPA:OR) and **Shiseido** (TYO:4911), which are the French and Japanese cosmetics companies that compete in similar markets with **Estee**. You've got this great ability to look across and see what the competitive advantages might be for one versus the other or see where certain trends might be emerging in one at the expense of another.

So it really brings in a great ability to view the entire universe, the global universe of competitors under one umbrella from a research standpoint. I've referred to this as believing that it's intellectually honest to go in and think of all of those as investable ideas. If **L'Oreal** happens to be chipping away at market share of an **Estee**, then you may want to own **L'Oreal**, in which case that should shape your opinion on **Estee** as it relates to domestic portfolios.

Across borders, the business drivers and business models and thematic trends are similar, and so you're going to see the development of biologics, by way of example, which transitions into immuno-oncology. That's going to be something that's going to be impacting the entire world. Other themes would be electrification and smart buildings or industrial automation. Those are all themes that we look at, and those are all themes that exist throughout the world.

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There are a handful of companies that have some competitive advantages into those end markets. And so from that standpoint, it really does transition smoothly into thinking about the drivers of both domestic and international businesses, and how we might be able to generate investment returns on them.

We focus on the developed markets, principally due to the lower volatility of currency and better peace of mind around the policy and legal components of their underlying marketplaces. That allows for us also to have more peace of mind as we exercise our investment discipline, which involves longer holding periods and supporting management in their execution of their business strategy. It's a little harder when you have less confidence in the accounting standards, less confidence in the regulatory framework and less confidence in rule of law or policy direction. So those are some of the reasons why we believe that the approach that we've taken to our investments and our investment philosophy within the domestic market transitions and translates well into the developed international large-cap space.

TWST: You just mentioned a few investment themes. Are there any others that you would point to that you're paying special attention to these days?

Mr. King: As I mentioned, one is the biologics, and we've certainly been building out exposure there through a few different securities, both in the capital equipment and consumables for production, as well as outsourced manufacturing of biologics. And then, electrification that goes into the buildings and smart buildings. Better ways of utilizing energy is one theme, as well as the electrification of autos. The amount of semiconductors per automobile that is manufactured continues to increase, which means that is a growing value within each automobile produced.

You have the continual improvement in industrial automation. This goes into discrete manufacturing and robotics. As you're trying to improve productivity of an industrial plant, you're really leveraging

Highlights

Mason D. King discusses Luther King Capital Management and its international equity strategy. Mr. King says the firm uses fundamental bottom-up research to find competitively advantaged companies with strong management teams. He describes the firm as having low turnover and high active share. The international strategy is based on the idea that companies have the same business models irrespective of marketplaces. Some of the themes Mr. King is looking at are biologics, electrification, industrial automation, and cloud computing and internet of things.

Companies discussed: Estee Lauder Companies (NYSE:EL); L'Oreal SA (EPA:OR); Shiseido Company, Limited (TYO:4911); Fluidra SA (BME:FDR) and CSL Limited (ASX:CSL).

technology in order to do that by either de-emphasizing the FTEs on a manufacturing line or increasing the productivity of each man-hour employed, as well as minimizing waste and improving throughput.

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Another would be cloud computing and internet of things. These are continuing to surge forward in an environment of remote work, which we're all experiencing today. We can appreciate the benefits of virtual networks and cloud computing in order to access our "desktop" and software remotely during this unconventional work environment of the pandemic.

1-Year Daily Chart of Fluidra SA

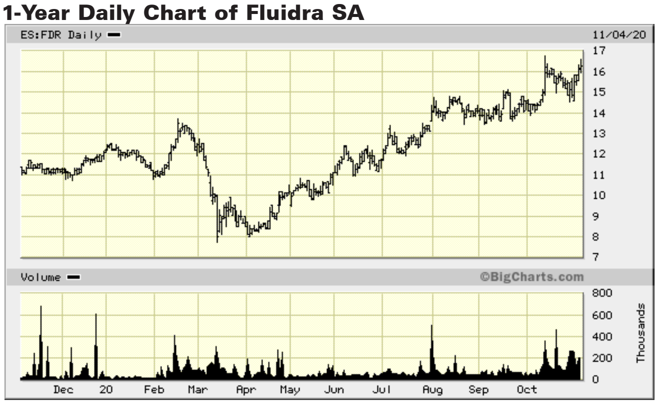

Chart provided by www.BigCharts.com

So those are some of the big themes that we're looking at. There are others as well, but those are a few of the highlights.

TWST: Would you share a few of your favorite names and tell us about why you find them attractive and how they illustrate your investment criteria?

Mr. King: One that's pretty interesting, and we've been invested in for a little over a year now, is **Fluidra** (BME:FDR). It's a Spanish company. It is a small-cap name and is the smallest name in our portfolio but is one that we've been particularly excited about. It has been well-positioned from a growth-in-a-cycle standpoint in this environment, and that's because they are one of the largest providers of pool equipment and chemicals into the global market.

The company went through a merger with Zodiac in 2018. It was a Spanish company, and Zodiac was a U.S. company. This created a global leader in pool supplies. Some of the brands they have are Jandy and Polaris. And this puts them in a great position to capitalize on what we're seeing in the pool industry today.

When we got involved, the investment thesis principally revolved around the merger of the two companies, new management leadership over the combined entity. They will move forward with productivity initiatives that we believe should drive down costs and, through the synergies that they've already targeted, drive up the margins over the next few years. Unbeknownst to us, there was going to be a pandemic, and people were going to start to suburbanize, if you will.

The more and more they are spending time at home, we've seen a phenomenon over the past six months of increased installations of residential pools. This is a phenomenon that's related both to the homebuilding sector, in which we are seeing a lot of activity in the U.S. where people are buying homes and exercising household formation on the heels of low interest rates as well as people and families in existing homes that want to improve their home environment during a time in which they're spending many more hours of the day at their residence.

Now, we're seeing backlogs at pool installation and construction companies go out over a year in some cases. That becomes an installed base for **Fluidra**, and that is now creating a cyclical tailwind for **Fluidra** at the same time all these management initiatives and synergistic benefits should start to flow through. You should get topline tailwinds as well as operational improvements, which should drive solid bottom-line performance on a stock that is also reasonably valued in this environment right now.

Another one is **CSL** (ASX:CSL), and it is a blood plasma and fractionation company that is based in Australia. This is a little bit different in that it is actually an oligopoly. During a rationalization of the industry that occurred about 20 years ago, many of the blood collection and even fractionation companies failed. Correspondingly, there was a global consolidation within the industry to three remaining companies that control nearly 100% of the capacity. With that discipline came better visibility and consistency in returns.

1-Year Daily Chart of CSL Limited

Chart provided by www.BigCharts.com

They manage their supply through both company-owned donation sites as well as sourcing blood plasma from external sites in order to have some diversification in their sourcing. They bring that blood in and basically fractionate the blood, separating out all the proteins and effectively marketing those proteins to health care needs throughout the world. Albumin is a big product that comes out of that; that market continues to grow. **CSL** is dominant in that refined product.

There are many treatments and vaccines that are dependent upon these blood proteins. As long as we continue to suffer certain ailments and as long as we continue to treat them with existing blood proteins, then they'll continue to have a market.

CSL has been a consistent grower through the years. They also have a lot of revenues within the United States as well as tapping into a growing Chinese market. There are no domestic Chinese competitors at this point in time, principally due to the health standards and safety standards of **CSL** and the other two competitors, which are significantly higher than what exists in China today. Not to say that they can't get there, but there's higher confidence in the existing participants right now.

They are not as cheap. They trade at a higher multiple, which is not uncommon for incumbent health care names in oligopolistic marketplaces with good growth profiles and returns. But they still have continued to execute well and surprise on the upside. Some concerns earlier in the year around plasma supply and potential disruptions from that have been dispelled. Now, there's better visibility going forward for them to continue to execute well.

TWST: You focus on the bottom-up analysis, as you mentioned earlier, but are there particular geographic markets and/or sectors that you're positive on, that you're finding more opportunities present right now?

Mr. King: On geographic markets, I would say that right now, it's really hard to make any calls based upon the uncertainty in the environment. There have been a ton of monetary and fiscal stimuli that have been put in place to help offset some of the economic disruptions as a result of the pandemic. That being said, the strength that we do see within Europe still remains in the core markets of Germany and some of the Scandinavians and, to a lesser degree, France, especially in light of the infection rates and new cases that they've been seeing over the past month.

The weaker links continue to be the PIGS, if you will, which is Portugal, Italy, Greece and Spain. They continue to see difficulties in rebounding back to pre-COVID levels on economic activity. Particularly in Spain, where you're seeing record new cases, there are risks to more draconian lockdowns even beyond the current restrictions. In the absence of a treatment, a vaccine or a decrease in new cases, it's going to be hard to be too constructive for the shorter term on any region.

But we are constructive longer term; we do believe that we'll get through this pandemic. We have better visibility of treatments and vaccines. It's just a question of when they become available. Then, that will lead us to certain conclusions about the capital costs that will be incurred during the course of the cycle and then how we come out on the other side.

As it relates to sectors, I'll actually be a little contrarian. The sectors today that have done really well principally have been in the technology arena. Those have done really well, multiples are healthy, and outlook is robust. I think that segment of the market is priced close to full value, though it could continue to surge forward in a low interest rate environment and with that visibility for continued growth. That all being said, I'm starting to get more constructive on some names outside of the growth area, specifically in financials and possibly energy. These names have seen a whole lot of cyclical headwinds.

Financials have had uncertainty around credit costs, which we still don't have good insight into. They've been under pressure because of the rate environment, and all of this has led to them having depressed returns and depressed earnings in 2020, and thereby depressed multiples on book value in 2020. Some of the multiples in the financials have reached lows that haven't been seen since the great financial crisis, though these names tend to have more capital on their balance sheets and have more support in this environment than they did during the great financial crisis as it relates to supporting their loan books and preventing a major systemic credit issue.

The visibility for such returns on financials is still uncertain, which still makes it a hard place to invest. European and Japanese banks are particularly challenging because they tend to have lower, cyclically adjusted returns relative to their U.S. peers. So it's not an industry that would fit perfectly consistent with our investment philosophy, but I do see a tactical opportunity here to buy the higher-quality banking and even insurance names that should benefit from a rotation.

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Additionally, energy has seen some dire days during 2020 where supply dramatically outpaced demand. Demand has been coming back; supply has still been in excess of this demand. We believe that will come into balance; it's just a matter of time. There's still quite a bit of bloodletting that needs to occur before the storm has passed, but we believe that valuations at this point are getting attractive enough to start looking into opportunities there.

In prior cycles, there's been a ton of private equity that's come in and backstopped many of the free-falling companies that had poor business models and were basically unsustainable in our view, but after backstopping it in the 2016 time frame, most of those have been absent in the 2020 cycle. The tighter access to capital should allow a little more rationalization of that industry, which should prove constructive moving forward.

TWST: What are you cautious about, and what questions or concerns do you hear from clients?

Mr. King: Most of our clients are domestic, and most of those are relatively local. Most of the caution that they have would probably be COVID and the pandemic and the continuing impact that this will have on economic activity, particularly concerns as it relates to the risks of moving back into more draconian lockdowns or other incredibly restrictive policies. That would probably be number one. Everybody wants to see better visibility to treatments and vaccines so that we can get economic activity back up to where it was prior to the epidemic.

And then on top of that, I would say that weighing on our clients' minds would be the upcoming election. I imagine that this is something that is weighing on many investors' minds, especially those in the taxable arena. At this point in time, we have done a lot as a nation, and other nations have acted similarly, to provide both monetary and fiscal stimulus in order to provide liquidity and capital to get out of this self-imposed recession — a necessary self-imposed recession — as it relates to our responses to the epidemiological risks.

But the momentum that we currently have and the V bottom that we've seen to date could be at risk, now both from a resumption of restrictions and lockdowns as well as policies that may be less accommodative to growth. So at this point, many of our clients are eyeing the potential for increased taxation, increased regulation, and those would be the two primary concerns that seem to be on the horizon. That brings with it some level of uncertainty of the exact impact on economic growth and thereby the outlook for future earnings of both domestic as well as international participants in the United States.

We see fewer of those policy risks in other countries. Many of the countries outside of the U.S. have actually been moving down corporate tax rates before us, and so we were the conspicuous outlier at 35% for the G-7. France is now the outlier on the upper end, but they have a path down with legislation passed last December to lower their corporate tax rates over the next few years. The current simple average statutory corporate tax rate in Europe is 21.9%. You don't see the same phenomenon over there or, for that matter, in many other nations like you're seeing that risk play out here in the U.S. for corporate rates raising costs of capital.

TWST: What are your thoughts on current valuations in the market, especially given the pressures the global pandemic is putting on our economies?

Mr. King: I would say that this is a really unique environment. Principally, as you look at it with growth versus value, you really have a bifurcated market, where many of those GARP-y or momentum-type themes or securities have run to valuations that could be perceived as elevated or full. Alternatively, you have a lot of names that may be more value-oriented — or deemed value — that are trading at compressed multiples on book values, as manifest by the two sectors that I mentioned earlier, financials and energy. And so you really have this story of two markets.

If you look at the MSCI Growth Index, it's actually up about 5%, but the complementary Value Index is actually down about 19%. Likewise, on growth versus value interplay in the United States, you're seeing the same phenomenon play out. It's even better expressed within the S&P 500 cap-weighted index, in which case you've got five megacap growth names representing 23% of the index. Those have been supporting the headline price returns of 4%, whereas on an equal weight basis the market is actually down approximately 6%, excluding dividends.

So I think that valuations are something to remain cognizant of. I think that there's really a story of two different markets. There are some that perhaps provide good investment opportunities based upon valuation alone, but they also run the risk of being value traps for some period of time, and perhaps indefinitely depending on the name. Alternatively, those that have good visibility in this uncertain environment of continued growth and solid returns are actually trading at pretty full multiples, albeit appropriately compensating those that hold the names for that certainty in an environment flooded with low rates and liquidity.

TWST: Thank you. (MN)

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