

Investor Insight: Hotchkis & Wiley

The negative case is usually obvious in typical value-investing ideas. Which is exactly why they might be interesting, say George Davis and Scott McBride.

INVESTOR INSIGHT



Hotchkis & Wiley

George Davis (l), Scott McBride (r)

Investment Focus: Seek companies for which expectations built into share prices overly reflect a current, under-performing state of affairs that is not likely to persist.

After earning a Stanford M.B.A. in 1988, George Davis worked with well-known San Francisco investor Claude Rosenberg to develop a tool to measure sentiment on individual companies, flagging stocks held in low regard by Wall Street as worthy of interest. “We called it the ‘straw hat’ indicator, because you want to buy straw hats in the winter when nobody wants them,” says Davis. “That mindset stuck with me.”

Now CEO of \$29 billion (assets) Hotchkis & Wiley, Davis continues to put that value mindset to productive use. Today for the Large Cap Value Fund he co-manages – which over the past ten years has earned a net annualized 14.5%, vs. 12.8% for peers tracked by Morningstar – he’s finding mispriced bargains in such areas as financials, industrials, media and energy.

In past interviews with your colleagues, earnings reverting to “normal” comes up often as a central component to your investment ideas. Describe why.

George Davis: In our experience, market mispricing occurs because the investment community tends to be too short-term in its outlook, resulting in stocks being priced on an extrapolation of current trends. But for a number of reasons businesses may currently be earning at levels far below what they should earn over longer periods of time. The difference between a stock price based on an extrapolation of current trends and one reflecting a more likely reversion to a normal level is what creates value investing opportunities.

There are any number of reasons companies underperform. It can be the macro environment, which we’d argue today is creating value in banks due to historically low levels of interest rates. The market is in many cases pricing banks as if interest rates will stay at today’s levels forever, and while it may be hard to see why that changes in the near term, we think it’s very likely we’ll have a higher global interest rate structure that will benefit banks’ earnings power in the next few years.

With more cyclical companies it’s often just recurring industry cycles. Energy is an obvious example, where you have a considerable amount of pessimism when oil and gas prices are low, which causes companies to pull back on spending, which makes it even worse for companies throughout the energy ecosystem. But that pullback in spending is what leads to supply coming back into better balance with demand, which works toward self-correct-

ing the pricing issue and ultimately driving earnings back to more normal levels.

Then of course there are more company-specific issues, from things like making big product transitions, implementing new business models or investing heavily in technology or people or infrastructure to drive future benefit. All those can result in earnings today falling well short of where they can be in the future. That’s also true in situations requiring more fundamental and broad-based turnarounds, which we’d argue is the case today with a company like General Electric [GE].

This is company specific as well, but it’s also not uncommon that cost-reduction programs, sometimes arising from M&A and sometimes not, go unrecognized or are deemed as not possible. As an example today, we believe expense levels at Wells Fargo [WFC] are far above where they could be. A lot of that is because they’re trying to fix past mistakes and maintain confidence in their brand. Looking out five years it’s not difficult to imagine Wells’ productivity metrics being materially better than they are today. We don’t believe the market is thinking about that.

How does your research process work to weed out temporary problems that can revert from permanent problems that won’t?

GD: Part of it is building confidence that the businesses have good liquidity, access to capital and balance-sheet strength, which protects you – as is often the case – when you need patience to see your thesis play out.

But avoiding value traps is mostly just about doing your homework. With large caps in particular, we think it’s very im-

portant to break companies apart and understand them business unit by business unit from the ground up. Our investment team is made up of industry experts that have been at Hotchkis & Wiley for an average of 15 years. They spend all their time meeting with companies, talking about the industry they follow and developing as complete an understanding as possible of industry competitive dynamics, cycles and trends. Only with that can you arrive at credible estimates for long-run margins and returns on capital on a business-by-business basis and have conviction, as you say, about the extent to which problems are temporary or permanent.

I should add, though, how important it is to continually view any opportunity or situation with a fresh mindset. The danger in the way we approach things is getting too locked into a point of view that is unalterable and you're not willing to consider you might be wrong. I see it as part of my role and of the other portfolio managers here to make sure we bring the required humility to the table. If we don't, the market has a way of teaching the value of that pretty effectively.

Can you describe a representative case in the fairly recent past where you couldn't build conviction that the situation at hand would sufficiently improve?

Scott McBride: We'd owned IBM [IBM] off and on for some time, attracted by its businesses with good market shares, its strong cash-flow generation and its return of capital to shareholders. But it became evident that changes in the world of technology, particularly the movement to the cloud, were going to make things difficult for the company going forward. That would result in pressure on key software and outsourcing businesses, and we didn't believe their newer-generation offerings in areas like the cloud, machine learning or artificial intelligence held up particularly well against the competition. The stock wasn't at all expensive on current earnings, but the outlook for those earnings wasn't very good and the shares weren't discounted enough to warrant our holding

on to the position. Our view on that, especially in light of some of the recent capital-allocation decisions the company has been making, hasn't changed.

Why do you appear less worried about the prospects for certain traditional energy companies?

GD: We understand that the future in energy will not look like the past. Renewable energy sources will continue to grow and the cost curves and usage of renewables will change. Consumer acceptance of electric vehicles will surely increase. You have to incorporate all of that into your long-term view.

But it matters how long it takes for these types of things to have a material impact on the supply and demand dynamics for traditional oil and gas. We still believe that investment in oil production in particular isn't sufficient to meet long-term demand. If we're right, activity levels will increase and oil prices are likely to be higher than they have been in recent years. That should eventually make the current prices we're having to pay for the exploration-and-production and oilfield-services companies we own turn out to be extremely attractive.

That doesn't mean we're finding everything in the sector interesting. We're much more skewed to the upstream part of the energy complex, where the commodity-price sensitivity is highest. The market seems much more enamored with the large integrated oil companies, where we don't see as much value.

Are there other sectors you're currently finding particularly bereft of value?

GD: What's been mispriced on the high side in our view have been low-volatility, higher-yielding businesses like regulated utilities, real estate investment trusts and, in many cases, consumer staples. They tend to have high valuation multiples without a lot of underlying growth, so rather than see them as the safe havens the market does, we just generally consider the valuation risk too high.



George Davis, Scott McBride

Divide and Conquer

Investment managers regularly debate the merits of populating their research teams with specialists or generalists. Count Hotchkis & Wiley CEO George Davis and President Scott McBride firmly in the specialist camp. "We've concluded there's considerable value in covering businesses and their stocks over cycles," says McBride. "We just believe that gives you a knowledge base and perspective you wouldn't get by jumping around from industry to industry."

That specialization, he says, helps most in assessing the investment merits of complicated and diverse companies like General Electric. As its share price imploded last year, H&W put a team of specialists together to analyze the company's component parts. "Whether it was aerospace, power, healthcare or insurance, we were able to assign analysts with 10, 15 or 20 years' experience with those individual industries," he says. "If you're an aerospace analyst, how are you going to understand the reserve adequacy of long-term-care insurance? Building from the ground up by industry should give us an advantage in assessing the overall opportunity." Time will tell: after not owning it for decades, the firm bought GE stock for multiple portfolios in 2018's fourth quarter.

Describe in general how you approach valuation.

SM: We will consider valuation from a few different perspectives, but the discussion starts with estimates of normal earn-

ings power and the fair-value multiple. We describe normal earnings as mid-cycle or average cash earnings, assuming a properly capitalized balance sheet. Our primary tool for estimating the fair-value multiple is a proprietary three-stage dividend discount model. The first stage uses explicit earnings projections for years one through five, assuming that a company achieves normal, mid-cycle cash earnings in the fifth year. The second stage reverts the company's returns to market averages over the next fifteen years. The third stage, making assumptions for long-term growth, determines the terminal value of the stock. We then discount all these values back at a market-derived cost of equity to fix a price target.

People often ask about the importance to us of business quality. All else being equal, we prefer to invest in companies with high and sustainable returns on capital. This clearly feeds into the fair value of the company as we derive it – higher-return, more-sustainable businesses are going to be worth more than lower-return, less-sustainable businesses. But if the shares don't trade for a significant discount to what we believe they're worth, we're just not going to be interested.

For your Large Cap Value mutual fund, you won't buy a stock that doesn't meet minimum hurdles with respect to earnings yield and payout ratio. Explain those two hurdles and the rationales behind them.

GD: The first is that we're looking for a normalized earnings yield on forward estimates that is 300 basis points above the risk-free rate, which we define today as the rate on the 10-year Treasury. With the 10-year at 2.5%, that's not a very high hurdle – a 5.5% earnings yield translates into an 18x earnings multiple. The rationale, though, is that we need to be compensated for the risk of owning equity and we want normalized earnings of at least a minimum level to justify the price we're paying.

The second hurdle is that either the dividend yield or the payout yield, including share repurchases, exceeds that of the S&P 500. We're all for reinvesting in the

business, but in the large, mature companies we target we also like the discipline of their returning capital to us rather than to empire build or otherwise put excess capital to unproductive use.

The fund currently owns around 50 stocks. Why that level of diversification?

GD: We do value diversification and the spreading out of risks. We won't hold more than 5% of the portfolio in a given stock or more than 15% in a given indus-

ON DIVIDENDS:

In large, mature companies we like the discipline of their returning capital to us rather than using it to empire build.

try segment. We also after the financial crisis have incorporated more tools that allow us to track and analyze the exposures we have at the portfolio level to a variety of macroeconomic factors. We always had a sense of our exposures, but now we measure them more comprehensively than before. We'll take on incremental risk, but we're now clearer on the level of risk we're taking and even more attuned to making sure we're being compensated for it.

On the other hand, we think holding 40 to 60 positions at a time allows us to concentrate on our best ideas – we generally have 35-40% of the portfolio in our top ten holdings – and results in the high active share that is obviously critical if you want to outperform.

It's hard to think of a company more in need of mean reversion than General Electric. Describe in more detail your investment case for it.

GD: I would just start out by saying that I don't believe Hotchkis & Wiley had ever owned GE stock until last year. In its heyday it was always valued at a premium multiple. Even when it got slammed in the

financial crisis, we always felt we could find the industrial and financial exposures it offered elsewhere at a better risk/reward.

When the stock price was at \$30 in 2017, it wasn't compelling at all. As it got into the teens, relative to our estimate of intrinsic value it started to get more interesting. We didn't expect the price to go into the single-digits, but when it did in the fourth quarter we made it one of our largest purchases.

SM: Some of what we think has gotten lost in all the turmoil around GE is that the company's core businesses generally have large market shares in big markets and benefit from extensive installed bases that produce a lot of high-margin recurring aftermarket revenue. They have 70% of the global commercial jet-engine market. They have a 50% share of the global diagnostic medical-imaging market. They have 50% of the total market for gas power turbines.

The investment case essentially comes down to our belief that there is a big gap between current earnings and cash flow and our normalized estimates for both. We estimate normalized earnings power at about \$1.25 per share and normal free cash flow around the same level. Current earnings are around 55 cents a share and current free cash flow is negative.

The biggest reason for the gap is the power business. It has been weaker than expected for a number of reasons, including more competition from renewables, a problem with one of their new turbines that resulted in paying costly damages, inheriting too many money-losing projects in acquiring Alstom's power and grid business in 2015, as well as some natural cyclicality in the industry.

To our mind these problems don't permanently impair the business. While renewables will continue to take market share, they aren't going to be able to completely meet the world's power demands, and gas turbines like those GE makes are likely to replace significant power-generating capacity now fueled by coal, oil or nuclear. At the same time, the business is going through a restructuring that will

INVESTMENT SNAPSHOT

General Electric
(NYSE: GE)

Business: Fallen-from-grace industrial conglomerate with key operating segments focused on aircraft engines, power turbines, renewable energy and medical imaging.

Share Information (@4/29/19):

Price	9.73
52-Week Range	6.40 – 14.99
Dividend Yield	0.4%
Market Cap	\$84.74 billion

Financials (TTM):

Revenue	\$121.61 billion
Operating Profit Margin	6.6%
Net Profit Margin	(-18.4%)

Valuation Metrics

(@4/29/19):

	GE	S&P 500
P/E (TTM)	n/a	22.0
Forward P/E (Est.)	13.7	17.6

Largest Institutional Owners

(@12/31/18 or latest filing):

Company	% Owned
Vanguard Group	7.3%
BlackRock	4.3%
State Street	3.9%
Fidelity Mgmt & Research	3.0%
T. Rowe Price	2.7%

Short Interest (as of 4/15/19):

Shares Short/Float	1.5%
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GE PRICE HISTORY



THE BOTTOM LINE

The company is significantly underearning its potential, particularly in its gas-turbine, jet-engine and renewable-energy businesses, says Scott McBride. As results in those units improve, he estimates per-share earnings power within the next few years at \$1.25. At what he would consider a reasonable 16x P/E, the shares would then trade around \$20.

Sources: Company reports, other publicly available information

take out a lot of costs, increasing earnings power and cash flow in the future.

Another source of improvement we see is in the jet-engine business. The LEAP engine, produced jointly with Safran Aircraft Engines, has been a big success in the market and should become considerably more profitable as the product matures. Costs should come down through increased manufacturing efficiency, and the growing installed base should result in an increase in high-margin service revenues.

A smaller item I'd mention that should improve earnings power beyond what seems to be expected is the fact that GE

also has a big renewables power-generation business that is essentially making no money. We believe it will be a strong competitor in a growing market, translating into much better profitability than is currently the case.

How are you thinking about the company's debt load?

SM: If you combine the balance sheets of the finance and industrial businesses, there's \$130 billion of debt and net pension obligations. A finance company balance sheet looks different than one of an

industrial company, so when we adjust for an appropriate amount of leverage on the finance business, we believe the industrial business is left currently with about \$52 billion in net debt. That may be too much for GE to be considered an investment-grade credit, but it's not close to more than the value of the company's assets. In fact, we expect more than \$40 billion in asset sales, which as they close in coming quarters will reduce the net debt position on the industrial business to a very manageable \$10 billion. That includes pension obligations – if you exclude those there would be \$10 billion in net cash. To us the balance sheet is not really an issue.

Do you consider the long-term-care insurance issue under control?

SM: The incremental reserves they had to take on this business were obviously very large, but relative to where the rest of the industry is, we think they have reserved conservatively on this. We don't know exactly what the ultimate liability will be, but given the gap we see between current value and intrinsic value overall, it's unlikely this liability will have a material impact on our investment outcome.

With the stock at \$9.75, how big do you consider the gap between current value and intrinsic value?

SM: Given that our \$1.25 per share estimate for normal earnings power would consist of unlevered high-quality earnings, we don't think it's at all unreasonable to expect a P/E of at least 16x. That would result in a share price of \$20.

There were a lot of mistakes made at GE and there is a lot to fix. We think Larry Culp, the new CEO, is taking the right approach. He's asking hard questions. What he's selling makes sense to sell, and he's getting good prices on the sales. It all strikes us as rational and well thought out, which is exactly what the company needs.

Describe as well why you think Wells Fargo will work successfully through its own current problems.

SM: In a competitive industry recovering from the financial crisis, Wells Fargo has been able to consistently earn a higher return on tangible equity – an average of around 17% over the last decade – than most of its competitors. The reason is that it generally has very strong market positions in solid, growing markets. It has an excellent U.S. retail branch network and is one of the best deposit gatherers in the business. It has a very strong middle-market commercial business. It has a top-five wealth-management business that doesn't use a lot of capital. High market shares allow you to spread costs over a bigger base, leading to higher efficiency ratios and therefore higher returns.

The stock today [at around \$48.25] trades at only 7.9x our \$6.10 per share estimate of normalized earnings, which we consider an unreasonably low valuation. Why is that? One key reason is the sales-practices scandals, the resolution of which is clearly consuming a considerable amount of management time and effort. As George mentioned earlier, we believe that's resulted in the company not managing costs as aggressively as its peers have. As Wells over time gets expenses in line, we believe that will have a significant positive impact on earnings power.

The second point I'd make is that the company has had excess capital building in the business. In late 2016 into 2017 they were in the regulatory penalty box and were not able to return nearly as much capital to shareholders as they otherwise would have been allowed to. We believe there's about \$20 billion in capital – close to 10% of the market cap – in excess of what's required and what we expect to be normal. At some point these regulatory headwinds pass and shareholders will benefit from either larger dividends, share buybacks, or both.

How do you think through the potential of lasting damage to the brand, or that the sales culture is what made the company successful and might be going away?

SM: With respect to the brand, the best data we can use to measure any impact

is how customers have responded. So far on a number of metrics we're not seeing much impact at all on customers' relationship with the bank. It's something to watch, but we think they're doing the right things and if that continues to hold, the reputation shouldn't suffer long-term damage.

The harder question is assessing how important the previous selling culture was to Wells' ability to build strong market positions and generate high returns. Here I'd say that we think there's plenty of upside just from getting a better handle on expenses and from returning capital. We

don't really believe market shares are at significant risk from changes in the sales culture, but even if there is some short-term difficulty, at today's share price we think we're being well compensated to take that risk.

You haven't mentioned a view on interest rates. Do you consider that a risk or opportunity here?

SM: We think it's an opportunity as the normalization of interest rates to higher levels would result in an increase in earnings power. But, again, given the currently

INVESTMENT SNAPSHOT

Wells Fargo
(NYSE: WFC)

Business: U.S.-focused bank holding company organized around operating segments in community banking, wholesale banking and wealth and investment management.

Share Information (@4/29/19):

Price	48.27
52-Week Range	43.02 – 59.52
Dividend Yield	3.7%
Market Cap	\$217.79 billion

Financials (TTM):

Revenue	\$83.72 billion
Operating Profit Margin	36.4%
Net Profit Margin	27.6%

Valuation Metrics

(@4/29/19):

	WFC	S&P 500
P/E (TTM)	10.7	22.0
Forward P/E (Est.)	9.2	17.6

Largest Institutional Owners

(@12/31/18 or latest filing):

Company	% Owned
Berkshire Hathaway	9.4%
Vanguard Group	7.1%
State Street	4.0%
BlackRock	4.0%
Capital Research & Mgmt	2.0%

Short Interest (as of 4/15/19):

Shares Short/Float	0.5%
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WFC PRICE HISTORY



THE BOTTOM LINE

Confident that the sales-practices scandals impacting the company will not cause lasting long-term damage, Scott McBride believes its normalized earnings power is \$6.10 per share, driven from today largely by increasing operating efficiency. At the 13-14x earnings multiple he would then consider justified, the share price would be closer to \$80.

Sources: Company reports, other publicly available information

depressed valuation the stock is still attractively priced if you assume interest rates stay where they are indefinitely.

If your \$6.10 per share estimate for normal earnings comes through, what upside do you see in the stock?

SM: We'd argue that the shares at that level of earnings and with the quality of earnings we expect would warrant a 13-14x multiple. That would give us a share price for Wells of around \$80.

From banking to media, explain why you believe Discovery [DISCK] is mispriced.

SM: The company owns a collection of what we think are strong media-network brands – including Discovery Channel, HGTV, Food Network and Eurosport – with large global audiences. They own eight of the top 25 cable channels in the U.S. They own the four top cable networks for women in the U.S. They have the leading kids network in Latin America. Eurosport is the top sports network in Europe. Overall, 60% of revenues come from the U.S. and 40% are international.

We think the outlook for Discovery's earnings is more positive than generally assumed. One driver of that is the fact that the company is currently under-monetizing its audience share in the U.S. Discovery's networks represent approximately 13% of total hours spent watching TV in the U.S., but earn less than 5% of the market revenue generated.

One impetus for that gap narrowing is the acquisition last year of Scripps Networks, which added the HGTV and Food Network brands to the portfolio. Scripps has done a much better job in generating advertising revenue on its U.S. content than Discovery has, and Discovery has done a much better job of generating distribution revenue than Scripps. We expect monetization levels to improve as the best-in-class teams in each of these functions take control of the merged company.

We also see a lot of opportunity outside the U.S. Discovery has been much better at monetizing its content outside the U.S.

than Scripps has, so incremental improvements for the big Scripps brands can have an impact in the hundreds of millions of dollars on the overall bottom line. Unlike in the U.S. where the market is fairly saturated, there's also upside in non-U.S. markets for increased penetration of pay TV, which would be a clear positive for a major content provider like Discovery.

The key reason the stock is cheap in our view is because people are worried about the changing pay-TV ecosystem, particularly in the U.S., and how that will impact Discovery. Our general view is that consumers like its content, the content

isn't that expensive to produce, and that Discovery should be able to increasingly monetize its content regardless of how the media industry evolves.

Discovery's shares have been dead money for the past five years. How cheap do you consider them at today's price of \$29.30?

SM: Management guidance has been for well over \$600 million in annual cost synergies from the Scripps deal, which accounts for an important part of the expected increase this year in earnings to around \$3.60 per share. With the shares

INVESTMENT SNAPSHOT

Discovery
(Nasdaq: DISCK)

Business: Global developer, producer and distributor of televised media content; leading networks include Discovery Channel, Animal Planet, HGTV, Food Network and Eurosport.

Share Information (@4/29/19):

Price	29.33
52-Week Range	19.24 – 31.55
Dividend Yield	0.0%
Market Cap	\$22.36 billion

Financials (TTM):

Revenue	\$10.55 billion
Operating Profit Margin	29.9%
Net Profit Margin	5.6%

Valuation Metrics

(@12/29/19):

	DISCK	S&P 500
P/E (TTM)	40.1	22.0
Forward P/E (Est.)	8.1	17.6

Largest Institutional Owners

(@12/31/18 or latest filing):

Company	% Owned
Vanguard Group	9.6%
Hotchkis & Wiley	6.7%
BlackRock	4.8%
State Street	4.6%
State of Wisconsin Inv Board	3.8%

Short Interest (as of 4/15/19):

Shares Short/Float	1.3%
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DISCK PRICE HISTORY



THE BOTTOM LINE

The market appears to expect material deterioration in earnings from the \$3.60-per-share estimate for this year, says Scott McBride, but he believes EPS will at least stabilize as the company better monetizes its high-demand content. If he's right, he sees on the order of 80% upside in the stock as the valuation re-rates over the next few years.

Sources: Company reports, other publicly available information

trading at 8x that number, the market appears to be pricing in a deterioration in earnings from there that we just don't see.

If we're right that sustainable normal earnings are at least at the \$3.60 per share level expected this year, we think the stock should significantly re-rate. We'd argue this business should be worth more like 15x earnings, which would translate into more than 80% upside in the share price from its current level.

The final thing I'd mention is that we're comfortable that our interests are well aligned with key stakeholders. John Malone is a board member and owns \$500 million worth of the shares, representing 21% of the vote through his ownership of super-voting Series B shares. CEO David Zaslav owns roughly \$100 million in shares and has options to buy another 2.5% of the company at strike prices about equal to today's level.

Why have you made National Oilwell Varco [NOV] your only oilfield-services energy bet?

SM: The company is a leading global provider of oilfield capital equipment, consumables and related services. Its main historical expertise is in providing drilling-rig packages, across a broad range of geographies and drilling environments, for which it supplies almost every key piece of equipment. For some major types of rig equipment, it has more than two-thirds of the market.

The rig-systems industry is in year four or five of below-trend activity worldwide, as spending on new rigs declined sharply after a fall in oil prices and then has been slow to recover, particularly in offshore and other more difficult environments where National Oilwell Varco's position is particularly strong.

Our basic view, as George said, is that the energy market just isn't investing enough to meet long-term demand requirements. There won't be enough supply globally unless investment spending picks up, and when it does, NOV is very well positioned to benefit from that.

One primary thing we don't think the

market appreciates is the breadth of the company's activities beyond the deep-water rig-equipment market. They have a variety of other businesses, from drill-pipe inspection to the manufacture of wireline equipment, which are well entrenched in shallow water markets and onshore, including shale. In fact, more of their equipment is consumed per barrel of oil in shale exploration and development than in deep water. In arriving at our estimate of normal earnings we don't assume much of a pickup at all in offshore rig building. That market coming back would be a free call option for us.

We also don't think the valuation today – which is around 8.5x our estimate of normalized earnings – reflects the fact that this is a high-ROE, low-capital-intensity business that, unlike a lot of energy businesses, generates free cash flow through the cycle. The balance sheet is also extremely strong and can withstand a prolonged downturn here.

How do you expect the shares, now at \$27.75, to be valued if you're right about normal earnings?

SM: Assuming oil prices of \$70 per bar-

INVESTMENT SNAPSHOT

National Oilwell Varco
(NYSE: NOV)

Business: Global provider of oilfield capital equipment, consumables and services used to support a broad range of onshore and offshore energy exploration and development.

Share Information (@4/29/19):

Price	27.75
52-Week Range	24.27 – 49.08
Dividend Yield	0.7%
Market Cap	\$10.71 billion

Financials (TTM):

Revenue	\$8.60 billion
Operating Profit Margin	1.9%
Net Profit Margin	(-0.5%)

Valuation Metrics

(@4/29/19):

	NOV	S&P 500
P/E (TTM)	n/a	22.0
Forward P/E (Est.)	42.0	17.6

Largest Institutional Owners

(@12/31/18 or latest filing):

Company	% Owned
Vanguard Group	10.7%
First Eagle Inv Mgmt	6.1%
Harris Associates	5.9%
Vulcan Value Partners	5.7%
BlackRock	4.9%

Short Interest (as of 4/15/19):

Shares Short/Float	2.8%
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NOV PRICE HISTORY



THE BOTTOM LINE

Scott McBride doesn't believe the market appreciates the breadth and depth of the company's operations or its staying power through difficult cycles like today's. Assuming drilling activity levels necessarily rebound, he thinks the company's share price should rebound as well – at 15x his normal EPS estimate, the stock would trade at closer to \$50.

Sources: Company reports, other publicly available information

rel for West Texas Intermediate crude and closer to \$80 for Brent, as well as the levels of global drilling activity we expect to be needed, we arrive at a normal earnings power of \$3.30 per share. For a business like this we'd consider a normal multiple of 15x to be reasonable, which would result in a share price closer to \$50.

I'd add that our normal earnings estimate is well below a peak level. The business has in the past earned well north of \$5 per share and, again, we're not counting on an uptick in the offshore-rig cycle. If that uptick did happen, earnings would likely be much higher than \$3.30.

Do you find that stocks trade differently now that so much trading is automated in one way or another?

GD: I do think that automated and algorithmic trading have created more volatility in the marketplace. This is really a positive for our style of investing. The more that prices are dislocated from underlying fair value, the larger our opportunity set becomes.

Have the last several years in the market

shaken your confidence at all in mean reversion as the central tenet of your investing philosophy?

GD: Is the world changing? Absolutely. Can those changes create situations where value is just one big value trap? In some

ON VOLATILITY:

Automated and algorithmic trading have created marketplace volatility. This is a positive for our investing style.

cases, yes. If you don't acknowledge that the landscape has changed considerably for retailers, for example, you're like an ostrich with your head buried in the sand.


At the same time, I've been around long enough to remember periods like the tech bubble, when we'd talk about our commitment and discipline to stay focused on investing in companies trading at deep discounts to their fair value and not just owning what was working at the time. About

how you need to think about investment risk in addition to business risk. That often fell on deaf ears and people would say we didn't "get" the new economy. We stayed the course then and have since. Reversion makes every bit of sense in the world and we're going to stay with it.

With graduation season soon upon us, what advice would you give to a budding value investor today?

GD: There are a number of things I love about investing. I like competing and trying to win. I like that almost anything that happens in the world, economic or political, can ultimately influence asset prices, so you're rewarded for endless curiosity and diligence in trying to figure things out. Outperforming for clients is tremendously gratifying.

To be successful in the business you need to be driven, and to have a belief system that makes sense to you and that you stay with consistently. Ours is the value way. It's not for everyone, but if all of this sounds interesting to you and you enjoy the work that goes into it, it can be a wonderful path to pursue. **VII**



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Hotchkis & Wiley is a boutique asset management firm specializing in value investing. We manage more than \$32 billion across our ten Institutional and Mutual Fund strategies. The firm prides itself on an active, team-based, investment approach driven by fundamental research and bottom-up security selection. Privately held, the majority of our employees have an equity stake in the firm.

Equity	Income
<ul style="list-style-type: none"> Large Cap Diversified Value Large Cap Fundamental Value Mid-Cap Value Small Cap Value <i>(Limited)</i> Small Cap Diversified Value Global Value International Value Opportunities 	<ul style="list-style-type: none"> High Yield Capital Income

Value Investor Insight
April 30, 2019
Hotchkis & Wiley Large Cap Value Fund

Average Annual Returns as of March 31, 2019

	1 Year	3 Year	5 Year	10 Year	Since 6/24/87
Class I	1.46%	11.51%	6.87%	15.73%	8.94%
Class A	1.20	11.22	6.60	15.44	8.68
Class A (w/sales charge)	-4.10	9.24	5.46	14.82	8.50
Class C	0.49	10.40	5.81	14.58	7.86
Class C (w/cdsc)	-0.51	10.40	5.81	14.58	7.86
Class R	0.96	10.94	6.34	15.16	8.41
Morningstar Large Value Category Avg	4.48	10.01	7.20	13.68	n/a
Russell 1000 Value Index®	5.67	10.45	7.72	14.52	n/a
S&P 500 Index®	9.50	13.51	10.91	15.92	9.67

The performance shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Investment results and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. To obtain performance data current to the most recent month-end, access our website at www.hwcm.com.

The Fund's total annual operating gross expense ratio as of the most current prospectus is 0.95% for I Shares, 1.20% for A shares, 1.95% for C shares and 1.45% for R shares. Expense ratios shown are gross of any fee waivers or expense reimbursements.

Returns shown for A, C and R Shares for the periods prior to their inception are derived from the historical performance of I Shares of the Fund during such periods and have been adjusted to reflect the higher total annual operating expenses of each specific Share class (Inception date: I Shares-6/24/87, A Shares-10/26/01, C Shares-2/4/02 and R Shares-8/28/03). Returns shown for A Shares and C Shares without sales charge do not reflect the maximum sales load of 5.25% or the Contingent Deferred Sales Charge (CDSC) of 1.00% for the first year; if reflected, performance would be lower than shown. Returns for A and C shares reflect the deduction of the current maximum initial sales charges of 5.25% and 1.00% CDSC. C Shares convert automatically to A Shares approximately eight years after purchase. A Shares are subject to lower annual expenses than C Shares. I shares sold to a limited group of investors. Periods over one year are average annual total return. Average annual total returns include reinvestment of dividends and capital gains. Expense limitations may have increased the Fund's total return.

You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at www.hwcm.com. Read carefully before you invest.

Mutual fund investing involves risk. Principal loss is possible. Investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks, such as business risk, significant stock price fluctuations and illiquidity. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.

Top 10 holdings as of 3/31/19 as a % of the Fund's net assets: American International Group Inc. 4.9%, General Electric Co. 4.2%, Citigroup Inc. 3.9%, Microsoft Corp. 3.9%, Wells Fargo & Co. 3.8%, Goldman Sachs Group Inc. 3.1%, Hewlett Packard Enterprise 3.0%, General Motors Co. 3.0%, Oracle Corp. 2.8% and Hess Corp. 2.6%. Portfolio weightings, sector allocations, and/or fund holdings are subject to change and should not be considered a recommendation to buy or sell any security. Opinions expressed are those of the author and are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice. References to other products should not be interpreted as an offer of these securities.

Free cash flow is earnings before depreciation, amortization, and non-cash charges minus maintenance capital expenditures; Return on capital measures how effectively a company uses the money (borrowed or owned) invested in its operations; Payout yield is dividends plus share buybacks divided by equity; Dividend yield is calculated by annualizing the last quarterly dividend paid and dividing it by the current share price. The dividend yield is that of the securities held in the portfolio; it is not reflective of the yield distributed to shareholders. Earnings yield is a measure of a company's earnings relative to its market cap; Mean reversion is the theory that interest rates, security prices, or various economic indicators will, over time, return to their long-term averages after a significant short-term move; Market capitalization of a company is calculated by multiplying the number of outstanding shares by the current market price of a share; Price-to-Earnings (P/E) is calculated by dividing the current price of a stock by the company's trailing 12 months' earnings per share; Basis point is a unit equal to 1/100th of 1% and is used to denote the change in a financial instrument; Forward P/E (Est.) represents the current market price per share divided by a company's estimated future earnings-per-share. Projected earnings are consensus analyst forecasts; actual P/E ratios may differ from projected P/E ratios; TTM-Trailing Twelve Months; Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Price-to-book is the price of a stock divided by its book value; Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity; M&A (Mergers & Acquisitions); Active share is a measure of the percentage of stock holdings in a portfolio that differ from the benchmark index; and EPS and P/E growth is not representative of the Fund's or underlying securities future performance.

The Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500® Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The indexes do not reflect the payment of transaction costs, fees and expenses associated with an investment in the Fund. It is not possible to invest directly in an index. The Fund's returns may not correlate with the returns of their benchmark index.

NOT FDIC INSURED ■ NO BANK GUARANTEE ■ MAY LOSE VALUE

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