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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Value Managers Make the Case for FIS, Flex and TotalEnergies

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SECTOR — GENERAL INVESTING

TWST: Why don't we start with an overview of the firm?

Mr. DeGulis: Sound Shore is a single-strategy, long-only value boutique and has been around since 1978. We manage one strategy that is focused in on companies that are attractively valued, often contrarian situations, in a reasonably concentrated portfolio of around 35 to 40 stocks.

TWST: Do you want to detail your investment approach?

Mr. DeGulis: Sure. It starts with valuation, given our heritage as value investors. So we pay very close attention to price and ultimately the value that we believe we're paying for a company's earnings power. But that's just the beginning of the process for us. That gives us the opportunity set.

And then we go in and do classic securities analysis, fundamental due diligence on the industries, the businesses, the management teams in order to assess those where we believe today's stock price is not reflecting the value that we think is apparent to us, and also should be apparent to others within our time frame, which is usually a matter of years.

Our average holding period is about three years. And when we get it right, we own a stock for a very attractive price relative to the earnings and cash flow that the business generates two to three years from now.

Our portfolio is diversified by industry and sectors, and it's also principally a large cap strategy and mostly domestic, but we'll have the occasional multinational global company as well. Ultimately, it's a fundamentally driven value strategy.

TWST: Do you want to talk about some specific stocks in the fund?

Mr. Bilik: Sure. We bought **Fidelity National Information Services** (NYSE:FIS), known as **FIS**, in the second quarter of 2023 after the company's enterprise value fell from around $113 billion to $50 billion over a period of two years.

The decline stemmed from the unsuccessful acquisition of Worldpay, which they bought for $48 billion in total consideration in 2019, and later sold a 55% stake in the same asset at a $12 billion valuation. The revenue synergies did not come as advertised and management turnover hurt the performance of both businesses.

After the leadership team responsible for the deal was forced out, Stephanie Ferris, formerly with Worldpay, was appointed CEO. She led a strategic review and quickly concluded that the assets had to be separated to regain operational focus.

It was shortly after her plan was announced that we initiated our position at a p/e valuation of about half the market multiple. And this was for a legacy business that had generally traded around a market multiple for the previous decade.

So, **FIS** is now left with its legacy core bank processing business where they provide critical software and services to their bank customers and a security services back-office platform serving many industries from asset managers to insurance companies. These businesses have high levels of recurring revenue, solid growth prospects, healthy margins, and excellent free cash flow generation.

With operational performance starting to improve, the stock's multiple has already recovered to around 70% of the market. This still leaves a lot of upside if they continue to execute as we expect over time.

We also believe **FIS's** 45% position of Worldpay will be additive to shareholder returns. Charles Drucker, the previous CEO, has returned to run the company and we expect he'll be able to right the ship.

Overall, using the market multiple on **FIS** and a modest improvement in Worldpay's value, we see the stock exceeding $100 over the next couple of years, returning more than 40%.

TWST: How about a second company?

Mr. Evans: I can talk about **Flex** (NASDAQ:FLEX). **Flex** is a leading electronic manufacturing service company. Basically, what that means is they have factories that manufacture and assemble electronic products. They have a very strong leadership team that has focused the company on longer duration and higher value customer relationships, and they benefit from the ongoing nearshoring and onshoring trend.

I think what's interesting about **Flex** is it's quite diversified. There's no single end market that's greater than 15% of sales. Mexico is the largest country with about a third of their capacity. The U.S. has just over 15%. China has just under 15%. Then other countries are smaller than that. And lastly, the largest customer is less than 10% of revenues.

They have very attractive financials with double-digit earnings per share growth and strong free cash flow conversion. Their leadership team led by Revathi Advaithi, who came from Eaton, has really focused the company on operational execution and continued to move up the value chain to more differentiated industries such as the industrial and medical sectors.

Our process always starts with valuation. So we bought **Flex** at less than eight times earnings or more than a 60% discount to the market with earnings growth that was likely to exceed the market. The initial thesis was that it was very attractively valued, given those dynamics.

I mentioned earlier the industry tailwinds. Not only do you have the onshoring and nearshoring, but you also have increased electrification throughout the economy. Semiconductors have shown that they're critical in myriad industries, and **Flex** buys those semiconductors and assembles them into products.

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The renewed focus on longer duration, higher-value customer relationships also differentiates **Flex**. A lot of these deals are not as competitive. They're single bid because of specific expertise that **Flex** has.

1-Year Daily Chart of Flex Ltd.

Chart provided by www.BigCharts.com

The company also has a very shareholder-friendly capital allocation policy. They've reduced their share count by over 30% in the last 10 years. And they recently spun out a company called Nextracker, which is a solar tracking company whose ultimate proceeds wound up exceeding our purchase price of **Flex**.

We believe **Flex** continues to be very attractively valued, trading at around 11.5 times earnings or more than a 40% discount to the

market. And given that it has diversified, double-digit earning growth with exposure to favorable growth sectors such as energy infrastructure, AI data centers and digital health care, we think that there are multiple ways that the stock can win.

Moreover, they have an authorization at this point to repurchase over 10% of outstanding shares. We believe that **Flex** will trade much closer to a market multiple, which means that there's significant upside from here.

TWST: And is there a third company?

Mr. DeGulis: I would like to talk about **Total** (NYSE:TTE), which is the large global integrated energy company based in France, but its operations are literally all over the world. And the case for **Total** centers on their ability to adapt to the changing environment for energy demand. And just like the previous two companies that we talked about, when we look at companies where we think they may be attractively valued, there's often industry changes going on.

We actually embrace change because the market typically fears that. And if you can do your research and be patient, you can find companies that are adapting very well to their environments, and in fact, are winning and creating very strong cash flow-producing businesses that are taking market share, solving their clients' problems and driving shareholder value.

It's not just valuation that we seek; it's also businesses that are surviving and thriving in today's environment. And the previous two are two good examples of that, and so is **Total**. **Total** has got about a $170 billion market cap, a very modest amount of debt, $12 billion of net debt. This is on a business with about $45 billion of EBITDA and about $17 billion of free cash flow. It trades for around eight times earnings.

And then there's about 20% in what they would refer to as their low carbon or renewables business, which is largely electricity or power generation.

1-Year Daily Chart of TotalEnergies SE

Chart provided by www.BigCharts.com

This is a business that has tremendous cash flow characteristics. They're taking about 5% of their shares out annually in share buybacks, and you also have a dividend yield of about 4.5%. So that gives you about 9.5% return of shareholder capital annually for a business that grows in the mid-single digits.

And they're very well positioned to continue to take the cash flow from their legacy energy businesses and invest in the renewables as the world continues to decarbonize.

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Traditionally, businesses such as this trade for 11, 12 times earnings. But in the last 10 years, concerns about carbon energy demand and concerns about peak oil demand have driven a number of names in the energy space to much lower multiples than they historically traded.

Total is very well prepared for this. They have a balance sheet that I just mentioned, which is extremely strong. It gives them the capital to invest in their core businesses, continuing to lower their breakeven in their core oil and natural gas businesses, and also take about a third of their capital into new renewable resources, which, for them, largely are in the power market.

So this is a business that's about 40% of upstream oil business. They have about 40% in gas. Most of that is integrated gas of the liquified natural gas business.

It's not just sourcing natural gas. More importantly for them, it's constructing the facilities on both sides of the ledger there to move natural gas around in the world and take a toll on that as well. So it's an infrastructure energy or tolling business as well.

A lot of the larger energy companies have had mixed success in investing in new energy sources and alternatives or renewables, if you will. **Total** has been very disciplined. The return on capital in their renewables business is double digits, and they have rightly focused in on a number of electricity markets where they could use their natural gas foundation and know-how to continue to forward integrate into the electricity markets.

And as you've probably been reading, electricity demand in the United States and elsewhere is growing faster than anybody had predicted, given the trends of more electricity for home heating, more electricity for cars. And now, most recently, there's a lot of news, as you may have read, about data center demand driving increased electricity demand as well. And so, they're very well positioned in that.

So this is a remarkably cheap stock, which has potentially good optionality to the upside, very high return of current shareholder buybacks and dividends with mid-single-digit growth. If it gets back to its more traditional low-double-digit p/e or 7% free cash flow yield, that would garner a stock that's 40% to 50% higher than today's price.

TWST: What advice do you have for investors for the rest of this year? What are some of their concerns and what maybe should they be thinking about when they're looking at different stocks?

Mr. DeGulis: Well, we are very targeted and focused in pursuing our strategy. What we have learned over the years is that you should know what you own and invest with a duration or a time frame that allows you to absorb the volatility and uncertain outcomes that are inherent in investing. We do that every day at Sound Shore. We own stocks for years, not months. We focus in on our best ideas.

And when you take a step back and think about where the markets are today, you've had a pretty good run in the overall equity markets. The valuation levels for the cap-weighted indices are reasonably high. Interest rates are now normalizing at a level that's very high relative to recent history, but not very high relative to long-term history, but that's still going through the economy. We're still digesting those changes.

And so, if history is any guide, it may not be just as simple as owning the capitalization-weighted indices. You're going to have to be a little more targeted to generate sufficient return. And we think there's going to be more differentiation under the hood as you look forward over the next five or 10 years versus the previous.

So we're going to keep executing our strategy, know what we own, stay focused in on the stocks that we believe have the best risk/reward characteristics in this market, and try to catch those inflection points and change points that I mentioned earlier in the industries, given all that's going on in the world, and then we stick with it.

You've got to be patient with your investments, trust the managers that you have committed capital to, and then rebalance when you have outsized moves in any direction. But we're going to stay very focused on our strategy.

TWST: And it sounds like too, from your approach, that you just can't look at one sector or one big trend in the economy or in the market, but you do have to look very carefully at the individual company and its finances and a variety of other factors specific to that company.

Mr. DeGulis: Yes, that's absolutely true. I think oftentimes people take a step back and they take a look at exposures by sectors, for instance, whether it's health care or information technology or financials.

And yet when you peel back and take a look underneath the hood of the individual companies and industries and sub-industries within, there's a lot of different outcomes and a lot of different performance and valuation opportunities. Outside of the very well-known capitalization-weighted indices, there's a very robust ecosystem of investment opportunities, if you're willing to look.

TWST: Because you're at a boutique firm, maybe you could explain why that might be the best place for investors to be, rather than one of these international firms that has offices all over the world?

Mr. DeGulis: Simply stated, it's focus and commitment. This is all that we do. We have our entire profit-sharing plan for the employees here at Sound Shore, sitting right alongside our fellow shareholders in the Sound Shore mutual fund and also in our separate accounts. So we eat our own cooking, as it were. We have no place to hide.

We believe deeply in our ability to execute in this strategy because over the years, if you're patient with it and disciplined, it has provided tremendous value. It does take patience and people can lose that from time to time, whether it's the value and growth debate or active versus passive. But in spite of all that, we've been able to add value by staying very focused and committed to our strategy.

And when you work for a boutique — the shareholders of this firm or the adviser are owned by the employees and our personal profit-sharing plan is invested right alongside our clients. We are very committed and focused in on this strategy. That certainly doesn't guarantee success, but it certainly gives you increased odds.

TWST: Thank you. (ES)

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