

E X C E R P T E D F R O M :

JANUARY 4, 2021

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

THE FOLLOWING REPORT IS EXCERPTED FROM
THE WALL STREET TRANSCRIPT

01-04-21

INVESTING STRATEGIES REPORT

NOTICE

The Wall Street Transcript does not in any way endorse or guarantee the accuracy or reliability of any of the information, statements or opinions expressed in the reports or comments of other firms or individuals. We take due care to report or transcribe accurately what has been written or said by others but because of the possibility of human or mechanical error, we cannot assume any liability for the correctness of the transcription. We point out further that, of course, all opinions expressed are subject to change without notice. Neither the information or any opinion which may be expressed constitutes a solicitation for the purchase or sale of any securities referred to herein. For further information, contact the individual or investment organization concerned.

CHIEF EXECUTIVE OFFICER FORUMS/INTERVIEWS

Important Note: Wall Street Transcript forums and interviews with Chief Executive Officers are published verbatim as editorial content and include "forward-looking statements" (as such term is defined in the United States Private Securities Litigation Reform Act of 1995). These "forward-looking statements" may be subject to and be made pursuant to the "safe-harbor" provisions of Section 27A of the United States Securities Act of 1933, as amended, and Section 21E of the United States Securities Exchange Act of 1934, as amended. Since these statements are based on factors that

involve risks and uncertainties, actual results may differ materially from those expressed or implied by such "forward-looking statements". Such factors are often included in the company's filings of reports with the United States Securities and Exchange Commission, including Forms 10-K, 10-Q, 8-K and Proxy Statements; the company's annual and interim reports to shareholders and similar documents. In carrying out our responsibilities to our readers and to the Chief Executive Officers selected for forums or interviews, we are required to offer, and we offer, each Chief Executive Officer an opportunity to back-up the interview and provide our readers and potential investors with specific financial data, including earnings statements, balance sheet statements and other material business and financial data, through the sponsored publication of such reports or highlights therefrom, with meaningful information.

Founded 1963
Published by Wall Street Transcript Corporation
622 Third Ave, 34th Floor New York, NY 10017
Copyright 2017 Wall Street Transcript Corporation
All Rights Reserved

Factoring ESG Data Into Analysis of Intangible Assets

G A U T A M D H I N G R A , H I G H P O I N T E C A P I T A L M A N A G E M E N T , L L C



GAUTAM DHINGRA is the Founder and CEO of High Pointe Capital Management, LLC.

He developed the firm's pioneering investment approach based on the concept of Franchise Quality, which holistically integrates ESG factors. Dr. Dhingra's research interests include ESG investing and valuation of intangible assets. He holds a Ph.D. in finance from the University of Florida. He was a faculty member at Northwestern University's Kellogg School of Management for two years, and he has also taught courses

in Securities Analysis and Derivatives at University of Florida. Dr. Dhingra started his career as director of investment research at Hewitt, a consulting firm specializing in working with Fortune 500 clients; he rose to be the partner in charge of Hewitt's consulting for the Midwest, Southwest and Western United States, and his clients included numerous Fortune 100 companies. Over the years, Dr. Dhingra was a member of the Board of Regents for CFA Institute's Financial Analysts Seminar; a Judge for the CFA Global Research Challenge; and the Chairman of CFA Chicago and a member of the board for six years. He has written and published articles on various investment topics in publications such as *Pension Investment Handbook*, and has been quoted by various media outlets including Reuters, CNN, Fox Business, BBC, National Public Radio, and *Chicago Tribune*.

SECTOR — GENERAL INVESTING

(AHT504) TWST: Start, if you would, by describing the investment philosophy and process that High Pointe uses managing portfolios for your clients.

Dr. Dhingra: High Pointe's investment philosophy is to buy stocks that are inexpensive relative to their franchise quality and growth prospects. Our thesis is that, one, valuation of a company is driven by its franchise quality and growth prospects; two, franchise quality is a function of intangible assets such as patents, brand equity, and monopoly power; and three, our competitive edge

Highlights

Dr. Gautam Dhingra discusses High Pointe's Capital Management's investment philosophy of buying stocks that are inexpensive relative to their franchise quality and growth prospects. High Pointe uses an eight-point "Franchise Quality Score" to measure a company's intangible assets, which becomes a key component for selecting stocks in keeping with their value-oriented strategy. Dr. Dhingra incorporates ESG factors holistically into the analysis of intangibles, having found that historically high ESG companies perform the same or better than low ESG companies, with lower volatility. Dr. Dhingra's greatest concern with the current market is the amount of government and corporate debt.

Companies discussed: [Southwest Airlines Co. \(NYSE:LUV\)](#); [Charter Communications \(NASDAQ:CHTR\)](#); [Ameren Corp. \(NYSE:AEE\)](#); [NextEra Energy \(NYSE:NEE\)](#) and [BioMarin Pharmaceutical \(NASDAQ:BMRN\)](#).

is to systematically incorporate intangible assets, and in doing so identifying opportunities before others discover them. That's our philosophy, and if you'd like me to get into the details of the investment process, I'm happy to go into that.

TWST: Yes, please do.

Dr. Dhingra: Our investment process was developed on the central premise that as the U.S. economy made its transition from the manufacturing era to the information era, more and more of the value of companies was going to shift to intangible assets. That insight led us to create a metric called the

“Franchise Quality Score” to measure a company’s intangible assets and use it as a key component for selecting stocks for our value-oriented strategy.

This Franchise Quality Score is calculated by assigning value to eight component factors. Those eight component factors are, one, barriers to entry; two, degree of competition; three, pricing power versus customers; four, pricing power versus suppliers; five, quality of management; six, governance standards; seven, engagement with employees, community and government; and eight, sustainability of competitive advantage.

“But one thing is for sure, we believe that the right way to incorporate ESG data is to do it holistically as part of the overall investment process, rather than to use it by simply excluding companies that may not meet one or more ESG criteria.”

We incorporate ESG factors as intangibles in some of the eight factors I mentioned. And the sum of these eight factors is then fed into our valuation model to figure out whether a stock is undervalued from a quantitative perspective. If the quantitative valuation model does show undervaluation, we then take a third step towards making a final decision, and that is a risk assessment based on fundamental analysis to make sure that there are no extraordinary risks facing a company that might explain its undervaluation. But once that third step has been cleared, that means the stock has passed both our quantitative and qualitative evaluation process. It then becomes a candidate for purchase, subject to any diversification requirements.

TWST: The shift you mentioned — the transition from manufacturing to the information era — would you say that has been accelerated during this pandemic? What are your thoughts on the impact of that?

Dr. Dhingra: There’s no doubt there has been some acceleration because of the pandemic, but the trend is so powerful and so long-term secular in nature, that ultimately even this acceleration would seem like a small bump. The bigger trend, frankly, is what started in 1979 with the advent of the PC, and we see no end to it as far as the eye can see.

TWST: Would you tell us more about how you integrate ESG factors into both the research and portfolio construction and management?

Dr. Dhingra: ESG factors to us are just another type of intangibles, and that’s why they attracted our attention very early on. If a company like **Southwest Airlines** (NYSE:LUV), for example, in the 1990s had a workforce that was a happier workforce, a more productive workforce, it was able to get more out of its employees compared to legacy airlines, where the employees had an adversarial relationship with management and one employee group had adversarial relations with another employee group.

For example, flight attendants, machinists, and pilots at legacy airlines — they seemed to have their own objectives and they did not care if those objectives conflicted with the others’. By contrast, **Southwest** was a cohesive workforce with good relationships between the management and employees, and that showed both in terms of its operating performance, its market share gain, and ultimately its stock price. If you think about it, it wasn’t called an ESG factor at that time, but it is a type of social factor that’s now considered more relevant, but it has always been relevant.

Because we focused on intangibles as part of our stock evaluation, we started to think about these factors very early on in our investment process, and over the last few years that process has become more robust. At the beginning, our work was primarily qualitative in nature when it came to ESG types of intangibles. As ESG data became more abundant, we became more prolific users of this data.

A few years ago, we undertook a major research project to scientifically analyze ESG data to see if it could either enhance returns or reduce risks. The results of our study showed that historically high ESG companies have produced a track record that is as competitive, or perhaps even a bit better, than that of low ESG companies. More importantly, they have produced the better performance record with lower volatility.

We have presented it at various forums such as the Washington University Research conference, and it was later published by the CFA Institute on its Enterprising Investor website under the title, “ESG Investing: Can You Have Your Cake and Eat It Too?” Our answer to that rhetorical question was that yes, you can. Our work on ESG investing was also picked up by United Nations’ PRI when they profiled our integration approach of ESG factors in their *Guidance and Case Studies* publication.



Chart provided by www.BigCharts.com

So our process used to be qualitative primarily, and with the advent of more data it has become both quantitative and qualitative. But one thing is for sure, we believe that the right way to incorporate ESG data is to do it holistically as part of the overall investment process, rather than to use it by simply excluding companies that may not meet one or more ESG criteria.

TWST: So you're able to take ESG into account without sacrificing alpha. Do you still encounter skepticism about that?

Dr. Dhingra: No, we do not encounter skepticism from the outside world. We, interestingly, are cautious about it ourselves, in the sense that we think ESG is not a panacea, and sometimes it's presented as such by some people as if it is the ultimate solution. From our perspective, ESG assessment is a useful tool that can help us better understand the quality of a company, and then we can take that quality into account to figure out how much we want to pay for that company. So, to that extent, we are our own critics more than the outside world is.

“As time has gone on, it has become clear that nobody can live without broadband Internet, and the COVID pandemic made that even more clear. So now broadband is a utility but it is not regulated as a utility, and that allows cable companies to earn a higher rate of return, and we find it to be a very attractive business.”

TWST: Are there a few favorite investment ideas or top holdings that you would share with us? Tell us a bit about why you like them and how they meet your investment criteria.

Dr. Dhingra: One of the companies that we have had an investment in for several years now is **Charter Communications** (NASDAQ:CHTR). **Charter** is a cable company, and cable companies are essentially government-granted franchises with limited competition and, therefore, higher pricing power. Very few people remember it anymore, but in the 1980s, when the cable business was first getting started, there used to be a requirement that each local area had to have at least two cable companies, and that provision was there to ensure competition. But over time, cable companies convinced the local regulators that that provision was not necessary, so now in most local areas there's only one cable company providing broadband Internet.

And although there are some non-cable company Internet providers, there are certain inherent advantages in cable companies' ability to do it with a higher bandwidth. That, combined with the fact that the cable business is a monopoly, means that there is very limited competition and these companies are able to raise their prices and improve profitability.

As time has gone on, it has become clear that nobody can live without broadband Internet, and the COVID pandemic made that even more clear. So now broadband is a utility but it is not regulated as a utility, and that allows cable companies to earn a higher rate of return, and we find it to be a very attractive business.

Charter is a company that has done very well for us for three years, but we still think it has further room to grow, so it continues to be a holding in the portfolio despite a significant runup in stock price. Would you like me to give an example of a new buy?

TWST: Yes, that would be interesting.

Dr. Dhingra: A couple of examples come to mind. One happens to be ESG related, and that's a utility in Missouri called

Ameren (NYSE:AEE). **Ameren** is a recent buy for us and it is replacing a stock that has done very well for us. The stock that has done very well for us is **NextEra Energy** (NYSE:NEE). **NextEra** is a company that is the largest producer of renewable energy in this country. They have been the leader, and we have owned that stock for many years and it has done very well.

But by now, that success is reflected in the stock price. The question for us was, can we identify the next **NextEra**? There are probably five or so utilities in this country that are trying to do something similar to what **NextEra** has done, and although they won't be as successful, there is potential for them to take the same business model and use it to improve their profitability.

The reason we chose **Ameren** is because it has laid out a clear path to go carbon neutral by 2050. In order to do so, it would need to replace its coal generation with a renewable energy portfolio that will require significant capex, and the regulators have agreed to let them earn a reasonable amount of return on that capex. The combination of significant capex coming and the regulators letting **Ameren** earn a reasonable rate of return on it would mean that this company would have significant growth — more so than the average utility — for several years to come. And hopefully along the way it will catch the attention of ESG investors as well.

As the proportion of the income coming from renewables increases, if more ESG investors are attracted to it, that might also improve the valuation for reasons other than fundamental reasons such as earnings growth. We are buying **Ameren** at a forward enterprise value divided by EBITDA ratio of 11, versus 17 for **NextEra**, and this is based on forward two years out valuation metric. So the logic here is to take the profits from **NextEra** and apply it to a situation which may be the next **NextEra** and hope to replicate that success, perhaps at a lower rate, with the new company.

1-Year Daily Chart of Ameren Corp.



Chart provided by www.BigCharts.com

TWST: Is there one more you'd share?

Dr. Dhingra: Another recent buy for us is **BioMarin** (NASDAQ:BMRN). **BioMarin** is a pharmaceutical company that focuses on rare diseases. Rare diseases impact only a small group of patients, and for that reason they are not of interest to Big Pharma. By focusing on these rare diseases, **BioMarin** is able to get what's

called an orphan drug status from the government, and that allows for a greater degree of protection. So, in virtually every field that **BioMarin** competes, it either has no competition or very limited competition. And that's where the franchise quality comes from — from the patents and the orphan drug status that leads to no competition and, therefore, high pricing power.

BioMarin has a significant portfolio already, and it has two drugs in development: one is for hemophilia and the other one is for dwarfism. Both of these have reasonable chances of success. But what happened in August of 2019 was that the FDA gave them a complete response letter asking for longer-term data for its hemophilia drug, and that meant, at a minimum, a delay in the introduction of the drug.

The reaction of the stock price was significant, and the company's value dropped by roughly one-third. But from a long-term perspective, the whole value of that hemophilia drug was probably not quite worth one-third of the company, so the stock price drop was more than commensurate compared to the event.

At this point, there's still a reasonable probability this drug will get approval; it is still under review by the European agency, and **BioMarin** will be submitting additional data next year for possible approval in 2022 within the U.S. again. So, the stock price drop was much more than what should have happened given the event.

And on top of that, the dwarfism drug is also potentially a significant drug, whether it gets passed based on the current one-year data or whether the FDA requires two years' data, which would mean the drug would get introduced later. Either way, the early data are good, and if either one of these two drugs ultimately passes, then, with hindsight, people will realize that the one-third decline in the value of the company in August of last year was a time to get a diamond in the rough.

And that's the reason for our purchase: It's a strong franchise quality, given the nature of the company's business, combined with a rare opportunity to buy it at a price which doesn't reflect the current pipeline plus any optionality from the two future drugs.

TWST: I'm wondering what your thoughts are on where the market and valuations in general are going. It seems despite all the economic challenges that we face globally, markets just reach ever higher. Do you think that is sustainable? What's your perspective on that in the current macroeconomic and political backdrop?

Dr. Dhingra: We think valuations in the market on average are higher than where they should be. But I would separate the valuation of technology-oriented stocks from the rest, and say

that most of the overvaluation is based on a small number of stocks, whereas there are many segments of the market where the valuations are more reasonable. Health care happens to be one of those sectors. So, at the sector level, industry level, and individual stock level we can find many good companies where valuations are in the low-double-digit price-to-earnings ratio.

On our portfolio, looking two years out, our EV/EBITDA ratio is only 11, and these are companies with limited amounts of debt, so that they have less risk, they have reasonable growth prospects, but they just are not the darlings of the market right now. If we can find companies like that, we are happy to buy them, even in this environment.

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

Dr. Dhingra: The thing that we are probably most concerned about is the amount of debt owed at the government, as well as at the corporate level. Therefore, we are being conservative. On average, our portfolio companies have less than half the debt of the average company in the index. To counter any disruption that might come from the fact that government or corporate debt is too high, we own companies that would be able to see the light on the other side of that disruptive event. The potential hiccups caused by serious debt overhang is our number-one concern looking five years out.

TWST: Is there anything else you'd like to talk about to wrap up?

Dr. Dhingra: I know that over the last decade or so indexing has become a big trend, especially in large-cap U.S. equities because that segment is considered efficient. Our view is different than the consensus. We think even within the large-cap U.S. equity market, one can generate significant alpha. There are not many firms that can show a more than 20-year record of adding 3% alpha per year over the benchmark, but we've been able to do it, and the reason we've been able to do it is because we are looking at it through a different lens than everybody else, and that is, we understand that a lot of the value of companies is now in intangibles. When we value a company we take those intangibles into account systematically and logically, and that has allowed us to build this performance record.

TWST: Thank you. (MN)

DR. GAUTAM DHINGRA

Founder & CEO

High Pointe Capital Management, LLC

email: gdhingra@highpointecapital.com

www.highpointecapital.com