MD Sass Concentrated Value

MD SASS

Q2 2023 Commentary

July 24, 2023

The MD Sass Concentrated Value ("CV") strategy was up +8.8%, net of fees, in the second quarter of 2023, vs. +4.1% and +4.0% for the Russell 1000 Value ("R1V") and Russell 3000 Value ("R3V") indices, respectively.

Year-to-date through the second quarter, CV was up +11.8%, net of fees, vs. +5.1% and +5.0% for the R1V and R3V indices, respectively.

From inception (January 2019) through the second quarter of 2023, CV had a net annualized return of +18.0% vs. +10.8% and 10.6% for the R1V and R3V indices, respectively.

Often, when we explain that we seek long-term investment opportunities we understandably get asked about portfolio turnover with the implication being that turnover is indicative of one's investment time horizon. We typically have annual portfolio dollar turnover of more than 100% and name turnover in excess of 50%. The reaction to these statistics is generally one of surprise – how can we label ourselves long-term investors if we churn the entire dollar amount of the portfolio each year and if our average holding period is less than two years? There are several reasons why we believe these statistics are entirely consistent with long-term investing:

1. *We are frequently wrong and seek to identify and act quickly on our errors.* Even the best investors in the business are wrong approximately 40% of the time. In the asset management business, being wrong frequently is a feature, not a bug. Great investors recognize when they are wrong as quickly as possible and exit those positions with urgency. We have no interest in holding investments where we believe our thesis is no longer valid, simply to tell clients and consultants that we hold stocks for the long term. If we are wrong 40% of the time and our average holding period for the 'losers' is 6 months, and we are right 60% of the time with the average holding period of 3 years for our winners, then that would suggest a weighted average name turnover rate of 2 years. Selling potential losers early will certainly elevate turnover statistics but is consistent with the algorithm for successful long-term investing.

2. *When we are 'right' on an investment, we sell when our view is no longer differentiated from consensus, and we can't control when that happens.* As we have articulated in prior memos, we are attracted to investment opportunities where we have a materially out-of-consensus view of forward revenues, free cash flow and/or EBITDA. Typically, the difference between our forecast and the consensus widens the farther we look out in time because minor differences compound to become material differences over a two-to-three-year period. We can't control how consensus estimates will change over time and there are times when good news or strong earnings can lead to meaningfully positive earnings revisions for a given stock. Such positive earnings revisions may lead to a situation where our view is no longer differentiated. This can take years, but occasionally happens in just a few months. We don't believe in holding onto investments unless our expectations for future financial performance are consistently above the Street. To the extent our long-term view is no longer differentiated, we will sell that position. Does that mean we are not long-term investors? We don't think so. We certainly approach each investment opportunity with a long-term investment mindset, but as the market's sentiment or expectations evolve (as they always do), we believe it is prudent to re-assess the attractiveness of the investment relative to other opportunities and in absolute terms.

3. *As the risk-reward changes for any given investment, we adjust the weighting, which increases dollar turnover but we believe this is prudent risk management.* Thus far, I've discussed how name turnover can appear elevated despite a long-term orientation. An important driver of dollar turnover comes from risk management. For each position in the portfolio, we derive an upside target price, a downside target price and a more draconian downside target price that represents a buy trigger price. We probability-adjust these scenarios and incorporate five qualitative factors (conviction, business quality, timeliness, management quality and leverage) to derive a probability weighted return ("PWR") for every stock in the portfolio. Typically, those stocks with the best PWR represent the biggest positions in the portfolio and those with less compelling PWR's on a relative basis are smaller positions. As markets move and as our view of the various scenarios evolves over time, the risk-reward ratio for any given stock can change considerably. For stocks where the PWR moves higher, we are inclined to buy more. Conversely, when the risk-reward deteriorates for a given position, perhaps due to a dramatic increase in the share price despite no corresponding positive change to our estimates, we are inclined to trim the position. We believe this is sound risk management but nonetheless causes an increase in dollar turnover. During times of extreme market volatility, such as the Global Financial Crisis or 2020, the dramatic swings in risk-reward can lead to a very high dollar turnover. We do not believe it is rational to maintain a constant position size despite changing risk-rewards just for the sake of optics and simply to boast of a low dollar turnover.

Our investment philosophy centers around maintaining a long-term perspective, however, it's essential to acknowledge that certain factors may lead to elevated turnover statistics. We firmly believe that these factors, rather than indicating a short-sighted approach, stem from a robust framework designed to safeguard and grow capital over the long haul while maintaining diligent risk management practices.

Q2 PORTFOLIO REVIEW

The biggest contributors to performance in Q2 were *APi Group* **(APG)**, *AmerisourceBergen* **(ABC)** and *CACI International* **(CACI)** which collectively contributed approximately 380 bps to performance.

APG was a large contributor to performance in Q1 as well, and our view of the opportunity set remains unchanged. We shared the following thoughts on APG's outperformance in our first quarter memo:

> *"APG has chronically traded at a discount to its business service peers, and we believe this is largely due to its relatively poor FCF conversion and overabundance of non-GAAP adjustments to EBITDA. APG's Q4 2022 earnings report in February went a long way to show that FCF conversion is improving and that the non-GAAP adjustments will dissipate in the next few years after Chubb cost synergies are fully realized. Additionally, the company provided solid 2023 guidance with Chubb's organic growth improving. The outlook and results largely explained the 19.5% rise in the stock in Q1. We believe APG will earn approximately $2/share of FCF in 2024, making the stock attractively valued at current levels."*

We believe ABC's outperformance in the second quarter was fueled by favorable industry trends driving improved sentiment that has led to ABC's multiple expanding from ~14x EPS at the end of Q1 to over 16x by the end of the Q2. Generic drug deflation, which historically has had some impact on the financial performance of drug distributors, including ABC, has moderated over the past few months with some months experiencing price inflation. Furthermore, the outlook for the Specialty business is improving, as evidenced by growth in the drug Keytruda, which we view as a proxy, with Barclays

noting 19% and 21% growth in Keytruda sales in April and May, respectively, driving an acceleration in two-year CAGR trends. We continue to believe that ABC’s outlook is very bright as the business continues to mix shift to higher margin businesses that will drive margin expansion and higher returns on invested capital.

CACI continues to be our top holding because we think consensus revenue growth rate expectations over the next three years are as much as 500 bps too low. During the quarter, CACI solidified over $8B in contract awards that we believe will drive a material acceleration in sales growth in fiscal 2024 and 2025. Given management’s focus on margins, we believe these awards will be margin accretive and drive EPS to over $25/share by fiscal 2025 vs. the consensus estimate of under $22.50. We believe the 15% increase in the stock in the second quarter was a function of these new contract wins coupled with strong quarterly earnings that drove the full year consensus estimates higher.

The biggest detractors to performance in Q2 were *PayPal* **(PYPL)**, *Corteva Agriscience* **(CTVA)** and *Avantor* **(AVTR)**, which collectively hurt performance by approximately 66 basis points in the quarter. We sold PYPL in the quarter as we believe the decline in ‘core’ gross profit dollars in the quarter was puzzling and came with little disclosure or transparency from management. According to management, a mix shift within branded checkout toward certain lower take-rate markets such as Germany and Western Europe, combined with continued weakness in cross-border transactions, led to a decline in overall take-rates (and thus transaction gross profit). Despite a reacceleration in industry-wide U.S. eCommerce volumes, PayPal isn’t seeing a rebound in its business in the places that matter most for profitability, invalidating a core tenant of our thesis. PYPL is a good example of a name that we owned for a brief period and sold once we believed we were wrong.

We also sold CTVA based on concerns that there may be elevated customer inventory levels which may drive a reduction in guidance for the full year. Negative preannouncements from peers such as *FMC Corp* **(FMC)** and *Croda* **(CRDA.LN)** support our concerns. Given CTVA’s elevated valuation vs. history and less favorable risk/reward, we exited our position.

We added to our position in AVTR and believe the headwinds of difficult COVID comps, FX headwinds and inventory de-stocking are closer to the end than the beginning and that growth will re-accelerate which will drive both positive earnings revisions and multiple expansion. We continue to be bullish on the long-term growth opportunities associated with bioprocessing, and we believe the stock is attractively valued at less than 15x our 2024 EPS estimate.

We initiated new positions in *World Wrestling Entertainment* **(WWE)**, *Clean Harbors* **(CLH)**, *Flex Ltd.* **(FLEX)** and *Wabtec* **(WAB)** in the quarter, which we discuss below.

WORLD WRESTLING ENTERTAINMENT (WWE)

In April 2023, a transformative event unfolded as WWE and *Endeavor* **(EDR)** announced their merger, uniting WWE with EDR's UFC to form a new entity, dubbed "NewCo," which is set to be listed on the NYSE. This merger created a new pure play $21B global live combat sports and entertainment venture that can create substantial shareholder value through cost and revenue synergies, which, in our view, are not fully appreciated by the market. While initial estimates of cost synergies stood at $50M-$100M, we consider them to be unduly conservative. Under the guidance of Ari Emanuel, WWE's non-allocated corporate expenses, currently exceeding $130M annually or approximately 10% of WWE's revenues, are poised to witness a significant reduction over the coming years. This alone is likely to propel NewCo to the higher end of its cost synergy goal,

with ample room for further gains as other allocated costs are streamlined. Notably, the merger of UFC and WWE holds even greater potential for cost synergies compared to EDR's past acquisition of the UFC, as they share more similar business models.

Moreover, a crucial aspect that we believe has been overlooked by the market pertains to sponsorships. Despite hosting 80% fewer events annually than WWE, the UFC manages to generate double the sponsorship revenues, primarily due to its emphasis on event and in-ring signage, an aspect historically disregarded by WWE. We expect the experienced leadership of EDR to capitalize on this untapped potential, monetizing WWE events through increased event signage and sponsorships, thus driving substantial high-margin revenues in the years to come. WWE currently lags major U.S. sports leagues in terms of sponsorship revenue as a percentage of total revenue and sponsorship revenues per event. However, Stephanie McMahon's optimistic vision of reaching "hundreds of millions of dollars" in sponsorship revenues within the next three to five years seems plausible with Ari Emanuel at the helm.

A June research report from Morgan Stanley highlighted that WWE has the lowest media rights fee per regular season linear viewer relative to any other major sport in the U.S., and by a significant margin. Morgan Stanley estimates WWE generates $1.52 per viewer, which is well behind the second lowest ranked sports property, the Premier League, which generates $4.07 per viewer. Guggenheim Securities has published a similar analysis highlighting WWE's *Raw* and *Smackdown's* relatively low media rights fees per regular season viewer hour and noted a 1.8x increase in their fees would still place WWE towards the bottom of the list. WWE's media rights deals with Fox and Comcast, which account for 40% of 2023 revenues, expire in 2024, and we believe WWE will get a significant boost in the value of those rights when they are renegotiated. The emergence of Big Tech (Alphabet, Amazon, Apple, and others) as media rights bidders means more competition for scarce sports media rights and likely higher value for the owners of the intellectual property. We believe WWE's low media fees per viewership hour coupled with NewCo's ability to package WWE rights with UFC rights will lead to significant value creation. It doesn't hurt that WWE now has the best media rights negotiators in the business as significant equity holders.

Proforma for cost synergies and the potential uplift in media rights from forthcoming renewals, we believe NewCo will generate annualized free cash flow in excess of $1.1B and EBITDA of over $1.5B in 2026. This would value the company at 13x EV/EBITDA which is a significant discount to other publicly traded sports properties such as *Formula One* **(FWONK)**, *Madison Square Garden Sports* **(MSGS)**, and *Liberty Braves* **(BATRK)**. We think the stock can achieve a mid-teens IRR over the next three years as NewCo exceeds its cost synergy target and renews media rights deals at significantly higher values, which would drive the valuation higher.

CLEAN HARBORS (CLH)

CLH is the largest hazardous waste disposal company in the United States. Its primary business model is to 1) gather waste, 2) transport waste and waste oil, 3) transfer and consolidate the waste, and 4) treat, recycle, refine, incinerate, or landfill the waste. Barriers to entry are high given the regulatory hurdles, difficulties in obtaining permits for greenfield investments, high customer switching costs and substantial capital investment needs. From 2018 through 2022, EBITDA margins expanded over 400 bps and grew at a 19% CAGR while return on invested capital accelerated from low single-digits to nearly 11%.

CLH has ~70% market share of the non-captive commercial hazardous incineration business in North America with nine of the 13 commercial hazardous incinerators, 25%+ market share of hazardous landfill volumes, and ~30% share of TSDF (treatment, storage & disposal facilities) volumes. CLH has consolidated the market through strategic M&A and organic growth, which we believe will enable it to flex pricing power and drive higher incremental returns on invested capital that is greater than consensus expectations. We believe the company found religion during COVID when inflation and increased logistical complexities forced management to raise prices aggressively. To their surprise, they saw little discernable customer churn. The stickiness of the customer base in the face of significant price increases caused management to better appreciate their dominant market position and the scarcity of industry capacity and has awoken them to the ability to continue exerting pricing power regardless of inflationary factors. Michael Battles, Co-CEO of CLH, recently said at a Baird Conference:

> *"We feel like inflation was probably the best thing that happened to Clean Harbors because it forced us to raise price, it forced us to be more aggressive. It forced us to push back at our customers…I see no reason why we can't price these assets, these scarce assets like they are, like the solid waste guys do, like the Casella's do, and we can have the same type of return metrics and the same type of multiples that they enjoy because I think it's very similar."*

Bank of America estimates that U.S. manufacturing will grow at a 7.8%-8.9% CAGR from 2019 to 2025, a significant improvement compared to the 2.5% CAGR witnessed from 2007 to 2019. This forecast is in line with Morgan Stanley's estimates, which foresee a 4%-5% uplift in U.S. manufacturing over the next five years, driven by major near-shoring initiatives and capital expenditure announcements. The growth acceleration is particularly fueled by robust investments in electric vehicles (EVs) and semiconductor production. BofA estimates $52B of announced EV battery investments in the U.S. and $166B of semiconductor investments. These investments are set to drive substantial quantities of hazardous waste, presenting an opportunity for CLH to benefit directly. CLH is well-positioned to capitalize on this trend as it charges a premium for managing and disposing of hazardous waste generated during EV battery manufacturing and semiconductor production. The cost discrepancy is noteworthy, with incinerating dirt costing as little as $0.15-$0.20 per pound, while specific bulk liquids and highly chlorinated waste streams can command prices as high as $0.80 per pound. This favorable pricing environment is expected to drive sustained positive financial results for CLH as it serves the higher-tech manufacturing sector in the coming years.

Moreover, the industry capacity for hazardous waste management is currently tight, bolstering the prospects for CLH. The company's new facility in Nebraska, slated to begin operations in 2025, is poised to drive a 12% increase in capacity for CLH. Notably, our analysis suggests this facility will yield an attractive pre-tax ROIC of 16%, further enhancing CLH's growth prospects and financial performance.

CLH trades at a meaningful discount to solid waste peers such as *Casella Waste Systems* **(CWST)** and *Republic Services* **(RSG)** which is justifiable given CLH's exposure to some lower quality businesses like its Safety-Kleen re-refinery. However, by 2025, we believe the high-multiple Environmental Services business will represent ~85% of EBITDA and CLH's multiple will converge towards that of its solid waste peers as they demonstrate stable volume growth and sustained positive pricing and mix benefits that will drive margins and ROIC higher. We believe consensus 2025 estimates are materially too low and the stock can achieve a mid-teens IRR over the next few years as earnings are revised higher and the stock's multiple converges to its solid waste peers.

FLEX LTD. (FLEX)

FLEX is one of the world's largest electronics manufacturing services ("EMS") companies, offering outsourced engineering & design, manufacturing, and supply chain services to customers across 100 facilities in 30 countries (45% Asia / 35% Americas / 20% Europe). The company reports its business in three segments: Agility (52% of revenue / 46% of segment income), which includes high volume, short life-cycle products, including consumer electronics; consumer appliances; and data center, communications, and enterprise networking equipment; Reliability (42% of revenue / 40% of segment income), which includes longer life-cycle, higher-margin products such as automotive systems, medical products, industrial equipment, and renewable energy; and NEXTracker (6% of revenue / 14% of segment income), a manufacturer of solar tracking systems used to enable utility-scale solar arrays to track the movement of the sun throughout the day, ensuring maximum energy efficiency. On Feb. 8th, 2023, FLEX completed a partial spin-off of *NEXTracker* **(NXT)**; FLEX continues to hold a 51% economic interest in NXT and consolidates it in its financial results. The company has indicated they intend to complete a tax-free spin-off of the remaining 51% of shares in the near term.

The history of the EMS space dates to the 1960s but in many ways the heyday of the industry was the 1990s when the PC revolution spurred a generational increase in demand for consumer electronics. With seemingly endless demand for new products produced at scale, FLEX and its rivals built out manufacturing facilities across the globe. In time, many of the formerly nascent new product categories began to mature and competition for business amongst EMS players intensified as Chinese and Taiwanese competitors such as Foxconn (Hon Hai) gained scale by leveraging local low-cost labor. Following the burst of the dotcom bubble, the proliferation of smart phones, tablets, flat panel televisions, and related products were the primary driving force within the industry. But for the last half dozen years, a meaningful change has taken place, led first by *Jabil* **(JBL)** and now carried on by FLEX. Rather than continuing to subject themselves to the annual feast-or-famine life cycle of the next smartphone or tablet, JBL and FLEX have increasingly pursued business in categories that are 1) outsourcing to the EMS world for the first time, providing a multi-year growth opportunity; 2) have strong secular growth trends; 3) have longer product life cycles and more reliable demand forecasts; and 4) require specific technical expertise, regulatory approval, or other features that limit competition. This shift in focus has enabled them to increasingly play in their own sandboxes, away from the ultra-competitive end of the market that has come to be dominated by Foxconn. And because several new categories exist for which FLEX and JBL are uniquely well-positioned to tackle, both are now in the position of being able to choose their customers to suit their strategic goals, providing a tailwind to both revenue growth and margin expansion. As one contact stated, "this is a golden age for EMS," yet the market continues to value FLEX in much the way it has for the last decade.

Since taking over as CEO four years ago, Revathi Advaithi has made a concerted effort to walk away from low-margin, fast turn business and prioritize longer duration programs where FLEX can add more value, has greater visibility, and can earn better margins. In FY20, Consumer Devices accounted for 15% of revenue; today they are half that. Reliability revenue today accounts for 45% of Core Revenue (excluding NEXTracker), up from 39% when Advaithi took over. With Reliability revenue poised to grow in the mid-teens this year, and Agility likely stagnant, Reliability will account for approximately half of Core revenue by the end of the current fiscal year. This matters for two reasons: 1) as the fast-growing lines of business become larger, they will continue to put upward pressure on consolidated revenue growth, even if we see some moderation of growth rates in the underlying business lines; and 2) Reliability has historically garnered better margins than Agility. Though the benefits of this transition have shown through in FLEX's revenue growth over the last year, transitory issues related to pandemic-induced supply chain shortages have had an adverse impact on operating margins, particularly in FLEX's more

attractive Reliability segment. Free cash flow has also been negatively impacted by supply-chain issues. For the last two years, FLEX has been forced to stock excess levels of inventory as it awaits key components needed to complete production runs, putting pressure on FCF by approximately $1B. These issues are now beginning to abate, and we believe FLEX is poised to return to margin expansion and see outsized growth in FCF over the next few quarters. Specifically, we expect consolidated revenue growth of 8% in 2024 and 13% in 2025, with margins of 5.0% and 5.5%, respectively. This compares to consensus revenue growth of 2% and 5% over the next two years, with margins of 4.9% and 5.1%.

We value FLEX on its Core earnings (FLEX excluding NXT) and add to it the current market value of FLEX's stake in NXT, net of tax leakage. We think Core FLEX can generate EPS of $3.00 in FY25 (ends 3/31/25). Capitalizing it at 10x yields a value for Core FLEX of $30.00. NXT and cash from NXT shares already sold adds another $8.34 per share of value, for a target price of $38, or 35% above today's price.

Further, with the recent IPO of NXT and the anticipation that it will be fully spun-out later this year, FLEX is poised to repurchase as much as 20% of its stock over the coming year, which should help to close the considerable discount at which Core Flex trades relative to its EMS peers. Management made clear their #1 capital allocation preference right now is for share repurchases. They were unable to buy a significant amount of stock last quarter given the impending NXT IPO. Ultimately, they repurchased $337m for the entire year. With $1bn of cash proceeds from NXT share sales sitting on its balance sheet, and the expectation of at least $600m of FCF produced over the next year (a figure we believe is likely to be much higher), FLEX is sitting on significant excess capital. Beyond that, FLEX currently has no net leverage. Should management choose to, they could modestly increase their leverage and buy another turn or so of the equity. Ultimately, we think FLEX could repurchase as much as 20% of shares outstanding over the next year or two, which would go a long way to closing the valuation gap between FLEX and its peers.

WABTEC (WAB)

Wabtec (formerly Westinghouse Air Brake Technologies) is the leading global provider of equipment, systems, digital solutions, and value-added services primarily into the rail industry. The Freight segment (80% of profits) predominantly sells into Class 1 railroads in North America, but customers also include short line railroads and International with Brazil, Australia, India, and Kazakhstan as the largest countries. WAB further segments Freight revenues into Services (50% of segment revenues), Equipment (mostly locomotives and 25% of segment revenues), Components (15%), and Digital (10%). The other 20% of profits come from the Transit segment which manufactures and services components for passenger transit vehicles, including brakes, door systems, heating, ventilation, and air conditioning equipment. Transit revenues are primarily in Europe.

We believe WAB's business is at a positive inflection point as years of under-investment by North American railroads has led to poor service quality and the loss of market share to trucking. The main driver of reduced rail investments over the past decade was the implementation of so-called precision schedule railroading ("PSR"). This concept, pioneered by Hunter Harrison in the early 1990s, emphasized simplified routing networks, fixed train schedules, and increased train lengths. The increased focus on efficiencies led to fewer railcars and locomotives in service, fewer workers, and substantial decreases in railroad operating ratios (higher margins). Our analysis suggests that capex per revenue-ton-mile decreased 21% and locomotives in use dropped nearly 11% from 2014 to 2021. Although PSR boosted margins, ROIC and share prices of the rail

roads, shippers have complained about delays and service quality and railroad workers have raised concerns about safety due to reduced inspections and staffing. We estimate that rail equipment accidents per million train miles increased 10% from 2014 to 2021. Several high-profile derailments over the past couple of years have shed a spotlight on the issue including last year's Missouri train derailment that killed 4 people and injured another 150, and the East Palestine, OH derailment that led to the dumping of 100,000 gallons of hazardous materials.

A new Railway Safety Act, which has bi-lateral support in Congress, could lead to tighter regulations that will force increased rail investments, which we believe would benefit WAB. In June, the Biden administration said it will conduct safety assessments of all major U.S. railroads following the Ohio derailment. Senate Majority Leader Chuck Schumer's office said the recent derailments "make it clear that the freight rail industry has perpetuated a culture of cost-cutting and shortcuts that has led to horrific damages in communities, injured workers, and even death."

Meanwhile, some major rail companies have articulated plans for material capex increases in a bid to gain share back from trucking and perhaps to appease watchdogs on the heels of the major derailments. At its April 2023 Investor Day, *Canadian National Railway* **(CNI)** outlined a plan to grow capex by 20%-40% over the next couple of years with the goal of growing volumes and taking back market share. In late 2022, *Berkshire Hathaway*'s **(BRK)** BNSF announced a $1.5B rail facility in Southern California to link their system with the ports to take share from trucking. After hiring a new CEO, *CSX Corp* **(CSX)** has increased capex plans which we expect to grow from $2.1B in 2022 to over $2.4B by 2024. Overall, we expect the major Class 1 railroad companies to increase capex by 7% in 2023 and 9% in 2024. With consensus estimates of 6% and 5% growth in WAB revenue in 2023 and 2024, respectively, we believe there are positive earnings revisions to come. The market is likely more fixated on near-term rail volume weakness and is missing the bigger picture capex growth story over the next few years, which we believe has created an opportunity in the stock.

Longer term, we believe WAB will benefit from regulatory initiatives towards zero emissions. For example, the California Air Resources Board ("CARB") recently passed a new rule that requires locomotive operators to fund a trust account that will be used to purchase new or remanufactured Tier 4 locomotives. Further, the rule states that only locomotives that are 23 years of age or younger can operate in CA by 2030. This new rule likely raises awareness of locomotive emissions more broadly and the EPA could adopt similar regulations that will have national implications. Certainly, the railroads will fight the rule, which will lead to delayed implementation or specification changes, but we believe the opportunity is significant for WAB over time. Our research suggests that only 1,100 Tier 4 locomotives have been built, yet the "big 6" Class 1 railroads have over 25,000 locomotives combined. WAB has sold virtually no new locomotives in the United States over the past few years so any increase in the replacement cycle will have positive implications for future growth. Interestingly, *Caterpillar* **(CAT)** recently disclosed it is exiting the North America Tier 4 locomotive business and wrote down the assets, leaving WAB with a virtual monopoly on Tier 4 locomotive sales.

In the near term, we believe there is upside to WAB's 2023 guidance due to recent sizable orders and better than expected results from railcar manufacturer, *Greenbrier* **(GBX)**. Our 2024 EPS estimate is nearly 10% higher than consensus as we believe higher railroad capex will lead to growth rates in excess of both consensus and management's guidance.

MD SASS

MARKET COMMENTARY

The recent moderation in inflation, particularly evident in core CPI, combined with a robust labor market, has raised the likelihood of a soft-landing scenario, instilling confidence in equity markets. Additionally, the fervor surrounding AI advancements has driven remarkable share price gains for Big Tech companies, consolidating their dominance in major indices. Amidst low volatility and historically low equity risk premiums, we cannot ignore the fact that equity valuations are relatively high, and investors' sentiment leans more towards greed than fear. Likewise, we find the overall risk-reward proposition in the market less appealing at present.

Considering the aforementioned, we maintain a conservative approach to underwriting assumptions for our portfolio positions. Our strategic focus lies in aligning the portfolio with investments demonstrating strong potential for positive earnings revisions. While our portfolio is not immune to broader economic conditions, we have strategically chosen companies with resilient business models, limited cyclicality tied to broader economic cycles, or specific catalysts that we believe will outperform macro challenges in the short term. We acknowledge the possibility of a recessionary environment, but our investments are carefully curated to withstand potential headwinds, allowing us to capitalize on opportunities that we believe will prevail even amidst market uncertainties.

As of July 20th, our five largest positions were CACI International (CACI), APi Group (APG), Avantor (AVTR), AmerisourceBergen (ABC) and Formula One (FWONK), representing 33% of the total portfolio. Approximately 13.4% of the portfolio is currently held in cash.

As we navigate through these challenging times, adhering to our investment process, avoiding behavioral biases, and fostering a culture of intellectual honesty will be critical to our success. We appreciate your trust in us, and we remain committed to serving both our current and future valued clients. Please don't hesitate to reach out to us if you have any questions or concerns.

Sincerely,

Ari Sass
President & Portfolio Manager, M.D. Sass

MD SASS

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The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Index is unmanaged and may not be invested in directly.

The Russell 3000 Value Index measures the performance of the 3,000 largest publicly held companies incorporated in America, as defined by total market capitalization. The Index is unmanaged and may not be invested in directly.