



## Investment Philosophy and Process: Separately Managed Accounts **Invesco International Companies ADR SMA**

### **Objective**

The portfolio seeks long-term growth of capital

### **Universe**

Typically ADRs of companies in the MSCI All Country World ex-US Index with a market capitalization of \$1 billion, including both developed and emerging markets. May also include non benchmark companies and small- and mid-cap companies.

### **Team**

- Matt Peden, with Invesco since 2009
- Jeff Feng, with Invesco since 2009
- Assisted by 3 analysts
- The managers use a disciplined investment approach to investing in quality companies

### **Philosophy**

We view ourselves as business people buying businesses and consider the purchase of a stock as the purchase of an ownership interest in a business. We seek to invest in a concentrated selection of companies that represent our highest-conviction ideas driven by independent thought.

The two key questions that we ask ourselves are:

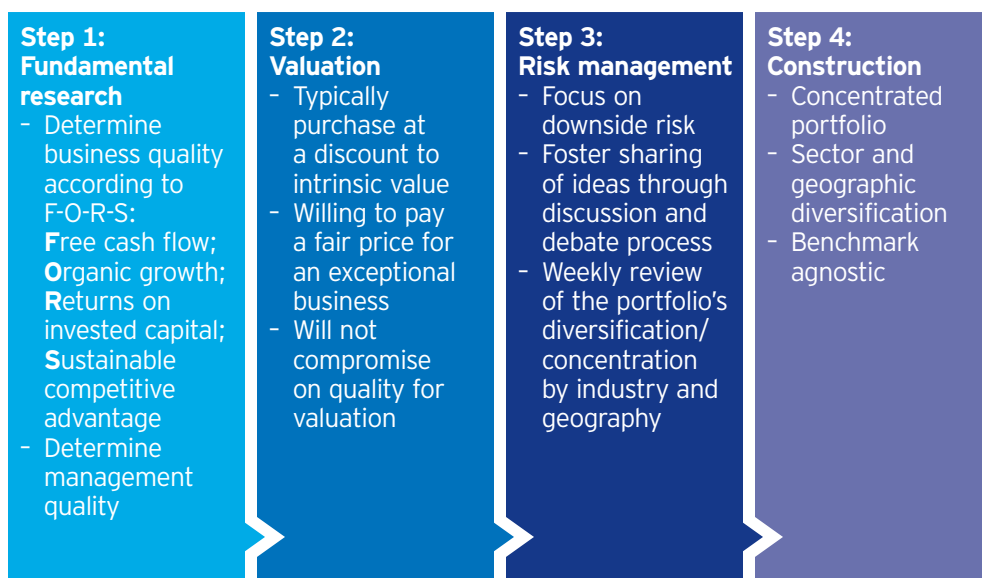
- Is this a great business?
- How much is it worth?

Our view is that markets are inefficient over the short term, and thus we take a long-term view (typically three to five year investment horizon).

### **Process**

We use a bottom-up, fundamental investment approach to analyze the quality and value of companies.

### **Investment process overview**



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## Step 1

### Research

In conducting a comprehensive, fundamental analysis of a company, we focus on three areas: business quality, management quality and valuation.

Our objective is to identify companies that are in a strong competitive position that we believe can survive and prosper through economic cycles.

Of utmost importance is business quality, if this criterion is not met, the stock is no longer considered for investment.

We first look and assess a company's business quality using the acronym "FORS," which stands for: free cash flow, organic growth, returns on invested capital and sustainable competitive advantage:

- **Free cash flow.** Businesses must convert a high percentage of earnings into free cash flow. We are focused on free cash flow, not accounting earnings as FCF drives long-term shareholder value creation.
- **Organic growth.** We seek businesses with the ability to compound intrinsic value at a mid single digit or higher rate.
- **Returns on invested capital.** Businesses must earn consistent, attractive unleveraged returns on tangible capital averaging mid-teens or higher through a full market cycle.
- **Sustainable competitive advantage.** Businesses must be protected by an enduring competitive advantage that is both difficult to replicate and allows the firm to sustainably earn excess returns on capital. Examples include brand loyalty (pricing power), network-effect, scale, etc.

We seek management teams that tend to be "best-in-class" operators with a focus on cost minimization that also foster a meritocratic, high performance culture. Our focus is to understand management's behavior by assessing their abilities as capital allocators and operators, and emphasis preferably on compensation system/ownership structure aligned with shareholder value creation.

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## Step 2

### Valuation

Once we assess for business and management quality, we then perform further valuation analysis. We consider a company for inclusion in the portfolio if it is trading at a sufficient discount to intrinsic value. For each company, we create a financial model that incorporates historical financial statements, profitability drivers, as well as forecasts and sensitivity analysis.

In certain cases, we are willing to pay what we believe is a fair price for an exceptional business. We do not compromise quality for valuation.

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## Step 3

### Risk management

Imbedded within our research process is a rigorous review of each potential investment candidate by the entire team. Our discussion and debate process is focused on downside risks. We challenge the investment thesis by seeking to identify potential pitfalls for each company. To help assess the portfolio's risk exposures, we perform a weekly review of the portfolio's diversification/concentration by industry and geography. This process fosters an environment that promotes the sharing of knowledge within the team and seeks to ensure a thorough understanding of each potential investment, and accountability for all investment decisions.

## At a glance

Construction and risk management:

- Typically purchase at a discount to intrinsic value
- Willing to pay a fair price for an exceptional business
- Will not compromise on quality for valuation
- Sector and geographic diversification
- Benchmark agnostic

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## Step 4

### Construction

Our fundamental, bottom-up process drives our sector, country and cash allocations. The end result is a concentrated portfolio, with initial position sizes typically between 2% to 5%. We generally seek broad diversification across economic sectors and geography; however, the final portfolio will differ significantly from the index.

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### Sell

We consider selling a holding when:

- Full valuation is reached
- More attractive investment opportunity identified
- New information arises that changes the team's thesis on the future of a business

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