

Stocks in the Spotlight

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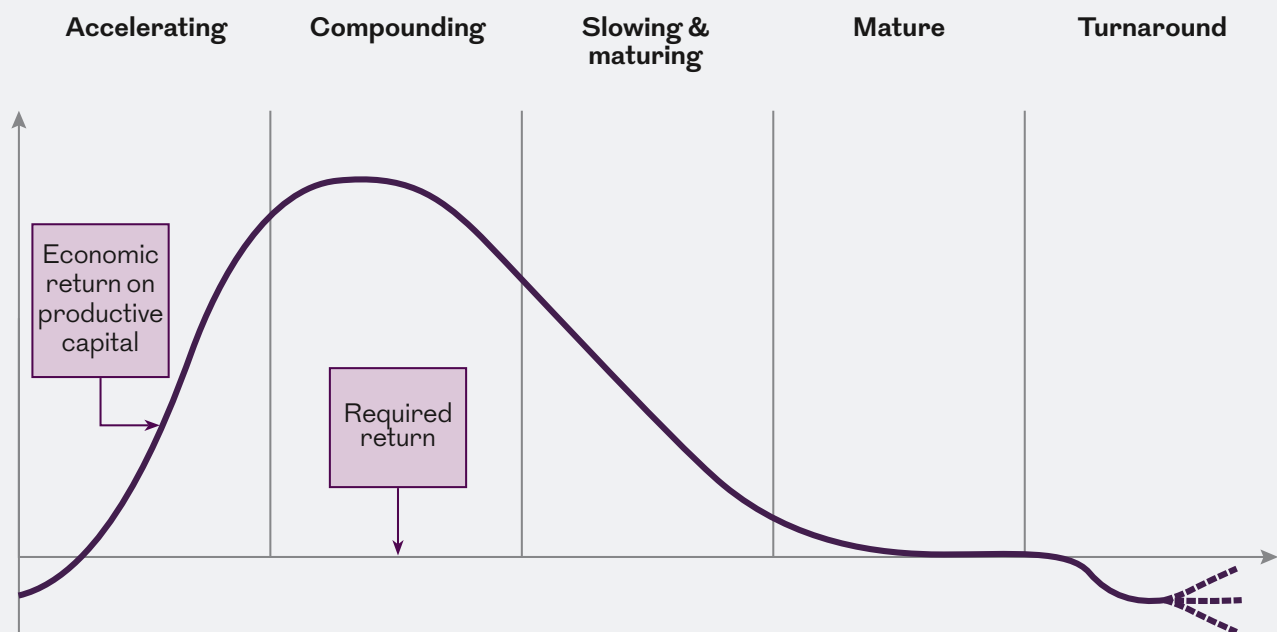
Word from the desk

Our Stocks in the Spotlight series brings our investment approach to life by providing details of specific portfolio holdings. This approach runs across different Corporate Life Cycle stages, from growth-orientated Accelerators and Compounders to the value-biased Mature and Turnaround universe.

While wealth creation can occur across the entire Corporate Life Cycle, the drivers are very different depending on what stage of Life Cycle the company is in.

Figure 1: Corporate Life Cycle

Corporate returns on productive capital and growth tend to progress along a Life Cycle. Every company can be located economically in a Life Cycle category.



Source: Royal London Asset Management for illustrative purposes only. Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation.

In this edition, we focus on three of our stock holdings – Safran (Compounding), KB Financial (Mature), and Sylvamo (Turnaround).

SAFRAN (SAF FR)

Stock profile

MCAP (\$bn)	98bn
Headquarters	France
Sector	Industrials
Life Cycle Classification	Compounding

Company description

Safran is a key player in the global aerospace propulsion and equipment market. The business engages in the design, manufacture, and sale of aircraft, defence, and communication equipment and technologies. Safran is renowned for its innovative jet engines through its partnership with GE (CFM International).

Life Cycle characteristics – Compounding:

- Large addressable market
- Strong momentum
- Ability to reinvest back into the business

Investment thesis

The aerospace propulsion segment, which accounts for over 50% of Safran's revenue, operates as an industry duopoly between the Safran/GE partnership (CFM International) and the Pratt & Whitney/MTU Aero Engines partnership.

Safran's core competitive advantage lies in its extensive technical expertise, strategic partnerships, and entrenched position within the aerospace industry. As a Compounding business, Safran is well positioned to generate positive returns above its cost of capital over the long term, leveraging its leadership in aerospace propulsion systems. The market appears to underestimate Safran's Compounding potential and growth prospects, presenting a compelling investment opportunity.

News and outlook

The company's latest set of results came in strong with management raising expectations for full year profit.

From the results:

- Revenue for the first nine months of 2024 amounted to EUR19,686 million, up 17.4% compared to the same period the previous year.
- LEAP engine deliveries were up sequentially with 365 units in Q3 2024. These are the engines used to power narrow-body aircrafts such as the Boeing 737 Max series and the Airbus 320 family.
- Safran launched a €500 million share buyback program, following a previous program of €1 billion.

KB FINANCIAL (105560 KR)

Stock profile

MCAP (\$bn)	25bn
Headquarters	South Korea
Sector	Financials
Life Cycle Classification	Mature

Company description

KB Financial Group is a Mature, diversified financial services company primarily based in Korea. Approximately 95% of its operations are focused on the domestic market, with banking activities contributing around 70% of its net profit. The remaining revenue is derived from a variety of financial services, for example Credit Card services, Asset Management and Insurance products.

Life Cycle characteristics – Mature

- Operational efficiency
- Cash flow focus
- Growth less important

Investment thesis

KB Financial is following a textbook strategy for a Mature business in a relatively mature market. They are also likely to benefit from favourable structural changes within their industry. Firstly, KB is focused on improving the quality of their balance sheet and strengthening their capital position. They now have industry-leading regulatory ratios. Secondly, they are reducing costs and diversifying revenue streams away from credit risk. Finally, they are focused on shareholder returns through increased dividends, and share buy-backs. A tailwind to this will be the consolidation of the Korean banking market, where the six largest players now account for 80% of the market by loan value. The current share price implies the market does not share this view, with KB trading at 0.7x price-to-book. We believe this represents an attractive valuation opportunity.

News and outlook

KB Financial reported third quarter earnings at the end of October.

From the results:

- Diversification across securities, insurance, and card businesses has sustainable strong profitability, delivering return on equity above 10%.
- Continued enhancement to cost efficiency led to reduced cost income ratio of 36.5%. The cost income ratio is a measure of a bank's efficiency.
- The Board of Directors are set to approve a cash dividend of KRW 300bn per quarter (KRW 1.2tn for the year).

SYLVAMO (SLVM US)

Stock profile

MCAP (\$bn)	3.5bn
Headquarters	US
Sector	Materials
Life Cycle Classification	Turnaround

Company description

Sylvamo is a US-based paper and pulp company. It was spun out of International Paper in the third quarter of 2021. It specialises in the production of uncoated freesheet (i.e. printing, copy, and writing paper), which accounts for 89% of revenue. It also produces coated paperboard and sells excess pulp on the open market. The company has assets in North America, Latin America, and Europe. Latin America is the most profitable region, accounting for 41% of operating profit but only 21% of revenue. North America is the least profitable region, accounting for 49% of revenue but only 21% of operating profit.

Life Cycle characteristics – Turnaround

- Increase returns
- Shrink weak assets
- Strong balance sheet

Investment thesis

Sylvamo is an underappreciated Turnaround opportunity that is currently held back by a challenging external environment but should generate through-cycle positive returns on its cost of capital once the external environment normalises. The company enjoys significant economies of scale as one of the largest uncoated freesheet producers globally and is also advantaged by its vertically integrated business model and cost-competitive assets, especially in Latin America. Following the spin out from International Paper, management is now entirely focused on the core business and can prioritise cash generation to fund cost-reduction capex, deleveraging, and shareholder returns. The market is not pricing in any sustainable recovery in earnings, which makes the valuation very attractive.

News and outlook

Sylvamo reported strong third quarter FY24 earnings in November.

From the results:

- Cash generated from operating activities of \$163m versus \$115m in the previous quarter. Free cash flow of \$119m versus \$62m in the previous quarter.
- Sylvamo demonstrated good commercial execution and strong operational performance aided by encouraging increases in industry demand.
- Sylvamo continue to allocate capital to generate long-term shareowner value. Year-to-date the business has repurchased \$30 million of shares and are authorised to repurchase an additional \$120 million.

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