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BARRON'S ROUNDTABLE

William Priest: Bullish on Screen Technology and Chip Gear

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Barron's: Bill, where do you see value these days?

William Priest: Trees don't grow to the sky, but I am going to repeat two picks from last year that have gone up a lot because I believe they will keep rising. The first is Universal Display [OLED], an $8 billion-market-cap company. When a colleague of mine discovered the company, he told us that it was the best stock idea he had seen in 30 years. Epoch Investment Partners became the second largest institutional shareholder after Vanguard. Universal Display has 4,500 patents around OLED technology, or phosphorescent organic light-emitting diodes. The company gets a royalty for every OLED screen manufactured. It has a monopoly on what are called red and green emitters, and it is developing blue emitters, which would be a big deal. OLED screens are replacing LCD [liquid-crystal display] screens in handsets such as the iPhone. The addressable market could grow 30% this year.

How well has the stock done, and where is it heading?

Priest: We bought the stock at $48. It closed on Friday [Jan. 5] around $180. The company is earning around two bucks a share. It ought to earn $7 a share by 2020, and if it can commercialize the blue emitter, it could earn about $12 a share. Apple is important to Universal Display, but all phone makers are going to have to license the company's intellectual property down the road. Our target price is $350 to $400 a share.

Next, we like Applied Materials [AMAT]. We also owned Tokyo Electron [8035.Japan] in the past. If the two companies had merged a few years ago, as planned until the Justice Department intervened, they would have had a world-class position in the semiconductor-equipment market. The government broke up their plans. Nonetheless, Applied Materials is a leading semiconductor-equipment manufacturer. It is at the center of all these powerful trends we've been talking about today—artificial intelligence, the growing impact of technology across industries. The company is continuing to gain market share. Shares trade for $52, or 13 times our 2018 cash-flow estimate of $4 a share. By 2020, Applied Materials could be generating close to $6 a share, and the stock could be trading for $80 to $85.

Have you brought us some new names, too?

Priest: Everybody knows Starbucks [SBUX]. The stock has done nothing since 2015. Comparable-store sales have decelerated significantly since then, from 6% or 7% to maybe 3%. Current guidance looks achievable. The company is forecasting same-store sales gains of 3% to 5%, high-single digit revenue growth, and earnings-per-share growth of 12% or more in the next three years. The rate of earnings growth is down from 15%-20%, but the company will be returning roughly $15 billion to shareholders from 2018 through 2020 through stock buybacks and dividends. They will be front-end loaded.

What does the stock yield?

William Priest

CEO and co-chief investment officer,

Epoch Investment Partners

New York

Priest: The current yield is 2%. Starbucks has been streamlining expenses. Examples include the closing of its Teavana retail stores; refranchising of Germany, Taiwan, and Singapore; the sale of Tazo to Unilever; the elimination of the Starbucks e-commerce operation; and the consolidation of China. China is the second-largest and fastest-growing market for Starbucks. The company is growing organically in China by 7% per year. It just purchased about 1,300 stores from Uni-President Enterprises in China, and is adding 600 stores per year in that country. In total, the firm is growing 25%-plus per year there.

Starbucks' return-on-capital target is roughly 25%. The company generates some of the highest returns in the restaurant industry. Even though the stock hasn't moved much, it isn't cheap. The company has a market cap of $85 billion and trades for 14 times enterprise value to Ebitda. It trades for 24 times calendar-year earnings. We expect Starbucks to benefit from tax reform, including through a lower tax rate and repatriation of cash held overseas. It has been paying taxes at a 33% rate. Shares trade for $59, and we have a price target of $70.

Do you worry that Starbucks might be saturating the market?

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Priest: Not really. They are concerned about the return on incremental capital deployed against their cost of capital. They have started to focus on this and have shut a number of stores and closed other parts of the business. China is something that people don't spend a lot of time on in analyzing Starbucks, but it is going to be a big piece of the business. We think the stock could rise 20% to 25%. To me, it is the ideal kind of stock to own, as it has done nothing for a while. The bad news has come out. I don't think one can lose a lot. We acquired our initial position in Starbucks at $54-$55 a share. The growth in China helps, and if they can deliver on expectations, based on guidance, you'll see some positive movement in the shares.

Martin Marietta Materials [MLM] is another name we like. The stock had a big move up in 2016 and has been flat ever since. I don't know if we'll get an infrastructure bill out of this Congress, but even without it, the stock has upside. Martin Marietta produces aggregates for highway infrastructure and construction materials for commercial and residential construction. At $225 a share, the company has a market cap of $14 billion, and trades for about 14 times Ebitda. It sells aggregates for about $13 a ton. It is the No. 1 or No. 2 company in 85% of its markets. The stock could be worth maybe $300 in the next 18 to 24 months. It would be helpful if we could get an infrastructure bill passed.

My last pick is MetLife [MET], a leading global provider of life insurance and other protection products. The company spun off its U.S. retail life-insurance and annuity business under the name Brighthouse Financial [BHF] last year. The spinoff allowed MetLife to get rid of a lot of profit variability. Operating cash flow will now increase substantially. You are going to need an upward-sloping yield curve to make the story really work. I expect the yield curve to shift upward, but the slope may be flatter than what it is now, as we don't see the long end going up a lot—staying under 3% for the 10-year Treasury, unless inflation really gets going.

Jeffrey Gundlach: One of the most overcrowded trades is people betting on the yield curve flattening.

Priest: I agree. MetLife Management has an ambitious cash-payout program, involving dividends and stock buybacks. It plans to return about 9% of the market cap of the company to shareholders in the next four months or so. Shares trade for $51, or 10 to 11 times 2018 estimated earnings, and the company has an operating cash flow yield of 9%. MetLife could return 20% to 25% over the next year, including dividends.

Thanks, Bill.

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