

Lisa:

My name is Lisa Roth. I'm a partner at Pzena Investment Management. And to give you some context for today's episode. We are disciplined value investors. We look for companies with solid long-term prospects trading at prices substantially below their intrinsic value. On today's episode, I'll be speaking with a number of our portfolio managers who've each selected a stock to watch, representing an opportunity that they find particularly compelling.

Our first guest today is the founder of Pzena Investment Management, our chairman, co—chief investment officer, a portfolio manager on our U.S. large cap strategies and in my opinion, just the nicest guy you could ever hope to work for. Mr. Rich Pzena, welcome to the podcast, Rich.

Rich:

Thanks, Lisa.

Lisa:

So as you look at the current environment for value, what company strikes you as a particularly interesting or compelling opportunity as we head into the new year?

Rich:

I'm going to talk about Humana. Great. Humana is one of these businesses that for so many years people loved. It was its Medicare Advantage. It's basically a health insurer, which nobody loves. But but it was Medicare Advantage and Medicare Advantage, having become a senior citizen recently. So you're you're inundated with the decisions you have to make at the, at the, at age 65 about your health care.

And what's compelling about Medicare Advantage is that that and most seniors, most people before they reach their 65th birthday don't really think of Medicare other than something that's going to take care of them when they're healthy. Yep. The problem is, it's not a complete program and it doesn't cover 100% of your doctor's bills. It covers 80% of your doctor's bills.

And so if there's a catastrophic illness later in your life, it can bankrupt you.

Lisa:

Absolutely.

Rich:

So people have bought some kind of a supplemental policy. Medicare Advantage is a policy that covers the other 20%. And any deductibles. So deductibles and co-pays, in exchange for you accepting their narrower network. So you can't go to any doctor you want. You have to go to the

one that's in your network. Now, most people retiring today have grown up with that kind of corporate insurance policy.

So they're used to it. So it's gone from zero to half of all seniors over the last 30 years. And it's been a very nice growth business. Now there's short-term issues. So while this is the stock to watch in 2026 that's that's the question. It's not certain that it's going to be great in 2026 because we don't know.

But what we do know is it's great long term because this achieves something that seniors want and it helps control health care costs. So despite the rhetoric of or anti-insurance company rhetoric, this is a very good business that's selling for as we estimate less than four times what it should earn in a few years. Mostly because it's not earning it this year because there were some excesses in the system.

They over-earned for a while. They got aggressive on increasing the benefit package. The government got aggressive on trying to control costs. People are afraid of that. And so you get this kind of unique opportunity to buy this kind of business. Yeah.

Lisa:

Well, I want to thank you, Rich. I know everyone's always eager to hear your thoughts. So we appreciate your time and, are excited to see long term what happens with Humana. Fantastic. Thank you.

My next guest is John Flynn, who has been with the firm for over two decades and is a portfolio manager for most, if not all, of our U.S. strategies.

He's on small caps, mid mid-cap, large cap, and our focused value service. John, you've been on the podcast many times. Welcome back.

John:

Thanks, Lisa. It's good to be here.

Lisa:

And, so where are you seeing opportunity? We want to share with us today.

John:

I think one interesting area where we've been seeing opportunities in the market today is really in the staffing space. And, and there's a number of different names in the portfolio, but one I'd highlight here that I think is really compelling is Robert Half. So Robert Half is a staffing

company that's focused on finance and accounting functions. And that's about two thirds of their business.

And then they've got another third of their business. That's a consulting business focused more on regulatory compliance and digital transformation projects for financial institutions.

Historically, it's been a very strong business. I would say kind of if you look historically, some of the financials average operating profit somewhere in the \$400 million range. Okay.

That's depressed today because staffing turnover across the board, not just in financial functions, has been at historical lows.

And really how the company makes money is a place people inside a company for temporary purposes. Maybe sometimes that becomes a full time role, but that's just not happening right now. And that's depressed. And so if you look, at the stock today that the market cap is around \$3 billion. They're forecasted this year to do probably I think consensus is in the mid two hundreds in terms of free cash flow.

So off of a very depressed level right. That that to that mid two hundreds historically would be more like 400. But you're getting a high single digit yield on the stock today. The balance sheet's net cash. So you're not really taking any, balance sheet risk with this. And we think this is indicative of some of the opportunities we've seen across the board where cyclical lows, you know, we maybe Robert Half just reported earnings last week.

They talked about things recovering a bit. And they're sort of green shoots, but it's still very much bouncing along the bottom in the industry. And in a name where we just see the valuation pretty washed out. And for somebody who has a longer term horizon and willing to wait for that cycle to churn, it's a compelling opportunity.

Lisa:

Well, it sounds like just the thing that we would be looking for. So, again, excited to have you back on the podcast. I'm sure I'll see you here again soon. We love to have you on. All right.

John:

Thanks a lot for chatting.

Lisa:

Bye. Next, I want to welcome to the podcast, someone we have wanted to have on here for a while. Takashi Okumura, who is our portfolio manager for our Japanese focused value service. Thanks for joining me today.

Takashi:

Thanks for having me.

Lisa:

Which stock would you like to discuss today?

Takashi:

I like to talk about the Olympus, the medtech company in Japan.

Lisa:

Nice, nice. Okay. Why don't you tell us why we should be watching this stock?

Takashi:

Okay, so Olympus is a pure play medical device company and the clear global leader in GI endoscope. They have roughly around 70% global share in GI endoscope. This is a very attractive business because switching is hard. Doctors need to learning and comfort with the tools. Hospitals integrate the system into their workflow and the power and scope have to work together.

So once a hospital adapts, Olympus customers tend to stay. And importantly, the profit pool is not just a one time earner. So Olympus earns the cutting high margin revenue from scopes and the data products. The endoscope market itself is structurally stable. It is effectively an oligopoly led by leading Japanese players, which keeps barriers to entry high and gross, sterile tailwinds.

In the U.S., the recommended starting age for colorectal cancer screening has moved down to 45, which supports procedure volumes, over time. Looking ahead, AI should improve image quality and workflow. Olympus advantage is scale. They have the largest installed base which gives them the most real world procedure data. So over time they have built smarter tools and a better workflow solutions.

So why the stock underperformed. Olympus has been going through a long transformation from a diversified company to a focused medtech player. But execution has has been uneven. The organization has been complex. Overhead has been heavy. And the quality and the regulatory processes gaps. Those gaps led to FDA warning letters, remediation costs and delays in production launches commercially. The tower launches slipped first and then pushed out delayed endoscope launches, which hurt the sales momentum, especially in the U.S.

In China, the environment also got tougher. Anti-corruption enforcement and the buy China dynamics clustered for implants and Olympus was late ramping local production versus competitors. Now we think the setup is improving. The FDA remediation is in the late stage. So

the temporary quality data costs should roll off. New products are being launched across key markets, which should support the recovery in scope driven revenue.

And local production in China is now up and running, which should improve competitiveness and help normalize sales to get. Finally, leadership has changed. The new CEO, Bob White, came in June 25th from Medtronic. That matters because Olympus issues operational quality, system launch discipline and global execution. And the company also had a high fixed cost base. The Asian sales ratio is more than ten percentage points higher than peers.

So there is little room to streamline costs and improve margins. This is exactly where a seasoned medtech operator is hired to fix. Overall, we see a high quality franchise with recurring economics, near-term earnings normalization, and the potential for structural margin improvement. Yet the stock trades at the at only about 15 to 16 times next fiscal year adjusted EPS, which we think still does not fully reflect the upside.

We have two ways to win. Earnings normalize as temporary costs fade and multiple rerates if cost themes.

Lisa:

Nice. Well, that makes a lot of sense. It sounds like there's a lot of potential there. So thanks, Takashi, for sharing about Olympus today and for coming on the podcast. I know I've been bothering you to come on the podcast for at least two years now, so I appreciate your time.

Takashi:

Thanks for having me.

Lisa:

Thank you. Next, I want to welcome back to our podcast, Jason Doctor, who is a portfolio manager on our international small cap strategy. Jason, thank you for joining us.

Jason:

Lisa, thanks for having me on again.

Lisa:

So what stock would you like to tell the listeners about today?

Jason:

So I would like to talk with you guys about Wizz Air.

Lisa:

Wizz Air.

Jason:

Yes. Wizz Air is an Eastern and Central European based ultra low cost carrier. Okay. It's a it's a name we own in both the international small cap portfolios and in the emerging markets portfolios. You know, I like to think of it as a good business that has had everything possibly go wrong for it, that it possibly could.

In the last five years it has had COVID happen to it, which, as I'm sure you know, is hugely disruptive for the aerospace and is for the aviation industry. It has had, a material presence in Ukraine, which was impacted by, the invasions there, including three planes trapped on the ground for several months.

It has a material and profitable business shuttling people back and forth from Israel, which was impacted by the conflict there. And then to top it all off and the cherry on top, and really, the thing that catalyzed us to make it a bigger, bigger position across the firm was, the Pratt & Whitney geared turbofan issue. So a geared turbofan is a particular kind of jet engine.

That was one of the options on the current generation of the Airbus A320 family. Wizz Air is one of the largest, one of the largest operators of the of the A320 family in the world. And they chose to, they chose to to, use the, the Pratt & Whitney geared turbofan on the engine.

And unfortunately, new technology, exciting technology, one that has a potential for sort of lower fuel burn, lower CO₂ emissions, all the kinds of good stuff that you want to see. But, it had a problem. It was not able to perform at the level that was promised by Pratt and Raytheon. And in addition, the life cycles were much shorter than was expected.

So really, what's happened over the last few years is those planes have had to go back to the manufacturer to be repaired. And if you think about, like what running an airline's all about, not knowing how many planes you have, when you're going to have, where you're going to have, is like hugely disruptive. Yeah. So you had a couple issues.

So you had just how do you schedule an airline when you don't know when a plane is going to be taken out from underneath you? Right. You had an issue where once they were gone, you didn't know how long they were going to be gone for, and you had an issue where you had to lease planes to replace those planes on top of it.

So, as you can imagine, even a, even a, an incredible management team is going to have have difficulty doing that. And so what ended up happening was especially in sort of fiscal 2025, costs

just really spiraled out of control. It really looked like these guys had lost control of their business. And, what you realized when you dug under the covers and really thought about things and really spent some time saying, okay, here are the direct costs.

How can we think about the indirect costs? Of the of, of of this issue of not having your planes. You know, what is the business really done? And and when we did that work, what we discovered is actually if you look at the cost performance of the, of the airline without this turbofan issue. It was comparable, if not better than what.

Ryanair, the other ultra low cost carrier in Europe, was doing. But yet when you looked at what the market was saying, the market was saying, this is just a broken business, right? That's how you get something like trading at five times normal earnings, trading at, you know, sort of at a high teens, low 20s free cash flow yield.

And we remain really firmly of the view that this is not a broken business. It's just a business that's had a lot of bad things going on. We think over time, as we get past the geared turbofan issue, you will see that this is actually, you know, one of the two lowest cost airlines in Europe. There is a reasonable market structure where both Ryanair and Wizz Air sort of recognize the person they should be attacking isn't one another.

Instead, it's the legacy carriers. And finally, sort of really excitingly, it Ryanair's really been sort of a winner from Wizz Air as issues. But because of Boeing's own issue producing 737s, what you'll see is that Ryanair is unable to increase capacity over the next few years versus Wizz Air will finally be recovering, finally being able to get their act together, and they'll be growing their capacity at a level that we think is reasonable.

There's a period of time where maybe management was a little bit too optimistic on how much capacity they could grow out, but, they've sort of pulled things in and we feel better about that. So, you know, it's just it's it's like a classic example and an industry that's maybe not a classic Pzena industry. Right. Airlines usually not a place we love to invest in.

We felt like, you know, look, airlines are after utilities. Airlines are probably the most commodity commodity ish business possible. And so usually when you have a chance to buy the guy at the bottom of the cost curve in a commodity industry at what feels like a really cheap multiple, you want to do that. And that's kind of what's here.

And when you walk through sort of what's happened to them, you kind of understand how you ended up there. So it's just an idea that I think as a team we're really excited about.

Lisa:

Great. Well, I'm excited to see what happens with Wizz Air, over the next year. Two years. Three, you know. Yeah. However long it takes. But it sounds like a great opportunity for us.

Jason:

We're excited.

Lisa:

About it. All right. Thanks, Jason. I want to thank you again for taking the time to be here with us.

Jason:

Thanks a lot. Hey.

Lisa:

Now I want to introduce Akhil Subramanian, who has been with the firm since 2017 and is a co-portfolio manager for the Emerging Market strategies. Welcome, Akhil. It's always a pleasure to have you on the podcast.

Akhil:

Thanks for having me, Lisa.

Lisa:

Yeah. I think this whole thing was your idea. If I remember correctly, you came up with the idea to talk about stocks that the portfolio managers were interested in.

Akhil:

Well, if it's going well, then I'm happy to take credit. I'm also happy to take any feedback you guys have.

Lisa:

Nice, nice. Well, so let's get down to it. What stock are you finding the most compelling right now?

Akhil:

Okay, sure. So I'm going to pick PVH as my pick. PVH is a consumer company. It's kind of an odd name. But the core business is two brands that everyone's heard of, which is Calvin Klein and Tommy Hilfiger. So PVH is a global business that operates the two brands of Calvin Klein and Tommy Hilfiger. And this company is facing a lot of headwinds, and I think it's trading at a very compelling valuation.

Now, as you know, at least everything we do at Pzena is around normalized earnings thinking five years out, what can happen on a mid-cycle basis. But the interesting thing about PVH is in a year like 2025, they faced numerous headwinds. And so you could classify 2025 as a not good year rather than a mid-cycle year. And the stock is even compelling on that basis as well.

So after a year like 2025, where the company has faced headwinds from macroeconomic pain, headwinds from implementing and taking on the burden of tariffs and headwinds from an execution mishap at Calvin Klein, which they're in the process of fixing. The stock is projected to earn something like \$11 a share. The interesting thing is the stock price is only around 60, \$62 a share.

So after a fairly terrible 2025, the stock is trading at less than six times a bad year's earnings. And I'm using inverted commas here. So that's why I think this business is really interesting. You know, on a normalized basis, we obviously think the earnings can be a lot higher. But just taking a terrible year like 2025, the stock is trading at a pretty attractive valuation of last year's earnings.

Now in terms of where we are at the moment, you know, the business is generally considered mature. Calvin Klein and Tommy Hilfiger are not brands that are growing 15, 20% a year. They're growing on a fairly mature basis. They operate around the world. There's more or less penetrated most of their geographies. There are some pockets in Europe and some pockets in Asia that each of the brands has further opportunity to go.

But on a top line basis, we think the business can grow low to mid-single digits. Underlying all of that is, you know, some scope for margin improvement. Some of that margin improvement will come from lapping the operational mishaps that they had last year, for example, in Calvin Klein. And some of it will just be from, you know, the macroeconomic picture being a little bit brighter than what it has been.

And so on a mid-cycle basis, we think the stock is very attractive. And then from a pure capital return and capital allocation policy perspective, you know, the company last year bought back approximately \$500 million of stock. And the market cap of the company is around \$3 billion. So what's exciting for us is that this business, which is very modestly levered, has been buying back more than 10% of its shares every year.

In fact, depending on the stock price could be almost as much as 15%. So what you have in PVH is a global business operating two brands that are known to pretty much everyone, Calvin Klein and Tommy Hilfiger. The brands have growth runway ahead of them. In terms of the operating margins, we see some ways in which there is idiosyncratic, company specific improvement.

And the management team has a very good capital allocation policy where they are retiring almost 10%, if not more, of the share count every year. So on that basis, I think this is a really interesting setup. And that's why I picked PVH.

Lisa:

It sounds like a lot of potential. So I'm excited to see what happens with PVH. And I'm excited to have you on the podcast again soon, I hope.

Akhil:

Yes, I hope so too. Thanks, Lisa.

Lisa:

Talk to you soon.

Akhil:

Bye bye.

Lisa:

Our next guest is on the podcast so often he hardly needs an introduction. But this is John Goetz, our co-chief investment officer and a co-portfolio manager on our global, international, European and Japanese focused value strategies. Thanks for joining me, John.

John:

You're welcome. Good to be here.

Lisa:

What company are you going to talk about today and why is it interesting?

John:

Yeah. I'm going to talk about Daikin, which is a Japanese company, Japanese HVAC, heating, ventilation and air conditioning company.

And the reason I'm going to talk about it is we often say we're deep value, but we also say we like buying good businesses when they're on sale. And if you look at the the HVAC industry globally, it's actually a really good business. Meaning there are some very leading global companies involved. People in the United States are very familiar with this because they either buy a Carrier, which is about regarded company, or Trane, which is also well regarded.

So the industry structure has been good historically. And one of the reasons for that is because it's both a technology business, meaning you have to keep up with increasing demands, regulatory demands, etc. on air conditioning. But also client trust and I call it reliability is critical. No one wants to be without their house.

And, you know, without air conditioning. So, so, you know, it's one of those, good industries, if you look at it historically. By the way.

I, we we wrote this up in our quarterly newsletter. So if the listeners want more, on this, they should just go to our, our letter. But but I'll hit the highlights and why I'm picking this. Oftentimes good businesses can have issues or have elements of pain in their reported results. And Daikin has three major things hurting it right now from a financial optics standpoint.

Two of them are related to the company itself. One is really the industry itself, right. Because if you're selling air conditioning units, the more new houses being built, the more buildings being built, the more units you sell, right? And and if you look across their regions, because Daikin is really big in China, is really big in Europe, and is really big in the United States as well now.

It really the fact that all three of those markets have elements of pain in them is one of the reasons why the reported profitability is, is lower than you might, might expect. If it was just that alone, you might say, well, we could buy any one of the three. But that really isn't the key to this investment case.

Yes, that's in the background, but there's, a couple of elements for Daikin specifically, that are painful at the moment. One is they were not highly represented.

The United States, one of the biggest markets in the world. They decided since they were running a superior technology, actually, historically in Asia and Europe, they thought, you know, why shouldn't we win in the United States as well? Because there's lots of service in this industry involved in presence of installers, etc. You can't just walk in and take over the market.

So they actually did it via acquisition and they actually acquired a couple of weaker players. Goodman being the largest, where if you asked anyone where does Goodman rate relative to Trane and Carrier, they'd say below it. And therefore there was an investment required to update their technology. They actually built up, some vertical integration as well in the business to improve the quality of the offering.

So there's been a big investment period here, for Daikin, that has raised the capital invested with nothing to show for it, really, until you start making those sales, which is now happening. And we do think the future involves share gain, in, in the North American market. So one element of

pain was all that investment, which made the company look like it's having a declining return on investment.

We really think it is a proper investment in the future. And then the second is they stumbled actually in a regulatory shift here because as soon as the U.S. said you can't manufacture on the old refrigerant beginning in 2025, they stopped and immediately began making things to the new regulatory refrigerant standard. Installers, particularly in the consumer market, in the home market.

They didn't want to get to the new stuff before you really had to, which is actually 01 / 2026. Where you can no longer install equipment with the old refrigerant. They jumped the gun there and lost share. But the reality is they're ready for 01 / 2026.

So so that that also, you know, it looked like made it optically look like they were losing share. Even though what had happened was it just hadn't met kind of with the current demand requirements, which.

Really backward facing rather than forward facing. So what we see here is between the pain in the markets, for HVAC in general across the globe, including China, and their own self-inflicted wounds, we would say that over the next five years, which is our horizon, we're we're looking at earnings that we really do think the earnings can be roughly a double.

So so that's that's our case is there's a lot of current pain in Daikin, and we think at, at our current valuation, they're trading at somewhere in the 8 to 9 times our normalized earnings power.

Lisa:

Well, as you mentioned, Daikin was our highlighted holding in our newsletter. And if anyone wants to really read the full write-up, you can visit our website at pzena.com. Thanks, John. I just want to, as always, appreciate you sharing your knowledge and your thoughts, and we hope to have you back on the podcast very soon. I'm sure we will.

John:

Thank you for listening.

Lisa:

Next up, I want to welcome to the podcast Evan Fox, who has been with the firm 19 years. Is that right?

Evan:

Yeah, 18.5 or so.

Lisa:

Almost 19 years. So exciting. He is the portfolio manager on our global small cap, U.S. small cap, mid and mid-cap strategies. Thanks for joining me, Evan.

Evan:

Yeah, great to be here with you.

Lisa:

So, what stock do you think that we should be watching right now?

Evan:

One that's really interesting is Spectrum Brands. This is a company with a pretty complicated history, but that complexity is actually part of what's creating today's opportunities. Over the last several years, management has fundamentally reshaped the business, simplified the portfolio, and materially improved the balance sheet. Yet the stock is still being treated as if none of this progress really matters.

And people are so focused on what's been happening in terms of tariffs. Maybe they'd go back a few years. It's helpful to set the stage. So you go back and Spectrum had owned a home hardware business. Think of locks and door hardware and related products. Okay. In 2021, they announced plans to sell them to a European competitor at a great valuation.

It went through antitrust issues for two years. Keep in mind this is the prior administration. I feel like in today's administration, this would go through in a week. Yes. But this was multiple years of fighting, led to a lot of distractions, issues. But ultimately it did get sold at the original purchase price that they wanted, summer 2023.

Importantly, they didn't just redeploy their capital into another acquisition. Instead, they used the proceeds to buy back over 40% of the shares over the last two years. And reduce leverage. So now it's a really strong balance sheet. So now let's talk about what the business actually is today. At this point it's a much more focused company. Cleaner balance sheet, fewer moving parts.

And it's centered around three core segments. They have a global pet care, a home and garden business, and a home and personal care business. First is global pet care, which I'd argue is one of the highest quality parts of the portfolio. This is one that makes aquariums and treats for cats and dogs. A range of other products like that.

Pet trends remain pretty favorable. Some nice recurring demand here. And this contributes about 40% of sales. But actually 55 to 60% of earnings. Second is they have a home and garden

business, which has some well-known brands tied to lawn care and insect control. So picture Cutter bug spray, Spectracide weed and insect control for your lawn. Pretty good brand loyalty.

Steady demand. It always moves around a bit based on what the weather is. And you see some normal seasonality and trends because it's always too wet or too dry in different parts of the country. But overall, this is a nice business. That's about 20% of sales. But 25 to 30% of earnings. The third segment, and the one that everyone was afraid of last year, is the home and personal care business.

This actually sells a lot of products you've probably heard of. They have the Black & Decker toasters and blenders, the George Foreman grills. I admit I just bought my first one since college. I had a 20-year-old Foreman grill. They're still using it and, decided to get one that can do four burgers instead of two. 'Cause my son, two burgers is just not enough.

Lisa:

It's definitely not enough.

Evan:

They also make Remington hair care products and a range of other things. So again, this is really where the fear comes in because they import a significant portion of the products from Asia, which makes it exposed to tariffs. And on top of that, management had previously talked openly about wanting to divest this business or put it into a JV because it didn't like it as much.

So investors see tariffs, uncertainty, a business that management doesn't even seem to want for the long term. And they fixate on that. As a result, the stock valuation became increasingly disconnected with the underlying earnings power of the entire company. But here's the key point. The home and personal care business is not the whole company. It is about 40% of sales, but only about 15% of earnings.

And about three quarters of that earnings is from outside the United States, not exposed to those tariffs. But that really dominates how people think about Spectrum Brands. And so now, you know, we're at this point where even if you assume most of the appliance business goes away, the stock is still at a really depressed valuation. It's really a strong balance sheet, and the market's pricing it as though the appliance business is permanently impaired and the rest of the company doesn't fully matter.

So now we look at it. After all the buybacks, after reducing the leverage, that's trading just over five times normal earnings with overblown fears around tariffs. So Spectrum Brands is really a classic case of fear overwhelming fundamentals. And that's exactly the kind of setup we like going into the year.

Lisa:

Yeah, that makes a lot of sense. Well, Evan, thank you for for telling us about Spectrum Brands. And for being with us today. And, I look forward to having you on the podcast again soon.

Evan:

Great to speak with you.

Lisa:

Thank you.

Lisa:

So our next guest today is Dan Babkes, co-portfolio manager for our U.S. large cap and focused value strategies, and our global strategies. Now, Dan, you've been on the podcast before, haven't you?

Dan:

Yes.

Lisa:

Great. Well, we welcome you back. Always excited to have you. What stock have you chosen to tell us about today?

Dan:

Thanks. You know, today I've decided I'm going to pick Cognizant as my stock to watch for for 2026. So Cognizant is one of the leading global IT services providers. And this is a really great example of of the types of ideas that we're finding in the current market. So this is a company that has an exceptional history of being one of the market leaders.

And, and it was really a great long-term success story. They've had a company specific issue which has weighed on on the results in more recent history. The valuation derated because of this and presented a really, really unique opportunity for us. And I think today it's just fundamentally mispriced. And I think this is pretty interesting, even though it's becoming increasingly evident that the company specific problem is now already in the rearview mirror.

So I'll go through a little bit of the history. You know, Cognizant, most of their workforce is in India. So, so it was really a wild success story during its early years. And part of that was they had really a better delivery model for IT services. So there's, you know, fun fact, there was actually a Harvard Business School case study written about the great success that Cognizant had, and effectively what they were doing was providing better customer service.

They were outgrowing the industry for years and years and years at a slightly lower margin rate. Okay. Then, if I go to the origin of a company specific problem that got Cognizant to be really cheap. Back in around the 2016 timeframe, they had a series of, of, well, I would refer to as one-off issues that caused, caused execution problems within the company.

So, one, they had a Foreign Corrupt Practices Act investigation, which caused a reshuffling of their leadership. At the same time, they had an activist investor which waged a campaign against them. And the basic premise around this was they should raise their margins up closer to the peers they'd been outgrowing forever. So so they started to manage the business a little bit more with a short-term mindset.

Got the margins up in the short term, but then the long-term growth trajectory started to break down. So fast forward now, they've gone through a couple of leadership transition changes. You'd seen that they've been underperforming their peers for years. And this used to be the high flying, you know, premium multiple stock because it was, it was one of the best performers in the industry.

And it's completely derailed it. So just put it in perspective. Today it's trading about 13 times earnings. 13 times earnings. If you look at the closest peers, some of which are listed in India but not all. Accenture would be one example. It's listed in the U.S. The peers are trading at a range of, you know, 18 to 22 times earnings.

So so if they were to trade at a peer multiple, you know, pretty massive upside in the stock price. And what's happened is after recent leadership changes, they've basically fixed the execution issues. And we're not just taking their word for that. You can actually see increasing evidence in the financial statements that they've turned the corner.

So, during the period when they were derailing, it was kind of right for the market to trade the stock down because they were growing a lot slower than their peers, and they weren't seeing the same demand signals. They were experiencing a lot more personnel turnover than the rest of the industry. And if you look at it today, they're actually outgrowing the entire space.

Yeah. Plus, they've had to make a series of investments to fix some of the execution issues. So their margins had gone down. They've now turned the corner on that as well. And they're experiencing margin expansion that looks differentiated versus their peers as well. So when you look at it today, from a financial perspective, there's a company that's growing faster, is already expanding margins, and has a lot more room for margin expansion.

So the combination of that is their earnings outlook is is probably at the very high end of the entire peer group. And yet you're buying it at, you know, 50% plus discount to its closest peers in

an industry that has a wonderful long-term history of growth. Yeah. So the question you're probably asking is, how is it possible that it's so evident now in the financial statements that they've they've turned this around and yet it's still trading at this massive discount.

And why do I like it for 2026. Yes. So I'll, I'll, and you know, as you know, we're we're not, we're very long-term focused investors. So, you know, my history of this company is more about how it's performed through cycles as opposed to, you know, any short-term call. But I do have some logic behind why I like it for next year, actually.

So, in terms of, in terms of why I think it's trading at a discount, I think it took a while for them to fix their execution issues and frankly, it took two sets of management teams before they did it. So I think the market takes some time before they're going to start to give credit for what they're seeing in the financials.

I just want to see a little bit more sustainability. It's actually one of the reasons I like it for 2026 is I think the longer that their outperformance persists, the more that valuation gap should just continue to narrow. And I think the company is not going to sit still. I think their board of directors are likely having conversations with the management team about how do we narrow this valuation gap, and I don't know what they're going to do.

But one option I could think of, for example, would be if I have peers in India that are growing slower than me and trading at 20-something times earnings, maybe I should do all this in India, you know. So I think there's there's strategic options that they're likely going to be thinking about if, if the valuation gap doesn't close on its own. And then, you know, the other the other question I think is like, why is why why is this opportunity exists?

I think the other angle to this is there's a little bit of fear in the market around AI. So is AI going to disrupt the long-term growth rate of IT services companies. So I'll make a couple points around that. Number one, if we accept that premise, which I think that premise is actually not correct, but but let's, you know, I don't I don't know that for the sake of argument.

Lisa:
Yeah.

Dan:
Let's, for the sake of argument, accept that that's right. If it is, would you rather be invested in a company that's trading at a much higher multiple, right, or somebody that has margin expansion opportunities and would face the same headwind, but seems like it's fundamentally as well positioned, right. So your your starting point valuation is actually is actually offering you a little

bit of protection in Cognizant versus, you know, a higher flier in that industry from a valuation perspective. So I think that's one point.

And then two, I think this kind of fundamentally misunderstands what Cognizant's business model is. So the biggest fear that people will point to is some of the new tools that have come out. You know, for example, Anthropic, that help people code more efficiently, that, you know, if, if coding efficiency increases, that means people are just not going to hire Cognizant or the, the efficiency is going to come out of their P&L.

I would say, first of all, take a step back. Over the last 30 years, the reason this industry grew a lot was because they reduced the cost of implementing technology. That is the core business model. Cognizant did that originally by arbitrage, paying workers in India versus workers in higher-cost jurisdictions. In the last ten years, the industry's been doing that, but also incorporating automation solutions and technology into the way they're they're constructing their projects.

So this isn't really a new concept. It's a new technology that the industry needs to adopt. But it's not a new concept that the cost of delivery is going down. And the winner through cycles, when you've seen that happen, has historically been the services companies. The other point I would make is the percentage of the business that's physically coding for Cognizant is quite small.

So even if we believe that that's going to be all done by machines in the future, they're actually adding a lot of value that's based on other things. It's not just coding. So I think the market's just overstating the amount of revenue that's really at risk from this. And then the last piece of it, I think the way that AI is going to start to potentially generate economic returns for all the people that are installing these data centers is you need wide-scale enterprise adoption.

It's very hard to make the massive work that these data centers are going to sustain themselves without that. And when we speak to companies and talk to them about their AI journeys, one of the biggest obstacles that everybody has is their data isn't clean. So even if the external tools work, those tools need to be customized for specific companies, specific applications.

Dan:

Their tech stack needs to work, and the data needs to be cleaned in a way that the artificial intelligence can actually make sense of it. So getting from here to there is generally going to require a lot of third-party work from companies like Cognizant. So what's been happening in the short term is the industry's slowed down a little bit.

We think that's more of a cyclical issue. There was a big boom in COVID. It's slowed down. Companies aren't sure yet how to implement AI and some of the new technologies they need.

They're not ready for it yet. So we think there's there's this kind of interesting dynamic in the market right now that companies need these service providers to start installing the technology that people are worried is going to disrupt the service providers.

But they're not ready to spend the money yet because the technology isn't ready. So if you if you think about the, if you think about the, the loop of that, it's it's just a pretty interesting, it's a pretty interesting situation. You are seeing some, some industries that have kind of come through that cyclical malaise already.

So one example is financial services, where the revenue is growing nicely. So there's a lot of proof points to say that this business model is going to have a very significant and potentially growing role to play in the future as AI is going to be more broadly adopted amongst enterprises. And again, what I like about Cognizant is it's not priced for that.

Right? It's priced like there is going to be no growth, especially in the industry. And, and so I think the risk reward is really in your favor at this price. Yeah.

Lisa:

Well, Dan, you have definitely made me a believer. So I'm excited to see what happens with Cognizant. And thank you. Thanks for coming on today. Thank you. We'll look forward to having you on the podcast again soon.

Dan:

Thanks.

Lisa:

Thanks.

Our final guest today is Miklos Vasarhelyi, portfolio manager for our European focused value strategy. Miklos, welcome back to the podcast. It's, it's been a minute since you were here.

Miklos:

Thank you, Lisa.

Lisa:

So what stock do you want to talk about today and why would it be interesting to a long-term value investor like us?

Miklos:

Yeah. So today, and my best idea for 2026 is a long investment in Barry Callebaut, the chocolate processor.

Lisa:

Oh, exciting. Tell us about it.

Miklos:

Yeah. So, for those of you who are not familiar with Barry Callebaut, or Barry, as I'll probably call it, Barry is the world's leading independent chocolate processor. So basically, what that means is Barry buys cocoa beans from farmers, primarily in certain geographies, with Ivory Coast and Ghana being the largest growers of cocoa beans. They take those beans, and then they process that into chocolate liquor and cocoa butter, and then they take those products and then sell them primarily to large FMCG companies like Nestlé or Hershey.

It's a very high quality business. They really benefit from their scale, just being the largest player in this market and having the number one position. They have very long-term established relationships, both with the farmers, as well as the companies. And then also they enjoy a great reputation for just being a very reliable supplier of chocolate, because this is a difficult industry and a difficult market to, to navigate.

And because of that, historically, Barry's been kind of traded on a pedestal and been treated, and has historically traded at about 25 to, to 30 times earnings. Just given the high barriers to entry to this industry, as well as the historical stability of the earnings.

Lisa:

So outside of our quintile, exactly.

Miklos:

So, you know, what's really gone wrong with Barry and what's created the value opportunity for us is that, you know, going back to the middle of 2020 to, to Barry's stock price trough in the middle of 2025, Barry's share price was down over 65% in this period. And that's because of an unprecedented spike in cocoa bean prices.

So just to give you some historical context for that. So for the 20-plus years leading up to 2023, global cocoa bean prices averaged about \$2,500 a tonne and generally kind of traded within a range of, you know, \$1,500 a tonne to \$3,000 a tonne. However, starting in 2023, cocoa bean prices spiked and actually went up over four to five times that peak, to about \$12,000 a tonne.

And the main driver of that was, you know, there are a couple of factors, but the main driver of that was just poor crop conditions, a bad harvest in some of those key markets like Ghana and the Ivory Coast. So the result of those bean prices, that higher bean price really weighed on Barry's share price.

And it's weighing on Barry twofold. So the first is Barry, you know, they buy the beans. They process that into chocolate liquid and cocoa butter and they sell it. But as a result, they're holding on to that inventory for a number of months. So basically it's really holding on to that higher-cost inventory. It used to cost you \$2,000 a tonne to buy this tonne of beans.

Now you're spending \$12,000 a tonne to haul that, that that tonne of beans. So Barry, they don't take any commodity risk themselves. It's purely hedged. But they still have to carry that inventory for several months. And as a result of that, that's put a lot of pressure on Barry's balance sheet. So basically their leverage has gone up significantly just to carry that, that working capital.

So that's the first headwind that Barry's faced. And then the second headwind, you know, not surprisingly, is the higher cocoa bean prices also resulted in higher chocolate prices. So that's impacted overall chocolate demand and volumes twofold. So first, you know, consumers dealing with inflation and going to their local supermarkets. You know, you're seeing higher chocolate prices.

So maybe you're rethinking that decision on a Hershey chocolate bar or KitKat. And then secondly, there are customers like the Nestlés or Hersheys or Danones of the world have also been aware of this. So they've been trying to, at the margin, you know, reformulate some of their products to use a little bit less chocolate. So that's also weighed on demand.

So our view kind of, you know, with this in the rearview mirror and why we're really excited about Barry as an investment is that we think that over time, cocoa bean prices are going to normalize back to their pre-crisis levels. And that's really driven by, you know, crops. You know, you have a good year. You have a bad year.

Unfortunately for Barry, but fortunately for us, because it's given us this opportunity, it's been kind of three consecutive bad crop seasons. So we think that eventually that will recover. And then also, Barry and the industry has been reacting to this by trying to encourage farmers in other markets like Brazil, or other markets or other countries close to the equator, to grow new supplies of cocoa trees.

And this is an industry where there's a little bit of a lag because if you plant a new cocoa tree, it actually takes two to three years, usually kind of three years, for that tree to actually start producing beans. So there is a lag in the supply response. So, you know, our view is that this may

take a little while, but we think that, you know, the supply will recover. And in fact, it's looking like this year is actually going to be a good year for cocoa bean supply. So what we've seen is, cocoa bean prices have gradually been coming down, and now they're back down to about \$4,000 a tonne from that peak of 12 K. And that pre kind of crisis level of around, you know, \$2,500 a tonne.

And so this decline in, in the cocoa bean prices already started being reflected on Barry's balance sheet. So their leverage levels to fund that inventory and that working capital already started coming down. But we think that if the bean price stays where it is or continues to drift lower, you know, that's just to further help Barry clean up its balance sheet.

And then secondly, you know, we think that Barry's earnings are going to gradually improve because, you know, Barry, as I said, it's a pure pass-through on that higher cost. But but the flip side is as volumes have come down, right, there's extra cost. And as well as, you know, you have that financing cost of having more debt to supply that inventory.

So they've been slowly passing that onto their customers. So they are actually seeing an improvement in kind of EBIT per tonne, which is kind of the key metric that people in this industry focus on for profitability. And then lastly, as chocolate prices or cocoa bean prices come down, that'll help consumers as well. And I think that'll help consumers in twofold.

So first, it'll probably result in either flat or potentially even declining chocolate prices. And then secondly, you know, the industry, the customers, like Nestlé or Hershey, they seldom actually cut prices for their products. But if all of a sudden their input or raw material prices, so the cheaper chocolate prices come through, they're making more money on that product.

So what they'll do is they'll increase promotions. So they'll start discounting or trying to push that product because all of a sudden it's gotten more profitable. So we think that over time, that will really help drive a recovery in chocolate demand. And, you know, I think one thing that's important to understand here is, you know, chocolate demand is, you know, historically it's grown 2 or 3% per annum.

You know, children eat a lot of chocolate. You know, everyone likes chocolate.

Lisa:

It's good.

Miklos:

And we think it's going to continue to grow as, you know, there's a nice tailwind as people in lower-income or developing countries get wealthier. You know, chocolate is a luxury and a treat

that they'll have. So long-winded way of saying, we're really excited about the investment opportunity in Barry Callebaut. It's trading at around ten times our estimate of normal earnings. And I think it's my my top stock pick for this year.

Lisa:

Nice. Well, I'm excited to see what happens with Barry and cocoa bean prices. I certainly do understand that, why that sounds compelling. I want to thank you so much, Miklos, and really, thanks to all of our portfolio managers who participated today in what has become an annual fan favorite episode of Positive Perspectives. Yeah.

Miklos:

Thank you, Lisa.

Lisa:

Thanks. Thank you for joining us for today's episode of Positive Perspectives. If you'd like to hear more, be sure to subscribe to this podcast. And for more insights on value investing, visit our website at pzena.com. That's P-Z-E-N-A dot com. You can also follow us on LinkedIn or Twitter.