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Paul Whymper-Williams:
Good morning, and and welcome, everybody, to our mid-year global outlook for value. I'm just going to give it a few more seconds, a minute or so, just to allow a few more late arrivals to join us, and then we'll get things going. Well, I can see the numbers, continue to tick up, but I think we will, we'll kick things off. So, a very warm welcome, to everybody who's joined us today for the Pzena Mid-Year Global Outlook for Value. I'm Paul Whymper-Williams, and I'm part of the team that looks after our Australian and New Zealand intermediary clients. And it's a real pleasure to have you here today.

We're at the halfway mark of the year, and the first half has certainly not been short on surprises. We've had conflict in the Middle East, growing concentration risk in emerging markets. The so-called SaaSpocalypse in software and a very striking melt up in semiconductors. And with the World Cup well into the knockout stages, this feels a little like a half-time team talk, but… but let me be clear, the team talk isn't, for predicting the final score. Nobody knows what the second half of 2026 holds, and we're not going to pretend otherwise. What a halftime is for is an honest look at the run of play. What's working, what isn't, and what the company fundamentals and valuations are actually telling us.

I'm joined by two people who spend their days on exactly these questions. Rich Pzena, who needs little introduction. Rich founded the firm in 1995. and is co-CIO and portfolio manager on our US value strategies. And I'm also delighted to have Akhil Subramanian with us. A portfolio manager on our on our emerging market strategies, who has who has been close to to both the semiconductor story and the software names which we'll get into. So Rich, Akhil, welcome and thanks very much for joining us today.

Rich Pzena:
Thank you.

Paul Whymper-Williams:
Throughout the webinar today, please submit your questions and I and the team will do our best to weave them into the conversation as we go. And to kick things off, and before we really get into the detail. I think it would be helpful to frame the discussion through a longer-term lens, so… So, Rich, your investment career spans four decades. Over your career, the market has twice been gripped by a story that technology was about to sweep away whole industries. First, the dot-com bubble, and then the fintech boom. Today, it's AI. So standing here at half time in 2026, how does today's sentiment compare with those earlier episodes and what did they teach you about what happens when expectations essentially run ahead of reality?

Rich Pzena:
Well, Again, thanks everybody for joining. You know, this is the… the question that you don't really think you're going to live through for the 3rd time in an investment career where massive technological change is shaping how people look at the markets. And… There are massive

differences. in the opinions Of the people who are very excited about the technology. Because… it's doing what technology is supposed to do and displacing the prior generations of technology. But what's what's been very common Across… The three cycles, and again, the internet bubble. FinTech, it was kind of a mini one. and specific to an industry. And now AI, the massive one. the differences between The providers of the technology. and in many cases the customers or the users of the technology. Is striking because the world likes to believe that the new entrants are the victors. And the incumbents are the losers and prices stocks accordingly.

So if you go back to the 1998-1999 timeframe as a historical reference point. We had this very new technology, the Internet, which promised to effectively bring to market products and services and and distribution. methodologies that were unseen before. And the incumbents were… presumably at risk, and And interestingly, if you, if you, you, if you go back to that environment and think about who the losers were then, or the supposed losers. And this is going to sound a little unrelated, but it is what people thought, which was Western manufacturers were going to be the losers, because at the same time that the Internet was getting hot. we also had a meltdown in Asian currencies, providing a striking difference in costs to produce goods in Asia and the West. And now that you had a technology that would allow these remote manufacturers to bring their products to market. You saw… Gigantic valuations for the companies that were creating the technology to make this happen. and really, really horrendous valuations for the companies that were going to be disrupted.

And and interestingly. if you talk to the market participants and contrasted that with the Ceos. of the incumbents, the people running these businesses. It would be, like, night and day. The market priced Western manufacturers as if they were going out of business. You could buy any one you want. You could… you could… you could pick… you had a host to choose from. that were selling for roughly 5 times the earnings that they had produced over the prior average earnings they produced over the prior economic cycle. which basically means the market thinks their earnings are going down significantly. And then, on the other hand, we didn't have trillion-dollar companies then, but we had half a trillion-dollar companies, which was… Kind of remarkable at the time. with these massive valuations.

Now, what's interesting and what kind of rhymes is that the people running those ones that were likely to be disrupted said, we're not going to lose any business. I don't really know what you guys are all talking about. We're the winners. from being able to use this technology in our operations, because what people care about or what our customers care about. are… the 100 year reputation of quality, reliability, service, the The fact that the sales engineers of these companies are embedded in the operations of the customers, intimately knowing what they need, that they have 24-hour-a-day, 7-day-a-week service, so that if something goes wrong. The plant's not down while you're waiting for something to be delivered on the internet. And we're gonna use the internet. Because there's nothing strategic about manufacturing outside the United States. We can do it, too, if that's what our customers want.

And so then you fast forward to what happened. All the companies that were viewed as these unassailable. a new entrance, and you have to put your your brain back in the late 19 nineties, but like Netscape, which was going to be the only Internet browser, and Alta Vista, which was going to be the search engine. The reality is, nobody really knew. They were very excited. And the

customers that adopted this technology because they had these fantastic franchises, which were very difficult to disrupt, didn't get disrupted. And when they retained their share over the next 5 years, not only did they retain their share, but the margin structures improved, reflecting their adoption of this technology and their moving of manufacturing to to Asia. And those stocks over the next 5 years, post-internet bubble, were doubles and triples and quadruples.

Then you had a similar situation in financial services. Roughly… 15 years later. And We all know that all the apps that were going to allow us to transfer money from our phones and charge our use our phones as credit cards and apply for loans and trade stocks, and all of these things that we actually do because they were really good technology. But the world decided that we don't need banks anymore. And it's interesting if you talk to the CEOs of the banks at the time, and I'll just tell one story about my interactions with Citigroup. And this was now later, this was, call it, 2017, looking backwards. and and he said, the CEO of Citigroup said, 5 years ago. Now we're talking 2012. I had an endless stream of 28 year old CEOs of startup fintech companies coming in my office telling me they were going to put me out of business. And I would think to myself, wow, you guys have very interesting ideas and are very motivated and aggressive, this is great stuff. Do you have any idea what a bank is? Because if you did, I can't imagine that you would want to be one. And and now, talking about the year 2017, he said, now I have a new stream, endless stream, of 28-year-old CEOs of startup fintech companies coming in here to sell me their technology, because they understood That putting the customer out of business was not a great business strategy for them. And so what happened? The big banks that all bought into the technology, spent lots of money on the technology. wound up growing their businesses, growing their share of deposits, and increasing their margin structure, so that post-financial crisis and post-adoption of technology and digitization of their platforms, their margins are higher than they were at any point in the past.

And now we're here today, where AI, same thing. We have all these companies. No one has any idea which one's going to win and which ones are going to be successful. We just all give them all trillion dollar valuations. because we're very excited about the technology. The technology is great. No, no denying any of that, and many of the firms who've seen their share prices decline by 50 to 80%, Are sitting there saying, We're gonna use this technology and make our franchises better. And of course. We don't really know what's gonna happen today. We can point to the… To the past 2 cycles, but this is where we stand today.

Paul Whymper-Williams:
Thank you, Rich. Let's put these… Let's put those lessons to the test with the most extreme example of today's exuberance, perhaps. Semiconductors and and memory in particular. And Akhil, bringing you in, the numbers are frankly extraordinary. But the case we have made is that AI will change the world without negating the cyclicality of memory demand. Could you, could you, Akhil, talk us through what has happened to these margins and how durable they really are?

Akhil Subramanian:
Sure. Thanks, Paul. So thinking about memory, where I'm sure it's now hit the cultural zeitgeist, these companies such as Samsung, Micron and Hynix, have had massive appreciations in their stock prices and also massive appreciation in their earnings. Just to point out, a couple of years ago, these companies were in a downturn. These are inherently cyclical businesses. We were

having this discussion earlier where I mentioned my 5-year-old daughter has lived through a memory mid-cycle, up-cycle, down-cycle, and now she's living through the up-cycle. So she's only five years old, and she's lived through basically a full cycle at this point.

So where we are today is these businesses happen to be… At the point where their product is the main product in shortage for this whole AI boom. We're all short memory, HBM or DRAM is the main thing that's constraining the output of the AI build out. So much so that the hyperscalers, as they talk about their CapEx being. hundreds of billions of dollars are citing that memory is inflating and escalating part of that bill of materials.

So where we are today is these memory businesses that historically had, say, 40% gross margins, and we can pick on one, Micron, for example. The average margin through the cycle was 40%. When my daughter was born shortly after that, it got down to almost zero. So they had break even on the gross profitability. So we've gone from an average of 40, a trough of 0, to now 85. The three memory players are projected to have higher gross margin than companies like Nvidia and TSMC, Taiwan Semiconductor, which are perceived as actual monopolies. So what we have is a three player market that's living through an extreme shortage. Producing gross margins that are frankly higher than businesses that are perceived as monopolies, and we're going to talk about software later, also producing gross margins higher than companies such as software companies, where the marginal cost of delivering a new product is basically zero.

So where we're living through at the moment is this extreme shortage, and what it's leading to is multiple increases in pricing. Just to remind everyone on this webinar, if your gross margin goes from 40% to 80%, your pricing hasn't gone up 2x. For the math to work, your pricing has gone up 6 to 7x. And that's the world that we're living in. Samsung made more money in Q1 this year than all of last year. And so we're living in this moment where. The margins have gotten to their upcycle potential. Companies are talking about the magic four words, this time it is different. And we're always thinking about what do the industry fundamentals look like, what does the market structure look like, and what do we think a mid-cycle or normalized environment looks like for these businesses in terms of their earning power.

Paul Whymper-Williams:
Yeah, thanks, Akhil. And just picking up on something you've said there and really to ask you to elaborate. There are some that think this is a, you know, a new plateau. Why… could you just elaborate on why we don't think that's the case, and why this is more likely to resemble a peak rather than a plateau?

Akhil Subramanian:
Yeah, why don't we just give you the bull case? The reason why people think that this is a plateau is because we see news flow out there that companies such as Micron are signing LTAs, long-term agreements, or SCAs, strategic customer agreements. What they're signing in theory is a ironclad contract where a customer is obligated to buy X amount of volume at X amount of price. And the reason people think that this time it's different is these kinds of agreements were never signed in prior upcycle. And people believe that with this ironclad agreement to buy memory at current prices or above at certain volumes, that the trough is not going to be as bad as prior troughs.

It's possible this might play out, but we also have to think about what are the supply demand dynamics that eventually end up dictating mid-cycle or normalized earnings power. So memory, just by virtue of it being, you know, a commodity, we have to remember that, you know, two years ago, Micron had zero gross profit. Actions will happen when there is a shortage. There will be supply coming on, and each of these three players is adding supply. You're also seeing companies in China, for example, such as CXMT, adding supply as well. So we're seeing a supply response due to the shortage because everybody wants to add more supply, given that the demand feels insatiable.

You're also going to see a demand response where people who were historically buyers of memory may not be able to afford the current pricing. For those of you who sort of followed the news, you would have seen Apple announced price increases across iPhone, MacBook and some of their other products. Apple is historically known as a very savvy buyer of memory. They lock in really good prices, they get good volumes from all of these players, and Apple sort of coming to the table and saying, I have to increase prices, is going to lead to some kind of demand destruction. We're seeing that not just at Apple, but across the smartphone supply chain, across the laptop supply chain. And, you know, the thing to point out is. As much as we talk about memory and servers, the AI server is less than a quarter of current demand. Obviously, it's growing a lot. And the general purpose server, maybe collectively, you can say in a bull case, is approximately half of demand. So there still is another half of the market that's facing extreme price increase and therefore thinking about demand destruction by having to push through this price increase because they can't tolerate the pain in their margins.

So, for us, we always think about, through the cycle, what does mid-cycle EPS look like? What… and that is usually based on the underlying fundamental industry structure. How many players are there? What is the response to demand shocks? What is the response to supply shocks? And you put all of that together, it's certainly possible there could be a scenario where the margins can plateau at maybe not 85% gross margins, but maybe 65. But the underlying structure of the market doesn't make that a short bet. Really, what it makes it is a duration bet along how long this shortage is going to last. And that's just not something that we do at Pzena. You know, by contrast, we see so many other interesting opportunities in the market where there is basically no hope Especially in all the companies that have been left behind from this AI trade. And so for us. we see a range of outcomes for an average memory player. We see the upside case, we see the downside case, but we see much more compelling opportunities elsewhere.

Paul Whymper-Williams:
Thanks, Akhil. Rich, let me bring you back in and actually weaving in a question that we've received. Akhil, he's just described the most extreme of the market's chosen AI winners. So the market has essentially decided who the AI winners and losers are. The question is, are investors correctly assessing where value will ultimately accrue?

Rich Pzena:
Well, I mean, I don't really know how investors could possibly know. you know, we're in one of these environments where When… Yeah. when when there's extreme optimism around, the most optimistic people wind up setting the price. And so you know I I it's it's always very difficult to say I have no idea, but I have no idea.

And and yeah. you know I had a I had a very interesting experience early in my career. I was in my early twenties. I was working in the oil industry, and this is 1980. Now. And… I went to work for a company called Amoco, which It doesn't exist anymore, but… We had an oil price forecast that by the year 2000, the oil would hit $200 a barrel because we were short. There was demand growth and no supply. And in the in the midst of that. The U.S. government opened the Gulf of Mexico to Area-wide leasing in a competitive bid process and I was a 22-year-old. finance person working with geologists and engineers, and you have to go back to that time period where The best you could do is be have a 10% probability of success when you were drilling an exploratory well. And so I had to work with these guys to come up with some economic justification to how much to bid on a piece of acreage. So I came up with a number on one particular block. I'm going to bore you with this story of $1.2 million, and our small offshore division committee had a million dollars of spending authority, so we recommended a to the regional management team who, like, fell in love with this project and wanted to bid $6 million, and had to kick it up to the corporate headquarters, who kicked it up to the senior executives, and then to the board, and we bid $93 million. the bids were opened in… the sealed bids were opened in the Superdome, and we won. and the second highest bid was $800,000. So it just is. Nobody when nobody knows anything. The excitement and the stories drive things, and and We clearly didn't know who the winners were going to be last cycle. We presume that we know, because the winners to some extent are involved. But there's a lot of players that we never heard of back then that are also have trillion dollar plus valuations.

And and You know, what do you do, right? This is… This is the philosophical question we get as value investors. what do we need value for? And why don't we just buy the indices or buy or Really, that's it. Why not just buy the indices? And you know, The… the… The reality is that value. is not changed that much over the decades. The kinds of things that we buy are very similar to the kinds of things we always bought. Technological change is always a threat that forces people to be nervous. But one of the things that has not happened is it has not gotten more expensive to buy value stocks. In fact, the opposite has happened over the course of the last 10 years, while it's gotten Way more expensive to buy. the what everybody wants. And so… You know, oh. There's a there's a room in a portfolio for everything. The question is, Do you want to bet on? the where the the optimists are setting expectations? Or do you want to bet where people are so discouraged that that… Skewing between the upside case and the downside case becomes gigantic, and you get paid for taking the risk that, wow, maybe this is a great franchise that is gonna survive. And I can double my money on just it surviving.

Paul Whymper-Williams:
Absolutely. Thank you, Rich. And actually, Akhil. Let's… let's… you know. Dig into some of the perceived losers. Software has been, well, has sold off dramatically because the market believes AI has broken some of these business models. Could, could you, could you outline exactly what this SaaSpocalypse moment is?

Akhil Subramanian:
Sure. In a nutshell, it's quite simple. It's the fact that AI is going to completely disrupt the business of software. The manifestation of how that happens varies a little, but a very high level. People think that if you can vibe code software, so using tools such as Claude Code or Codex, maybe that means. the barrier to a minimum viable product is quite low. And so the concern is

there are a lot of software companies that have made a good living charging for basically an interface. between some data and a user, and now they can be vibe coded away. That's one concern. The kind of follow on from that is there's going to be a lot more competition because there's going to be a lot more people vibe coding some kind of solution to salesforce.com or Oracle or whatever it might be.

And the last sort of related point is software's historic pricing model was on a per seat basis. So for a company such as ours, they would have said, you need 30 seats of Salesforce, it's going to cost $200 a year, something like that. And for someone like you, Paul, who use Salesforce all the time, that's great value for us. For someone who's sitting around and opening Salesforce once a month to check a report. That is great value to Salesforce. So the transition of this pricing model from per seat to per outcome, we don't know what the outcome will be, but each company prices differently, whether it's number of widgets made or per revenue or per number of documents processed. That's going to be another huge deflationary headwind, because maybe charging per seat was not the right economic outcome for these businesses.

So this has led to a broad-based re-rating of the entire sector, and you'll see the twitchiness of investors, because when Anthropic releases a tool that can do some kind of basic software work, any software in that vertical will sell off on the day. And then also what you'll see is the twitchiness to earnings, where if a company says, I might grow 13% and they grow 12%, stock sells off because people conflate. And sometimes, rightly so, the issue that AI is here, and that's going to lead to a massive decline in the terminal value of these software companies, which were more or less perceived as bulletproof, not, you know, less than 12 months ago.

Rich Pzena:
And there's a question specifically about this in our chat about how do you handle terminal value when the terminal state is genuinely unknowable is the question, and has AI changed the way that you think about growth rates and those sort of things. It's worth answering that philosophically, and then we can go back into the specifics. But the reality is, this is the thing that I always find mind-boggling. every technology company in the world. has the objective of displacing the existing technology. And some of them are successful. And we sit here, and don't worry about the terminal value of the technology companies, but we worry about the terminal value of the customers of the technology who have businesses that are totally unrelated to that technology. And they're excited about the new technology because they want to strengthen their franchises. So to me, the question is almost backwards. The terminal value on tech stocks is what's unknowable. way more so than it is on franchises unrelated to tech.

So for us. The question, like. The idea is value dead because you can't do any of this. Value can't be dead, because by definition, value is buying something for less than it's worth. So really, the question is, how do you calculate what it's worth? and and the people that get excited about the things that they put trillion dollar market values on are obviously forecasting very high growth rates to make that happen, and I can forecast very high growth rates and to discount them back to the present and say, these things are cheap. The problem is when you're of a massive scale, like trillion dollar valuations, the sheer magnitude of the growth that you have to achieve to make that arithmetic work. even though it's working now, and I can't. I can't argue, and it might keep working. I can't argue that point. All I can say is that the societal change that's required for that to

happen, and the amount of money that has to be refocused and refunneled into those companies. is massive to make it work. So you're betting a lot on optimistic assumptions. That's why I brought in the oil industry example.

So And, and, and… and and taking it to one which is another question in the chat room here of value traps. The reality is, you don't know what's a value trap and what's not a value trap. All you know is What does the business do? How protected are its revenues from competition, at least How have they historically been? Are there real threats to that or or not? And is it priced so that if the bad outcome happens. you. It's already reflecting that. And if and if it turns out that these companies do what the banks did in the late half in the last 10 years, and what the Western manufacturers did 25 years ago. You can. You can have massive upside. This is the skewing that we live for as opposed to the skewing the other way, where you have to be right. in order for any of these things to work.

Paul Whymper-Williams:
Thanks, Rich, and well done for including those questions that are popping up. Akhil, and highlighting something that we, we do as part of our process, and, you know, visit companies that we're interested in. in potentially, owning. I… I know that you've… you've recently been out on the… on the west coast of the US, seeing some of the companies affected firsthand by the… the… the SaaSpocalypse. Can you tell us a bit more about that? Was that a fruitful trip? And where are we finding opportunities more broadly in software at the moment?

Akhil Subramanian:
Sure, of course. When we have a moment like SaaSpocalypse, where an entire sector is selling off. It gives us the opportunity to be very discerning in understanding each and every single individual business and trying to really rifle shot the most interesting ideas because you may be faced with these instances where everything has been thrown out kind of under the same premise.

So the trip. Was one thing that we did, and it was very fruitful. We met with companies that are kind of exposed to this. crux and key issue. And then we've been talking to a lot of software companies trying to understand how are they navigating AI. And this is going to be a callback to pretty much everything Rich said at the beginning of the call. But let me try and summarize it, you know. For us, we found some very interesting rifle shot opportunities where we see good businesses with what we perceive to be a very high barrier to entry that are seeing this AI disruption theme as an opportunity to both grow revenue. and also attend to their cost structure.

So one very simple example is we bought a company called Workday. Workday is an enterprise resource planning company, ERP. And within ERP, what they do has a very strong kind of focus on companies where human capital is the core resource of the company. So just take an example of a retail company like Walmart or a restaurant like Chipotle. What they're doing is giving you the software to manage the entire life cycle of your employees. So everything from recruiting, onboarding, training, promoting, moving around through retirement or maybe retrenchment. And they tie that into their financial suite. So thinking about things like payroll, accounts receivable, tax, incorporating the local laws around, you know, what is the minimum wage rate? And, you know. If you think about how mission critical this business is, it is directly integrated into the

workflows of a company, especially in companies where their assets are people. And you need this software to close the books. You will not get a clean audit unless the software is functioning properly. And you can see that in their retention rates. They have very, very low retention rates. I think low single digit percent. And primarily that retention rate is coming from business failure because companies can go out of business or companies getting acquired and the acquirer was on a different platform. But this is a business that has taken share because they have a cloud native solution to doing ERP.

What we see at the moment is valuations have come off a lot. And it's kind of living in a no man's land of not growing so much that a growth investor would be excited about it and not as profitable as one might think it could be, which makes value investors not that excited about it. So why are we bothering with this company in this moment? I think we are really anchoring to the fact that this is mission critical software. There's plenty of software out there that is a point solution that is a nice to have, not a must have. But this is mission critical to Chipotle handling 200 job applications every week for their stores, or Walmart handling millions of job applications for their entire business.

What we see is the company is incorporating AI to improve the products that it is serving its customers. So just going back and torturing this Chipotle Walmart example, they have conversational AI. So when 200 people apply to a job at a Chipotle store, the AI can basically converse with them and figure out which ones to prioritize so the hiring manager can actually do their job. So that's an example of an AI product that they're developing for their customers. On the flip side, we talked about vibe coding and how, you know, one of the big AI use cases is software development. Well, they're looking to leverage AI to make their productivity much higher. If you think about any given software business, the two biggest costs are sales and marketing and R&D. And Workday has a big R&D budget because they've been building a lot of modules over time. And they are looking to accelerate their delivery of new products by leveraging AI in the core process. And there's a good chance that margins could improve a lot from here, as they can do a lot more with what they have. So this is an example of a business that we found that we like. It's mission critical. We think that it's very difficult to replace. An average workday implementation is 6 to 18 months. And it's able to leverage AI to produce new products, also leverage AI to improve its cost structure. So that's why we're drawn to this business.

And there's another example we can briefly touch on, which is SAP. Now, for those of you on the call who remember SAP from 20 years ago, it's still the same company. So SAP also does Enterprise Resource Planning, or ERP, but its core competency is in manufacturing or supply or asset-intensive businesses. So think of your BMWs or Daimler truck. Again, this business is mission critical. It has low single digit churn rates. You can't close the books unless your SAP is functioning properly. And what we're living through again is the same AI concerns around SAP. But what they're doing is actually migrating customers who are on very, very old versions of SAP that they don't want to support any longer. One such version is called ECC. They're trying to migrate them to their new cloud ready enterprise solution, which is called S/4HANA. Every one of these migrations leads to a 2x to 5x increase in their revenue per customer because they're doing more for them. And what we're seeing is The market is getting very scared about how this transition is going to go. If we try and build in the layer cake of how they're migrating their

existing customer base, we see a path to decent revenue growth. And again, going back to the Workday example, we see a very decent path to margin expansion by leveraging things like R&D. And so for these businesses, again, you have to be a rifle shot about it. We're finding businesses that have large moats we perceive, because it's impossible to rip out. And by the way, we're trying to find customers every day that are trying to rip these businesses out, and it's really hard to find them. And what we're looking to find is extremely compelling valuations, where, going back to Rich's point, you don't have to assume a very large tail, given how much the business has collapsed in value. And if they can get through this environment of terrible and get to an environment of not so bad. The stocks are very, very compelling investment opportunities.

Paul Whymper-Williams:
Thanks, Akhil. Rich, go on.

Rich Pzena:
No, no.

Paul Whymper-Williams:
Go ahead.

Rich Pzena:
I was going to change the topic a bit to because we're talking about It's very AI focused. And but the AI losers quote unquote. Workday. that that people perceive them to be losers. are still a very small portion of our, of our portfolios. I mean, the re, the reality is. We're… we're buying things that nobody is paying any attention to. or is afraid of, not because of technological change. but because their business are going through the problems that businesses go through, and and so there's very The vast majority of the things that we invest in, you would say, are neither particularly positively influenced by AI or particularly negatively influenced by AI. They're just boring, uninteresting. having their own troubles, having something that causes people to be afraid. And there's a lot of that out there. today, primarily because people are not putting money to work in these kinds of investments.

Paul Whymper-Williams:
No, absolutely, Rich. We may get into, some of those if we've got time, you know, those, those sort of, those boring stocks that, that, that, that we, that we look for with the, with, with, you know, the opportunity for significant, significant upside. But I, I think one. One thing, and zooming out a bit, one thing that we haven't touched on directly is the concentration in the index itself. Akhil, in EM, it's related to the memory boom. It runs through both the main index and the value index, and it has been extreme. A handful of AI-linked semiconductors are driving the lion's share of returns, to the point where just two stocks, TSMC and Samsung. now make up around a fifth of the EM value benchmark between them. And semiconductors as a group have swelled to roughly twice the index weight of software. For an active manager, that's a real dilemma. How do you think about that concentration, and what does it mean for how the portfolio is positioned?

Akhil Subramanian:
Yeah, great question. Before I answer that, I just saw in the chat someone mentioned Workday's

current PE, and you're exactly right, the current PE is very high, 40%, 40 times. It goes back to… what is the current earnings of the business, and where can it go when things are normalized? So the very simple characterization of Workday being 40 times PE is they're massively investing, and they always have. And that is suppressing the margins. So the EBIT margin of Workday is less than 10 at this point. And again, just for everyone's clarity, we do not treat stock-based comp as a non-cash expense. We penalize companies for it. By contrast, if you look at Samsung and Hynix. Their current PE is 6 because their margins are over earning. So we always are thinking about, you know, not just what the current PE is, but what is the earnings that is underlying that price to EPS. And so what we believe in buying a business like Workday is they can leverage AI to basically improve their cost structures. If you benchmark a company like Workday against all their software peers, they're easily spending, you know, at least 10 points more than their peers on R&D. So again, it all comes back to fundamental analysis, thinking about what can they earn when the environment is normal, not when they're overspending to build products. And that's how it always comes back to our price to mid cycle EPS valuation. So hopefully that was clear. If not, please follow up with us after. We're happy to have a lengthier conversation there.

But just very briefly touching on index concentration, you're right, Paul. There is, a healthy amount of index concentration at the moment in EM. I think the top 3 companies are 30% of the index. TSMC, which is 15% of the index, is larger than the country of India. Which is a country that we perceive to be expensive, and we are underweight, too. So we are seeing a lot of concentration. And also in this moment, we're seeing a lot of performance accruing to some of these largest companies in the index. In terms of what does it mean for how our portfolio is positioned, we're underperforming in this moment of time where there is extreme concentration and performance is accruing to the biggest companies. What does it mean for our portfolio, our investment philosophy? Not a lot of change. We are continuing to do what we've always done. And what we're finding is when you have this period of extreme concentration, you are seeing very interesting opportunities that have not participated in this rally. Often these are businesses where they may be scary, as Rich mentioned, they may be something at the forefront of the AI crosshairs of disruption. There may also be businesses whose fundamentals are improving. But the market is giving them no credit because people are selling it to go and buy memory stocks. So for us. What we are finding outside of this heavy concentration is very interesting investment opportunities, often at compelling, extremely compelling valuations. And that's what's energizing for us. In a moment such as this, we are still finding very, very interesting investment opportunities, good businesses that have trouble that's befallen them, and they look very cheap on our, you know, again, mid-cycle EPS estimate rather than current earnings.

Paul Whymper-Williams:
Thanks, Akhil. This is a question that's come in a couple of times, and just… we've covered it to a certain extent, but just to sort of… To give either of you the opportunity to, to tackle it, There's a narrative that says that value managers are simply sitting out of the AI rally with their heads in the sand. How do you square the fact that AI genuinely has lifted companies' earnings power? With the discipline of not paying any price to own them.

Akhil Subramanian:
Yeah, I'll start there. you know, for us, if you take the most extreme example, so say a memory company whose margin has gone from 40% to 85%, and therefore their pricing has gone up 6X,

We're not trying to ignore it. We're happy to give credit for a company that may have supernormal earnings, say in 2026 and supernormal earnings in 2027. But then when, as you know, going back to our price to mid cycle or price to normalized earnings framework, we have to think about what is the mid cycle earnings power of that business. based on the fundamentals of the industry. What is the supply-demand like? Is it a commodity? Is it not a commodity? Does this supply chain, strategic consumer agreement become a real thing, not a real thing? When you put in your supernormal 2026 and your supernormal 2027, and then you revert it back to what you think is a reasonable industry structure. Some of these businesses are still expensive. And this is a memory point, but it's also happened in the past to other businesses we've owned that go through the upcycle. So we're not ignoring it. The distinction is trying to figure out whether today's peak is the new normal. And if we aren't so certain that it is the new normal, and it looks expensive. Trimming or exiting that position, because there are so many more compelling investment opportunities outside, where you have businesses in the cheapest quintile of our universes that have befallen across a variety of problems and look very cheap.

Rich Pzena:
And I'll add to that from philosophically, philosophically, more than analytically. The reality is that the last 10 years for value has been the same as the 10 years before that and the 10 years before that. It's not like anything has changed. nor have the opportunity sets changed. It's the it's what we're missing. And that was your question, Paul, are we putting our heads in the sand? The answer is… No, we stare at this and say, if I have to assume. A 10 or 20 year, 20% annual growth rate to make this look cheap. We're just gonna pass, and let somebody else do it. It's not our… it's not our expertise. But, can we make… 10 to 12% a year for the next 10 years, based on what we see? We think so. And in the end, the idea that Massive amounts of capital. can earn these kinds of high returns that they've earned. Over the prior 10 years, is what really seems like a head in the sand. Now, you're getting the words of a value investor. So That's the way that we would perceive it.

Paul Whymper-Williams:
Thanks, Rich. I'm just gonna tackle a question that's come through from Tim asking if there's a a limit to, emerging market holdings in our global focus value fund? Yes, the answer, which you've correctly observed, is around 10%. Currently, the, the amount of EM we have in the global fund, the limit, or the ceiling, is 25%. But Rich… Just picking up on, you know, we talked about, areas, I mean, you… arguably, unrelated to AI and disruption, where we're… we're seeing opportunities, and… and healthcare is… is… is perhaps the… the clearest example. Do you just want to talk about why the market is… is… You know, handling… handing us, such high-quality businesses at prices we're currently seeing today.

Rich Pzena:
Well, I mean, a lot of these, a lot of these US companies that we've bought, are… More service providers than they are. things like pharma or biotech. We've been… We've been granted a giant opportunity, some of which has already run its course in health insurance. The world hates health insurers. The American public certainly does. Both political parties do. They've run into classic cycles where They didn't charge correctly relative to the benefit plans that they offered, and they got caught. Covid added to that to that phenomenon. And we've got the opportunity to buy these companies at sub 5 times their normal earnings power. And these are companies that are in

oligopolies with giant market shares in businesses that have grown double digits for the last 4 decades, and none of the Factors that would… that you would have on a forward-looking basis are different than what has happened over the past other than people don't like them. Even though… They are People demand them and want them. And the government saves money by… by enabling them.

So you look at these things and you say, wow, these are gifts. We, we, we have our biggest holding in the US is Humana, which has now run a lot. but you know, 8 weeks ago was 3 times its normal earnings power. and today one that hasn't run is Baxter. Baxter makes Supplies and… and equipment for mostly for use in hospitals. historically has had high margins, high return on capital. They ran into a number of simultaneous problems in the last few years that they didn't manage their way through. Well, they have a new management team in there that's fixing things. They're already starting to see some evidence that the fixing is starting to work, and there's been no movement. but they're half the price or less of where they used to trade. So those are the kinds of things that that we have that we're seeing that we're very exciting about that are dominating. the positions that we have in our portfolios. and it's hard. I'm sure they're all looking at AI, too, to figure out how to make their businesses better. But it's not what's critically matters to What their future revenues look like.

Paul Whymper-Williams:
Thanks, Rich. Okay, just weaving in another question or a theme that's appearing. And this is to either of you, perhaps, Rich, if you want to start. How do you, how do you, or how do we make sure that we're buying? The cyclical and the fixable, and not businesses that are, are generally, genuinely structurally broken.

Rich Pzena:
Well I mean, if you knew that they were structurally broken, you wouldn't buy them, of course. And so when a business is in decline. You have to be worried about whether it's structurally broken or temporarily having problems. but… you know, the the reality is, you can't be a value investor and avoid value drops. It's just not possible. And all the people that tell you who are that say they know which ones are value and which ones are value traps, they're the same people who think they know what the internet's going to — what AI is going to do. No one knows these things. All you know is where they're priced. how they've done in the past, what their business Plans are, and what the industry structure is, and The key is buying at a low price, and if you buy at a low price, and half the ones you buy at are value traps, and half are the ones that were real value, and you double your money on the good ones, and you lose a little bit on the bad ones. You're going to have a good record, and it's an intensive research process. Can you make you 60 40, which is about what we think we are in in that decision making. Then you can have a good, a great record over over time. So… Obviously, if we knew which were going to be the value traps, we wouldn't invest in them, but we don't know.

Paul Whymper-Williams:
Thank you, Rich. Akhil, anything to add there or any closing comments? Because we're getting pretty close to our time here.

Akhil Subramanian:
No, that was perfect. I might just touch on the pharma biotech conversation and just illustrate by way of an EM story. So there's a company in EM called LigaChem. It's a biotech. We looked at the business. They have. this wonderful technology for a specific part of the cancer market called antibody drug conjugates, ADCs. It's a very hot part of cancer drug development, and what they have is a technology that allows you to deliver really big payloads to target different types of cancers all across the body. They have no commercial revenue. And they may have commercial revenue in 5 to 6 years. So everything is in a Phase 1, Phase 2, or pre-Phase 1 trial.

So why am I torturing this analogy? There is a Korean snack company called Orion, which we own. So about a year and a half ago, they bought 25% of LigaChem. And the stock went down. So this is a company that makes… their core product is choco pies. For those of you in the international audience who've had a Korean choco pie, it's that company. So they make cookies, snacks, chips, gummies, ice cream. And they went and bought a cancer drug development company. And they said, well, you know, we are a health lifestyle company, and this is kind of in the health category, it's adjacent. But obviously, investors hated it, and the stock sold off.

So we spent a lot of time looking at LigaChem, just to try to understand why did they even bother. And what we learned is they have really excellent technology, it is a really good way of delivering high payloads to cure different kinds of cancers. But it has no revenue. So, in looking at this company that makes cookies, we decided that LigaChem had fantastic technology, but we decided to ascribe it a value of zero. Then we looked at the actual snack business of the company, Orion, and we decided that, you know, based on our extensive research of its value proposition and things like that, how we think it's going to grow relative to the snack market in Korea and China, which are their two biggest markets. Then we met with the companies and they said, you know, we all understand that you hate us doing this cancer deal. We promise never to do it again. So what we decided to do is penalize Orion for doing acquisitions every year that generate no value. So we basically penalized their cashflow statement where they spent X hundred billion of Korean won every year buying businesses like LigaChem that may have no revenue whatsoever. And on that basis, the stock was still so compellingly cheap that we decided to add it to our portfolio.

Now, the irony of all of this is, since they bought LigaChem, its valuation has basically tripled. Stock price has tripled. So if you look at this boring Korean snack company that we own now, they have a boring snack company that's gaining market share and doing well. And 50% of its market cap is cash and a publicly traded Korean biotech. These are the kinds of opportunities we get in EM, where we're trying to find good businesses that have done something, and to Rich's point, if you can put numbers around what terrible looks like, they continue to do bad deals, and it's still a cheap stock, if they just don't buy anything. Could be a very, very attractive investment opportunity.

Paul Whymper-Williams:
Fantastic. Thanks, Akhil. That's a great way to wind things up. So, you know, we are up against it on the time front. So that is where we will leave it. Rich, Akhil, thank you both very much. That was genuinely a fantastic tour of where we are at the halfway mark. And thank you to all our guests for joining us and for submitting questions if we've missed any. or you have any

thoughts or comments, please reach out. Have a great day or evening, depending on where you've tuned in from. And we look forward to catching up with you again soon. Thank you.

Akhil Subramanian:
Thank you.