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EP 136 | International Equities: Insights from the Road

Anum Siddiqui (00:01):

Hi everyone, on this episode of the podcast, I sit down with Peter Lampert, Lead Manager of our international equity strategy. We start off the conversation going through some of the team's recent travel. Particularly, Peter having spent three weeks in Europe meeting with existing and prospective holding companies, he speaks to the varying benefits of "investing with your eyes," and what that looks like across different business models.

We also spend some time digging into the strategy's regional exposures, looking at how our bottom-up approach is paired with top-down risk considerations using our recent decision around the emerging markets as a case study. We take the opportunity to talk about some holdings, which reinforces the importance of excellent management teams and sustainable competitive advantages.

Anum Siddiqui (00:46):

And finally, given the recent prominence around the topic, we talk about how artificial intelligence may have both positive and negative impacts to some of the companies we invest in. I hope you enjoy the conversation with Peter as much as I did.

Disclaimer (01:26):

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Anum Siddiqui (01:43):

Hi everyone, welcome to the podcast. With me today is Peter Lampert, lead manager of our international equity strategy. Peter, thanks for joining us today.

Peter Lampert (01:53):

It's great to be back.

Anum Siddiqui (01:54):

So, Peter, I was looking back and it looks like the last time you were on the podcast speaking to international equity was in August of last year, and I know the team has done quite a bit of travel since then, meeting different companies on their own turf.

Anum Siddiqui (02:09):

I know you specifically have done a couple of research trips more recently and it sounds like you haven't just been meeting with management teams in the boardroom, but you've actually been in the field for different companies. I'd be interested in knowing how some of your research trips have gone.

Peter Lampert (02:26):

Like you say, it's been great getting out there and travelling. Since Covid we've been doing a lot more video meetings like everyone else and that's been fantastic. We've had more, I think, management access; we get to speak to a lot of companies, speak to the management teams, which has been great doing that by video.

So when we get out there and travel and get to see companies in person, we're not just sitting in boardrooms but also getting out, seeing the companies' operations and their assets and really helping us get a deeper understanding of the businesses in which we're investing.

I went for three weeks to Europe in May, and it was a great trip. I saw lots of our existing companies in the international equity portfolio as well as some new potential investment ideas. And like I said, I made an effort to really get out there and see the businesses.

Peter Lampert (03:11):

There [were] a lot of highlights. Probably one of the most interesting ones was going out to Equinor, the major Norwegian offshore oil and gas producer, and taking a helicopter ride out to visit one of their oil platforms at Johan Sverdup. This is a newer project, it's massive, and they're very proud of it. It's very efficient, very profitable, and very low carbon emissions. This is kind of the oil of the future, and it was great to see.

And it's just impressive to see how much logistical work goes into it, operating in a harsh offshore environment and what a fantastic job Equinor has done. They have a track record of operating, especially in the North Sea on the Norwegian Continental shelf. They continue to find more oil and produce it in an environmentally sustainable way. Johan Sverdup in particular is powered by wind, unlike most which are powered by diesel.

Peter Lampert (04:03):

It's much more efficient, and it's just great to see—to get an appreciation of how complicated it is, how much work goes into it, and see why they're a world leader. And also, some of that translates into their growth area; into offshore wind farms, which is another area that they've been growing in their renewables portfolio. They have that expertise operating in these harsh offshore environments from their oil and gas assets.

So, to see it in person, to have the tour, really brought that to life and an appreciation of how hard it is to do and what a great job Equinor's doing. After that, in Norway, I went to visit AutoStore™. This is one of our investments in warehouse automation. They have a proprietary system, which is a much better use of space, three-dimensional cube where products can be stored and picked in warehouses and it was great to see.

Peter Lampert (04:49):

I went to their test center where they have new products, new warehouse automation systems that they're testing and trialing for customers and that helps to understand their growth path, where they see the opportunities addressing customer challenges. In this case, moving into new markets and tailoring their solutions for different customer segments to drive that growth going forward.

It's great when we talk about it, but to actually see it in action, to see what they're doing and help us make the investment case more concrete.

After Norway, I went to the Netherlands and I saw some of our other holdings there, one called Ahold [Delhaize], which is a grocery retailer (sounds pretty basic). They have 50% market share in the Netherlands, so of course I saw a lot of their stores just walking around the streets. I love going into the stores, just walking around, investing with your eyes.

Peter Lampert (05:35):

I also had a guided store tour with the manager and that was great to see; to walk through and to really understand everything they're doing. As a consumer, [it's] all the little things that you miss in a store but that tie back to their corporate strategy. Whether it's the way they've have a good, fresh offering of [a] café, bakery, a little kiosk, [or] sushi to really drive traffic to the store. (The sushi was great by the way!)

Or whether it's their ESG commitments and the way they have a large shelf space dedicated to plant-based meat alternatives because they want to drive lower carbon emissions and that's one of their KPIs. That's something they're tracking. Europe is very forward-thinking on that, and that's important to their customers. It's great to see that in action.

Another area is seeing their private label products. They have a very strong private label offering and how they're positioned relative to the major brands.

Peter Lampert (06:24):

So, just walking through understanding that and helping to understand why this is such a well-run and profitable grocery chain, and maybe some of those things that they're doing that they may be able to transfer to some of their other geographies where Netherlands is very strong for them. They also have a strong operation in the U.S., but maybe [with] some room for improvement. They have some other operations in Belgium and Eastern Europe, again with some room for improvement. If they can take some of what they've done in the fantastic Netherlands operations that I got to see and share those ideas with the other country brands, there's maybe some room for improvement there.

Next, I went to see Weir. They're based in Scotland, but they have a manufacturing facility in the Netherlands in a small town called Venlo. I got to go see where they manufacture and test pumps and grinding mills.

Peter Lampert (07:13):

These are used to process ore at mine sites. So, when miners dig up the ore, there's a lot of processing that goes on at the mine site to filter it down and get the metal, the gold, or the copper that they need to filter under the ore. The rocks need to be crushed down into smaller pieces, filtered, pumped through slurry pumps and Weir makes that critical equipment. It was great to see.

First off, the machinery is just bigger than I expected. These are massive pumps, massive grinders. And what's really impressive is how these have to be operating 24/7 because if there's downtime in one piece of equipment, it's downtime for the whole line. So the reliability is extremely important. They're operating in very harsh conditions. The abrasion of the rocks going through the equipment wears down the metal, parts need to be constantly replaced for that.

Peter Lampert (08:03):

And that's why it's a great business, because Weir has good customer relationships, they have the installed base, they have the spare parts, and that's very much a recurring business as they continue to sell those spare parts. But just gaining another better appreciation of what they're doing, how reliable these machines have to be, and how important they are to their customers…

And even in some cases it's as simple as an office tour—that can give a lot of insight into the culture as well. I visited Adyen, which is a payments company, and they have more of a Silicon-Valley-type vibe in the middle of Amsterdam. It's interesting to see their culture. They have a lot of autonomy, the workers have a very nice work environment, beautiful building, nice café in the lobby. And just seeing the kind of environment, the type of workers they're trying to attract…

Peter Lampert (08:48):

They even say they're not looking to pay top dollar; they want to have a great workplace and attract employees who are committed to their mission of making payments better, which they've done. And seeing that unique culture really came through on the office visit.

Genmab is another one with a very strong, unique culture. I got to visit their head office in the Netherlands. They're a biotech company. They have a fantastic track record coming up with new and differentiated drugs, and they take a different approach to the way they do R&D and come up with the drugs, which is I think why they've been so successful. It was fascinating to meet the CEO and he gave me a tour of the office and his side hobby happens to be architecture, so he had his hands in building this beautiful office building, helping the architects and designers.

Peter Lampert (09:32):

And there was a real emphasis on the collaboration; on the way the space is designed. Lots of open spaces, lots of light, lots of windows, very enticing to bring people together a nice café in the lobby. They're in the middle of a science park. They want to attract scientists from the neighbouring hospitals and research sites and universities into their building to get that collaboration, that idea sharing. And seeing the office building is one thing, but understanding how that ties into their culture and how they think about people and ideas and why they've been so successful, was really great to see.

Peter Lampert (10:03):

After I visited Europe, I spent a few days in Kazakhstan as well. We have one small position there in Kaspi, which is a fantastic business. It's a leading fintech company. They provide payments and loans to consumers, and they've really leapfrogged and replaced cash and grown well ahead of Visa and MasterCard as their QR-code-based payment network has taken over the country.

Peter Lampert (10:24):

So that's the story, that's what we read, and it was great to go see it in person. I met with Kaspi, met with the CEO, and got a great update on the business, but what I really appreciated was just walking around the big cities in Kazakhstan.

Firstly, it's a lot nicer country than a lot of people probably think. It's just a very nice place to be. Nothing like the Borat movies [or] what people think about when they think of Kazakhstan. So, throw that image aside. But going there and just walking through the malls, walking through restaurants… again, investing with your eyes; seeing how many shops have the Kaspi QR code stickers in the windows showing that they accept Kaspi payments. I estimate it's about 50 or 100 times more than their number two competitor in terms of the number of shops I saw accepting Kaspi payments.

I stood at the checkout line in a grocery store and just watched how many customers are paying with a car,d versus their QR code on their phone, versus using cash. And it was about one-third each from my sample size. So, even though Kaspi has already been very successful, there's still penetration room, there's still room to gain share from the other payment methods.

Again, that's what I mean when I'm talking about "investing with your eyes." Of course we wouldn't make an investment solely based on these kind of anecdotal observations. It's a small sample size, you have to take it into context. But in conjunction with all the other research we do, it can help support or refute an existing investment case.

Anum Siddiqui (11:45):

Wow, lots of different business models that you described there. But it sounds like regardless of the business model, the "investing with your eyes" piece was actually beneficial across the board. Hopefully you got some good free samples at Ahold. I don't know if the sushi was free or not [laughs], but anyways, thanks for that Peter.

So, I think around the same time when you were in Europe, one of your colleagues on your team, Siying, visited India. I was wondering if there [were] any helpful takeaways from Siying's trip to India.

Peter Lampert (12:12):

As you mentioned, Siying went to India, she had a great trip. She came back very positive about the potential in the country and a lot of the businesses in India. And [in particular] the one holding we have in this portfolio in India is HDFC Bank. They're the leading bank in India. They've done a fantastic job of serving their customers well and as a result, [are] making good profits for shareholders.

Peter Lampert (12:33):

Right now, they're undergoing a very major merger. HDFC Bank [is] merging with its sister company, somewhat confusingly called HDFC Ltd., which only provides mortgages, and HDFC bank provides all other banking services outside of mortgages. So, they're merging that, bringing it all under one roof, a major merger of major companies. And Siying was able to go to their Investor Day, help [us] understand the rationale for the merger, what they see as the benefits, and meet a lot of the different executives—not only the CEO and CFO, but across the organization—to understand their merger plan and how they plan to implement this and get value out of it. And [that] gave us more confidence in the merger—that it is likely to deliver value for shareholders.

So, it is great getting out there and meeting with the companies and taking that back, discussing with the team, and seeing how it may or may not impact our investment case.

Anum Siddiqui (13:26):

Okay, great. Just shifting gears a little bit, I do want to talk about some of the regional exposures within the international equity strategy. Now, our listeners will know that we're very much bottom-up investors, so our regional allocations within the portfolio are very much an outcome of our bottom-up process.

That being said, there is often curiosity around some of the exposures that we have. And so since we were talking about India, I'll start off with the emerging markets. If we were to look at the emerging markets exposure within the strategy over the last year or so, you would notice that that exposure has come down. So, I was wondering if you could explain and provide some background on why that is, and how that evolved over time.

Peter Lampert (14:09):

Yeah, as you know, our international equity strategy invests around the world outside of Canada and the U.S., so that's a pretty big opportunity set. We have lots of great companies, as you said, that we find on a bottom-up basis. We want to invest in the best companies around the world in this portfolio. Within that, sometimes those companies are in emerging markets. Currently about 10% of the portfolio is in companies headquartered in emerging markets. That's at the lower end. Historically, the range has typically been about 10 to 20% in this portfolio. So it is at the lower end.

We still have some great companies like HDFC bank that I mentioned, Kaspi in Kazakhstan, and others like TSMC and Samsung. But in general, we have been reducing our weight in Chinese stocks.

Peter Lampert (14:53):

So, NetEase and Tencent remain in the portfolio. They're fantastic, well-run businesses, very attractive from a bottom-up basis. But over the last year, we have exited a number of other Chinese holdings. And this is where the bottom up and top down come together, because even though many of these stocks are very attractive from a bottom-up point of view—great businesses, great management teams, and valuations have generally moved down in China over the last couple of years—at the same time, they're reflecting higher risks.

Peter Lampert (15:21):

Risks have increased with the way that the government is regulating companies more in China. And then as well, the geopolitics and the tensions between China and the U.S. and how investors could get caught in the middle of that. We saw in Russia where, due to geopolitics, foreigners were completely shut out of the Russian market. Who knows what could happen in China, but if tensions continue to escalate, if tensions increase, perhaps the worst case outcome could happen there as well.

Peter Lampert (15:48):

So, that's something we have to keep in mind when investing in China. It is a factor in our emerging markets weight because China and Taiwan combined are about half of the EM opportunity set. And we look at it as, the risk-reward has shifted on a lot of those Chinese stocks.

We have a large opportunity set, we can invest elsewhere, and if we can get a similar risk-reward elsewhere, similarly attractive businesses at similarly attractive valuations without taking some of that geopolitical risk, then it makes sense to shift a little bit at the margin, which is what we've done.

We haven't made any huge wholesale changes, but incrementally we have shifted out of some of our Chinese names and that's the main reason reflecting our lower emerging markets weight today, than, say, a year ago.

Anum Siddiqui (16:32):

Thanks Peter, the insight and refresher on the risk-reward mindset is helpful. Someone was wondering, "what would we need to see to add back to China?" So, we have decreased our exposure to China, but is there anything that the team is looking out for? Certain triggers or events or anything in particular in terms of the geopolitical situation that would lead us to reconsider adding to certain names or reconsidering new ones?

Peter Lampert (17:00):

Yeah, certainly. You know, as an investor, I think one of the most important things is always to remain open-minded. To not get too hung up on one particular scenario or conclusion or think that you've figured things out and always question your assumptions and be willing to consider new information.

So, our investments in China or any other investments, we always need to be reviewing them and asking ourselves questions [like, "should we reconsider?"], specifically in the case of some of these Chinese stocks.

Yeah, lots could change. If we see governments take a change in their stance toward the Chinese government in terms of how they're regulating companies and move more to a focus on allowing the companies to be profitable, more of a laissez-fair approach that they had taken historically toward especially the internet sector where we have Tencent and NetEase. And then on the geopolitical side, [if] we see signs of tensions stalling, the rhetoric cooling off around Taiwan and those tensions between China and the U.S. [lessen]...

Peter Lampert (17:53):

Right now, we're seeing businesses talk about decoupling and moving away from China and [that] may be a headwind, but that could all change, and we need to remain open-minded toward all of that and not get stuck in our views.

Anum Siddiqui (18:04):

Great. No, that makes sense. Being open-minded always seems like a good practice. Okay, so maintaining the theme in terms of regional exposures within the strategy.

Something that had come up over the last year quite a bit with clients, at least from my perspective, is just our overall exposure—our relatively higher exposure, rather—to Europe and the United Kingdom. I was wondering if you could speak to how the team thinks about the exposures within these regions, both from a standpoint of where companies are listed as well as where their revenues are generated.

Peter Lampert (18:37):

Currently in the international equity strategy we have about 23% of the portfolio in UK-headquartered companies and another 50% in companies located around the rest of Europe. So, yes, we have a large exposure to companies in Europe, but when we drill down and look at where these companies generate the revenue across the portfolio, one-third of revenues are coming from Europe, one-third from Asia, and one-third from the Americas.

And that's really because most of the companies we're investing in are multinationals. There are a few "national champions," but generally, we're investing in larger multinational companies operating around the world. As a result, the portfolio is well diversified. It gives us less exposure to some of those more direct risks. Last year, Europe was really under the microscope. People were very concerned with Europe moving off of Russian gas and moving to higher cost energy, how that would impact their manufacturing sector, and if they could go into a recession. Certainly, we were concerned about that at the time for our direct exposure.

Peter Lampert (19:39):

But I just made the point [that] it's not 73% of exposure into Europe, it's more like a third of the portfolio when you look at the revenues. That said, we did make some small tweaks. For example, at that time we trimmed a bit of our position in Air Liquide. Again, these are just minor changes at the margins, but Air Liquide's a big user of natural gas and if there were problems securing gas or being able to operate their business, they could have been impacted. On the flip side, we added a bit to Equinor, which is the Norwegian oil and gas producer I talked about, and they are a major exporter of natural gas into Europe from Norway, replacing some of those lost Russian volumes, so, they benefitted from the higher gas prices.

We positioned the portfolio to try to minimize or reduce the impact of that negative outcome. And fortunately, Europe got through the winter just fine. They did a great job reducing consumption and also benefitting from warm weather. And I think that's a lot of what risk management is about. Oftentimes we're preparing for a risk that doesn't end up unfolding, but hopefully we're preparing for the risks, not predicting which ones are going to play out or not. But then for the ones that do play out, the portfolio is hopefully better positioned to weather those storms.

Anum Siddiqui (20:49):

Okay, great. Let's talk about some holdings. We were just talking about Europe and the UK, and I know one holding that I particularly find interesting is Compass Group. I was wondering if you could walk through the thesis around Compass Group, some of the history, and just explain to our listeners why we hold the position.

Peter Lampert (21:08):

Compass is the largest catering company in the world. You've probably eaten at their cafeterias, whether at an office building, a school hospital, or sports stadium. It's a pretty boring business, but it's the management team that makes it an excellent business, that sets them apart from their competitors. One big concern though was during COVID-19, during the pandemic, with the shutdowns of lots of schools and office buildings that they'd be impacted and then the ongoing work-from-home trend, you know, would they be able to bounce back? And amazingly, the company is stronger now than it was even before the pandemic. They came out of 2022 with higher revenues than they had in 2019 before the pandemic with a dip there in between. But they've done a fantastic job because they have a great culture, they are able to really communicate their value proposition to their customers to make those sales, and then really deliver on it. They're fantastic at the execution.

Peter Lampert (22:02):

It sounds simple, but there's lots of operational expertise that goes on behind the scenes. And in this environment that we've been in in the last few years, it's actually been a very challenging environment for anyone operating, a cafeteria. With the lockdowns and facilities opening and closing and having to get the staffing levels up and down and being able to adjust them.

Compass can do that. And they can move their employees around between different sites since they're the largest in the world. With food inflation and labour inflation, again, that's been a big challenge, but Compass is used to dealing with that. They're able to tailor their menus to work within the budget constraints of their customers and to optimize the labour usage. (Again, if they need to move them around between sites.) And as a result, they're the most efficient, they're the best operators.

Peter Lampert (22:50):

We've seen many companies or organizations that are still doing their in-house catering have just found it more complex to do over the last few years, and as a result, more of them have moved toward outsourcing. When that happens, Compass is best positioned to bid and win those contracts. Not only has the outsourcing market been growing, but they've been gaining a bigger slice of that pie as well.

Again, it comes back to the culture, the management execution—they just have a fantastic performance-driven culture. They're driven to make the sale and then to deliver on their promises to the customers.

So, what has been a very challenging environment for the industry actually turned out to be a tailwind for Compass and they've been able to take advantage of that.

Anum Siddiqui (23:32):

Okay, very interesting Peter. So, from a holding that we've had in our portfolio for a few years now to a newer addition to the strategy, I wanted to get your thoughts on Chugai, which is a Japanese pharmaceutical company that we recently added to the strategy. Can you talk to us a little bit about why the position was added?

Peter Lampert (23:51):

Chugai is, in our opinion, a great pharmaceutical company. I think a lot of people when they look at pharmaceutical companies—especially from the 20,000-foot view—they kind of all look the same. It seems like a black box, they do some R&D, it's kind of random if they get a successful drug out of that or not…

What we're trying to do when we invest in pharmaceutical companies is find the ones that yes, there is some element of luck in whether the drugs work, but also we think the companies that can put the odds in their favour. By having a good structure, a good approach, and the way they approach their R&D process.

We think Chugai is really well-positioned to do great R&D, come up with great drugs. And ultimately, that's how a pharmaceutical company can deliver value for shareholders—by first coming up with drugs that are differentiated from what's on the market, that meet patient needs, and make their lives better.

Peter Lampert (24:44):

And to do that, you have to be willing to invest in different areas, to go into R&D and come up with differentiated drugs than your competitors. One reason that Chugai is well-positioned to do that is because of their relationship with Roche. This is another portfolio holding—the Swiss multinational pharmaceutical company. We've been investors for many years, and they've been a majority owner. [They've had] a 61% stake in Chugai since 2002.

And along with that ownership interest, they allow the company to operate separately, but they have a lot of collaboration agreements. Namely, Roche sells its drugs into Japan exclusively through Chugai. So, Chugai has a sales force and markets their drug in Japan, and all the R&D and drugs that Chugai develops, they generally commercialize through Roche, or at least Roche has a right of first refusal to sell those drugs [to] the rest of the world.

Peter Lampert (25:35):

So, because of that, Chugai has never had to build a global sales network and try to spread themselves thin and be all around the world, which some of their Japanese competitors have tried to do. And frankly, they're just not big enough to do that. They're not as big as a Roche or a Pfizer. That would potentially spread their resources too thin.

But because of this fantastic relationship with Roche, they don't have to do that. And instead, they can just focus on doing what they do really well, which is serving the Japanese market and focusing on R&D. And as a result of that very intense R&D focus, not having to worry about global sales, they have a great track record of developing differentiated drugs. Their big one right now is HEMLIBRA for hemophilia. That's been a huge success for them and driven their recent growth, but we're equally excited about the long-term prospect of Chugai and the pipeline that they have.

Peter Lampert (26:26):

They're investing in peptides. It's still early, but this is a newer class of drugs or type of technology that could treat different diseases and make a meaningful improvement for patients. So, if they're successful there, we think there's a lot of long-term upside.

We don't know which specific drugs are going to pan out [or] which candidates that they're researching today will ultimately be successful, but we think because of this structure, because of their culture and their focus, they've put their odds in their favour. And that's what we look for in a pharmaceutical company and why Chugai fits in our portfolio.

Anum Siddiqui (26:58):

Okay, that's really helpful. It's also good to hear what exactly we're looking for when we're looking at pharmaceutical companies. Because as you said, it can seem—or, at least to an outsider can seem—like a little bit of a black box. Thanks for that, Peter.

The final topic that I want to talk to you about is artificial intelligence, which has clearly dominated the headlines more recently. Of course, there have been some businesses and stocks that have benefitted from this recent interest in [the] surge in artificial intelligence and others that have not.

So, I'd be interested in hearing your thoughts on how the team is thinking about the topic and how different holdings within the strategy are potentially going to be impacted. Some of the exposures that come to mind are of semiconductors and some of the professional publishers that we own within the strategy.

Peter Lampert (27:47):

Yeah, AI has certainly been the most discussed topic since ChatGPT made headlines earlier this year. It comes up in every conversation that we have with companies and management teams. They're constantly being asked about their AI strategies, if it's a threat to their business or perhaps an opportunity. And we're looking at that for every company in our portfolio as well.

In some sense, AI and machine-learning algorithms have been used for many years, so this is just more of the same, a natural progression of technology. Perhaps though, you know, a lot of people are thinking this is a step change and could have even bigger implications than previous technological changes.

So, we do go through [those questions] and there are some really obvious winners. NVIDIA's the poster child. I think everyone's very excited about their processors being used in servers for AI applications. And to some extent, some of our companies benefit from that.

Peter Lampert (28:36):

TSMC, the leading semiconductor manufacturer, makes all of NVIDIA's chips, so perhaps some benefit for them. Samsung, the leading memory chip manufacturer, another portfolio holding, makes the memory used in these servers. ASML makes the semiconductor equipment that then TSMC and Samsung use to make the chips.

So, to the extent that AI just has more use cases, requires more comput[ing] power, more servers, there could be just overall demand growth for the industry and the whole semiconductor supply chain could benefit. But it's still early days. So far NVIDIA's capturing most of that additional profit. But if this becomes, you know, a long-term structural driver for higher growth rates, that could be a benefit. We're not getting too excited because, like I said, it's still early days. But it is a nice upside to have for some of these stocks.

Peter Lampert (29:26):

And then the other ones you mentioned, yes, the professional publishers. We have Wolters Kluwer and RELX in the portfolio. These are some of our biggest weights. So, naturally we're very keen to understand how AI could either hurt them or benefit them.

A lot of people [are] thinking that these companies would be hurt because they provide whether it's legal or medical information to lawyers or doctors—and to the extent that lawyers or doctors can get that information easily through a ChatGPT-like interface. If the information is reliable and accurate, then perhaps the likes of RELX and Wolters Kluwer could be bypassed.

We heard the same concerns earlier in the internet days when Google came out: "Well, if everyone can just access all the information on Google, no one will need to pay for these services." But what they've shown is they actually provide a lot of benefit. They not only provide information to lawyers, doctors, accountants, but they collect information from different sources, publicly available sources, and their own proprietary data sets, and they clean the information, they analyze it, they have analysts making sure all the information is correct and accurate. And that's very valuable to their customers.

Peter Lampert (30:38):

So yes, even though other information could be found using Google online for free, these businesses have continued to grow and thrive because of the value that they provide to their customers. And along with that, we actually think that AI is a bigger opportunity for them—less of a threat—because specifically, RELX and Wolters Kluwer have proprietary data sets. RELX has a proprietary data set of insurance claims data that they provide to car insurance companies; Wolters Kluwer has similar proprietary data sets on medical data or legal and tax regulatory information that they've cleaned up and having their own database.

Peter Lampert (31:16):

So, as a result, we think that we'll see more and more of these companies integrating AI into their products and services and providing even more value for their customers. One example that RELX has done is their Lexis+ AI product, which they've come out and recently branded as an AI-enabled product, and it's a continuation of the types of software that they're already providing—allowing lawyers to research and summarize legal documents and help them draft documents—but with some AI help to allow the lawyers to do it more quickly, more effectively. And these AI models have been trained on LexisNexis®, or RELX's proprietary data sets.

Peter Lampert (31:59):

We think that the models themselves, machine-learning models, will become commoditized. And really, the differentiator will be how you train those models on proprietary data sets, which RELX and Wolters Kluwer have. So, we think [there are] a lot of winners in the portfolio, or at least companies that have the potential to benefit from some of these AI trends. It's not in our base case; we're not getting excited [or] really expecting a lot of additional growth from this, but it's [potential] additional upside. If it comes through, that would be additional bonus for us as shareholders.

One on the flipside that's come up a lot as [a concern] or been labelled as an "AI loser," is Teleperformance in the portfolio. This is maybe one of our more controversial holdings in that they operate outsourced call centres for multinational corporations.

Peter Lampert (32:46):

They have a fantastic track record. They've been growing very well because they serve their customers very well. More and more multinationals have outsourced their call centers over time. Teleperformance has gained share as the best operators, best able to meet their customers' needs, and as a result, they've done a fantastic job. Over the years they've incorporated more and more technology into their services, incorporating chat bots, allowing their agents to interact with customers either by phone or by chat. And using more AI-assisted tools so that when a call agent is on the phone, they can quickly bring up the relevant answers very quickly using the appropriate database.

So, Teleperformance could actually benefit from this by their agents becoming more efficient using AI assistance, or potentially Teleperformance delivering AI tools—chat tools—directly to the customers in conjunction the agents. Sort of a human + machine combination.

Peter Lampert (33:42):

There [are] lots of ways that Teleperformance may benefit as the largest player in the industry; they're best positioned to integrate the technology into their offering. But people are concerned. There is that bear case argument that AI is going to put them out of business. Once the chat bots are good enough, nobody will need to talk to someone in a call centre anymore. And that's a potential scenario.

Peter Lampert (34:03):

What we do is we look at all of the different scenarios that we can think of, we put different scenarios into our discounted cash flow models—What does the upside look like? What does the downside look like?—we run a Monte Carlo simulation to get a wide range of scenarios. And in the vast majority of scenarios, we think that the risk-reward is very attractive.

Peter Lampert (34:21):

Even in the very negative scenarios where the business eventually declines to zero because AI does put them out of business, we think as long as it happens over that 20-year timeframe gradually eroding, not overnight, then the company is still very attractive valued. For context, it's about 9x earnings today, even though that's just one data point. We're looking more on our discounted cash flow models and looking at those different scenarios.

But again, looking at the risk-reward [is] not as simplistic as, "is this company going to win or lose from AI," but what's priced into the stock? What are the different scenarios that could unfold? Is this an investment opportunity or not?

And that's why Teleperformance is actually one of the positions in the portfolio that we think has a very good investment outlook despite a lot of controversy around the name right now.

Anum Siddiqui (35:04):

Thanks for that, Peter. It's interesting to think about how one single topic, as important as it is right now in the world, has so many different types of potential impacts to different business models, so it's interesting to hear how the team is thinking about it. And as you mentioned, it is still early days, so, I think that is a great place to end.

Thanks so much for your insight and your time, and hopefully you'll be on the podcast soon.

Peter Lampert (35:30):

Great. Thanks a lot, Anum.