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EP 190 | Finding Hidden Gems in Emerging Markets

Rob Campbell: Coming up, Peter Lampert provides an update on emerging markets, examining what a bottom-up approach looks like in practice and how it can thrive in an often macro-driven market. We spend time on some of those bigger macro stories, but it's clear that the EM space is incredibly diverse—something you'll hear that gives the team a lot of energy. In this episode, Peter highlights two Polish companies in the portfolio: grocer Dino and recently initiated Asseco, with a connection to a long-standing holding in our Canadian equity strategy.

[0:36] Disclaimer: This podcast is for informational purposes only. Information relating to investment approaches or individual investments should not be construed as advice or endorsement. Any views expressed in this podcast are based upon the information available at the time and are subject to change.

[0:53] Rob Campbell: Peter, welcome back.

Peter Lampert: It's good to be here, Rob.

Rob Campbell: Well, it hasn't been that long. I think it was just last month you were on, and the markets continue to throw up some surprises for us, which I'm looking forward to asking you about later. But where I wanted to start today was a bit more back to basics, looking at things through the lens of philosophy and process.

When I speak with clients or consultants, often a question I hear about emerging markets is: are there things that we have to do differently—or way differently—when looking at emerging markets companies or an emerging markets portfolio that you just don't have to do in the developed markets world? Can we start there?

[1:31] Peter Lampert: We get that question all the time. Really, 90% of what we do is the same across Mawer's equity strategies—following the same philosophy, the same process, and it's no different in emerging markets.

There are always some subtle tweaks, particularly around macro. There's a little bit more macro awareness with emerging markets, but really, 90% of what we do is just following the philosophy, following the process, and that's no different in emerging markets.

One thing that's exciting about the universe is that it is a less efficient universe. In our philosophy, we look for wealth-creating companies with excellent management teams at discounts to their intrinsic value.
We're always making some trade-offs—there's no perfect investment.

But what we find in emerging markets is we can more frequently find those great companies with great long-term growth outlooks at very attractive valuations because there are more pockets of inefficiency. If you're willing to roll up your sleeves and turn over more stones, we can surface those opportunities. This even happens amongst the most well-known companies.

The largest company in emerging markets is TSMC right now. It's growing 20% a year and trading at 16 times earnings. You don't see that in developed markets—one of the world's best businesses, best management teams, fantastic quality, great growth outlook, and an extremely attractive valuation. But that's just one example. If we go through the portfolio, there are many examples like that.

So it's really just the same bottom-up approach, but I find we don't have to make the trade-offs as much. Then there is more macro awareness. Where that comes in is we have to pay a lot of attention to big macro swings in emerging markets—macro and geopolitical, I would put in that same bucket. We have to manage the risk.

We're not looking to make big calls or big bets on countries, but we think about what is the appropriate discount rate for a specific stock in a specific country. Is the risk-reward worth it? We really spend time thinking about the discount rate as much as the cash flow forecast in our discounted cash flow estimates and fair value estimates, and then managing those overall exposures at the country level.

If we find a lot of attractive companies in one country, we still need to manage the weight and manage that risk. So we do think about that a lot, and it is part of the process. It just gets maybe more emphasis in this strategy than it would in some other strategies.

[3:49] Rob Campbell: Peter, I've heard clients express—and by the way, this wouldn't just be this year, this would be probably a couple of years in a row now—that they feel like we're in a very macro- dominated market today. I'm curious whether you accept that premise as a bottom-up manager. We all saw the poster board on "Liberation Day," but regardless of whether you accept the premise or not, are those impacts of these macro events or implications being felt evenly across the emerging markets landscape?

[4:21] Peter Lampert: I do think that's a fair assessment. There are more macro drivers impacting stocks, more geopolitical uncertainty in the world, and over the last five years or so, this has been the trend. It's something that even bottom-up investors need to consider and contend with.

Like you said, it impacts everyone, but not necessarily evenly. We saw on "Liberation Day" when Trump announced tariffs around the world—China got hit with the highest tariffs. There was an immediate impact; lots of factory orders immediately stopped.

Now the tariffs are temporarily lowered, and there's a rush of orders to get in during this lower tariff period. So it is impacting real businesses on the ground, and we have to try to look through that for the long term. What are the businesses, the companies, the management teams that can not only survive but thrive in a more uncertain world?

[5:12] Rob Campbell: China is obviously a pretty important part of the emerging markets universe. We've got a pretty healthy allocation to Chinese businesses in the portfolio. Can you talk a bit more about the character of those companies that we own and some of the work that you've done on them recently?

[5:26] Peter Lampert: There are lots of great companies in China. There are lots of not-so-great companies too, but that's the beauty of having a large universe. We can be very selective and focus on those really high-quality companies that meet our criteria.

We've found a number, and we've really emphasized the ones that are exposed to the domestic economy —not reliant on that manufacturing export economy that has been the main driver of China's growth but is

reaching its limits and being tested in the current trade war.

Companies like Tencent, the social media leader; Tencent Music, which is a listed subsidiary that does music streaming; and NetEase, a gaming company. These companies have all done very well recently, despite the difficult macro backdrop in China.

The common theme is that they're not reliant on exports or manufacturing. They are reliant on consumer spending in low dollar amounts—gaming, online streaming—so less likely to be cut even in a downturn. But that said, we are seeing signs that the Chinese government is probably doing some stimulus.
They're not doing big splashy headlines, but there are signs that they are supporting consumers, supporting the economy more. That's also providing a more favorable backdrop in what otherwise is a challenging environment in China.
[6:47] Rob Campbell: We've also seen at the same time—and maybe this goes beyond China, but you mentioned earlier thinking a lot about discount rates—some pretty big moves at the long end of several rather important government yield curves around the world. We've seen some big currency moves too, most notably of the U.S. dollar, but also the Taiwan dollar.

More recently, how have you thought about that in the current environment, just going back to your comments around discount rates?

[7:13] Peter Lampert: We think about currencies and having a well-diversified, resilient portfolio that can do well in a range of different outcomes. Currencies are inherently very difficult or impossible to predict, so our approach is to be diversified, have exposure to a range of currencies, but avoid overexposure to any one currency.

You mentioned the U.S. dollar weakening recently. Historically, the U.S. dollar has been a safe haven in times of volatility—investors flee to U.S. dollars. That's attractive in an emerging markets strategy, which typically is a more volatile asset class, and having some U.S. dollar exposure can buffer that.

We have that, especially through our Middle East investments—companies in UAE and Saudi. We have some great businesses there, and they happen to operate in local currencies which are pegged to the U.S. dollar. So that's indirect exposure to the U.S. dollar, which has historically benefited the portfolio in times of stress and USD strengthening.

Right now, we're seeing the opposite—decreasing confidence in the U.S. dollar, associated also with the rising bond yields you mentioned—and we're seeing USD weakening and other currencies strengthening. So there's a lot of volatility.

We're not making any shifts on this. We think the portfolio is already well-positioned and diversified, but it's something we have to pay attention to and make sure we don't have any overexposure to a single currency.

[8:40] Rob Campbell: You mentioned the Middle East. When I look at the portfolio, one of the regions that stands out as having a generous allocation in terms of where we're finding businesses is EMEA—Europe, the Middle East, and Africa. I mean, a wide selection of potential countries in which these companies operate, but regardless of the bucket and how it's defined, what is it about that region?

Maybe we can start with Europe. What is it about Eastern Europe that seems to be a pretty great source of ideas for us as a team?

[9:13] Peter Lampert: Like you said, emerging markets as a whole is a very heterogeneous universe, and a bucket like EMEA is equally heterogeneous. But one of the common characteristics they have is being more off-the-radar markets.
If you look at EMEA, I think it's roughly 10%—maybe slightly higher—of the benchmark, but about 27% in our portfolio. That's driven by bottom-up research where we find opportunities. The largest country exposures within that would be Poland and the UAE, at 9% and 7% respectively.

So we're not making really big bets on any single country, but in that bucket of EMEA, there are lots of off-the-radar, overlooked countries where liquidity is a little bit lower. A lot of investors just aren't turning stones there, and that's our bread and butter—where we love to roll up our sleeves, turn over stones, and find great companies, great management teams building phenomenal businesses for the long term.

When my teammate and I were in Poland in December, we went there together, rented a car, drove around the countryside, visiting small towns, stopping at convenience stores, eating the hot dogs at the gas stations, visiting the grocery stores, shoe stores, factory tours, as well as the typical management meetings—but really getting to know the entrepreneurs and the culture in the country. There are a lot of great businesses there, and it's similar in the UAE, where there are a lot of great businesses and unturned stones that are overlooked by many investors.

[10:44 - 10:54] Rob Campbell: You mentioned meat counters—I know that's a particular investment we have in Poland—but one of the more notable additions to the portfolio so far this year, in fact the largest addition, is Asseco Poland.

[10:54] Peter Lampert: That was a newer addition to the portfolio since our trip last December, and it's a company that's been on our watch list for a number of years. It's an acquisition-led company of niche software businesses. Generally, they're buying very good businesses—we like that general strategy —but the prices they were paying and the returns they were getting weren't great. We thought there was room for improvement on the return on invested capital they were earning, and for that reason, we were on the sidelines.

That changed when Topicus came in as an investor earlier this year. Topicus is a subsidiary of Constellation Software, a Canadian company which Mawer has been a shareholder in since its IPO in 2006. We view that management team as world-class, one of the best—if not the best—capital allocators globally, and they have a very good system for deploying capital and generating very good returns on capital.

Topicus shares that culture and DNA, so now that they're on the board of Asseco—Poland remains a listed company—we expect that capital allocation to improve and returns on invested capital to improve.

When we saw that Topicus had taken a minority shareholding, we could quickly enter the position as well, given we already liked the business, and now we have higher appreciation for the capital allocation going forward.

[12:16] Rob Campbell: And the meat counter—Dino Polska—is a longer-standing holding within the emerging

markets portfolio.

Peter Lampert: Dino is a chain of grocery stores. They have great meat counters, which are very valued by Polish consumers who frequently go to the store for fresh meats. In Canada, we're probably most familiar with the sausages, but all of their meats are important in their culture.
Dino has just done a great job of rolling out stores in these smaller towns where we were driving around, where there is less competition. Historically, it's been small mom-and-pop operators, and they're just coming in with a better offering. They have their own meat processing plants, so they can consistently have fresh, high-quality meat in their stores.

They have a standardized store layout so they can quickly and cost-effectively build new stores and roll out new locations, providing a great offering at very competitive prices. That's a boring business, but just fantastic execution by the management team. They still have lots of growth outlook because they still have a small market share in overall Poland today.

[13:18] Rob Campbell: Peter, zooming back out, I'm curious about your most non-consensus view with respect to emerging markets at the moment. Is there something that you and the team feel that investors at large are really underappreciating right now?

Peter Lampert: I think that emerging markets as a whole—it's easy because it gets lumped into a bucket because China's the biggest part of the universe. Most people, when they look at emerging markets, they look at the index and, by extension, they largely focus on China. Our view is that that's just scratching the surface.

If you look past that, past some of the big names, you can really find these exciting companies. We talked about Dino, we talked about Asseco, but throughout the portfolio—and we're designed to do that.

The way we've set up our philosophy, our process, our culture, our team, our portfolio construction really allows us to get off the beaten path, go to these other areas, have a lot of exposure and investments in places like Poland and UAE like we've discussed. When people think about emerging markets, that's not usually what comes to mind. Usually, they're either thinking of China, which dominates the MSCI Emerging Markets index, or sometimes I hear people talking about Sri Lanka and Argentina.

These are actually considered frontier markets and not really part of our investment strategy. They have very minimal public equities available for investment in those countries, so not really applicable to what we're doing at all. Whereas a country like UAE is one of the wealthiest countries in the world. Poland is now closing in to surpass Japan on a GDP per capita basis. They've had phenomenal growth over the last two decades.

So emerging markets—like I said—is very heterogeneous, a wide range of countries in there, great companies below the surface, and not just a bunch of low-income countries. But the common denominator is that they tend to be more overlooked. There's less liquidity, more inefficiency, fewer investor eyes on these markets. And that's where we thrive. That's where we find the opportunity.

[15:18] Rob Campbell: Well, indeed, I know you and the team have spent an awful lot of time on the road. Just going back to the earlier part of our conversation on what you maybe do a little bit differently at the margin—certainly the

idea generation, the passion for getting out there and finding new businesses—that's common to you and the team. So thanks, Peter.

I appreciate you coming on the podcast. Now get back to work!

Peter Lampert: Thanks, Rob. It's always a pleasure.

Rob Campbell: Hi, everyone. Rob here again. To subscribe to The Art of Boring podcast, go to mawer.com—that's M-A- W-E-R dot com forward slash podcast—or wherever you download your podcasts. If you enjoyed this episode, please leave a review on iTunes, which will help more people discover the "be boring, make money" philosophy. Thanks for listening.