REPRINTED FROM NOVEMBER 5, 2018

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Building a Global Strategy From the Bottom Up

GRADY BURKETT, CFA, is a Portfolio Manager and Research Analyst at Diamond Hill Capital Management, Inc. He joined the firm in 2014. Grady has spent the majority of his equity research career covering the technology and telecommunications sectors. Prior to joining Diamond Hill, he held various Equity Analyst positions with Morningstar most recently serving as Strategist for the technology sector team. He received both an M.S. and B.S. in mathematics from Wright State University.

SECTOR — GENERAL INVESTING

TWST: Did you want to talk a little bit about the firm?

Mr. Burkett: Diamond Hill was founded in 2000 and has grown to about $22 billion in assets under management in both equities and fixed income. All of our strategies are based on a long-term intrinsic value investment philosophy.

TWST: Did you want to talk a little bit about the fund/strategy that you work on?

Mr. Burkett: The global strategy, which is a public fund, follows the same long-term intrinsic value investment philosophy as our other strategies. When we carry out that philosophy, we're building the portfolio stock by stock or business by business. We're building cash flow models to understand the amount of cash the business will generate over the next five years. From there, we apply a terminal multiple to the year-five cash flow to understand the perpetuity value of the business. We discount those cash flows back based on the risks that we believe the business faces. We only buy shares of the business when the shares trade below our estimate of intrinsic value. The Global Fund, along with all of Diamond Hill's strategies, are built from the bottom up.

TWST: Do you think the fund has a unique investment philosophy?

Mr. Burkett: Yes. I think that our long-term time horizon is unique. Another unique aspect of our firm is that we have 30 industry analysts that cover companies globally. The global strategy is about 55% U.S. and about 45% non-U.S. companies. Because our industry analysts have deep industry knowledge and a global perspective, we believe we have a better understanding, or a better lens, into the cash flows that a business might generate well into the future, including the competitive dynamics they face and the opportunities in front of them. Combining a long-term time horizon, an intrinsic value philosophy and significant expertise with 30 industry-focused analysts puts us in a unique position and provides an advantage in the marketplace.

TWST: Did you want to highlight a stock that you find interesting?

Mr. Burkett: Sure. One business that I like quite a lot right now is a midcap, U.K.-based company called **Howden Joinery** (LON:HWDN) (4.01%). **Howden Joinery** is a very well-run and niche home improvement supplier. **Howden** sells everything that a contractor needs to remodel a home kitchen. Because it has a singular focus on contractors, the company doesn't sell to retail customers. This focus has allowed the company to take market share from the broadline home improvement retailers and smaller operators.

One thing I like about **Howden**, besides its nice focused business model, is its great balance sheet. To the extent that we run into some economic weakness in the U.K. due to Brexit, I think the company is actually more likely to gain share in that scenario and come out of the cycle even stronger going forward.

TWST: Are a lot of the contractors doing work in Britain?

Mr. Burkett: Yes. **Howden Joinery** has 660 stores throughout the U.K. The stores are located in industrial areas rather than retail areas, which provides a real estate cost advantage. The contractors work with individual homeowners. When someone wants to remodel their kitchen, they'll find a contractor, and the contractor will work directly with **Howden Joinery**.

Howden does a lot of things for the contractor. First of all, they make sure they have everything in stock that the contractor needs to remodel the kitchen. They also extend eight weeks of credit to the contractor, so the contractor repays **Howden Joinery** after the job is complete and the customer has paid the contractor. Finally, **Howden Joinery** has design services, allowing the contractor to work with the customer at their home and then bring the homeowner into the **Howden Joinery** store where they can see the different materials and view the kitchen remodel on a computer. The company has a very close relationship with the contractor, and the contractor in turn has a close relationship with the end customer. **Howden Joinery** is a very beneficial business partner to home improvement contractors.

TWST: Did you want to mention a second company?

Mr. Burkett: Sure. Another company I like in the U.K. is **Ashmore** (LON:ASHM) (2.32%). **Ashmore** is a highly profitable specialty asset manager. It's a founder-led company. **Ashmore** focuses on emerging-market fixed income. The company takes a long-term investment focus. They have an ownership mentality. We believe that the emerging-market fixed income category is less likely to face meaningful passive competition over the next several years, which means they will not face as much pricing pressure as some other asset managers.

The business model of the company is particularly attractive. They're focused on performance and not being a low-cost provider. It's a pay-for-performance culture where almost half of the equity is owned by employees. The company has about $76 billion in assets under management. Of that $76 billion, about 90% of it has outperformed over the past three and five years. We think this is a function of the company having a longer-term time horizon. We think that the emerging-market debt markets are probably less efficient because they're less transparent. We also think there are a lot of opportunities for Ashmore to find value in these markets because of general erratic investor behavior toward emerging markets.

Highlights

Grady Burkett discusses Diamond Hill Capital Management, Inc.'s global strategy. The strategy is based on a long-term intrinsic value investment philosophy. Using this philosophy, Mr. Burkett builds the portfolio stock by stock from the bottom up. He buys shares when a stock is trading below his estimate of intrinsic value. Mr. Burkett believes volatility can create opportunities. He advises investors to understand the businesses they own and the cash flows that will be generated in the future.

Companies discussed: Howden Joinery Group plc (LON:HWDN); Ashmore Group plc (LON:ASHM); BT Group plc (NYSE:BT); Samsung Electronics Co. Ltd. (KRX:005930); Apple (NASDAQ:AAPL); Baidu (NASDAQ:BIDU) and Alphabet (NASDAQ:GOOG).

TWST: You mentioned the issue of transparency with emerging markets. Does a company involved with these markets need to make sure there is due diligence and take all the precautions necessary?

Mr. Burkett: That's one thing we like a lot about **Ashmore**. When you read their commentary, they have a very deep and long-term understanding of general macro conditions in many different countries because the company has been in business for 20 years. But they also have an employee base that is largely dispersed out into the markets that they're researching. As a global asset manager, we have very little emerging-market focus because we're not going out into the individual countries and living there and breathing it. **Ashmore** is one way for us to gain exposure to these emerging markets through a very well-run asset management firm that's on the ground, doing a lot of due diligence.

TWST: Did you want to mention another company?

Mr. Burkett: This is a completely different thesis, but it's in the U.K., so there are some of the same issues. **BT** (NYSE:BT) (1.27%) — **British Telecom** — is a company that we believe has a very durable market position. Shares have sold off a lot because they've run into some operational issues. The thesis on **BT** is that they have really, really solid assets and have the leading position in the wireless business and the leading position in fixed-line broadband in the U.K.

"The business model of the company is particularly attractive. They're focused on performance and not being a low-cost provider. It's a pay-for-performance culture where almost half of the equity is owned by employees."

However, they've had some issues with their global services business, which is a business that they don't need to necessarily be in, in a lot of the cases. They also have had some issues with their pension. They currently run a pension deficit, which we believe is somewhat artificial because interest rates have declined so much. Finally, they had been investing too much in obtaining sports rights, which is not something that provides much value to the firm. Most of the value accrued through providing sports content to their customers flows through to the leagues, the owners of the content.

1-Year Daily Chart of Howden Joinery Group plc

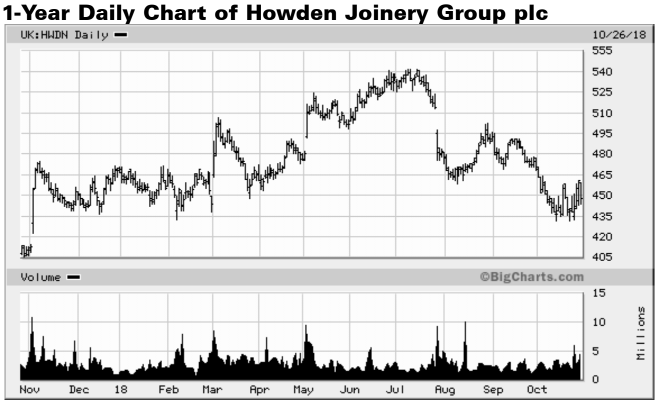

Chart provided by www.BigCharts.com

We believe the pension payments will wind down over the next few years and capital investments required to upgrade their fixed-line network will start to slow. We also believe there will be better cost control and less spending on content. For these reasons, we think cash generation is going to improve significantly into 2020 and 2021. When we look at normalized free cash flow out past 2021, we think shares probably trade at seven or eight times that number.

TWST: Is BT going to continue its emphasis on global business, and is there anything that lies ahead that might be interesting for investors?

Mr. Burkett: Sure. On the global services piece, it's been a pretty low-profit-margin business. They had accounting misstatements in Italy and have taken actions to reduce their footprint in that country, including selling their Italian assets.

They're also looking to partner where they can. They have no reason to run fixed-line networks in countries outside of the U.K. where they are subscale. In some of these countries where they're subscale and may have only a couple data centers and a small network footprint, they're talking about restructuring and pulling back. I think that if we see them deploy less capital into the global services business and redeploy that capital into improving their networks in the U.K. where they do have a scale advantage, we should see better returns on capital going forward as a result of that shift in capital allocation.

TWST: Do you want to mention a fourth company?

Mr. Burkett: Sure. I'll mention **Samsung** (KRX:005930) (2.55%). **Samsung** is obviously a large Korean company. It's a big phone manufacturer and television manufacturer. But the real crown jewel of the business is their memory business. Over the last 20 years, **Samsung** has steadily increased its market share in the memory industry. The company currently has 44% share in the segment of memory called DRAM and about 39% share in the segment of memory called NAND and about 40% share overall.

Shares have sold off recently, but they're also traded in a really depressed value of the trailing 12 months earnings because investors are rightly concerned about where we're at — both in the economic cycle and in the memory cycle. Right now, shares are probably trading at six times trailing 12 months free cash flow, and we'll certainly see pricing decline. And because of the high fixed cost of the business, we'll correspondingly see **Samsung's** cash generation decline at least over the next year or so.

But in our view, if we look out past the cyclical downturn and look out three or four years, we still see **Samsung** gaining share in the memory market, which is highly consolidated. There are only three DRAM suppliers accounting for 95% of the market. We see memory demand continuing to grow. We don't really see any change in people wanting to consume more data, and we think that there will be more places where memory chips are needed — for instance, cars.

1-Year Daily Chart of Ashmore Group plc

Chart provided by www.BigCharts.com

We think there's going to be really good long-term growing demand and continued consolidation of suppliers. We think when prices do recover, we'll see earnings recover, at least to their post highs and maybe higher. We think this is an extremely attractive business for investors who can look past a down cycle.

TWST: It looks like Samsung is still going to get a lot of its revenues from that semiconductor market.

Mr. Burkett: Yes, that's true. Right now, about 70% of **Samsung's** profits are coming from semiconductors. My expectation is that, that will probably decline somewhat, maybe sharply in a downturn. On a normalized basis, my expectation is that it will still be well-above 60% of operating profit simply because their market position is so dominant. The investment required to make memory chips has increased substantially over the last decade or so. As an example, **Samsung** has invested a total of $192 billion in research and development and capex over the past five years. Because of these investment requirements, it's an extremely difficult industry to enter, which is why it's so consolidated.

investors need to look out past 2020, 2021 and be comfortable that the company they own will be doing well in a normalized environment when they invest in companies in the U.K.

TWST: So for a lot of British-based companies, continuing trade with the countries in the EU continues to be important for their bottom lines?

Mr. Burkett: Yes, for many, not all. **BT** is an example where Brexit won't have much impact in terms of trade. It will be

"We think there's going to be really good long-term growing demand and continued consolidation of suppliers. We think when prices do recover, we'll see earnings recover, at least to their post highs and maybe higher. We think this is an extremely attractive business for investors who can look past a down cycle."

TWST: As far as their smartphones, do you think that there is still going to be competition from some of the other players, whether by Apple or from China?

Mr. Burkett: Yes. I think **Samsung's** smartphone position is less secure. They do have a good position because they are an integrated phone manufacturer. Not only do they have the memory, but they also develop OLED, the display screens required for smartphones. And they invest a substantial amount in R&D.

But the advantage that **Apple** (NASDAQ:AAPL) (Not Held) has that **Samsung** doesn't have is **Apple** has the operating system whereas **Samsung** is utilizing the Android operating system. **Samsung** doesn't have the ecosystem of applications and the switching costs that **Apple** enjoys. I would expect that **Samsung** will continue to face substantial competition from other Android-based phones and **Apple**. Now, the flipside of that is that as long as there are more phones out in the market with more memory installed, that should benefit **Samsung's** semiconductor business.

TWST: Changing gears a bit, we had mentioned during our discussion about the Brexit issue in Britain. Do you think that's going to be resolved next year? And if so, will that help some of the companies that we've been talking about and others that you are following?

Mr. Burkett: Even if we get some clarity on it next year, I doubt if the resolution will really provide a whole lot of certainty for companies for a few years. I think this is why we are seeing some of these attractive valuations. A lot of the companies that we're paying attention to have done a lot within their businesses to prepare for Brexit and set up subsidiaries or operating companies inside the EU where they need to. Five years out, I think these companies will adjust their operating models.

But it's hard to say next year, even the year after, how the impact from Brexit will affect demand in the U.K. market and, therefore, affect earnings of the companies. I think

1-Year Daily Chart of BT Group plc

Chart provided by www.BigCharts.com

a function of U.K. market demand and consumers' ability to spend on their phones and broadband services.

Howden Joinery is similar in that they have 20 stores in France. It's kind of a tough model for them in France. Nearly all of their profit comes from the U.K. It ends up being a function of U.K. customers' propensity to spend on kitchen upgrades, and that will be a function of the economic environment. I think it's more about how Brexit impacts the U.K.'s economy for a lot of the companies that we own in the U.K.

TWST: When you talk with investors and clients, what are some of their concerns as they look to the rest of this year and into next year?

Mr. Burkett: A lot of investors seem focused on where we are in the general economic cycle, including the U.S. as number one. Rising interest rates are definitely a concern. More recently, political and leverage issues that are popping up in certain emerging markets, like Turkey, have started to lead investors to be more concerned about emerging markets in general. Those are the three large concerns. Recently, the IMF lowered its global growth forecast by about 20 basis points to 3.7%, which to me is still a pretty good result, but that does seem to be creating more concerns in the market recently.

TWST: How important are the tariff and trade issues that we're hearing about in the news? Do you think that investors are following those?

Mr. Burkett: That's another important issue. We've seen more potential opportunities start to surface in China, specifically as a result of those. We hold two Chinese companies, one of which is **Baidu** (NASDAQ:BIDU) (1.95%). Its shares have come under a decent amount of pressure. We've seen this generally across some of the Chinese technology companies. I think some of this is over concerns about China's economic growth, which is partially due to concerns about how well China can do with these tariffs. That is a concern for investors.

We also had some volatility in Mexico and Canada before the NAFTA agreement was reworked. I think that you're seeing these tariff issues pop up in different places, and right now, it seems largely focused on the U.S.-China tariffs.

TWST: How important do you think the issue of volatility is for investors? We just had a couple of days where the market in the United States went down a little bit. Is volatility still an important issue for investors?

Mr. Burkett: I think volatility can create opportunities. I think it's important for investors to focus on the individual businesses they own and the types of businesses they own and the cash flows that will generate into the future. I think that if an investor looks at his or her portfolio and sees a company that they are sure of, a company that will be able to navigate a recession — because there will be a recession at some point in the future — they can consider buying more of that company as the share price falls.

If there's a company that concerns them, I think they may want to look at whether or not they should own that company. But if they're comfortable the company will be in business in 10 or 15 years, maybe a company like **Samsung** or **Howden Joinery** that can probably pick up share in a down market because of their strong competitive positions and balance sheets, these are the types of businesses we might be inclined to keep buying in the event of a cyclical market decline. But I think that volatility is just a part of equity investing, and investors need to expect that.

TWST: Do you think that sometimes, especially with individual investors, they might watch the business news on a daily basis and see things that pop up on that one day, and it's kind of hard for them to stay focused on the long-term picture?

Mr. Burkett: I do think that's hard for individuals. I honestly think it can be difficult for institutional investors as well. A lot of times, you will get news with no context behind it and sometimes even no real logic behind it. Sometimes you have to scratch your head.

As an example, a few months ago, there was a report that **Google** (NASDAQ:GOOG) (Not Held) was looking to re-enter the Chinese search market, and **Baidu's** stock price declined 8% that day based on that news. When you really get underneath it, you ask yourself, "What's changed about the environment today?" **Google** exited the market several years ago because they couldn't have an open search engine for customers. They had to respect the Chinese government's regulatory rules, which are quite severe.

So you ask yourself, "What about the market today in China is different? What is different about the regulatory environment? What is different about China's position toward U.S. companies? What's different today than it was seven or eight years ago?" Actually, it's probably even tougher for a company like **Google** to enter China, so it made no sense for **Baidu's** shares to sell off solely on that piece of information.

"I think volatility can create opportunities. I think it's important for investors to focus on the individual businesses they own and the types of businesses they own and the cash flows that will generate into the future."

More recently, we've seen news that China's foreign currency reserves had declined, I want to say $20 billion or $25 billion, in September. So the headline outflow number looks big, but when you realize that China has $3.1 trillion U.S. dollar equivalent in foreign exchange reserves, you realize that they won't go through those reserves for 10 or 15 years, even if the monthly outflows continue at a similar rate. I think investors can kind of focus on those short-term issues and headlines and forget about the fact that we're really looking at very long-term streams of cash flows for businesses that we hold.

TWST: Is there anything else you want to mention that your firm can do for investors?

Mr. Burkett: We've seen value investing strategies underperform in the U.S. recently. One thing that our firm can do is explain why we own the businesses we own because we know them really, really well. We can explain what we think they are worth and their competitive positions. We want to keep clients focused on why we're doing what we do and see them through periods of underperformance. These things tend to go in cycles.

I think that we can help investors not throw in the towel on a particular strategy or even a particular holding simply because that strategy or holding is going through a period of underperformance. If we see more market volatility and a reasonably decent decline in the equity markets, we can help clients understand that they own a collection of businesses and that those businesses have real value, even if the underlying equity prices are declining during a certain period of time.

TWST: Thank you. (ES)

GRADY BURKETT, CFA
Portfolio Manager & Research Analyst
Diamond Hill Capital Management, Inc.
325 John H. McConnell Blvd.
Suite 200
Columbus, OH 43215
(614) 255-3333
(614) 255-3363 — FAX
www.diamond-hill.com
email: info@diamond-hill.com