

# COOPER INVESTORS ENDOWMENT FUND QUARTERLY COMMENTARY REPORT



Cooper Investors Pty Limited

AFS Licence Number 221794

ABN 26 100 409 890

JUNE 2021

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	10.11%	8.46%	1.65%
ROLLING 1 YEAR	22.97%	29.10%	-6.13%
ROLLING 2 YEAR	10.27%	9.83%	0.44%
ROLLING 3 YEAR	10.94%	11.00%	-0.06%
ROLLING 5 YEAR	11.46%	12.65%	-1.19%
ROLLING 7 YEAR	11.41%	10.32%	1.09%
SINCE INCEPTION*	11.22%	10.09%	1.13%
SINCE INCEPTION^	118.00%	102.31%	15.69%

\*Annualised

^Cumulative (3 March 2014)

\*\*Before fees and expenses and adjusted for franking credits

#S&P ASX200 Accumulation Index – adjusted for franking credits

Past performance is not necessarily a reliable indicator of future performance

The purpose of the Cooper Investors Endowment Fund (the “Fund”) is to provide a conservative equities portfolio that may be suitable for investors who are in the pensions/decumulation phase. The portfolio may also be suitable for charities, foundations and others who are looking for a conservative equities exposure.

Whilst return is important the portfolio also aims to perform much better in down markets and to exhibit lower than market volatility.

The Fund commenced in March 2014. Over the ensuing seven years the portfolio has achieved its objectives of delivering a higher return than the market with a lower level of risk. These objectives have been achieved through stock selection and portfolio construction. The strategy is unchanged since the commencement of the Fund.

## Market and Portfolio Performance

The S&P/ASX 200 Accumulation Index (adjusted for franking credits) returned 8.46% over the June quarter and for the 12 month period to June 2021 returned 29.10%. The model Endowment Fund portfolio returned 10.11% and 22.97% for the quarter and last 12 months respectively.

The market (S&P/ASX 200 Accumulation Index) rose 2% in June completing an 9% quarterly total return, lifting the total return for FY21 to a superb 28.1%. While this was the strongest return for well over a decade, the ASX still lagged the technology heavy U.S. market with the S&P 500 rising 38.6%.

This stellar market performance occurred amid the backdrop of a strong ongoing economic recovery, booming commodity prices, vaccine optimism and reflation expectations. Together with significant government and central bank stimulus programmes, this has underpinned a robust recovery in corporate profits and the prospective outlook for future earnings.

Stock markets continue to benefit from ultra-low interest rates – for example, the ASX200 dividend yield is at a relatively attractive 4.0% in comparison to cash/deposit rates (pretty much zero) and the 10-year government bond rate of around 1.5%.

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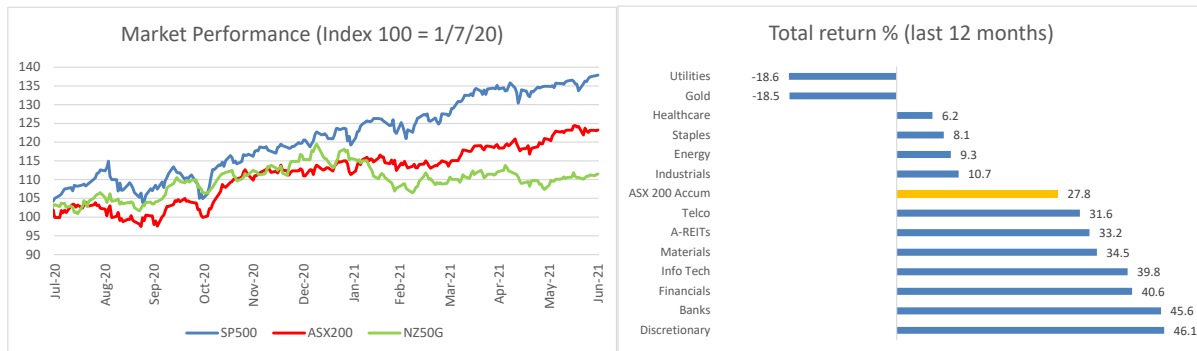


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Source: IRESS

The best performing sector in FY21 was Discretionary Retail (+46%) led by Autos (e.g. ARB Corp +144%, Eagers Automotive +149%), reflecting unprecedented fiscal support to households and COVID restrictions that greatly reduced both spending options and travel alternatives. In ARB's case at least, we also think the strong performance is a result of first class management and a superbly run business.

Utilities (-19%) and Gold (-18%) were the weakest sectors over the last financial year. Utilities faced multiple headwinds including low power prices, ESG concern related to the energy transition and valuation pressure from rising bond yields. Interestingly, gold prices fell as inflationary expectations receded, which showed that the gold price is heavily influenced by investor sentiment.

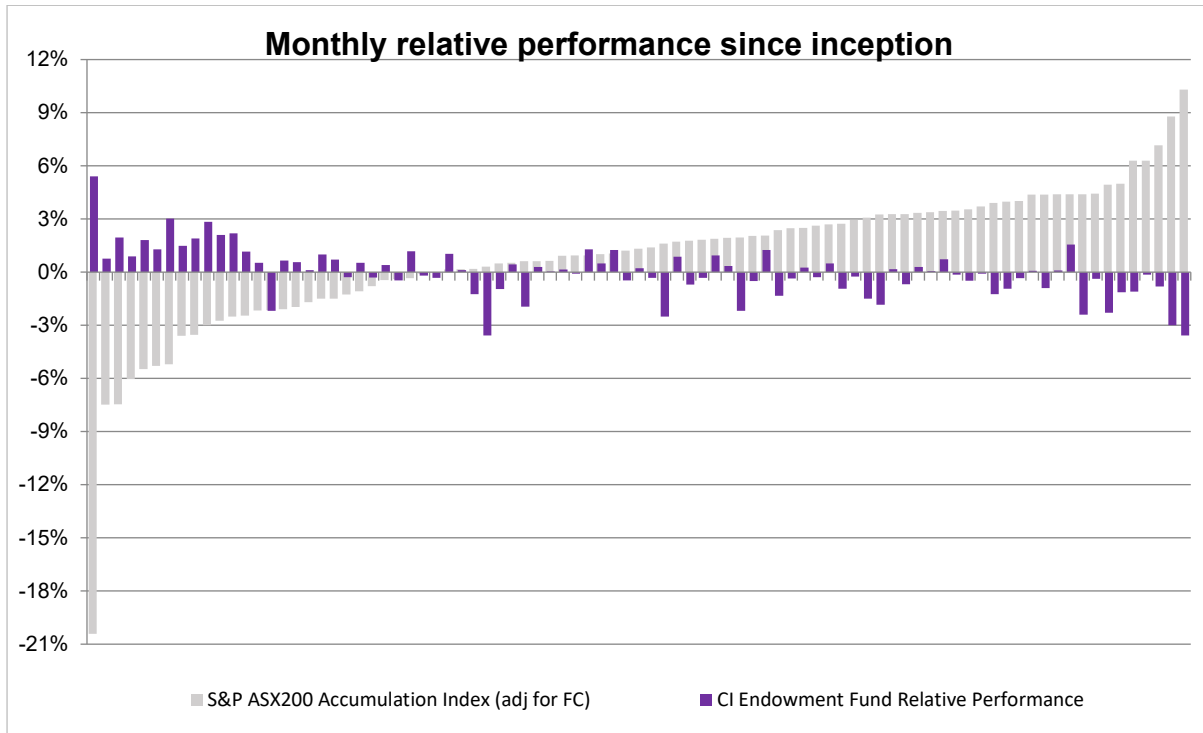
Stocks that performed well over the quarter were **Mineral Resources (MIN)** (improving outlook for the lithium market), **Intuit (INTU)** (strong 3Q21 results and raised guidance ~5%), and **ARB Corp (ARB)** (Ford and ARB announce collaboration agreement for selected off-road accessories).

Portfolio stocks that performed relatively poorly included **Chorus (CNU)** (concerns over regulatory risk and rising bond yields), **Ryman Healthcare (RYM)** (sudden resignation of CEO, lower completions for FY22), and **Unicharm** (did not keep up with value and cyclical rotation).

The international stocks in the portfolio (8 stocks, 15% of the portfolio) performed very well over the quarter, with a number delivering significant gains over the last year e.g. Intuit (+66%), Danaher (52%), Arthur J Gallagher (+46%), and Synopsys (+41%). The A\$/US\$ was a moderate headwind rising 9% over the quarter.

The chart below shows the Fund's monthly relative returns. The grey bars show each month's market return sorted from the worst to best month and the purple bars show the portfolio's return relative to the market for each month.

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Since inception the market (adjusted for franking credits) has shown a monthly negative return 30 times and in these months the portfolio has performed better than the market 24 times (80%). We point out that over the last 12 months there was only one down month which occurred in September 2020, and pleasingly the portfolio did better than market in this down month. The portfolio has also outperformed on 94% of 'meaningful' down days where the market fell 50bps or more.

When assessed using monthly data the portfolio has captured 69% of the market's downside and 86% of the market's upside. Since inception the volatility of the portfolio has been 80% of the market's volatility.

The portfolio owns 38 securities including eight global stocks (15%) and four New Zealand stocks (9%). The cash weighting is around 4%.

## Stock News

During the quarter **Danaher (DHR)** made a notable acquisition, spending US\$9bn (~5% of its market cap) to buy privately held Aldevron, a leading player in the fast-growing field of genomic medicine. Over the years Danaher has built up a unique portfolio of life science and diagnostic assets. Their key life sciences businesses involve providing the tools and services to research, develop and manufacture biotech drugs. For example, they are a key provider to over 400 COVID vaccine and therapeutic projects globally.

Aldevron expands Danaher's capability into gene therapy. Aldevron is a supplier of key ingredients for the next generation of therapies, namely cell and gene therapy and mRNA vaccines. Aldevron is the leader in these fields and this deal puts Danaher in pole position to participate in the wave of innovation occurring in this space.

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The acquisition multiple is high - Danaher are paying US\$9bn for what today is a US\$500m revenue business but growing 30% a year with 40% operating margins, in our view justifying the high price. Importantly, management can see an investment return in line with recent acquisitions.

As a reminder, Danaher's history and skill set is acquiring businesses and then improving their performance, which is how the company has been successfully built over 35 years. The shares were up 4% on the news and have gained nearly 20% for the quarter. Most companies would be sold down off the back of an announcement like this but Danaher has a long multi-decade track record of successful acquisitions and this fits a similar enough pattern.

The opportunity is to grow Aldevron into a multi-billion dollar business given the growth in genomics and RNA innovation that's occurring and as more of these types of therapeutics become approved. Overall as a key supplier with deep global networks across life sciences and medical research Danaher is very well placed to continue growing with the innovation in biotech and diagnostic markets. It remains an incredibly well run company and a high conviction investment in the Fund.

During the quarter **Mainfreight (MFT)** delivered a very strong FY21 result with sales growth +15%, and profit/EPS growth of +27%. This was particularly impressive given H1 was impacted by covid-19 related lockdowns as well as falling warehouse inventories (customer drawdowns due to strong demand) in some geographies.

Mainfreight operates in the freight and logistics sector under three core divisions 1) transport (mostly 'LCL' or less than container load freight), 2) warehousing and 3) air and ocean, which is also referred to as freight forwarding. Mainfreight's customers are skewed to non-discretionary sectors and Mainfreight provides a quality service, built around its strong culture. Mainfreight sits in our "owner-operator culture" group of proprietorial management teams.

Based on current observations, Mainfreight's operating trends are likely to stay strong over the near term. In particular, the group's Air and Ocean business continues to benefit from tight capacity and a global surge in freight rates as demand has accelerated over the last 12 months, with no sign this is about to soften.

Mainfreight management will continue to reinvest into its core geographies by way of new depots and warehouses, adding density to its network. Given operations are not only in Australia and New Zealand, but also in the US and Europe, Mainfreight's market opportunity is very large. However, growth will more likely be steady as it consistently builds out a quality customer base and continues to reinvest in its culture to consistently deliver a high-quality service to these customers.

Finally, the FY21 result further demonstrated the potential latent value still present in terms of Mainfreight's scale and margins. As Mainfreight grows, its margins continue to trend upwards. Margins in Australia, US and Europe still remain well below NZ, where it is a dominant player, which is a potential upside for Mainfreight's growing offshore businesses.

**Lifestyle Communities (LIC)** announced the purchase of adjoining land that will extend its St Leonards development by a further 160 homes (to 360 homes). The Bellarine Peninsula is an attractive area for LIC given the combination of relatively affordable land, proximity to a high growth corridor in Geelong and the Surf Coast, and the attractiveness of living seaside for many potential residents. LIC has demonstrated a strong track record of acquiring new sites, many of which are bought off-market and are not surprisingly a critical part of ensuring a long runway of growth.

The good news is Victoria remains under-penetrated with only ~50 land lease communities versus more than 150 in both NSW and QLD, a key positive given LIC remains the dominant player in the State. More broadly, land-lease communities still represent a low share of housing relative to the US,

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with product awareness also low. As the baby boomers hit retirement age (see more discussion of this below), we expect awareness and demand for land lease communities will grow in coming years.

LIC's high referral rates (current residents referring new residents, ~55%) is supported by the company's strong culture, which continues to build under founder/CEO James Kelly.

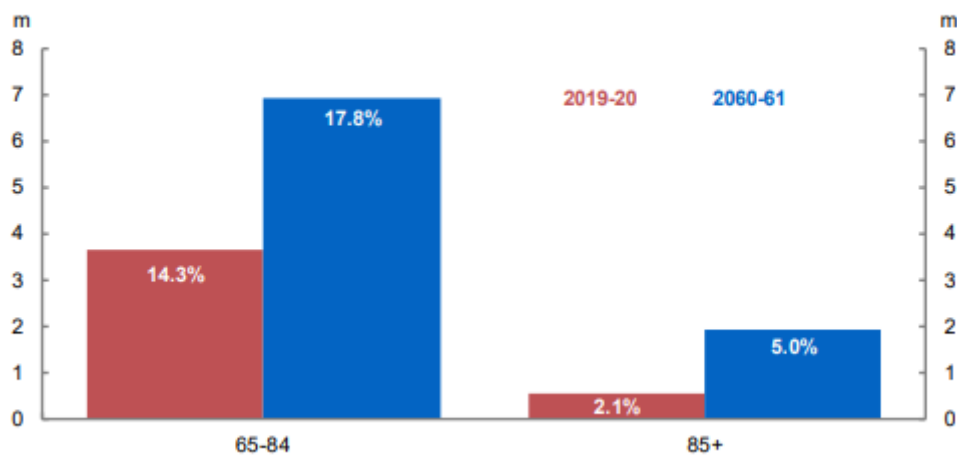
Sector returns (IRRs >20%) also continue to look attractive, with LIC receiving a high-quality annuity stream (rental payments for the land from Residents).

Finally, LIC is a real "business for purpose" given their product offering and operating model helps to address inequality in housing options for Australia's ageing population. Or put another way, helping retired and semi-retired people over 50 to live an independent life at an affordable price. In our view, there is a strong argument to be made that the LIC business provides a compelling social good.

During June 2021, the government released its latest Intergenerational Report, which had some insights particularly relevant to portfolio stocks such as Lifestyle Communities and Ryman Healthcare.

Despite the COVID bounce, fertility rates are expected to stay low and, with an ongoing increase in life expectancy, growth in the older demographics (65-84, 84+) is expected to accelerate.

**Chart 2.15 Older Australians by level and share of population**



Source: ABS National, state and territory population, September 2020, and Treasury.

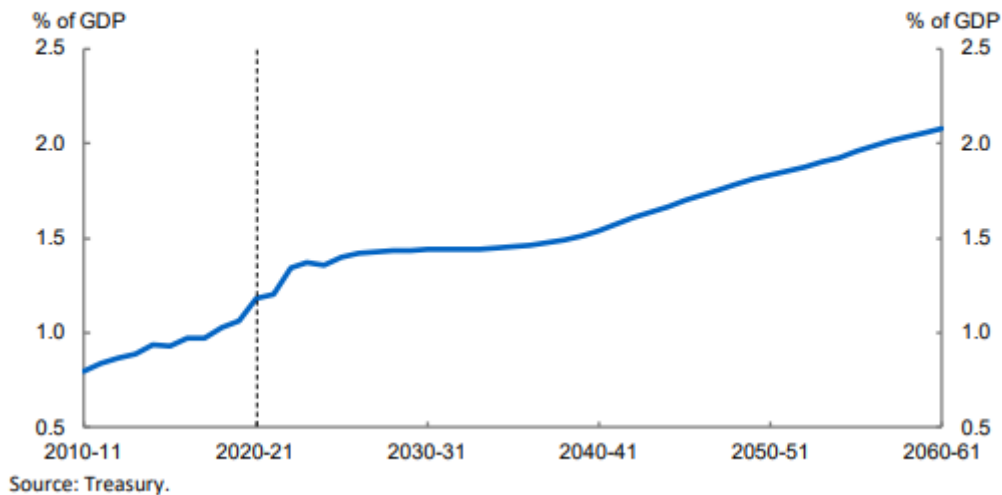
In numbers, this means there are expected to be ~1 million more 65-84 year olds over the next decade, while the 85+ group is expected to grow 60% in 10 years, and by nearly 250% in 20 years.

This will have profound impacts on the demand for various products and services over coming decades as the baby boomers age, in particular spend on Healthcare will increase significantly (as % GDP) as will the spend on Aged Care.

The Fund remains well positioned to benefit from these demographic trends over the longer-term.

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Chart 7.2.1 Aged care spending



Our investment proposition in **Telstra (TLS)** is beginning to play out. We have been patient investors and have been engaged with the board and management team with respect to the realisation of value from the company's infrastructure assets.

It was therefore pleasing to hear TLS announce that it sold a 49% interest in its mobile towers for \$2.8 billion to a consortium comprising the Future Fund, Commonwealth Superannuation Corporation and Sunsuper. The earnings multiple of 28x was well above expectations, which shows the current strong appetite for high quality infrastructure assets despite some concerns about rising interest rates.

Importantly, TLS retains a majority interest in the towers and have been able to agree terms that protects the business' mobile network leadership. There remains further value latency from the fixed component of the Telstra InfraCo assets – the mobile tower transaction gives us more confidence the value will be realised in time.

We are watching the mobile market (a key piece of the jigsaw puzzle for TLS) carefully for ongoing signs of rationality in the face of industry wide expenditure on 5G infrastructure.

After a long period in gestation **Endeavour Group (EDV)** was demerged from Woolworths just prior to the end of the financial year. Endeavour's operations encompass what were previously WOW's retail liquor franchises (Dan Murphy's and BWS), hotel operations (ALH), as well as a number of support or related businesses (Pinnacle Drinks, Langton's, Cellarmasters, etc.).

This Stalwart business has sustainable competitive advantages due to the strong retail franchise in Dan Murphy's and the scale of their operations relative to competitors. With the demerger from WOW we see significant benefits from the increase in organisational focus this enables, which is typical in demergers.

Additionally, the business has the opportunity for value creation over the medium term in both hotels and retail. These opportunities include online retail, retail footprint expansion, hotel refurbishment, and development and expansion of the hotel network.

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With Endeavour well positioned to take advantage of these opportunities, it comes down to the intentionality and capability of management to execute. Ultimately time and results will be the judge of this.

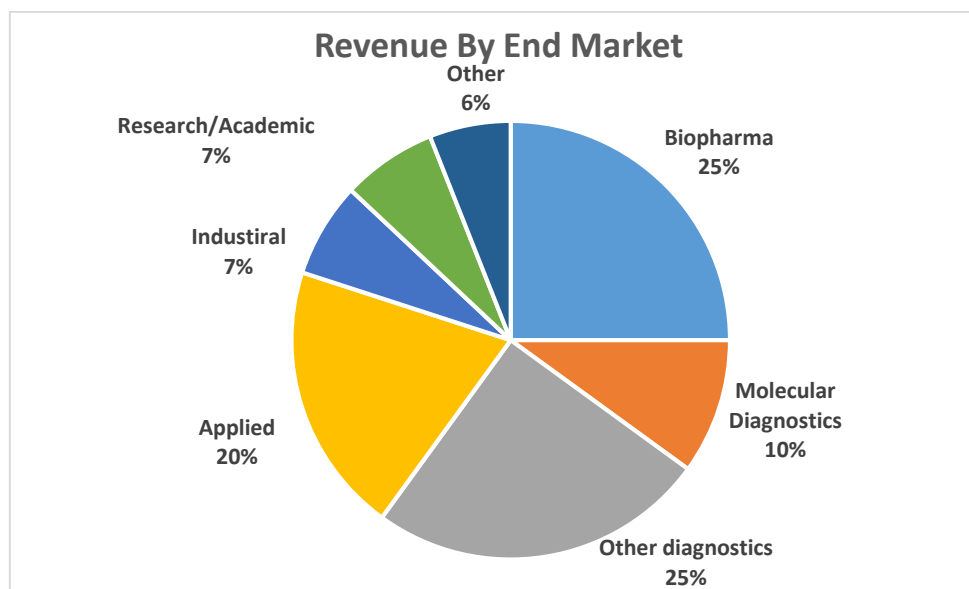
History would suggest that organisational capability is high and MD Steve Donohue has deep experience in retailing, including liquor retailing, while Bruce Mathieson Jr., MD Hotels, has similar experience within the hotel industry.

### Stock Corner

As we have written in previous quarterlies, the Fund can have up to 20% of its net asset value invested in international equities noting New Zealand listed stocks are not included in the 20% limit. International equities can provide significant diversification benefits for our portfolio by providing exposure to industries and business models not listed in Australia, markets where returns are not highly correlated to our local bourses, and foreign currency which can also be a diversifier (up to a point).

An international stock we have owned since inception is founder-led Danaher Corporation. In addition to improving both the quality and diversification of the Fund, it has also been one of our best performers over the last seven years. Danaher has built an enviable track record over its journey and below we discuss why it has been and remains a core holding in the portfolio.

Today Danaher is a US\$190bn market cap company with leadership positions in diagnostics and life sciences. On the diagnostics front Danaher makes the machines and consumables for testing for a broad range of conditions including infectious diseases, cancer, sexual health and many more. In life sciences Danaher manufactures the equipment and tools used in manufacturing biotech drugs.



But this is not what Danaher looked like 35 years ago when it was founded by brothers Mitch and Steve Rales. Steve has been Chair of the board since founding in 1984 and Mitch Chair of the Executive committee also since 1984. The brothers still own a combined 11% of the company, or near \$20bn.



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What is remarkable is that this company started out as a manufacturer of brake parts for trucks and automotive repair tools. With the acquisition of these businesses, Mitch and Steve Rales moved their focus from property development to manufacturing.

Around the same time they were exposed to Kaizen, the Japanese business philosophy of continuous improvement. Danaher was one of the first companies in North America to adopt Kaizen, applying it to their own operations and calling it the Danaher Business System (DBS).

DBS drives a cycle of never-ending improvement and permeates every aspect of Danaher's culture and performance. In the company's words "exceptional people develop outstanding plans and execute them using world-class tools to construct sustainable processes, resulting in superior performance".

We have seen this first hand with visits to a number of their facilities. Manufacturing operations have yellow tape on the floor designating the flow of people and goods and tools drawn on the wall to highlight where they are to be stored. The marketing departments have green, red and amber post it notes all over the walls signifying the progress or otherwise on key accounts or research projects. This is all done to remove waste and drive productivity continuously.

While many companies talk to continuous improvement, we are yet to see anyone reach the level of integration and performance of that of Danaher.

Danaher reinvests its cash flows into acquisitions to grow and pivot the company towards attractive growth areas. Whilst most acquisitions by listed companies often struggle to create shareholder value, with its continuous improvement mindset and business system, Danaher has a long history of generating attractive returns.

Over time Danaher has moved up the technology curve focusing on more sophisticated industrial equipment and technology. In the mid-2000s the company pivoted and established positions in healthcare markets. In 2016 the industrial assets were spun out into its own company called Fortive leaving Danaher with a \$20bn+ revenue base exposed to attractive healthcare markets.

The shares have generated a 21% pa return over 10 years and 23% pa since its IPO in 1990. The company has been able to deliver attractive mid-teens earnings growth over the long term. More so with the shift from a cyclical industrial business to a predictable, higher margin healthcare technology company the Danaher shares have been re-rated.

The organic growth profile and margins have never been stronger. Danaher have a unique presence in life sciences where they are the leading supplier of ingredients and parts into the biotech manufacturing process. We continue to see an attractive outlook for Danaher given their leadership position in growing markets.



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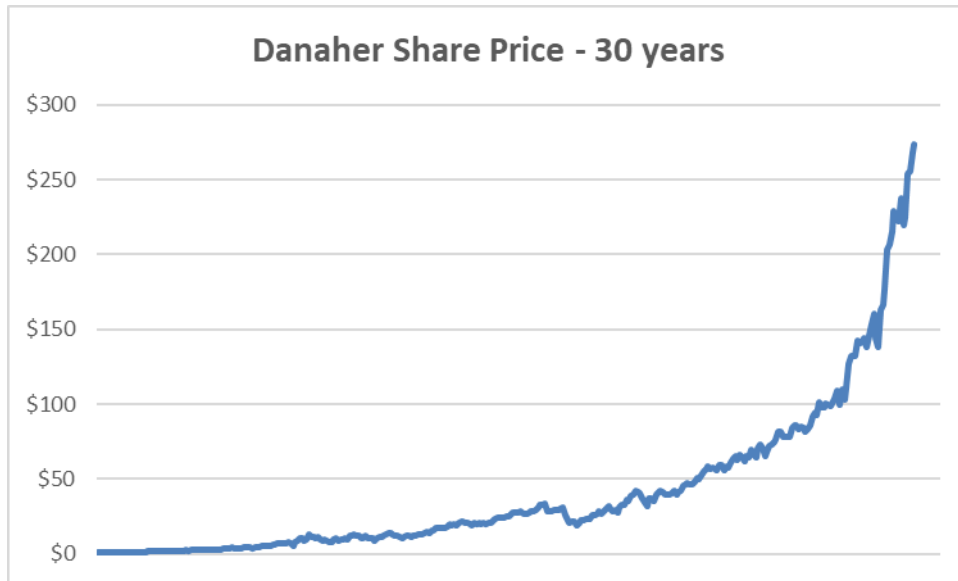


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Lastly, we think this company is making a huge contribution to the wellness of the world's population. Despite criticisms of its founder led governance structure, we want to invest in companies that are making a positive difference to people's lives.

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