

# COOPER INVESTORS GLOBAL ENDOWMENT FUND QUARTERLY COMMENTARY REPORT



Cooper Investors Pty Limited

AFS Licence Number 221794

ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

## JUNE 2021

	**STRATEGY	#REFERENCE INDEX	VALUE ADDED
ROLLING 3 MONTHS	9.27%	7.05%	2.22%
ROLLING 1 YEAR	27.87%	35.32%	-7.45%
ROLLING 2 YEAR	14.79%	16.77%	-1.98%
ROLLING 3 YEAR	14.63%	12.95%	1.68%
SINCE INCEPTION*	15.57%	13.84%	1.73%
SINCE INCEPTION^	93.72%	80.82%	12.90%

\*Annualised

^Cumulative (Inception Date of Strategy 05 December 2016).

# MSCI ACWI 100% Hedged to AUD Net Dividends

\*\*Before fees and expenses

Past performance is not necessarily a reliable indicator of future performance

## Portfolio Performance

Over the last 12 months the Fund has returned 27.9%.

Among the five top contributors to return for the year were:

- TSMC +88% (Taiwan-listed chip manufacturer)
- Latour +67% (Swedish-listed industrial investment company of the Douglass family)
- Danaher +40% (US-listed life sciences and diagnostics company)
- Brookfield Asset Management +46% (Canadian-listed alternative asset management firm)
- LVMH +67% (French-listed owner of diversified portfolio of luxury brands).

All of these investments remain high conviction positions in the fund. The list demonstrates the broad variety of sources of return, across geographies (5 different countries) and industries, including technology, consumer, financials, healthcare and industrials.

Among the largest detractors to return were:

- Baxter -13% (US-listed medtech business)
- Unicharm -8% (Japan-listed branded sanitary care business)
- Franco-Nevada -3% (Canadian-listed gold royalty business)
- DiaSorin -8% (Italian-listed diagnostic reagent supplier)
- Ferrovial +2% (Spain-listed family-linked infrastructure group).

These investments also remain high conviction investments. We note that the first four demonstrated the highly defensive characteristics that we aim for in this portfolio during much of 2020, while not quite keeping up with the value and cyclical rotation that has been more prevalent over the last six months. Ferrovial's key assets of toll roads and airports were impacted by the pandemic but the long term outlook remains compelling, the assets remain undervalued in listed markets and traffic volumes are seeing signs of recovery as populations begin to travel again post-vaccination.

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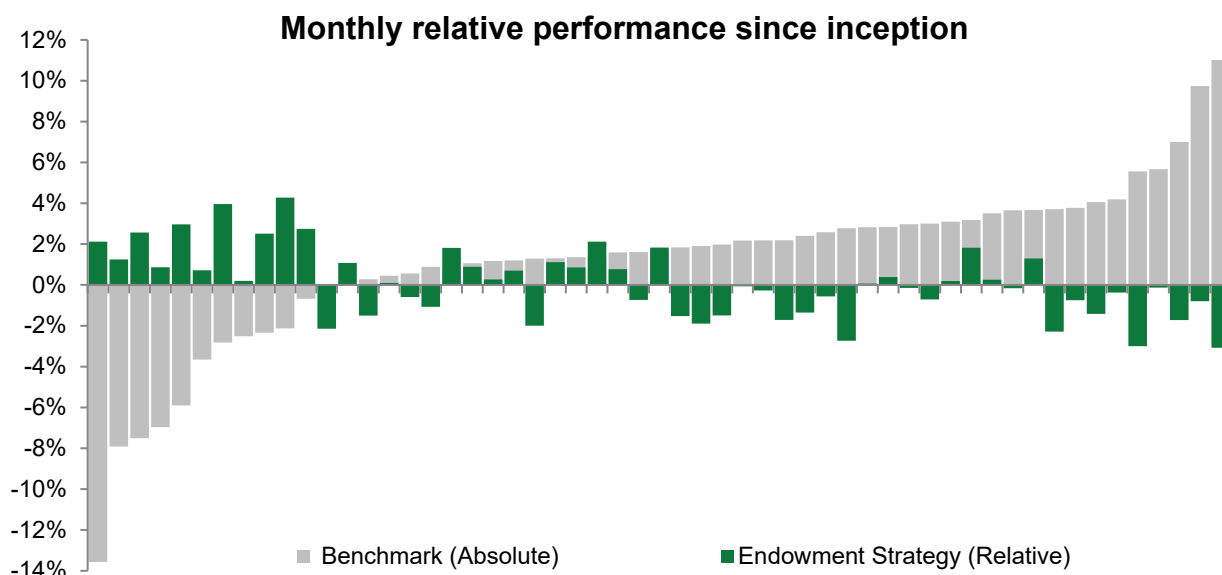
## JUNE 2021

Since inception the strategy has now compounded at 15.6% per annum. This compares to the reference index which has compounded at 13.8%.

We note the rather strong recent returns (and a strong equities market backdrop) and would reiterate that the single overarching organising principle of this portfolio is **reduced relative volatility and downside participation in order to generate steady long term compounding returns**. This is what we focus on when analysing the stocks in the Fund and discussing portfolio construction. It is front of mind when observing changes in behaviour or language from the management teams running the businesses in which we invest.

Since inception the Strategy has delivered cumulative downside capture<sup>1</sup> of **62%** and upside capture of **85%**, implying a 'capture spread' of **23%**. It has also outperformed all but one of 12 market down months, and on 'meaningful' down days (where market drops more than 0.5%) has outperformed 80% of the time.

The table below sorts *absolute* monthly market returns since inception from worst to best (grey bars) and shows *relative* return between the portfolio and the market (the green bars).



## Portfolio Structure

The current portfolio structure is as follows:

- 36 securities invested across 13 countries and 17 industry groups
- >75% in compounding-type Subsets of Value, zero turnarounds
- The US represents the largest single country weight
- Cash of 8% (7% net of hedges)
- >90% currency hedged
- Largest and smallest position weights of 4% and 1% respectively

<sup>1</sup> "Upside and downside capture ratios are computed as the ratio of compounded and annualised portfolio returns in the up or down months (of the Reference Index) over the compounded and annualised returns of the Reference Index in the same months."

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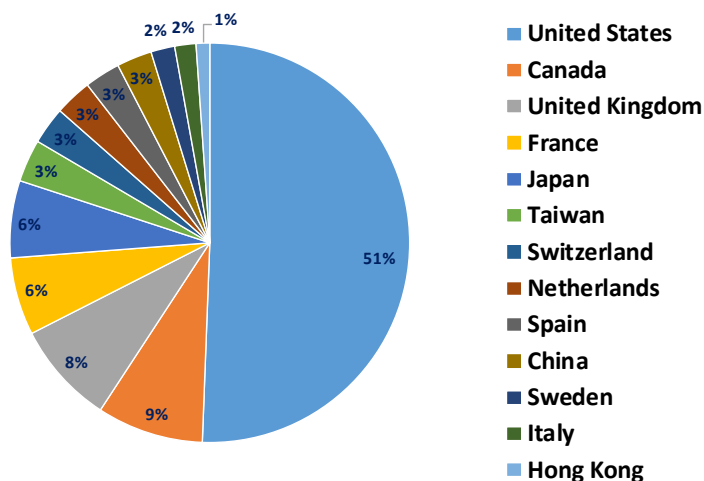
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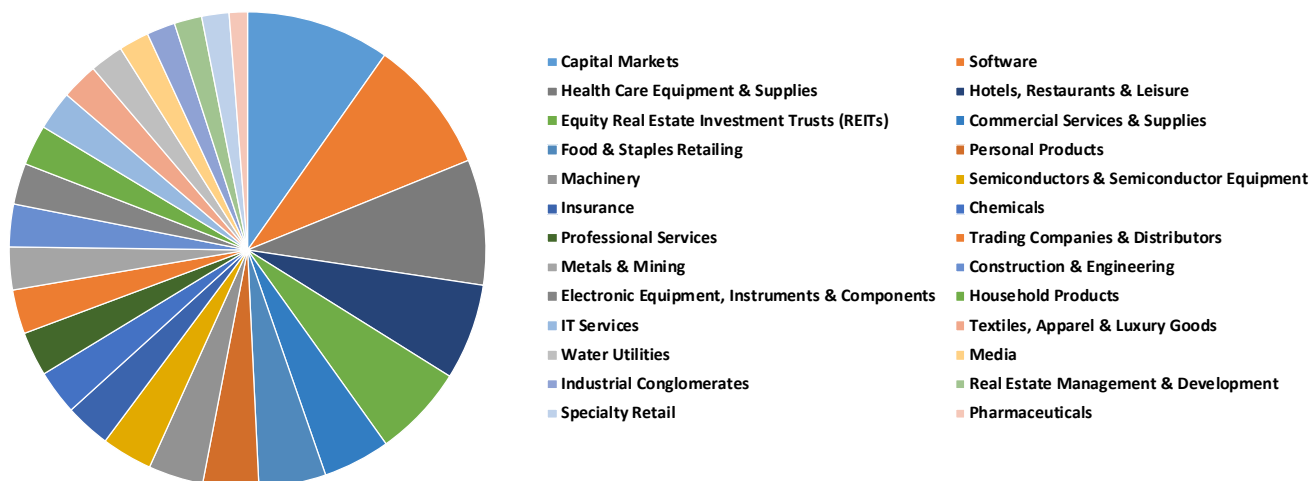
Country weightings as at 30 June 2021 were:

### By Country of Listing



Sector weightings as at 30 June 2021 were:

### GICS Level 2



It is expected the Fund will operate within the following guidelines:

- generally hold between 35 and 40 stocks
- be well diversified by country and industry
- have a bias towards compounding-type businesses per the CI Subset of Value methodology (Stalwarts, Growth, Bond-Like Equities)
- generally not invest in Turnarounds
- generally hold less than 10% cash
- generally hedge at least 70% of foreign currency
- generally not hold individual stock positions at greater than 6% of the portfolio

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## Portfolio Strategy

The entire Cooper Investors investment team undertakes stock analysis and the portfolio managers use this information to create a portfolio designed to meet the investment risk and return objectives of relative outperformance in down markets and lower volatility than the market.

The main way we hope to achieve these objectives is by constructing a portfolio that is well diversified by a number of measures and should have less downside in market drawdowns, although it cannot avoid losses altogether in down markets.

We can achieve diversification through a number of means, for example:

- Uncorrelated stocks
  - We want stocks that are as far as possible uncorrelated to each other, for example **Crown Castle** (a US-listed communications infrastructure provider) and **LVMH** (a French luxury goods company) which have a pair correlation of 0.0 (since inception)
- Industry spread
  - Investing in industries with cycles that move with a different cadence to or are highly resilient to the global economy such **Givaudan** (Swiss-listed manufacturer of flavours) and **American Water Works** (US-listed municipal water utility)
- International spread
  - Investing in domestic exposure of different regions, for example **Fiserv** (US-listed banking software) and **Unicharm** (Japanese-listed diaper company selling into Asia)
- Subsets of Value
  - Investing in Cyclical like **Ferguson** (Value-added distributor of plumbing supplies) and Asset Plays like **Latour AB** (Swedish-listed family-linked industrial investor)

The main way to achieve the objective of protecting the portfolio downside is to avoid stocks that are:

- Over-valued;
- Over-gearred;
- Facing industry headwinds;
- Poorly managed;
- Too keen on acquisitions;
- Have poor track records; or
- Paying unsustainable dividends

Stocks that exhibit some of the above features may look cheap and stocks that do not may appear expensive, so we are aiming to balance this trade-off between quality and price.

In practice we are attracted to companies with resilient business models, exceptional financial quality, strong balance sheets, and most importantly authentic and transparent management with a long track record of doing what they say they will.

An example is **Ferguson Plc**, an industry-leading plumbing and heating products distributor in North America, operating in all 50 states across the US and Canada. Ferguson's competitive position and growth opportunity, coupled with a resilient financial profile and top class management led by 20 year veteran Kevin Murphy make it a compelling investment within the Cyclical Subset of Value.

The business was founded in the 1950s and has grown to today earning US\$20bn of sales, of which about ~20% comes from its e-commerce tools. Ferguson plays a crucial role in its ecosystem, efficiently aggregating a large number of products (>1 million) from an extremely fragmented supplier base, selling to

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an equally fragmented customer base. Customer relationships in the industry are long dated and sticky, contractors want a distribution partner they can depend on week in week out, who can deliver the right products, on time, every time.

Ferguson has a high quality customer proposition for a couple of reasons. The first is scale – it has a network of ~1,400 branches and 10 distribution centres in the US – allowing for high levels of inventory availability and cost efficiency. This has become particularly important in a world of product shortages everywhere you look. The second reason is cultural, Ferguson has a highly engaged and customer centric workforce. The result of these factors is a business that generates high customer net promoter scores, steady market share gains and high quality financial metrics like strong organic growth and high returns on invested capital.

We would describe Ferguson is a high quality Cyclical, with a more resilient earnings and balance sheet profile than the average cyclical company. Since the GFC, management have steered the business towards the more resilient repair and remodelling end customer type, and away from the inherently volatile new construction segment. This has proven to be a prescient decision. Repair and remodelling revenues have tripled since 2008 compared with new construction revenues which are effectively flat. Repair and remodelling revenues now make up ~60% of total sales. The outcome of this should be a more stable earnings profile through the cycle.

In addition to this, Ferguson's balance sheet today is conservatively geared, with Net Debt to EBITDA of around 0.6x offering management firepower to add further independent operators into the group via M&A. Given the highly efficient operating model, acquisitions are typically highly accretive.

## Portfolio Changes

After a relatively higher period of portfolio activity during mid-2020 in which we took advantage of market dislocations caused by COVID, turnover has settled down in recent quarters and for the year to 30 June as a whole averaged around 13%.

During the quarter the Fund did establish one new position in **Royalty Pharma**, an investor in biopharmaceutical royalties.

Royalty companies are particularly suitable for this portfolio as they tend to exhibit both highly recurring cash flows and a low correlation to the broader equities market. Further, royalties from the pharmaceutical industry are highly attractive given their non-cyclical (essential nature of drug development) and counter-cyclical (greater capital needs in downturns) traits.

As observational investors one of the most powerful insights we develop comes from Pattern Recognition, recognising the signalling power from our previous experiences and learnings. We see many similarities between Royalty Pharma and another of our investments Franco Nevada, a gold royalty streaming business. Like Franco, Royalty Pharma is a founder-led business with strong alignment and focus, operating in a large and underpenetrated opportunity set with a highly compelling business model. We believe Royalty Pharma has the potential to become another world class royalty business.

Royalty Pharma was founded 25 years ago by founder and current CEO Pablo Legorreta, pioneering the industry. As a royalty investor, the company provides upfront capital to academic institutions, biotech and large cap pharmaceutical companies in exchange for a long dated income stream, attached to the sales of

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the underlying drug. They play an important role in helping to fund biopharmaceutical drug development – saving and improving the quality of patients' lives. This is particularly evident in the mid-market space, where affordable funding for early or medium-sized drug research can be difficult to obtain.

Over time the business has assembled an enviable portfolio of over 45 products, of which 21 are 'blockbusters' (US\$1bn or more in annual sales). As a partner in pharmaceutical innovation they focus their investments in only the best therapeutic areas, which they consider to be unique, life changing and with large unmet needs. Three such examples are royalties earned from (1) Vertex's cystic fibrosis franchise, the leading treatment for ~90% of CF patients (US\$6.2bn 2020 end market sales), (2) Oncology drug Imbruvica (US\$6.6bn), and (3) Gilead's HIV franchise (US\$16.9bn). Management invest in an equal proportion of approved and de-risked development-stage products. With no day-to-day operational involvement, the team focuses almost all of their attention on new opportunities.

This investment represents exposure to the large, growing and durable biopharmaceutical industry, providing financing in an environment with huge capital needs (biopharma represents >20% of total global R&D) and attractive secular trends of longer life expectancies and greater access to healthcare. They are able to participate in these strong industry trends whilst being agnostic to therapeutic area, product and marketer, only focusing in the best areas with the agility to change direction quickly. They are a founder-led company with significant skin (insider ownership of ~23%) and soul in the game, with a track record of long term capital deployment and value creation. The business model is of incredibly high financial quality with EBITDA margins of >90% and free cash flow margins of ~80%.

We believe the company could nearly double free cash flow over the next five years whilst also paying out a ~2% dividend yield, an attractive return outlook considering the shares trade on a mid-teen's multiple of earnings.

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