COOPER INVESTORS
GLOBAL EQUITIES FUND (UNHEDGED)
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.

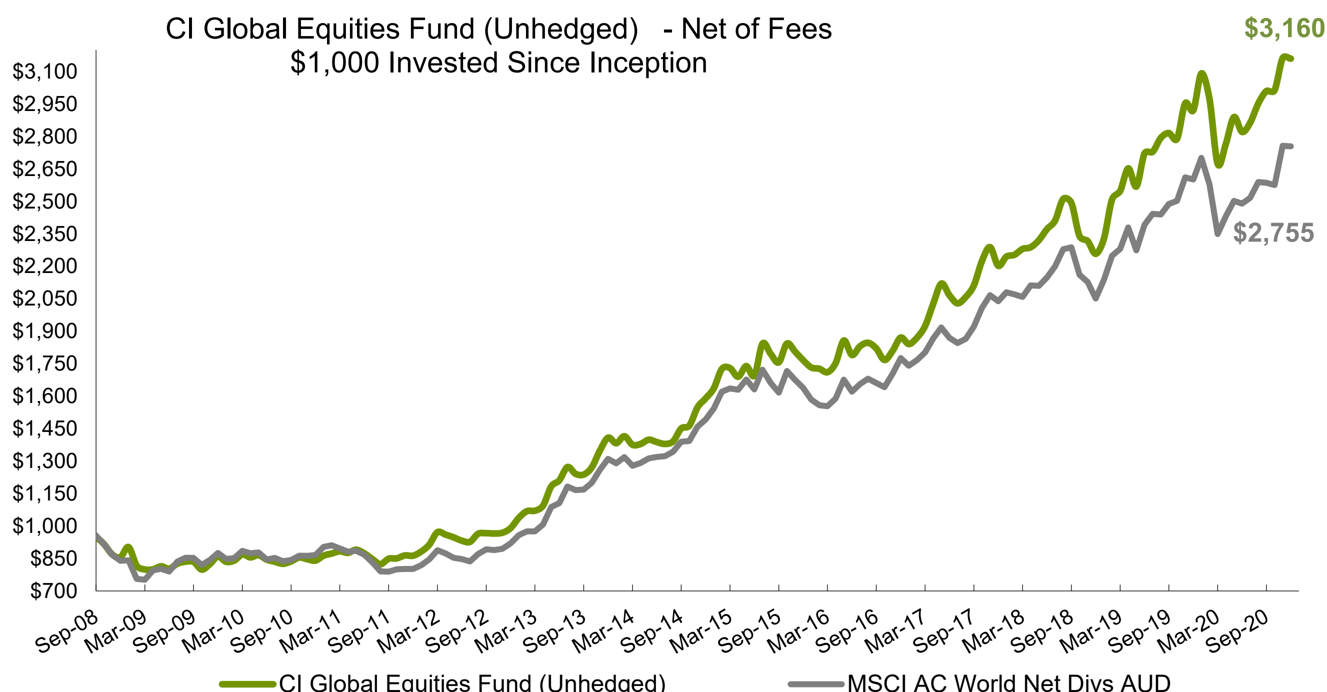
DECEMBER 2020

"Good investing requires a weird combination of patience and aggression, not many people have it." **Charlie Munger**

"I have striven not to laugh at human actions, not to weep at them, not to hate them, but to understand them." **Baruch Spinoza,** *Tractatus Politicus,* 1676

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	4.97%	6.52%	-1.55%
ROLLING 1 YEAR	8.17%	5.90%	2.27%
ROLLING 3 YEAR	12.78%	10.55%	2.23%
ROLLING 5 YEAR	12.33%	10.94%	1.39%
ROLLING 7 YEAR	12.24%	11.20%	1.04%
ROLLING 10 YEAR	14.16%	12.27%	1.89%
SINCE INCEPTION*	9.78%	8.56%	1.22%
SINCE INCEPTION^	215.99%	175.48%	40.51%

*Annualised
^Cumulative (1 September 2008).
MSCI AC World Net Divs in Australian Dollars
**Net of fees and expenses
Past performance is not necessarily a reliable indicator of future performance



Source: NAB Asset Servicing

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Market and Portfolio Performance

It was another volatile quarter to end 2020, a year which to borrow from Roosevelt, "will live in infamy".

Politically the period saw two major regional events in the West – November's victory for Joe Biden over Donald Trump in the US Presidential Election and the Brexit trade agreement between the UK and EU. In normal times either would be considered market-moving events but 2020 is far from ordinary and their impact, at least in the short term, paled into insignificance compared to November's announcement from Pfizer of the effectiveness of its coronavirus vaccine.

Companies whose stock prices had lagged heavily year to date, roughly speaking either businesses requiring face-to-face contact (physical retail, travel, transport infrastructure) or cyclical risk proxies (banks, property) saw double digit percent moves up overnight. The surge continued and by month end the S&P500 was +11%, its biggest monthly gain since 1987. European indices saw all-time record monthly moves - the French CAC40 Index gained 20% in November.

Having outperformed in October the portfolio lagged somewhat the post-vaccine market rip to finish a little behind the benchmark for the quarter, returning 4.97% versus 6.52%. For calendar year 2020 the portfolio has typically outperformed weak markets, kept up or better in up months and generally been fully invested, returning 8.17% versus the benchmark return of 5.90%.

The biggest contributors to outperformance in the quarter were **PTC** (execution of business model transition), **Sony** (underlying trends in all three key businesses remain strong) and **Paycom** (rose 35% on the back of increasing expectations of a rebound in growth).

The biggest detractors to performance included **S&P Global** and **Salesforce** (M&A events, see Stock News) and **Scout24** (pullback after a strong run with conservative guidance at the Capital Markets Day).

The Portfolio

The portfolio is positioned around Subsets of Value:

- **Stalwarts** (35% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (AON).
- **Growth companies** (38%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Costco).
- **Bond like equities** (2%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Ferrovial).
- **Low risk turnarounds** (7%) – sound businesses with good management and balance sheets. (Cerner).
- **Asset plays** (4%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (Sony Corp).
- **Cyclicals** (11%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ferguson).

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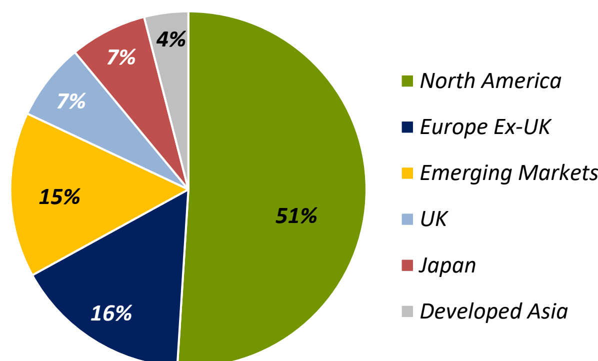
The portfolio is diversified by country and sector:

No. of Stocks	*44*
Region Weights *(by listing)*	*North America 57%* *Europe 23%* *Asia 16%*
Most OW Sectors	*Industrials, Health Care*
Most UW Sectors	*Com. Services, Materials*
Cash	*3%*

Geographical Exposure by Source of Revenues#



#Derived on a look-through basis using underlying revenue exposure of individual Fund stocks

Portfolio Changes

It was another busy period with strong markets and unusually high volatility creating opportunities to exit holdings where identifiable Value Latencies had become exhausted and redeploy capital into new positions. This quarter there were five new investments, four exits and one spin-off.

Buys

Operating mainly in Europe, UK and Canada, **Just Eat Takeaway.com** ("JET") operates market-leading online food delivery platforms which can be thought of as two-sided marketplaces that disproportionately favour larger players. On one side are consumers looking for the best selection of restaurants to order takeout. On the other side is a vast fragmented restaurant base who value the incremental orders JET's platform can offer. Food delivery is a high frequency, small ticket, impulse purchase – spending hours researching choices online when you are hungry isn't going to cut it. Putting this all together creates the conditions for a very good business for a leading platform.

JET is run by founder (and largest shareholder) Jitse Groen who in the year 2000 started the business near Amsterdam with just 100 guilders (~50 euros) and is considered one of the 'founding fathers' of online food delivery. Jitse and his management team have a track record of operational execution and disciplined capital allocation, while also investing aggressively and opportunistically when the right opportunities present themselves. This has been borne out over time and in different markets, notably in Germany where JET went from being a minnow to market leader with a focussed and aggressive strategy that was highly value accretive for shareholders.

The opportunity to buy JET occurred on the back of the announced acquisition of Grubhub ("GRUB") in the US and strong growth for logistics-led competitors (Uber & DoorDash). We view the GRUB acquisition as a sensible strategic move while providing fairly low risk optionality to grow in the underpenetrated US market. Food delivery is a hyper local business and GRUB's dominant position in several large US cities should remain very valuable, underwriting a good chunk of JET's acquisition price. Further we think the market overlooks JET's strong organic growth prospects and hard-to-replicate base of small marketplace restaurants which provide a significant ongoing profitability advantage vs logistics lead peers.

Finally and on this latter point, JET is almost unique amongst its peers in terms of financial quality. The business is already highly profitable in established markets with EBITDA margins of 30-40% across UK, Netherlands and Germany, while plenty of potential remains to grow margins in smaller but faster growing

markets like Canada. The business should do close to US$400mn of FCF in 2021 and we admire the cultural conservatism displayed in earnings quality, for example limited use of share-based payments or vouchering (which tends to boost the top line but is 'low quality growth').

The portfolio also established a position in **Warner Music Group** ("WMG"), a leading record label and music publisher. The portfolio has a long history investing in content assets across the spectrum of video, gaming and audio. Each of these content sub-segments has its own nuances and is at a different stage regarding the impact of technology on distribution and business models; video is still working through the technological impact of streaming whereas gaming is enhanced by technology which enables the creation of more immersive content.

Audio, and specifically the music industry, has transitioned through the most acute period of technological disruption with the unbundling of physical albums by both pirated and legal services occurring in the early 2000s. With the rise of streaming services like Spotify and Apple Music we now see the emergence of durable industry tailwinds. Put simply, penetration of streaming music is a compelling customer proposition and these services remain at under 10% penetration of global smart phone users today.

WMG is one of just three major suppliers of scarce IP to the rapidly growing streaming music market. Every time one of their tracks is played on a streaming platform they get paid. The relationship between the record labels and the streaming platforms remains symbiotic with both parties needing each other. We do not believe this will evolve much over the foreseeable future. Beyond streaming there are many other avenues for growth enabled by digital distribution facilitating the collection of royalty revenue, for examples Social Media (TikTok dances), Fitness (Peleton workouts) and Original Content (soundtracks in movies or games).

Management outlined a robust margin expansion plan including natural efficiencies from digital streaming taking share from physical, as well as specific productivity measures. Combined with the growth tailwinds outlined above, looking out we see a business with ~US$1bn of Free Cash Flow power annually or roughly triple the amount generated in FY20. This provides the base for a double digit annual return to shareholders.

Workday ("WDAY") is the Cloud leader in Human Capital Management (HCM) and Financials software. We first met WDAY 7 years ago as a much smaller enterprise but today it's on the verge of reporting ~US$4bn in revenues. WDAY has had great success in its HCM offering particularly with the world's largest companies. However its Financials product has seen more muted growth with customers reluctant to shift such a core function to the Cloud, success here tending to be in the mid-market. Financials comprise only 20% of company revenues today but with the pandemic forcing remote work and benefits, and reliability of Cloud applications becoming clear WDAY's Financials solutions appear ripe for mainstream adoption.

For all WDAY's success and averaging over 35% p.a. sales growth the share has barely outperformed the S&P500 since early 2014 as its sales multiple declined from 26x to 10x. WDAY now trades on a more reasonable but still elevated FCF multiple of 43x. However on our view of normalised margins this multiple of FCF would be even lower, below 30x. The nature of the accounting for SAAS (Software-as-a-Service) businesses is that most growth investment goes through the income statement in R&D or Sales and Marketing, versus capex for a typical industrial business. So growth investment tends to depress reported earnings. WDAY is investing to grow its top line 20-25% and if they were to slowdown and grow in line with the market (around 10%) we would expect to see a typical 30%+ software margin, up from the 17% reported margin today. WDAY is led by its founders who own 25% of the company - Chairman David Duffield is an industry pioneer previously founding Peoplesoft (eventually acquired by Oracle) while CEO Aneel Bhusri was Vice Chairman of Peoplesoft.

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Notwithstanding the level of media and investor attention paid to Corporate Governance reform in Japan it is our view that fundamental revivals in Focused Management Behaviour from unfocused to exhibiting strong elements of Proprietorial behaviour are exceedingly rare. We see portfolio holding Sony as one such example but find the majority of reforms more about making less value destructive decisions than more value accretive ones. So our attention was triggered when we observed successive decisions taken by **Olympus** management this year, including divesting their Imaging business and numerous bolt-on M&A transactions that appeared to signal something deep had taken root.

Olympus's core asset today is their gastrointestinal Endoscope business, a leading global Medtech business with a 70% market share, attractive economics and a moderate growth outlook. The quality of this asset was proven in its strong performance during the years of crisis.

The company has traversed the "hubris-to-humility" cycle, suffering a cathartic event during the 2011 accounting scandal which led to the removal of the Board and Senior Management. In the intervening years Olympus made significant progress in addressing their governance structure but not in increasing management focus, evident during our meetings with the company on previous research visits. But the appointment of Yasuo Takeuchi as CEO in April 2019 (along with influence from activist investor ValueAct) has changed this. Takeuchi-san has spent his entire career at Olympus but crucially the majority of that was outside Japan and outside the powerful engineering clique – similar to the situation we observed at Sony (insiders with an outsider's mentality). This has enabled Takeuchi-san to take on internal vested interests and commit to the transformation plan.

Given the authentic changes we see underway Olympus today represents a Low Risk Turnaround with a very high quality core business underwriting latencies from an improving cost structure and growth in the Therapeutic Division and we initiated a position this quarter.

We first met with **Cosmos Pharmaceutical** ("Cosmos") in December 2019 at their HQ in Fukuoka, southern Japan. As the senior executive described the company's history, culture and business model we were immediately struck by the strong signals of proprietorial management behaviour in his language. Following additional research throughout 2020 we initiated a position this quarter.

Cosmos operates drug stores in suburban Japan but unlike peers they derive no sales from dispensing pharmaceuticals – they this consider a poor allocation of selling space due to government regulations which limit turnover. Instead Cosmos generate 60% of sales from food (sold at a lower price than local supermarkets and drug stores) and the rest from "daily necessities" including health and personal care products (HPC). The low prices on food (sold at low margins) attracts customers with profits then generated from higher margin HPC products.

This model has thrived in Cosmos' home Kyushu region, which is known as the most price competitive retail market in Japan, making it an excellent proving ground for low cost retail models. Today Cosmos has around 55% of their stores in Kyushu which represents less than 15% of Japan's population. Thus we see significant latency in the store roll out strategy, including in larger prefectures of Kanto, Kansai and Chubu.

Cosmos is a Founder-led Company, with Founder and Chairman Masateru Uno maintaining around a 50% stake in the company. We see Cosmos as having attractive Stalwart characteristics with very stable cash flows underwritten by the resilient nature of food and HPC demand, a strong competitive position and a significant and steady runway for store growth.

Sells

During the quarter the portfolio exited its position in **Comcast**, a long term holding having been in the portfolio since 2013. We were attracted to Comcast's high quality cable assets which we view as unique communication infrastructure that continues to perform well as it serves the persistent demand for high speed broadband. However the outlook for their media and content assets in NBCU and Sky has become increasingly uncertain while remaining a key area of management focus and capital allocation. This clouded view on industry trends led us to seek more attractive investment propositions elsewhere.

Estee Lauder and **Paycom** were sold with both businesses experiencing very significant share price appreciation in a short period. We bought both these great companies earlier in 2020, however Value Latencies appear exhausted - to highlight this point Estee Lauder now trades on 45x Free Cash Flow and Paycom trades on 27x Sales.

The portfolio sold its small position in **Bentley Systems**. Since participating in the company's float in September, Bentley's share price has increased ~75% from the initial offer price. This appreciation in the share price has exhausted what Value Latencies we had identified. As a family-led company selling mission critical software there is still much to like about Bentley and it remains a closely followed Watchlist stock.

Stock News

In October **Fortive** ("FTV") spun out **Vontier** as a standalone listed entity. FTV itself was spun out of **Danaher** ("DHR"), another portfolio holding over 4 years ago as a portfolio of DHR's legacy industrial assets. The Rales brothers (who founded DHR and remain on the board) went across to FTV as directors and continue to be sizeable shareholders. Since separating in 2016 FTV had already sold a sizeable chunk of lower growth industrial businesses and Vontier was the final step in streamlining its portfolio.

New FTV is a smaller and more focused US$4.5bn revenue company in testing, safety, healthcare and software with 20% margins. With the spin they've increased exposure to faster growing businesses with sizeable margin potential. M&A has been a hallmark of the Rales brothers' businesses and with FTV back to a very strong balance sheet the company is ideally placed to capitalise on any investment and acquisition opportunities. Following the spin to FTV shareholders, the portfolio increased the position in Vontier.

Vontier is a collection of good industrial businesses largely focused on transportation and mobility end markets. However, they were not a focus area for growth at FTV. The largest businesses include Gilbarco Veeder Root in fuel retailing and Matco in automotive tools. The businesses inside Vontier are long time DHR/FTV operations and as such are well run and with established competitive positions. The company has $2.8bn of revenues with 20% EBIT margins and Free Cash Flow greater than accounting profits. Yet there remain many areas of upside given the small relevance and lack of attention previously inside FTV and DHR. We are often attracted to spin-offs due to this dynamic – solid businesses set to reap benefits of the "focus dividend" from being a standalone company. At spin the company was trading on ~10x Free Cash Flow. A key area of opportunity will be how management spend the excess cash on acquisitions and continue evolving the portfolio for a 21st century industrial technology business.

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During the quarter two portfolio holdings announced large acquisitions. **S&P Global** ["SPGI"] announced the acquisition of IHS Markit and **Salesforce** announced the acquisition of Slack.

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Both deals are somewhat contentious but for different reasons. With IHS Markit SPGI are acquiring a business roughly half their size in market cap terms. Salesforce on the other hand is only spending ~12% of its market cap on Slack but the price looks high. In our experience companies announcing sizeable deals often enter a sort of "deal purgatory" and over time prove out (or otherwise) the deal's merits, thus SPGI was down 11% for the quarter and Salesforce fell 12%. We prefer to see our companies do smaller deals but the reality is that over our history several portfolio holdings have elected to make significant acquisitions.

Some proved to be masterstrokes like IMS Health's acquisition of Quintiles (subsequently became IQVIA) or Danaher's acquisitions of Pall Corp and GE Biopharma. Others have proven to be strategic errors - we sold Unibail-Rodamco after its acquisition of Westfield (our view was this would be dilutive to Unibail's high quality European portfolio) and similarly exited Reckitt Benckiser after they bought Mead Johnson. For S&P Global and Salesforce, our assessment is that while the deals don't represent significant new sources of value latency both are very much within their wheelhouse and area of expertise. This materially reduces the risk of value destruction and enhances the likelihood of upside down the line with further revenue opportunities and cost synergies.

Salesforce is paying US$25bn for Slack, the collaborative tools provider. When the portfolio bought Salesforce in Q2 we identified a business that had been performing strongly operationally yet its share price was lagging SAAS peers due to many investor's negative view on the 2019 acquisition of Tableau. We felt these concerns were unfounded and saw Salesforce as very well placed with Cloud adoption accelerating with the pandemic and shift to remote working.

Management commentary had been focused on delivering on organic growth and margin opportunities. Salesforce has been built through savvy acquisitions, so whilst we knew acquisitions would continue we definitely were surprised with the size of the Slack deal. Yet we also understand management's position that Slack is a unique asset - time will tell whether it's a good deal or not.

The value latency in Salesforce is similar to that previously described in Workday. Salesforce is investing heavily to grow revenues at nearly double the market growth rate. The ramifications are that margins of 18% are below the typical levels for a US$20bn revenue enterprise software company. The company spends nearly 40% of revenue on sales & marketing, a high level. Plus any acquisition is typically dilutive to margins in the near term and temporarily stunts the organic margin expansion that is occurring. If they decided to slow their growth, margin expansion would follow - as such we see the company trading on below 25x FCF. In the meantime we believe organic investments are generating attractive returns. Management need to continue executing on the growth, margins and cash flows at this important time post a larger deal. Shareholders also need to be patient as Salesforce execute but the stock offers value latency in the SAAS space where the average company trades on nearly ~20x sales.

SPGI's acquisition of IHS Markit is in some ways a step-out for management. CEO Doug Peterson and the management team have done a wonderful job operationally – since taking on the role in 2013 Earnings per Share have grown at high teens CAGR and shareholders have enjoyed a 22% annualised total shareholder return. Acquisitions have not been a material driver of success though there have been some small clever deals along the way. At US$44bn in size (vs SPGI market cap of ~US$80bn) the acquisition of IHS Markit represents a significant move.

Whilst the risks of large acquisitions should not be discounted, the industrial logic here is sound – consolidation of data assets remains a strong theme and we have observed this across our portfolio and watchlist. The sources of the nearly US$700mn in synergies are uncontroversial – cost savings via leveraging the "tech stack" (ingestion, organising and distribution of data) and revenue synergies from cross-selling into each other's customers and combining data sets to create new products – for example

SPGI's ESG scores and IHS Markit's emissions data. Further the funding of the deal with scrip (SPGI trading at a record earnings multiple) and the modest premium (<5% to pre-deal price) also mitigate some of the risks.

In summary we do not believe the deal will destroy value for SPGI shareholders. Based on the stated synergies the upside does not appear to be significant either. However, as SPGI shareholders for over five years and having observed this management team closely we would not discount them outperforming synergy targets.

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