NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Global Equity Fund

Quarter One, 2020

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Portfolio Manager Commentary

Before our typical discussion, we wanted to acknowledge the serious nature of the Coronavirus pandemic. The impact of the virus is far more wide-reaching than its economic damage as it very sadly has a tangible human cost. Our thoughts are with those who are suffering or who have lost loved ones to this virus and with the many who are working hard to treat and care for the growing numbers of patients of this disease.

A Black Swan Event

Over the past few years, our analysis has indicated that equities as a whole have been somewhat expensive, driven to such valuations by monetary and fiscal policy makers. As a consequence of this, it had become increasingly difficult to identify quality companies that were available to invest in at levels commensurate with earning an attractive rate of return over the subsequent 5 years or so. Occasionally, opportunities would present themselves to us either in the form of individual companies facing a short-term issue or due to a wider decline in markets (such as Q4 2018) which then allowed us to deploy capital. However, despite these opportunities cash has remained at relatively elevated levels for much of the recent few years. The emergence of a global pandemic in Coronavirus has led to a major decline in all equity markets as economic activity has come to a standstill. Many shares have declined 25 – 40% with seemingly little differentiation between companies and sectors as investors have tried to come to terms with the implication for earnings, cash flows and balance sheets. The short-term (c.12 month) outcome is at present unknown and unknowable which is one of the reasons the sell-off has been so severe – there is nothing investors hate more than uncertainty.

At Veritas, we believe we have one major advantage in times like these: our long-term investment horizon. We have no special insight into how the virus will develop, whether there will be a material “rebound” in those countries where the virus has largely been eliminated or if it will recur in the Autumn / Winter. However, we can make some assumptions that look further out than the near term – looking out to a period when treatment of the virus is more successful (either due to the development of a vaccine or the widespread use of drugs that treat the symptoms of the virus better) and economic activity has returned to something more like normal. This long-term outlook then allows us to identify companies that we believe have been unfairly penalised in the short-term declines: companies with market leading positions, strong balance sheets and frequently essential products or services. In short, enduring companies with strong competitive advantages whose share prices have declined with all other companies in the knee jerk reaction to such an exogenous event.

We have approached investing in these companies using two scenarios: a base case and a more bearish case. The base case assumes that the global trajectory of the virus broadly follows the experience in China and South Korea. In these countries, somewhere between 40 and 60 days after lockdowns were imposed, the virus was in retreat with very few new cases. Good contact tracing then led to new cases (and their contacts) being rapidly isolated preventing significant further spread. Under this scenario the first half of 2020 sees limited economic activity due to wide lockdowns being imposed but the second half of 2020 starts to see a recovery, albeit uneven as localised breakouts of the virus lead to further (localised) lockdowns. The more bearish case assumes that the rest of the world do not contain the virus as well as China and South Korea (post lockdown) and consequently the virus remains circulating in the population for much longer, leading to longer (but more ineffective) lockdowns. In this scenario the second half of 2020 also sees limited economic activity with a slower recovery expected in 2021 (again with the expectation that the virus resurfaces during 2021). In either scenario, policy makers use all the tools available to them to accelerate any recovery once it begins.

Having developed our two scenarios, we then mined our list of quality companies for those we believe are likely to be least impacted in the medium to longer term. These are typically those in more stable industries and / or where the structural demand for their product or service is likely to remain strong over the medium term. We then set a range of entry prices for these companies with initial entry points (for smaller positions) set using our base case and scaling the position size up at lower and lower entry points until we would have a full position at our more bearish scenario. Following this process has led to cash declining substantially over the last two weeks of the quarter as we have managed to find attractive investments in quality companies at prices between our base case and our bear case. It may be that these share prices decline further from the prices that we invested but we feel confident looking out over a five-year horizon that the returns from these investments will be attractive.

The companies we have made new investments in include Mastercard, Cochlear, Becton Dickinson, Abbott Laboratories and Alibaba. In addition to these new investments, we have also increased our investment in a number of existing holdings where the share price declines have been outsized compared with our analysis of the long-term earnings prospects of those businesses and therefore believe that the current share price is giving us an opportunity to earn an outsized return.

Mastercard
We have long believed that the card networks are among the best business models in the world. Along with Visa, Mastercard operates in a powerful global duopoly and is the prime beneficiary of strong continued structural growth in global payments, thanks to cash moving to cards and electronic payments. It has a very attractive business model thanks to high barriers to entry; strong operating leverage; low capital intensity and a strong financial position. Furthermore, Mastercard carries no credit risk and has pricing power because the bulk of its revenues stem from network fees that are just a small part of the overall cost of processing payments for merchants.

Card networks are scarce but essential for the criss-crossing of card and electronic payments and, being the rails that are critical for these payments, Mastercard has solid and resilient prospects for many years to come. Secular growth is underwritten thanks to a large and growing addressable market, where card penetration is still under 50%, even for consumer payments for goods and services. Strong growth in e-commerce is driving penetration faster still. Being right at the centre of the payment infrastructure means that the card schemes, such as Mastercard, are the prime beneficiaries of these positive secular trends. By way of example, PayPal is the leading e-commerce payment operator but does not own any actual bilateral payment infrastructure and therefore must pay Mastercard a toll to run payments across the Mastercard network.

Although we believe the long-term future of Mastercard is secure, the company is facing near-term headwinds, thanks to the negative impact of COVID-19 lockdowns on spending volumes. In light of this, Mastercard has abandoned its earnings guidance for 2020. However, Mastercard has proved highly resilient in the past and we believe long-term secular support continues. Back in the GFC, Mastercard still managed to grow revenues even with declines in both US consumer spending and retail sales, as well as a stalling of growth in cross-border payments. This was because card payments displaced cash and Mastercard also raised network fees. Growing e-commerce is just making Mastercard more durable. Furthermore, Mastercard has operational flexibility and during the last crisis was able to reduce costs, increase its margin and continue to compound earnings strongly – and we believe Mastercard is good for its pledge to ramp up cost savings now.

We believe the recent decline in the share price of Mastercard started to discount woeful expectations for growth and we took the opportunity to exploit this. Based on highly stressed assumptions for the near term - we believe we secured an expected IRR of +15%. Despite the near-term headwinds, we expect continued structural tailwinds. In the meanwhile, the financial position of Mastercard is pristine with little debt and strong cash generation.

Cochlear
We have long appreciated that Cochlear is a high-quality company, being the market developer and leader in a growth market, with very high barriers to entry and pricing power, and earning a five-year average ROIC of 25% (2015-2019). Cochlear Limited is the market leading manufacturer of inner ear (or cochlea) implants, which convey an electrical representation of sound to the brain of those with profound deafness. It is a life-altering treatment, offering a place in the hearing world to those born deaf or those who have lost their hearing through age, illness or injury. There is no medical alternative for the profoundly deaf.

Cochlear is a company we know well, having owned shares in the past, selling only as we felt the valuation had become too stretched. The company has remained closely followed on our universe list in the hope that we would have an opportunity to reinvest at an attractive valuation. The impacts of the global coronavirus pandemic on elective medical procedures, coupled with a simultaneous unexpected patent litigation case loss in the US have given us this opportunity at an attractive IRR (>15%) in a company that for so long has been very highly valued.

While developed countries have embraced this technology for infants and children with hearing loss, penetration of cochlear implants remains very low in emerging markets as health systems begin to adopt reimbursement systems to allow children access to this technology. Another major opportunity remains in the adult market, where global penetration of cochlear implants remains very low, despite adequate reimbursement in major markets. However, awareness of the technology is growing, as is an understanding life expectancy is increasing and thus coping with hearing loss may otherwise be a multi-decade battle. Further, the correlation between hearing loss and onset of dementia is also generating much research interest and may in time expand access and awareness of cochlear implants.

Abbott Laboratories
Abbott Laboratories is a global healthcare products company with leading positions across diagnostics, nutrition, cardiovascular devices, diabetes care and established pharmaceuticals with sales of $32bn in 2019. These franchises benefit from Abbott's trusted brand, intellectual property, strong customer relationships and Abbott's global scale. Abbott is also well diversified by geography with a presence in more than 160 countries. 40% of sales are derived from a variety of emerging markets positioning Abbott to benefit from more rapidly growing demand for healthcare in these markets.

Despite Abbott's size and diversity, we believe the company can deliver high single digit organic sales growth in the coming years driven by several nascent but potentially significant markets where Abbott is amongst the leaders. We see the largest opportunity in continuous glucose monitoring (CGM) replacing traditional finger prick testing to become the standard of care for insulin using diabetics. Since launch in 2014 Abbott's Freestyle Libre has quickly grown to become the market leading CGM thanks to ease of use and a disruptive price point - approximately half that of competitive systems. Given Abbott's fully automated, scale manufacturing it is unlikely any of their peers will be able to match their pricing over the next four to five years and Abbott's cost position will continue to improve with scale. There are 425m diabetics globally today and their numbers are expected to swell to 629m by 2045 according to the international diabetes federation. Almost two million patients used Libre in 2019, around 2/3rds of all CGM users, generating sales of $1.8bn. Abbott's initial target is the c.40m insulin using diabetics in the 50 markets Libre is approved. If long run CGM penetration of insulin using diabetics reaches 75%, Libre price falls to c.$800 per year from $1,100 currently and Abbott can capture 1/3rd of the market. Libre sales could reach $8bn at high profitability.

There undoubtedly will be some disruption to Abbott's business in the short term as a result of COVID-19 likely reducing the demand for certain medical procedures and diagnostic tests but with its diverse collection of highly cash generative businesses and strong balance sheet Abbott will be able to manage through these headwinds. Cardiovascular procedures can only be delayed for a short time and Abbott may even benefit in the long run from increased levels of diagnostic testing. At our entry price the shares were valued at a 4.2% free cash flow yield and we estimate a c.15% IRR over our investment horizon.

Alibaba
Alibaba is China's largest technology company and is most analogous to Amazon in terms of business model. It currently has a 65% market share in the structurally growing Chinese e-commerce market (28% compound annual growth over the past five years) where it generates high returns (70% operating margins) but which we believe have room for further improvement. The company is also reinvesting into other areas where there could be significant value creation: AliCloud is the largest Chinese public cloud provider; Lazada, a leading player in the nascent South East Asia online retail markets; and, its large minority stake in Ant Financial, which is a significant financial services business (including payments platform Alipay).

The opportunity to invest has been driven by a year of external issues for Alibaba. Firstly, there was pressure from US/China trade tensions and latterly the COVID-19 outbreak in Hubei province. We have no differentiated insight into the success or failure of Chinese policies to stem the COVID pandemic. However, we believe Alibaba's competitive position and demand should improve, through the crisis for two reasons: firstly the crisis has spurred an increase in online demand for areas that are relatively underpenetrated in China (73% of the food retail remained in wet markets in 2016); and secondly, Alibaba has used its financial strength to maintain investments and provide support, including waiving some fees, to retailers during the stress where others have not been able to. Overall, Alibaba continues to have a strong core franchise in structurally growing markets and leading positions in a number of nascent opportunities which should generate value over time. The recent exogenous factors have allowed us to initiate a position at a prospective 20% five-year IRR which appears compelling given the competitive position and growth opportunities of the company.

Becton Dickinson

Becton Dickinson (BD) is a global provider of essential medical products used by healthcare providers on a daily basis, touching an estimated 90% of patients entering the healthcare system. Their products span the continuum of care from discovery and diagnosis, to the process of care and treatment of disease. Thanks to their unrivalled manufacturing scale BD are the low-cost producer of disposable medical devices such as syringes, needles, flush sets, intravenous catheters, blood collection sets and other related accessories. BD manufacture over 40 billion disposable medical devices a year and are the largest moulder of plastic parts in the world. These high-quality disposable devices also benefit from differentiated features like needle stick injury prevention. BD also enjoy a large and growing installed base of diagnostic instruments and medical equipment that generate recurring consumable revenue. They are increasingly incorporating digitally enabled services to provide additional value to their hospital customers and further entrench their position. All told, around 85% of BD's revenues are recurring in nature.

In addition to COVID-19 related market weakness BD's share price has been impacted by the recall of their Alaris infusion pump announced with their first quarter results. BD will be unable to sell the Alaris pump in the US until they complete a new regulatory filing incorporating a number of changes made to the Alaris software to correct for several errors. While it may take a year or more to return Alaris to market we see this issue as resolvable and expect BD to only experience modest infusion pump share loss. They are the dominant market leader in the US, with a market share of around 70%. The typical pump replacement cycle is about 7 years and BD should be able to persuade a large portion of their customers due to upgrade to wait for Alaris to return to the market given their dominant position and the need for nurses and other users to retrain if the hospital were to buy pumps from a different manufacturer.

Like all other companies BD will be impacted by COVID-19 but given the essential nature of their products we don't expect any impact on long term demand. We see a path for BD to return to mid-single digit sales growth driven by continued product innovation, expansion into adjacencies and increased penetration of their products in emerging markets. With modest margin expansion and the benefits of capital deployment BD should be able to compound earnings, free cashflow and dividends at a double-digit rate. At our entry price the shares offered an estimated 15% IRR over our investment horizon and were valued at a 5% free cash flow yield.

Longer term perspective

While it is understandable for investors to feel nervous in these extraordinary times, history shows that at some point, economics and markets recover. For investors, the "known, unknown" at this point is how long the pandemic will last and what the short- and long-term economic impact will be. Despite the pandemic induced decline in global equity markets, long term returns are still positive.

Operations

At Veritas, staff safety is paramount. Consequently, as the extent of COVID-19 became apparent in mid-March we implemented our business continuity plan with all staff members now working remotely. This transition has occurred smoothly and while methods of communication have had to change the business is operating very much as normal.

We hope that all our investors are keeping safe and well in this difficult time.

Attribution commentary

The portfolio outperformed the index over the quarter. While it was undoubtedly one of the most challenging quarters, the underlying picture as to which stocks contributed and those that detracted from relative performance, was a simple one. In short, the main detractors were the aerospace related companies whose fortunes are tied to the airline industry whereas the key contributors were found in areas related to increased online activity, consumer related goods such as food and cleaning products and healthcare companies providing critical products/services. As COVID-19 took hold the airlines around the globe increasingly grounded their services. The situation was summed up in a BA memo to staff on 13 March entitled 'The survival of British Airways' and spoke of 'a crisis of global proportions like no other we have known'. First off, it's worth putting the holdings in the portfolio into context. On behalf of clients, we only hold Tier 1 aerospace companies (Airbus, Safran, Raytheon/UTC) which have higher entry barriers and more resilient business models along with well-capitalised balance sheets. The threat and risk posed by COVID-19 has been one of severe liquidity, not solvency. This is an important contextual nuance. However, for airlines (who are the customers), the threat is both liquidity and, in some cases, solvency (high fixed costs, decremental margins and poorer balance sheets even in the event of a 'normal' downturn).

The Tier 1 suppliers have demonstrated resilience through multiple cycles and setbacks (9/11 attacks, SARS, the Global Financial Crisis (GFC), Eurozone crisis). China is where the coronavirus originated and there are signs that there is a slow recovery underway (corroborated by several US and European companies across multiple industries – aerospace suppliers (domestic traffic recovering first though international travel will recover with a significant lag given global case count is still not under control), consumer facing businesses and industrials like auto and early-cycle capital goods). According to OAG, a travel data firm, the number of grounded Chinese carriers has improved from 70% of flights to close to 40% of flights. Government support is something which should also be considered – liquidity, short term bridge financing as well as ability to furlough employees (with a government backstop) – all help companies tide over the crisis. In general, we expect all of our invested companies to be able to withstand and manage through the short-term crisis.

Airbus had a net cash balance sheet (pre COVID-19) and while there were certain one-off cash outflows (penalties/settlements and pensions) we were expecting for 2020, the company remains in a position of withstanding current pressures with €30bn of available liquidity (compares to €12.5bn of net cash in 2019) and support their customers and suppliers when prudent.

In 2020, estimated c.11.4bn of the c17.4bn of gross cash is unspent customer advances which are a source of liquidity. Airbus recently announced a new €15bn credit facility, withdrawal of the dividend for 2019 (to be paid in 2020) of €1.4bn (which we think is a prudent and sensible action), suspending top-up pension funding as well as cost actions and operational measures where possible. They are also likely going to be eligible for central bank commercial paper borrowings from the ECB. A proportion of Airbus's net cash is customer pre-payments, but Airbus's commercial aircraft backlog is overwhelmingly in the narrow-body segment (80%+) which has a long order book (and lower risk of cancellations, though some are inevitable). Temporarily, the grounding of their key competitor's aircraft (Boeing's 737Max) should provide more flexibility as well to reshuffle delivery slots for customers. Airbus operate what they call 'watch tower' lists where customers are able to change their place in the delivery queue. This is important as some airlines suffered after the GFC when they cancelled orders in rejoining at the end of a long list. In short, we believe management are doing all the right things to deal with the crisis at hand and over our time horizon (5 years+), the more favourable their prospects.

Safran has modest net debt on the balance sheet (pre COVID-19) to the tune of €4.1bn (or €9.5/share). They ended the year with €2.6bn of cash and have also withdrawn the dividend meaning an extra €1bn of cash flow has been saved.

Safran is a sole source supplier for the 737Max engines (LEAP 1B) which have been grounded. Safran had previously managed to negotiate cash inflows for maintaining production at a minimum viable rate but given the liquidity challenges at Boeing, this may be at risk. However, it is also likely that Boeing (like Airbus) are able to tap into liquidity pools. Safran remains one of the most important suppliers to Boeing and we would expect them to be able to manage through this. Whilst this has not been announced, we would expect Safran to be able to access credit/bridge financing over the short term as well as any agreements negotiated by their airframe customers (Airbus and Boeing, both of whom consider Safran as a key Tier 1 supplier).

Our thesis on **Raytheon** is a special situation which was catalysed by their announced merger with United Technologies' (UTC) aerospace business (after UTC itself would spin off their Otis and Carrier assets). We expect the combined Raytheon + UTC Aerospace to be a formidable player in the space with high barriers to entry throughout and an improving margin profile based on the increased production rates across their commercial aerospace programs. We expect the combined company to have significant 65%+ recurring revenues on a steady-state basis. Raytheon standalone has very little leverage (<0.5x) – however, UTC Aerospace does carry higher than average leverage (c3.4x) and pro-forma for the combination we expected 2020e net debt/EBITDA to be c2.2x.

Raytheon Technologies (the combined company) will be a Tier 1 supplier with key positions across a wide variety of aerospace and defense programs. We think the reason RTN (Raytheon standalone) has under-performed more markedly than one would expect is because of this 'tethering' to UTC Aerospace. Raytheon Technologies however had recently issued $17bn of debt which allows for significant liquidity cushion and we think the business model is valuable, viable and resilient long term once we pass this phase of acute stress for global aviation. In terms of longer-term implications for the industry, the near-synchronized forced shutdown of global travel is unprecedented (all previous downturns have been either localized or a slow-down (not a shut-down)). It is highly likely that airlines re-think their resilience and business models – this could include a focus on balance sheet strength (impacts airline capacity as this would mean lower cap-ex and lower demand for aircraft), revisiting leased vs. owned aircraft (impacts airframers), revisiting pay by hour vs. time and materials arrangements (engine suppliers) and so on. While we are not expecting a wholesale shift to the business models of the aerospace companies we hold, it is reasonable to expect several changes at the margin (which will have to be managed through). Underpinning the quality thesis of our holdings is also 'barriers to entry' – aerospace has one of the highest barriers to entry in any industry globally and if anything, these barriers are being raised by current events.

A key assumption that we are underwriting despite the short term and global health issues posed by COVID-19 is that air travel is an essential service for which there is no substitute and that five and ten years from now, commercial aviation will continue to grow secularly ('longevity').

Related to Aerospace, **Aena**, the Spanish airport operator, has clearly been impacted by the grounding of flights and air and passenger traffic passing through its various airports. Aena has debt level of c.€5.6bn of which €634 comes due in 2020 and a further €546m in 2021. Covenants on the debt are for ND / EBITDA to be below 7x. Current ND / EBITDA is c.3x so there is a long way to go before breaching covenants. In a normal environment, Aena generates c.1bn of Free Cash Flow annually and this is then almost all distributed by way of dividend. Given Aena is a regulated utility (Airports) which is 51% owned by the Spanish Government, we believe that it would be able to access additional borrowing. The company also has a €1.2bn credit facility available. The next regulatory period runs from 2022 and so if traffic declines are sustained the company will be allowed to increase landing charges.

Away from aerospace, the outsourcing company, **Capita**, was a detractor. The company, which carries out outsourcing services ranging from overseeing the London congestion charge, to managing public services for the Department for Work and Pensions and private companies such as Co-Operative Bank and Southern Water, reported a drop-in revenue and profits and adjusted their free cash flow guidance for 2020 from £200m to £160m.
Clearly the fact that it has now had to 'furlough' (temporarily lay off) a number of its 40,000 employees under the UK Government Scheme and suspend a number of its businesses (face to face training, contract centres

for retail and leisure clients, corporate travel agency) does not help sentiment. The company does have £450m cash liquidity and able to service debts, the order book to December 2019 is £6.7bn and one of its businesses is helping the government response to COVID-19 outbreak by contributing resource to healthcare call centres. The company is cutting central overhead costs, closing a number of UK offices and temporarily cutting senior management salaries by a 'significant amount'. The position had been halved last year on a strong rise in the share price leaving a very small holding, but the anticipated turnaround of the business is going to take longer.

On a relative basis, the two stocks **Amazon** and **Microsoft** show up as negative contributors, but this is by virtue of being underweight. Microsoft was sold out in the earlier part of the quarter so the weighted average holding over the three months was lower than the index weight. In the case of Amazon, we attempted to buy the stock during the market falls in March but only achieved a very small holding at entry point. So, again the weighting is less than the index and as Amazon outperformed, it's a relative drag.

Turning to the positive contributors, we start with **Charter Communications**. What is the one thing people need if cooped up at home for what may be weeks? A lightning fast broadband connection to help watch all the streaming media and game content. Charter is the second largest cable company in the US and the largest 'pure-play' broadband and cable operator without any large content investments. While the cable bundle has been under pressure from cord-cutting, the needs for high-speed broadband has been surging, and broadband is much higher margin to cable-operators. Charter has also been buying back huge amounts of its own stock, as management has foregone dividends for 100% buybacks. Since September 2016, Charter has repurchased an impressive 25% of its own shares outstanding. Charter has also increased its debt load over the years to do so. The company has given itself a net leverage of 4.5 times its EBITDA (earnings before interest, taxes, depreciation and amortisation). As the company's EBITDA has grown in recent years, so has its debt pile, which stands at over $78bn, keeping the company's leverage ratio just below 4.5x.

Nevertheless, Charter operates a very steady, almost utility-like business providing broadband and cable against no or one competitor in most areas, which allows for high levels of debt given the level of free cash flow it generates. Its results are unlikely to be significantly affected by COVID-19 but as interest rates have been cut in response to the virus, Charter can refinance some of its debt with lower-rate notes. Charter has been fairly consistent with its share repurchases, buying back stock each quarter as the stock increased over the past twelve months. The lower share price means Charter will be able to retire more shares from its buyback program, which sets the stock up nicely for potential future gains.

One of the platforms that has seen a significant increase in usage over the last quarter is YouTube, owned by **Alphabet**, and a relative contributor over the quarter. Alphabet is in an extremely strong position with $120bn in cash and only $4bn in debt. It could choose to buy back shares or make acquisitions at a time when the purchasing power of its cash will have increased. There clearly will have been some pull back in advertising revenue (last year $135bn of its $162bn revenue came from advertising) but given the dominance of its search engine (which held close to 92% of all worldwide search market share at the beginning of 2020) at a time when consumers are stuck at home utilising the internet, Alphabet's advertising platforms will continue to play a role and may even see an increase from some sectors. The demand for exercise equipment has gone through the roof and with it advertising for home friendly equipment. Alphabet has faster growing operating segments than search in Google Cloud (revenue doubled to $9bn between 2017 and 2019) and YouTube ad revenue (revenue up 86% over the last two years).

Within the healthcare positions held within the portfolio, investors will recall that our underlying theme is one of progression to more value based healthcare i.e. governments trying to reduce healthcare spend and that backdrop being a headwind for those companies that rely on increasing cash flow by increasing drug prices and a tailwind for those companies that help reduce healthcare costs or provide critical devices or services. The Portfolio Manager essay above explains how we have taken the opportunity to buy more of these businesses in the form of Cochlear, Abbot Laboratories and Becton Dickinson.

Over the first quarter, **Baxter International** was a contributor to performance (as was Cochlear given the uplift in price from the placing). Baxter International primarily focuses on products to treat haemophilia, kidney disease, immune disorders and other chronic and acute medical conditions. It is, for example, the leading manufacturer of products for general anaesthesia and one of the leaders in manufacturing of commercially prepared IV solutions. Chronic kidney disease (CKD) is an urgent and growing global challenge.
There are 4 million end-stage renal disease (ESRD) patients globally and millions more go undiagnosed. The condition is growing at 4-5% per annum as type 2 diabetes becomes more prevalent. Amongst Baxter's offerings, they provide home renal therapies which are widely regarded as positive for both patient and healthcare practitioner. The renal business remains stable currently but clearly any pull back in demand will be short lived given the critical nature. Baxter is seeing demand of IV solutions, antibiotics and diagnostics increase. The company reported during the quarter and saw worldwide revenue increase by 7%, ahead of expectations, but also increases across all its major segments. The company also issued strong guidance for Q1 of 2020.

The other sector that, probably unsurprisingly, offered contributors over the quarter, was Consumer Staples with Nestlé and **Reckitt Benckiser**, the best performers. Approximately, 25% of Reckitt Benckiser's business is health and hygiene brands that include Dettol and Lysol disinfectants which along with over the counter throat and chest medications like Mucinix and Strepsils have seen significant increased demand. The company has increased its direct to consumer business, which now represents 10% of the business with a target to double. It claims in some regions, customers can order Durex online and have it delivered within one hour. Whilst timing of delivery may have slipped under current conditions, demand for the brand has increased significantly in areas of lockdown!

Nestlé, the world's largest packaged food company, saw full-year net profits released during the quarter, jump 24% as it successfully reorganises its business to reflect changing consumer tastes. The company signed a deal with Starbucks last year and as part of their 'fast innovation' focus, launched a premium Starbucks product now successfully sold in 40 countries. It is also seeing fast growth in vegetarian and plant-based food products including its Sweet Earth Awesome Burger made out of pea protein. The company is being conservative on the effects of coronavirus. Greater China represents the second largest market for Nestlé at 8% global sales and is seeing a pick-up in demand. Pet food is one of the main businesses, with Purina Pet Care growing at 7% per annum. The premium brands are growing much faster and Nestlé has added to its offerings by buying UK based Lily's Kitchen which is a natural premium pet food brand. Approximately 50% of the UK own a pet and owners are trading up in the food they give their pets. The company has reported there has been some hoarding of product with the onset of COVID-19. Nestlé maintained its dividend, is buying back shares and likely to maintain guidance.

Another noteworthy contributor was **Canadian Pacific Railway** which is a Class 1 railroad, stretching from Montreal to Vancouver and as far north as Edmonton. Its network also serves Detroit, Chicago, Minneapolis-St. Paul and Milwaukee in the US. There are only two main operators in Canada and Canadian Pacific has recently completed implementing Precision Scheduled Railroading (PSR) having been one of the most inefficient railroads in North America/ Canada. The goal of PSR is to transport the same, or an incremental amount of freight, with fewer rail cars and locomotives using a more simplified, direct line of transport across the network. PSR uses departure schedules and point to point delivery methods to achieve low operating ratios and consolidate railroad networks. The importance of this is that Canadian Pacific entered 2020 on a strong footing with contract wins from the likes of Yang Ming shipping, increasing margins and market share gains. It also increased its credit facility on very good terms. Whilst there will undoubtedly be some slowdown from disruption in the global supply chain,

Canadian Pacific have an extensive network and operate the shortest and fastest routes in some of the most important paths across Canada and the US which bodes well for the future. In the meantime, 25% of the business is grain and they have increased market share with the introduction of new hopper rail cars. They also transport vital goods (food/medicine) to the likes of Loblaws (Canadian supermarket chain). The company is using the opportunity to retrofit some of the older trains to make them more energy efficient. Management is incentivised to lower the carbon footprint of the business (targeted KPI's) in what is already an industry that is four times more fuel efficient than trucks.

Relative attribution by region: 3 months to 31 March 2020

	Portfolio			Index			Relative Attribution Analysis		
Region	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Asia/Pacific Ex Japan	3.2	-9.4	-0.1	3.9	-27.6	-1.2	-0.1	0.9	0.8
Japan	–	–	–	8.1	-16.8	-1.2	-0.3	–	-0.3
North America	56.6	-15.6	-8.2	67.5	-20.2	-13.7	-0.3	2.8	2.5
United Kingdom	10.3	-21.8	-2.2	5.1	-28.8	-1.5	-0.4	0.7	0.3
Europe ex UK	18.8	-31.7	-6.3	15.3	-22.8	-3.4	-0.1	-2.2	-2.3
Africa/Middle East	–	–	–	0.2	-18.1	-0.0	-0.0	–	-0.0
Cash and equivalents	11.0	n/a	0.0	–	–	–	3.1	–	3.1
Total	100.0	-16.9	-16.9	100.0	-21.1	-21.1	1.9	2.3	4.2

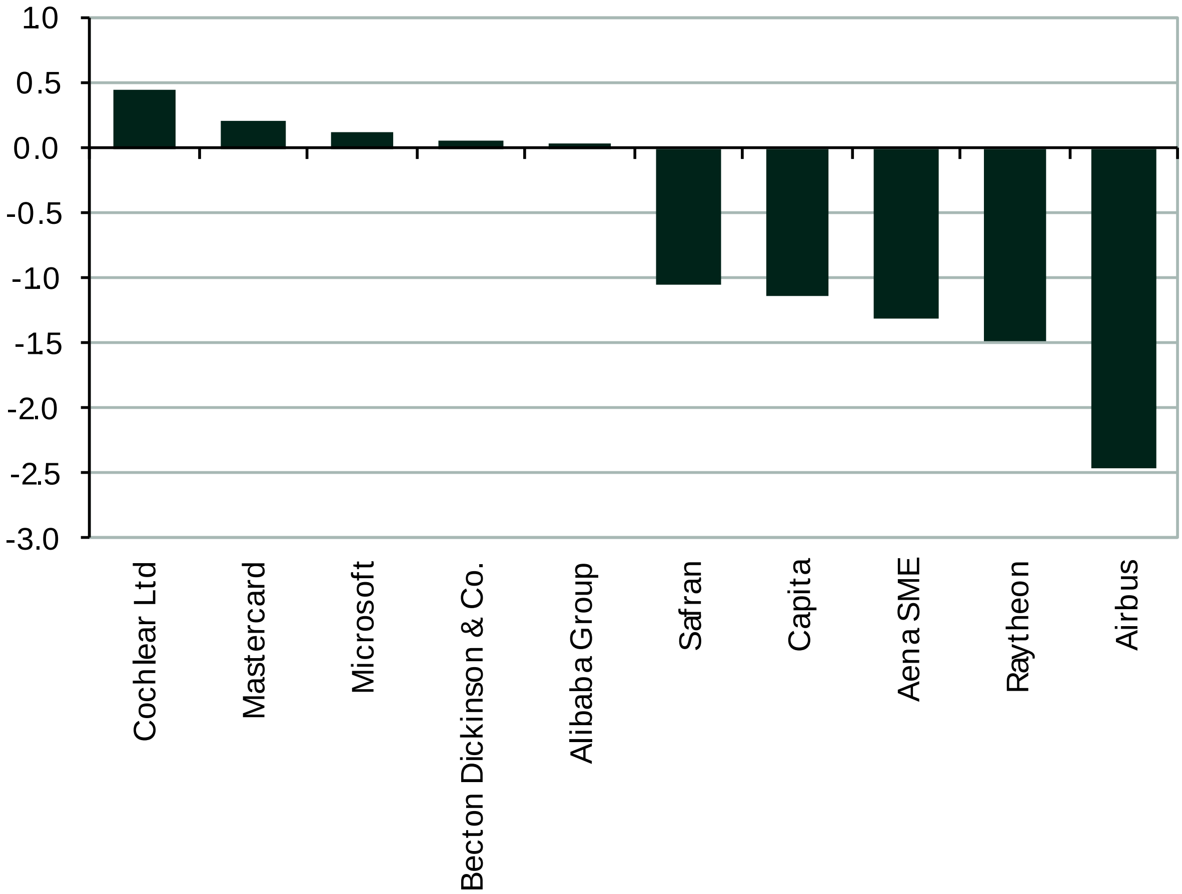
Relative attribution by sector: 3 months to 31 March 2020

	Portfolio			Index			Relative Attribution Analysis		
Sector	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Consumer Discretionary	0.7	6.5	0.0	10.3	-22.0	-2.2	0.1	0.2	0.3
Consumer Staples	12.9	-10.2	-1.4	8.5	-13.3	-1.2	0.3	0.4	0.7
Energy	–	–	–	4.2	-44.8	-2.0	1.2	–	1.2
Financials	6.3	-17.2	-1.3	15.0	-31.8	-5.0	1.0	1.1	2.1
Health Care	22.9	-14.4	-3.1	13.3	-11.5	-1.5	0.9	-0.8	0.1
Industrials	20.3	-34.0	-7.5	10.8	-26.1	-2.9	-0.6	-2.0	-2.6
Information Technology	2.5	-79.1	-0.8	18.3	-13.2	-2.2	-1.6	-1.0	-2.6
Materials	–	–	–	4.2	-26.4	-1.1	0.2	–	0.2
Communication Services	23.3	-13.7	-2.9	8.6	-17.5	-1.5	0.5	1.2	1.6
Utilities	–	–	–	3.6	-13.8	-0.6	-0.2	–	-0.2
Real Estate	–	–	–	3.3	-23.3	-0.9	0.2	–	0.2
Cash and equivalents	11.0	n/a	0.0	–	–	–	3.1	–	3.1
Total	100.0	-16.9	-16.9	100.0	-21.1	-21.1	5.1	-0.9	4.2

Relative attribution by security: 3 months to 31 March 2020

	Portfolio			Index			Attribution
Holding	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Total Effect
Top 5 relative stock contributors							
Charter Communications	8.3	-10.1	-0.8	0.2	-10.1	-0.0	0.9
Baxter International	3.3	-2.3	-0.1	0.1	-2.7	-0.0	0.5
Reckitt Benckiser	3.5	-6.5	-0.2	0.1	-6.1	-0.0	0.5
Alphabet	7.4	-13.3	-1.0	2.0	-13.2	-0.3	0.4
Cochlear Ltd	0.1	36.2	0.5	0.0	-26.7	-0.0	0.4
Bottom 5 relative stock contributors							
Airbus	3.7	-54.6	-2.5	0.2	-55.5	-0.1	-1.6
Capita	1.1	-81.3	-1.1	–	–	–	-1.0
Raytheon	2.3	-43.7	-1.5	0.1	-40.1	-0.1	-0.8
Aena SME	2.8	-42.9	-1.3	0.0	-42.9	-0.0	-0.8
Microsoft	0.9	2.0	0.1	2.9	0.2	0.0	-0.6

Key stocks driving portfolio results
3 months to 31 March 2020



Commentary on two significant stocks in your portfolio:

Cochlear Ltd
(Health Care, Australia)
36.2% in USD
We initiated a position in Cochlear, the leading cochlear implant company, during March during the COVID-19 declines. The company lost a patent case in the US and to increase liquidity decided to do an equity raise. This allowed us to buy a substantial part of our new position at a discounted price, since which time the shares have appreciated.

Airbus
(Industrials, France)
-54.6% in USD
Due to the restrictions on travel as a consequence of the COVID-19 pandemic, all companies that are involved in aerospace have seen a significant decline in share price. Our analysis indicates that while 2020 and 2021 will be difficult for Airbus given the pandemic, the company has sufficient liquidity (c. €30bn) to withstand the downturn and we believe over time the demand for air travel will recover.

Portfolio breakdown: As at 31 March 2020

Region	Portfolio %
North America	66.3
Europe ex UK	17.4
United Kingdom	8.8
Asia Pacific ex Japan	7.0
Cash and equivalents	0.5
Total	100.0

Sector	Portfolio %
Health Care	29.3
Communication Services	24.9
Industrials	19.3
Consumer Staples	13.2
Financials	7.0
Information Technology	3.2
Consumer Discretionary	2.5
Cash and equivalents	0.5
Total	100.0

Currency	Portfolio %
USD	69.3
EUR	11.4
GBP	8.8
AUD	4.5
SEK	3.5
CHF	2.5
CAD	0.0
Total	100.0

Top 10 portfolio holdings: As at 31 March 2020

Holding	Sector	Country	Portfolio %
Charter Communications	Communication Services	United States	8.7
Alphabet	Communication Services	United States	7.7
BAE Systems	Industrials	United Kingdom	5.3
Facebook	Communication Services	United States	5.0
Unilever	Consumer Staples	Netherlands	4.3
Baxter International	Health Care	United States	4.1
Cigna	Health Care	United States	3.9
UnitedHealth	Health Care	United States	3.7
Altice USA	Communication Services	United States	3.6
Canadian Pacific Railway	Industrials	Canada	3.5
Total			49.7

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FEES

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