



see money differently

A photograph of an open book with white pages, tied with a white string bookmark. The book is open to a blank page, and the pages are slightly curved, suggesting it is being turned or held open. The background is a soft, out-of-focus light grey.

Nedgroup Investments Global Equity Fund

Quarter Two, 2021



1. Market Overview and Outlook

Portfolio Manager Commentary

Plus ça Change

“At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at \$64? Do you realize how ridiculous those basic assumptions are? You don’t need any transparency. You don’t need any footnotes. What were you thinking?”

Scott McNealy, CEO of Sun Microsystems in 2002 (two years after the dot.com bubble burst)

As our investors know, our aim is to invest in a concentrated portfolio of high-quality companies when they are attractively valued, and then hold them for the long term to benefit from the compounding of earnings and cash flows that should arise if our analysis is correct. This should lead to a portfolio that delivers consistently good inflation adjusted returns over the long run and our long-term results demonstrate this.

One deliberate consequence of our investment philosophy and process is that we are not drawn in to investing in the latest fashionable areas. At the time, this can feel as though we are missing out on the party when these areas become substantial parts of the equity market and are driving market returns. However, unless both the nature of capital markets and the nature of human emotions has fundamentally changed, we think that like all previous investing fads, the current one will end badly for those heavily exposed.

The current hot arena for investing is in growth companies with a huge pool of money chasing high growth assets. With policy makers encouraging borrowing and risk taking, capital has rarely (if ever) been so cheap and available and consequently the competition to buy fast growing companies is intense.

Private equity, venture capital, public equity funds and retail investors are all clamouring to buy these fast growth businesses at ever increasing valuation multiples. For many of these “investors” presumably the intention is to sell to someone else at an even higher valuation multiple. In addition to these momentum investors there are a large proportion of funds that are completely value agnostic with one recent estimate putting fundamental long only and fundamental hedge funds at only 15% of total volume in the US equity markets. In the private markets we have seen a number of transactions where the value placed on a company expands multiple times in a few months, not driven by better operating performance but by an expansion of the valuation multiple ascribed to the business. While perhaps most obvious in the private markets, this phenomenon is also visible in public markets. Just taking the MSCI World (the largest quoted companies in developed markets worldwide) the performance and some basic metrics of the top performing companies over the past 18 months is shown in the table below:



Top performing MSCI World companies – 18 months to 30 June 2021

	Market cap US\$m	Sector	Return	PEFY1	EV/Sales	Price/Sales	Price/Earnings x	3y EPS growth	3y Sales growth
Tesla	522	Consumer Discretionary	712	156	24	23	680	-183	36
Pinterest	42	Communication Services	324	83	22	28	693	-	53
Snap	64	Communication Services	317	-	29	40	-	-	45
Twilio	63	Information Technology	301	-	27	33	-	67	65
Square	95	Information Technology	290	161	11	12	342	-277	60
Moderna	74	Health Care	282	9	44	112	187	-	39
DocuSign	52	Information Technology	277	169	30	36	-	-	41
Shopify	164	Information Technology	268	342	44	55	108	-443	64
Wayfair	23	Consumer Discretionary	249	71	2	2	74	-216	43
Roku	50	Communication Services	243	1156	23	32	595	-	51
NVIDIA Corporation	495	Information Technology	241	50	19	30	95	7	17
Average	150		319	244	25	37	347	-174	47
MSCI World			31	43		8	70	7	8

Source: MSCI/FactSet. Returns in USD

The period chosen for performance starts on 1 January 2020 and therefore starts before the COVID-19 pandemic impact. There are a few notable factors to draw out from this table. Firstly, the list is dominated by tech/communication services (in this case largely social media companies) that are large with the average market capitalisation of these companies at c.\$150bn. The valuation of the companies appears extremely high with the average enterprise value to sales (EV/Sales) ratio at 25x (note Scott McNealy's comments above related to an EV/Sales multiple of 10x!) and an average Price to Earnings multiple (for those that are actually profitable) of 347x historic and 244x prospective. Lastly, the average annualised sales growth has been an excellent 47%. However, had the EV/Sales multiple remained constant this sales growth would have resulted in an average total return of "only" 82% over the 18 month period. The remainder of the return (to get to 318%) comes from an expansion in the valuation multiple indicating that it is largely valuation expansion that has driven returns for these companies rather than the growth in sales.

How much further such valuation expansion can continue is impossible to know. With interest rates held at or near 0% and quantitative easing continuing, the competition to invest in growth assets is intense and clearly pushing up valuations. It is possible that policy never goes back to what was considered "normal" and that policy intervention and control of interest rates across the curve remains indefinitely. Under such a scenario, the temptation for both fiscal and monetary policy makers will be to continue to push the envelope, the long-term impacts of which could be extremely negative. What is clear is that the current levels of intervention are having hugely distorting effects with the markets no longer functioning in their role of price discovery.

Implications for the portfolio

At Veritas we will continue to invest in high quality companies when we assess them to be attractively valued assuming a more normalised world. This valuation discipline may seem like a handicap in a market such as we are currently experiencing but we believe it is a strength that will allow us to deliver consistently good inflation adjusted returns over our investment horizon.

A good example of the type of investment we seek to make is embodied in our recent investment in Moody's. It is a global credit-rating agency (CRA), operating in a well-behaved and enduring duopoly with S&P Global. This is evidenced by strong barriers to entry (the market has consolidated, with new entrants unable to establish footholds) together with pricing power - Moody's is able to achieve 3-4% price increases every year from its customers (corporates and governments that issue debt). Moody's also has an increasingly attractive data and risk management solutions businesses to reinforce overall revenue stability and to bolster its valuation.



Both Moody's and S&P Global feature on our Universe List of companies that we believe offer quality characteristics as investments at the right entry price. We wait patiently for opportunities to invest in these companies and have found that the market often penalises share prices when it is concerned about specific events that we believe are just short-term wobbles – and if that is the case and the share price falls enough, we can take advantage of those opportunities. We have exploited market concerns about soft bond issuance twice now – first in 2018 when we invested in S&P Global that we subsequently sold once it had reached our estimate of intrinsic value; and next in our recent investment in Moody's because the market was rightly concerned that record issuance in 2020 was unsustainable, but chalked down the shares in Moody's too aggressively and we were able to establish an investment position at a 4% free cash flow (FCF) yield with its shares at the bottom-end of its six year trading range.

Moody's is a global risk assessment firm (45% of revenues are from outside the US) – allowing its customers to make better informed decisions, whether that surrounds the credit rating assessment of entities (Moody's Investors Service, MIS); or insights surrounding other company-specific evaluation of risk, such as and including ESG, compliance and regulatory risk (Moody's Analytics, MA).

Moody's Investor Services (MIS) – 60% of revenues

MIS provides independent credit ratings. The CRA industry is effectively a global duopoly of Moody's and S&P Global. In the mature US market, Moody's and S&P Global have a combined market share of over 80%, with Fitch an increasingly distant third. Outside the US, the two have lower market shares but still compete strongly with regional players because their ratings bring considerable benefits to their customers. Attempts by new entrants to break into the attractive market have all failed in the past and the two incumbents have enjoyed uninterrupted mid to high single digit growth in revenues over the long term. Having a credit rating from both MIS and S&P is relatively cheap for issuers and brings the largest savings in interest cost – matchless value for its customers and both incumbents enjoy pricing power as a result – so we have a secure duopoly able to marshal pricing power. This is evident in strong margin – MIS enjoys operating margins of almost 60%.

This network benefit is very positive. To show this in more detail, the first chart shows the savings that an MIS-rated bond brings to issuers. For a typical 10-year bond issue of \$500m, having an MIS rating means the issuer achieves a 40bps saving in the coupon it pays to end investors, which amounts to cumulative savings of \$20m over the life of the bond. The issuer only pays MIS 7bps upfront, so the all-in cost is just \$0.35m (in fact, the effective cost is \$0.7m, as the issuer is most likely also paying 7bps to S&P too) but the point holds. This example is for starting fees on investment-grade bonds, fees are higher elsewhere as the savings are even larger for speculative-grade issuers, although margin is similar because the additional complexity is more cost intensive. Anyhow, new entrants are unable to source such large savings and access to capital. There are other benefits with issuers signalling a willingness for greater transparency, helping investor confidence and stability during periods of market stress. Together, these factors all reinforce the network effects of the global duopoly, but the value of these savings relative to cost means that MIS has pricing power – starting fees were 4.25bps in 2006 and have posted 3-4% compound growth since then to stand around 7bps nowadays and we expect this trend to continue.

As interest rates rise, investor demand is likely to tilt from fixed-interest bonds to floating-rate loans (note that MIS charges 1bps less for rating syndicated loans compared to bonds – but these re-price more frequently and end up in structured products that also require ratings, so there are more bites of the cherry). We also believe that higher expected inflation is likely to make it even more straightforward for Moody's to extract price increases.

Illustrative value of a Moody's Rating:

Example: 10 year \$500 million corporate bond		
Not Rated by Moody's		Rated by Moody's
\$500,000,000	Bond	\$500,000,000
x 2.5%	Interest rate	x 2.1%
= \$12,500,000	Annual interest payments	= \$10,500,000
x 10 years	Tenor	x 10 years
= \$125,000,000	Lifetime interest expense	= \$105,000,000
~\$20 million in total interest expense vs. lifetime cost of a rating		

Source: Moody's. Note: Illustrative spread differential based on our empirical study, on a snapshot of data from July 2020, which shows that having a Moody's rating (when rated at the same level as other agencies) typically saves approximately 40 basis points per year for issuers. Many factors go into the pricing of a bond.

With MIS enjoying high margin in an industry with effective barriers to entry, there is always risk of regulatory scrutiny. It used to be the case that end-investors paid the credit rating agencies for assessments, but the fee model shifted to the issuers paying for the rating because the benefit they derive is so quantifiable. There is a potential conflict of interest with issuers paying for ratings of course – and this partly explains why both MIS and S&P ratings are needed – but we think the risk of inflated ratings is small and even during the Global Financial Crisis (GFC), the eventual performance of the AAA-rated bonds (that attracted so much suspicion) has been as expected with very few experiencing actual losses.

MIS should continue to enjoy long-term structural growth thanks to further debt market (bonds and loans) issuance, driven by global economic growth. Disintermediation of the banking sector is very supportive as bonds and leveraged loans are both far more likely to carry ratings by issuers to secure savings in payments to end investors. This is the case even in more mature markets such as the US, but disintermediation has more latent energy to grow capital markets in Europe, Asia and in emerging markets.

But while issuance has long periods of sustained growth, it also has short soft patches. The long-term trend is upward because the key driver of debt issuance is global GDP growth, but it also has its ups and downs with companies adapting to business cycles and issuing debt to invest (Capital expenditure, Mergers and acquisitions (M&A)); to finance (dividends, buybacks), as well as refinancing maturing debt. Debt refinancing and M&A are the biggest reasons for new issuance – refunding needs for US and EMEA corporate sector bonds and loans is building to stand at \$3.8trn in total, which is a huge support for issuance over our investment horizon. That is just the corporate sector – sovereign issuance to finance Covid-related fiscal measures is also supportive. We expect issuance to continue its upwards trajectory from next year onwards. There are obvious headwinds: 2020 was a record year and the corporate and sovereigns have been on a debt binge. Default rates will no doubt deteriorate from record lows. And interest rates are starting to increase, although from very low levels. However, issuance is usually positive even in the face of these factors when GDP is growing and when refunding needs are so extended to act as a stabiliser.

Moody's Analytics (MA) – 40% of revenues

Moody's Analytics is a global provider of data and assessment aimed at helping customers make better and faster decisions. Management has shown strategic dexterity in acquiring relevant and complementary assets in key areas seeing strong demand. MA's subscription business has attractive characteristics including high

customer retention rates and strong recurring revenues that acts to help stabilise short-term fluctuations that can impact revenues at MIS.

Although MA revenues have grown rapidly and consistently, this also reflects the large number of acquisitions made – although these revenues also show a similar profile on a per share basis without sharp increases in overall leverage – so we have little doubt about the quality characteristics of these businesses.

MA has developed scale in complementary data assets, notably Bureau van Dijk (BvD) for business information and private company data; Reis in CRE data and Vigeo Eiris (V.E.) in environmental, social and corporate governance (ESG) – all of which is additive to its other risk assessment know how in financial regulation and anti-money laundering/know your customer (AML/KYC) compliance. We should expect MA to continue expanding its data sets – adding new sets solutions that it already offers to customers and making it all interoperable by enhancing cohesion between these, for example by combining Reis data on individual commercial properties with ESG assessment of flood and earthquake risk and even with MIS understanding of credit assessment of lenders to specific properties, giving investors in physical property or in commercial mortgage backed securities an edge in pricing risk. BvD is industry leading.

MA earns a decent operating margin of 30% and this should improve as cohesion scales among its data and risk tools. There remains scope to increase delivery in the cloud, further supporting margin expansion as well as deepening existing customer relationships as well as helping MA to acquire new customers.

Conclusion

Moody's has a very strong balance sheet with excellent cash conversion, which gives it operational and strategic flexibility. Capital allocation is strong with reinvestment at high returns. On the financing side, buybacks are preferred to its dividend. MA has reached 40% of total revenues and stabilises revenue growth. We also believe this attracts a higher valuation that is supportive for our investment that we secured with a double-digit Internal Rate of Return (IRR). At origination, we gained a 4% FCF yield with double-digit expected growth in FCF. This growth comes from around 7-8% revenue growth (pricing, issuance growth and increased penetration) plus another c.4% from margin expansion to give a very durable double digit FCF growth rate.

Governance is strong at Moody's and unlike most US companies, it has a separate Chairperson that we believe offers a strong structure for shareholders to engage with directly if needed. Having a separate Chair also means there is someone to offer advice to its CEO when needed. We believe that strong governance percolates into strong societal and environmental characteristics of businesses. We believe that Moody's has very strong management. Its track record and focus on MIS and building up MA without diluting shareholders or raising the risk profile of the business has been exemplar. Management is open and not fearful of allowing investors access to the people running different parts of the business. Management is also realistic and we believe honest about opportunities. As an example, the market is very excited about prospects for both Moody's and S&P Global to grow in the huge Chinese bond market but Moody's management is more circumspect because it would never impair the independence and validity of its ratings to grow in a new market such as China.

The company also offers a high degree of disclosure surrounding ESG factors and is a market leader in the transparent management of its carbon and waste footprints, with clear targets for 2030 and intention to seek shareholder support along the way. Its ESG affiliate V.E. has over 30 years' experience in helping other companies assess their ESG risk, as well as incentivising capital markets to adopt sustainable bond and loan issuance and integrate this into financial strategy – so the business is itself aligned to ESG development and the company itself has a good history of showing strong adoption of these principles. We believe that with Moody's we have a great business with excellent stewardship that maximises the chances of our investment achieving our targeted return.

2. Fund performance contributors & detractors for past quarter

Top 5 contributors and bottom 5 detractors

Holding	Portfolio			Index			Attribution
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Total Effect
Top 5 relative stock contributors							
Alphabet	8.6	18.4	15	2.5	18.4	0.4	0.6
Charter Communications	6.4	16.9	10	0.2	16.9	0.0	0.5
Moody's Corp	3.4	215	0.7	0.1	215	0.0	0.4
Facebook	3.1	18.1	0.5	14	18.1	0.2	0.2
Cochlear Ltd	19	18.1	0.3	0.0	17.6	0.0	0.2
Bottom 5 relative stock contributors							
Fiserv	3.7	-10.2	-0.4	0.1	-10.2	-0.0	-0.6
Baxter International	3.3	-4.3	-0.1	0.1	-4.3	-0.0	-0.4
Canadian Pacific Railway	4.3	15	0.1	-	-	-	-0.3
Alibaba Group	3.1	0.0	0.0	-	-	-	-0.2
Abbott Laboratories	2.4	-3.0	-0.1	0.4	-3.0	-0.0	-0.2

Source: Veritas Asset Management

Attribution by Region

Region	Portfolio			Index			Relative Attribution Analysis		
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Asia/Pacific Ex Japan	7.9	7.1	0.5	3.5	4.8	0.2	-0.1	0.1	0.0
North America	65.2	8.2	5.3	69.9	8.8	6.2	-0.1	-0.4	-0.5
Africa/Middle East	-	-	-	0.2	5.1	0.0	0.0	-	0.0
Europe ex UK	14.4	6.0	0.9	14.9	7.8	12	0.0	-0.2	-0.2
Japan	-	-	-	7.1	-0.3	-0.0	0.6	-	0.6
United Kingdom	8.3	6.0	0.5	4.4	6.0	0.3	-0.1	0.0	-0.1
Cash and equivalents	4.3	n/a	0.0	-	-	-	-0.3	-	-0.3
Total	100.0	7.3	7.3	100.0	7.7	7.7	0.0	-0.5	-0.5

Source: Veritas Asset Management

Attribution by Sector

Sector	Portfolio			Index			Relative Attribution Analysis		
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Consumer Discretionary	3.1	0.0	-0.0	12.0	6.4	0.8	0.1	-0.2	-0.1
Consumer Staples	5.8	7.7	0.4	7.1	5.8	0.4	0.0	0.1	0.1
Energy	-	-	-	3.1	8.8	0.3	-0.0	-	-0.0
Financials	6.2	14.5	0.9	13.9	6.6	0.9	0.1	0.4	0.5
Health Care	29.2	5.4	16	12.4	9.1	11	0.2	-10	-0.9
Industrials	23.0	4.3	11	10.8	4.2	0.5	-0.4	0.1	-0.3
Information Technology	10.5	2.4	0.3	21.3	11.5	2.4	-0.4	-0.9	-1.3
Materials	-	-	-	4.6	5.3	0.3	0.1	-	0.1
Communication Services	18.0	18.1	3.0	9.1	8.9	0.8	0.1	15	16
Utilities	-	-	-	2.9	-0.7	-0.0	0.2	-	0.2
Real Estate	-	-	-	2.7	10.1	0.3	-0.1	-	-0.1
Cash and equivalents	4.3	n/a	0.0	-	-	-	-0.3	-	-0.3
Total	100.0	7.3	7.3	100.0	7.7	7.7	0.6	-10	-0.5

Source: Veritas Asset Management

Portfolio Attribution Commentary

Whilst the portfolio slightly underperformed another sharp rising market in quarter two, there was no major news amongst the detractors, set aside, the fine administered to Alibaba. The five largest detractors, on the whole were flat over the quarter. We reinforce the prospects for each.

Fiserv shares did fall modestly over the quarter despite solid Q1 results. Fiserv has a unique business, which claims to reach 100% of U.S. households through its 10,000 financial institution clients and 6 million global merchants. The company delivers solutions to financial firms, assisting them with real-time payment processing, online customer portals, and risk and compliance. Consumer expectations are constantly evolving and they want more of their banking done in real time. The company is divided into three main areas. Merchant Acquiring (Acceptance Segment) – Merchant acquiring features the legacy First Data business acquired by Fiserv in 2019. The First Data / Acceptance business serves merchants by enabling them to accept credit, debit, mobile, and other digital payments via both point-of-sale and online terminals. Also included in the acceptance segment is Clover, Fiserv's competitor to Square's retail merchant solution. The acceptance industry exists within the larger payments ecosystem which is led by Visa and Mastercard. Merchant acquiring shares the secular growth trends of increasing digital payments and shift to e-commerce, as well as the inherent scalability and operating leverage of the payments industry. As a fee-per-transaction business, merchant acquiring serves as an inflation hedge if the dollar volume of payments processed were to increase due to inflation. Clover is outperforming Square and yet the valuation ascribed to it is far less. Payment Processing (Payments Segment) – The payments segment houses the US third-largest debit card network (after Visa and Mastercard). It also facilitates digital payments including Automated Clearing House, bill payment, electronic billing, account-to-account transfers, and person-to-person payments. The well-known and fast-growing Zelle payments app is also included in this segment. Revenue is fee-based per transaction, meaning that the segment will grow in proportion to inflation (in nominal terms) and in proportion to market growth and market share gains (in real terms). Risks to this segment include competition, fintech disruption, economic recession, and security breaches. Core Processing (Fintech Segment) – Fiserv's core processing solution is the software that powers banking transactions, deposit and loan management, and all other processes that must be maintained in a financial institution.

Much like other software systems, this is a recurring revenue business. Customer retention in this segment is exceptionally high due to product quality, long-term contracts, and very high switching costs. Growth comes from cross-selling additional modules and services with the core system, market share gains, and is offset by the risk of mergers and acquisitions that can result in elimination of Fiserv's existing customers. In the first quarter of 2021, the company managed to grow revenue across the three main segments, but also expanded its operating margins across the board. Fiserv primarily receives recurring and transaction-based revenue streams. These revenue streams are supported by client contracts that renew at high rates due to the inherent switching costs and the essential nature of these services to Fiserv's clients. While substitute services exist, Fiserv commands dominant market share and preference across most of its major business segments.

Alibaba reported revenues of \$28.6 billion, an increase of 64% on a year-over-year basis. The first quarter of 2020 was very weak due to the negative impact of the pandemic, but the year-over-year growth is still impressive. The quarter had been dominated, however by the record fine of 18.2 billion yuan (\$2.8 billion) Alibaba was ordered to pay after antitrust regulators concluded that the company had been behaving like a monopoly. The State Administration for Market Regulation had imposed the penalty following an antitrust investigation into Alibaba's "exclusive dealing agreements" that prevented merchants from selling products on rival e-commerce platforms — a practice known as "choosing one from two." The fine is equivalent to 4% of Alibaba's sales in China in 2019 and was less severe than feared. Beijing has been tightening the grip on China's national tech champions as part of a regulatory crackdown that President Xi Jinping has described as one of the country's top priorities for 2021. Ant Group, Alibaba's financial affiliate, was forced to shelve its IPO last November after Jack Ma, its founder, criticized Chinese regulators. Alibaba said the company had cooperated with the investigation and accepted the penalty "with sincerity and will ensure our compliance with determination". Beijing regulators wrapped up their probe in just four months, compared with the years that such investigations take in the US or Europe. They sent a clear message to the country's largest corporations and

their leaders that anti-competitive behaviour will have consequences. This in itself is not negative as it does not solely apply to Alibaba.

Looking forward, the company is well positioned. The underlying Chinese e-commerce market has accelerated as a consequence of COVID-19 and Alibaba continues to see mid-teens growth in Gross Merchandise Value (GMV). Alibaba's take-rate at approximately 3.8% is significantly lower than the 10-15% for Amazon. Whilst this will not increase significantly in the short term, we assume a modest increase to 4.3% by 2024, coupled with 12% GMV growth, resulting in a powerful impact on earnings. Alibaba Cloud, which had revenues of \$9bn in FY21 and is growing in excess of 30% p.a., should transition from break-even today to a 20% operating margin over five years. It could be worth between 30-60% of the current valuation. Additionally, a number of other business units lose \$13bn p.a. (and ascribed no value). This should moderate over time. It is currently, for example, investing heavily in south east Asia, in its Lazada platform (investing in technology, logistics and payments infrastructure in countries like Indonesia, Malaysia, Vietnam and Thailand).

There were two healthcare names in the top five detractors. **Abbott Laboratories** was also flat over the month, having fallen in early June when the company warned that profits for the year would be lower than guided earlier in the year because of eroding demand for COVID-19 tests. Full-year adjusted earnings from continuing operations will range from \$4.30 to \$4.50 a share, down from the previous guidance of at least \$5 a share. Abbott believed COVID-19 test sales would be maintained with the release of its 'BinaxNOW COVID-19 Ag Card' for which it was granted FDA emergency use authorisation. This over-the-counter test gives results within fifteen minutes and can be administered in schools, workplaces and at home etc. But as U.S. vaccination rates grow, infections wane and pandemic restrictions loosen, use of the assays has declined. During the quarter, U.S. health officials said fully vaccinated individuals will not need testing. Abbott reported that it has seen a rapid decline in COVID-19 testing demand and anticipates this trend will continue. This is not unexpected. Testing for COVID-19 has been a short term boon for the company but it expects continued growth in non-COVID-19 diagnostics. Compared with the first quarter of 2019, the most relevant pre-pandemic benchmark, the company's base business grew nearly 10% organically in the first quarter of this year. It is important to keep some perspective as the revised earnings per share (EPS) guidance is still up 20% on last year and more than 30% compared to pre-pandemic EPS in 2019.

Diagnostics is only one part of the business (which longer term will benefit with accelerated drug development and the need for corresponding tests) with the diabetes and heart disease related business benefitting from the longer term growth trend in these lifestyle diseases. They own market leading products in both these areas.

Baxter International provides a broad portfolio of essential healthcare products, including acute and chronic dialysis therapies, sterile IV solutions, infusion systems and devices, parenteral nutrition therapies, inhaled anaesthetics, generic injectable pharmaceuticals, and surgical haemostat and sealant products. Better than expected performance in the Baxter's first quarter results was driven by Acute Therapies reflecting sustained higher levels of product demand due to the ongoing COVID-19 pandemic. BioPharma Solutions also delivered double-digit growth driven by multiple collaborations to help manufacture COVID-19 vaccines on a contract basis. Additionally, Clinical Nutrition, Pharmaceuticals and Renal Care grew mid to high single digits. This helped offset declines in Medication Delivery and Advanced Surgery, reflecting lower rates of hospital admissions and elective surgeries, respectively, in the wake of the ongoing pandemic, as well as a challenging comparison to performance in the previous year's quarter. The company raised its dividend by 14%. The company expects acute therapies demand to recede from its pandemic peak and return to more typical levels over the course of the year. The demand for both in-centre Haemodialysis (HD) and Peritoneal Dialysis (PD) businesses has been dampened by patient volumes falling driven by higher mortality rates for End Stage Renal Disease (ESRD) patients in the wake of the pandemic. ESRD patient volumes should stabilise and return to normal over the next 18 to 24 months, but the pace of the recovery may vary by market/vaccine roll-out. Volumes had dropped most significantly in Latin America. The essential nature and durability of Baxter's portfolio, the breadth and diversity of the product lines, the expansive geographic footprint and the impact of the company's transformation, makes for a compelling long-term investment. The company remains focused on advancing innovation. Recent announcements have included; U.S. FDA approval for its Artificial Kidney (AK 98) dialysis machine, designed to be a portable and easy-to-use system to administer haemodialysis treatments.



Among its features, AK 98 offers encrypted, two-way connectivity, which enables the system to pull prescriptions directly from the electronic medical record (EMR) for simplified workflow and data handling. It has won Canadian approval of its leading-edge Novum IQ Infusion platform. The platform includes both large volume and syringe infusion pumps, and features including regulating dosing more accurately. Baxter announced an agreement with Moderna for Baxter BioPharma Solutions to provide fill/finish sterile manufacturing services and supply packaging for approximately 60 to 90 million doses of the Moderna COVID-19 vaccine in 2021. This partnership follows earlier agreements announced with BioNTech and Novavax to provide manufacturing services for their respective COVID-19 vaccines. Baxter has also strengthened its European and global pharmaceuticals portfolio through strategic rights acquisitions in line with the company's strategy to bolster its pharmaceuticals business and expand its presence globally in specialty pharmaceuticals. This included the company acquiring the rights to specified territories pharmaceuticals portfolio through strategic rights acquisitions in line with the company's strategy to bolster its pharmaceuticals business and expand its presence globally in specialty pharmaceuticals outside of the U.S. to the widely prescribed chemotherapy medication Caelyx. This supplements Baxter's U.S. rights to Doxil, acquired in 2019. Baxter also acquired full U.S. and specified OUS rights to the anti-nausea medication Transderm Scop, representing a key adjacency to Baxter's industry-leading inhaled anaesthetics portfolio. The company expects sales growth of 14% to 15% in second half of the year and like Abbott benefits from enduring healthcare trends in life style diseases and affordable care.

Canadian Pacific Railway's results exceeded Wall Street expectations despite the railroad's operating ratio worsening to 60.2 from 59.2 in the first quarter of 2020. Operating ratio (OP), or operating expenses as a percentage of revenue, is used to measure efficiency. The lower the ratio, the greater the company's ability to generate profit. However, OP improved if acquisition costs associated with its bid for Kansas City Southern (KCS), are stripped out. Canadian Pacific (CP) had made a \$25bn cash-and-stock offer for KCS earlier in 2021 only to be outbid last quarter by Canadian National who tabled a much higher \$33bn bid. The smallest of the Class I railroads, Kansas City Southern is extremely attractive, because it's the only railroad that operates deep into Mexico.

Last year, the U.S., Mexico and Canada ratified a new trade treaty, the United States-Mexico-Canada Agreement, which is expected to have a long-lasting impact on trade between the three nations, especially as it relates to agriculture and automotive production amongst other products. Given economists are forecasting the U.S. economy is likely to grow rapidly this spring and summer, Kansas City Southern is in a good position to be additive.

A relief to investors, was the announcement that CP would not engage in a bidding war. Instead, CP officials wrote to the Surface Transportation Board urging a close review of the rival offer from Canadian National, saying it would hurt rail competition throughout the central United States and could destabilise the balance between the industry's six largest players. It has been more than 20 years since the Surface Transportation Board (STB) approved a major railroad merger and it had said in the past when considering a deal involving any of the major Class I railroads that the agreement must enhance competition and serve the public interest to win approval. During the past two decades, the major railroad industry has been stable with two railroads in the western United States, Burlington Northern Santa Fe and Union Pacific; two in the east, CSX and Norfolk Southern; and the two Canadian railroads that serve Canada and the United States. The STB essentially prohibited large-scale railroad consolidation in 2001, and CP and KCS knew going in it would likely take until mid-2022 to win approval for this combination. That's a long time for KCS shareholders to be left waiting for an uncertain pay-out, and could be enough to discourage any merger attempt. Canadian Pacific, mindful of the long wait, structured the deal in such a way to alleviate most of the risk for KCS holders. CP proposed establishing an independent voting trust that will acquire the shares once KCS holders approved the deal, and before regulators have sounded off. Holders of KCS shares would get the \$90 in cash and 0.489 shares of Canadian Pacific as outlined in the merger agreement, even though CP would not yet officially own Kansas City Southern. The STB has already granted Canadian Pacific permission to set up a trust that would allow for Kansas City Southern shareholders to get paid even before the deal wins approval, eliminating the uncertainty. The STB has also said that due to Canadian Pacific and Kansas City Southern both being smaller railroads, they would have to prove only that their deal doesn't harm competition.



Canadian National, by contrast, will have its bid judged under a higher standard that requires it to prove its proposal will actually benefit shipping customers. The STB turned down Canadian National permission to set up a voting trust. The ruling came days after the U.S. Department of Justice said the Canadian National bid poses greater risk to competition than the Canadian Pacific bid. Canadian National has argued that its deal is beneficial for shipping customers, and has expressed confidence that it will eventually win approval.

But the regulator's scepticism, coupled with some risk that absent a trust, Kansas City Southern shareholders could be left waiting for more than a year to see how the regulatory review works out, could mean Canadian Pacific's bid is deemed more attractive even if the company fails to top the Canadian National offer price. In short, there is some short term uncertainty overhang surrounding this corporate activity.

Turning to the main contributors over the quarter:

Alphabet hit record intraday highs recently after the company posted first-quarter earnings and revenue that beat Wall Street expectations. The company also authorised a repurchase up to an additional \$50 billion of its own stock. A 34% rise in revenue supported by stronger advertising sales helped the company beat analyst estimates. The company has benefitted from increased use of search services and YouTube amid the pandemic. Revenue from Google Search rose to \$31.9 billion from \$24.5 billion and YouTube ads drew in \$6 billion, up from \$4 billion in the prior period. The company sees a permanent shift to digital attracting ever more ad dollars, with particular strength in YouTube as it is the new TV. Google has long had a shopping tab in its search bar and sometimes shows shopping results on top of links, but shopping has not been key to the company's business. That may be changing, as Google looks to develop tools to answer people's questions within Google. Since Google is one of the most likely options for initial shopping inquiries, it has an incentive to serve customers exactly what they are shopping for. Through recent partnerships with Shopify and Square, it's doing that on its website. The Google Merchant Centre within Shopify or Square can be used to promote products in Google and even sell on Google's site. Google is the top of the shopping funnel, directing users to the most relevant products.

This is a change to how Google has long treated shopping searches, which used to be a funnel to Amazon with Amazon ads often lining nearly every search.

Facebook's total revenue climbed by a much better than expected 48% year over year to \$26.2 billion. The main driver of this growth was Facebook's advertising business. Total advertising revenue grew 46% year over year to \$25.4 billion. The company attributed the significant increase in revenue to a 30% year-over-year increase in the average price per ad and a 12% increase in the number of ads delivered. Facebook said it expects its revenue growth to remain stable or accelerate modestly in the second quarter compared with slower growth a year prior due to the pandemic but then decelerate in the second half of the year. The company is bracing for "ad targeting headwinds" as a result of regulatory and platform challenges. Most notably, this includes Apple's recent privacy changes in iOS 14 that may make it more difficult for the company to personalise ads for iPhone and iPad users. Facebook are focusing on building e-commerce features as part of delivering a 'personalised experience' to users. The company has over 1 billion monthly active users who visit Facebook's Marketplace service, where users can buy and sell goods. The commerce part of the business has accelerated with the pandemic as more businesses move online. Building out payment technology, including the diem digital currency and Novi digital wallet, will be key to enabling more commerce on Facebook's services. Facebook also reiterated a number of new features the company is building to help Instagram creators make money. Features will incentivise creators to post more content on Instagram. The aim is for the platform to be the best place for creators to make a living which in turn means better content across the services. Facebook said it counts 3.45 billion monthly users across its family of apps, compared with 3.30 billion in the previous quarter.

Charter Communications, which has been discussed at length in previous quarterlies, saw profits more than double in the first quarter as the company posted net income of \$807 million, or \$4.11 a share, up from \$396 million, or \$1.86 a share, a year earlier. Charter disclosed that it saw its total customer relationships increase by

302,000 in the first quarter. The company added 355,000 Internet customers in the period. The company continues to benefit from the demand for fast broadband. Over the last twelve months it has added 2 million internet subscribers.

Charter purchased approximately \$4.0 billion worth of stock over the quarter. The shares continue to benefit from a powerful combination of cash generation, moderating capital expenditure and a stock repurchase program.

Moody's reported first-quarter 2021 earnings ahead of expectations. The bottom line grew 49% from the year-ago quarter. Results benefited from solid bond issuance volume, which led to strong revenue growth. Moody's is a US financial services company that acts as the holding company for Moody's Investors Service (provides credit ratings) and Moody's Analytics (sells data and analytic solutions). The growth in the MIS segment, which contributes around 60% of the total revenues, was mainly driven by higher corporate debt issuance (both investment-grade and high-yield). Notably, the global investment-grade corporate debt issuance touched \$4.8 trillion in 2020 (up 22% year-on-year), followed by \$547 billion in high yield debt (Refinitiv data). The higher corporate debt issuance levels were driven by the need to strengthen the cash position to handle the impact of the COVID-19 crisis and also the lower interest rate environment in the year. Moody's Analytics revenues grew 14% year over year to \$564 million. The company has tightened its offerings related to regulation in areas such as Anti Money Laundering and ESG. Moody's gave upbeat forward guidance and now expects adjusted earnings in the range of \$11.00-\$11.30 per share, up from prior expectation of \$10.30-\$10.70 per share.

Cochlear, a leader in hearing device implants that help to restore hearing, has performed well over the last six months following the company's positive results. Sales revenue dropped 8% in the first quarter, but rebounded to edge 8% higher in the following three months (Q2 FY21). Cochlear attributed the performance to varying degrees of growth across established versus emerging international markets. The United States, Japan, South Korea, and China recorded robust sales, while India and Brazil struggled with volumes. Emerging markets account for 20% of Cochlear's sales. Cochlear is projecting it will achieve FY21 underlying net profit between \$225 million and \$245 million. This is a 46% to 59% increase on last year's FY20 result. The company noted that the deployment of COVID-19 vaccines, and rapid return of surgeries, is a positive for its resilient business. Cochlear resumed dividends, declaring a \$1.15 dividend, representing 60% of underlying profits.

The company aims to return to its historical 70% dividend ratio in the near future and expects that the implant market will return to normal growth by financial year 2022-23. Cochlear leads the industry in R&D. It has received FDA clearance for Baha 6 Max, an implant that is more effective in dealing with noisy environments (normal hearing adapts seamlessly to varying levels of background noise, something implants do with varying degrees of success), and can accommodate music, calls and entertainment streamed directly from a compatible Apple or Android device.

Activity

There were no new positions or eliminations over the quarter. Positions were trimmed in companies that have performed well over the last twelve months. This included Cochlear, Alphabet, Airbus and CVS Health. Additions were made to Catalent, Microsoft and Charter (which had underperformed in Q1).

3. Current Positioning

Top 10 Portfolio Holdings

Holding	Sector	Country	Portfolio %
Alphabet	Communication Services	United States	8.2
Charter Communications	Communication Services	United States	6.9
Microsoft	Information Technology	United States	4.3
Canadian Pacific Railway	Industrials	Canada	4.2
Unilever PLC	Consumer Staples	United Kingdom	4.1
BAE Systems	Industrials	United Kingdom	4.1
UnitedHealth	Health Care	United States	3.8
Moody's Corp	Financials	United States	3.7
Vinci	Industrials	France	3.6
Safran	Industrials	France	3.5
Total			46.4

Source: Veritas Asset Management

Portfolio Breakdown

Region	Portfolio %	Sector	Portfolio %	Currency	Portfolio %
North America	66.5	Health Care	28.8	USD	74.3
Europe ex UK	13.5	Industrials	21.8	EUR	15.9
United Kingdom	8.2	Communication Services	18.4	GBP	4.1
Asia Pacific ex Japan	7.1	Information Technology	10.6	AUD	4.0
Cash and equivalents	4.8	Financials	6.6	CHF	1.7
Total	100.0	Consumer Staples	5.8	CAD	0.0
		Consumer Discretionary	3.1	Total	100.0
		Cash and equivalents	4.8		
		Total	100.0		

Source: Veritas Asset Management

Please refer to portfolio commentary under items 1 and 2 for further information on current positioning and outlook.

4. Responsible Investment

Proxy Voting

As long-term shareholders of equities, we believe in voting on all resolutions. We employ a customised policy which is applied by Institutional Shareholder Services ("ISS") and incorporates the Environmental, Social and Governance ("ESG") Red Lines, developed by the non-profit organisation Association of Member Nominated Trustees ("AMNT"). Whilst we believe in the philosophy behind the ESG Red Lines, they are designed to be applicable to companies within pooled vehicles and only companies domiciled in the UK.

As a result, we have signed up ISS to apply a customised screen whereby the Red Lines are applied to UK equities and Global equities on a best endeavours basis. ISS, our third party proxy advisor, provide us with company research and vote recommendations for each meeting resolution based on our blended policy, in addition to providing the vote execution service for the firm. The global investment team will use the research provided alongside their own analysis to determine their vote decision. It is not uncommon for the investment team to have a view which differs to that of our policy vote recommendation.

During the period there were 22 meetings and 391 votable resolutions across the companies: Abbott Laboratories, Aena S.M.E. SA, Airbus SE, Alphabet Inc., BAE Systems Plc, Baxter International Inc., Canadian Pacific Railway Limited, Charter Communications, Inc., CoStar Group, Inc., CVS Health Corporation, Facebook, Inc., Fiserv, Inc., Illumina, Inc., Intercontinental Exchange, Inc., Mastercard Incorporated, Moody's Corporation, Nestle SA, Safran SA, Thermo Fisher Scientific Inc., Unilever Plc, UnitedHealth Group Incorporated and Vinci SA.

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FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

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