NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Global Equity Fund

Quarter Three, 2021

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1. Market Overview and Outlook

Portfolio Manager Commentary

The Outside View

In normal times, interest rates are set by market forces and represent the price of money, which is then used to measure investment risk and determine the present value of estimated future cash flows. However, since the Global Financial Crisis this price has become distorted as policy makers around the world have held their collective thumbs on the monetary scales to keep the cost of money artificially low. As these policy makers are well aware, interest rates power everything in the financial world. Holding interest rates artificially low undoubtedly leads to excessive risk taking as investors who previously relied on safe interest income need to invest in higher risk assets to maintain the same level of return.

After more than a decade of policy makers determining the price of money (which they have effectively set at zero) it seems that investors have become increasingly disorientated with many (high growth) companies' valuations becoming dissociated from reality. One indication of this is how many investors now value companies not based on fundamentals but instead on "total addressable market" and "pro-forma" long run margin estimates. What they seem to miss in this work is how exceptional (based on historical examples) these companies would be if their forecasts prove correct. This is particularly the case in technological areas where rapid development increases the risk of a better solution being adopted and the existing technology thereby facing obsolescence within the long time horizon demanded by extreme valuations.

To illustrate just how exceptional these companies' results would need to be to justify an investment let's use a software company that currently has a c.$90bn market capitalization and similar enterprise value. In FY2021 this company delivered just under $600m of revenue to put the company on an historic EV / Sales valuation of almost 150x. The company is growing very fast (c.100% currently), has a large addressable market and has a common size P&L that looks like this:

	FY 2021
Revenue	*100%*
Cost of Goods Sold	*(41%)*
Gross Profit	*59%*
SG&A (not including Stock Based Compensation)	*(60%)*
Stock Based Compensation	*(51%)*
R&D	*(40%)*
Operating Profit	*(92%)*

To own shares in this c.$90bn company, we can work back from a point in the future when we believe it might be in a steady state (i.e. making a consistent profit that we can value) to see what assumptions you need to believe to hold it. Let's first off assume that as an investor you want to earn 10% pa in this investment and are prepared to hold for 10 years. This means the market capitalisation in 10 years' time would need to be c.$235bn. If we assume it is then more mature and so can be valued at a multiple of earnings, say 30x (implying it is still growing fairly rapidly), what does that mean for growth? Well, to work this out we need to make some simplifying assumptions. Let's assume that in 10 years the company has:

Gross margin: 80% of revenue (vs less than 60% now and historically)
SG&A: 30% of revenue (vs 60% now)
R&D: 10% of revenue (vs 40% now)
Stock based compensation: 20% of revenue (vs >50% now)
Tax rate: 20%

These assumptions seem fairly generous in that they assume a company that currently makes a substantial loss almost equivalent to its entire revenue will transition to an operating profit margin of 20% (post stock-based compensation) over 10 years. If this can be achieved and we value the resulting earnings at 30x, earnings would need to be c.$8bn ($235bn / 30) in 10 years. This means pre-tax profit of c.$10bn and therefore annual revenue of $50bn at a 20% operating profit margin. In 10 years. From c.$600m today. That works out at 56% compound annual growth rate (CAGR) in revenues for the next 10 years. Can that be achieved? Before we answer that, let's consider some relevant academic work:

Daniel Kahneman in his (fabulous) book "Thinking Fast and Slow" talks about the Inside View and the Outside View. The inside view is best thought of as specific to the case in hand where forecasts are made using the specific circumstances and evidence from the forecaster's own experience. It is the approach most forecasters stumble onto. The outside view on the other hand seeks broader external evidence not necessarily specific to the exact situation but instead more statistically rigorous due to a larger data set, such as base rates. The outside view is rarely the default way forecasters look at a specific situation but according to Kahneman is a better way of forecasting when there are "unknown unknowns" involved (pretty much everything involving the future then!). Kahneman's work was subsequently strongly endorsed by Philip Tetlock in his superb book "Superforecasting" in which he demonstrates that "super-forecasters" use the outside view much more heavily than average forecasters.

So what is the base rate for publicly traded companies with revenues of >$500m to compound those revenues by >55% over 10 years without material mergers and acquisitions? The answer to this is that there has only been 1 company that has achieved this in the last 22 years: Facebook. This goes to show just how rare such high growth is. Maybe this analysis is too harsh and we should use a lower starting revenue to account for inflation? If we use at least $100m as the starting revenue then 9 publicly traded companies have achieved >55% CAGR during the 22 year period (again excluding those that achieved it by material acquisitions such as China Evergrande). 9 out of the many, many thousands of companies with revenue above $100m. The base rate goes to show how difficult compounding at such high rates for long periods is and perhaps how demanding the assumptions built into the valuations of some tech companies have become. Now maybe the investors in this tech company would argue a different case. Fair enough. But give me your assumptions. Maybe the company will be valued at 50x earnings in 10 years, or stock-based comp will have been greatly reduced but these assumptions seem aggressive to us, and undoubtably leave little margin for error in the forecast.

This is one example, and it is possible that this specific company will go on to achieve growth rates above the assumptions laid out. However, there are many publicly traded companies in the technology sphere that are being valued similarly with very high required growth rates over long periods that seem unlikely to be achieved in the context of a base rate. Not all trees grow to the sky.

Implications for the portfolio

At Veritas we focus on buying companies that are competitively advantaged and available at attractive valuations. Two we have held for long periods in the portfolio are Alphabet and Charter and they represent two of our largest positions.

Our original investment in Charter was actually an investment into Time Warner Cable in March 2015 which was subsequently acquired by Charter (to get hold of both the assets and the remarkable management team). Our thesis was (and remains) very simple – cable companies invested huge amounts in connecting homes with co-axial cable in the 1990s and 2000s that has serendipitously proven to be an excellent infrastructure for distributing broadband. This puts the cable companies in a competitively advantaged position as the investment in the infrastructure has largely been made (and fully depreciated) and the growth in broadband is therefore a new, large and incremental revenue stream. To meaningfully compete against the cable companies any competitor would need to invest in fiber optic cable to every house which is hugely expensive. Furthermore, with (largely) cheap software upgrades the cable companies' coaxial cable can be upgraded such that upload and download speeds can be comparable to fiber optic cable.

The opportunity to invest arose because many investors were unimpressed by the overall revenue growth of the cable companies. This superficial analysis missed an important point: while the cable companies were losing video subscribers (to the likes of Netflix) they were gaining more broadband subscribers. At the revenue line this looked largely awash with revenue growth running around mid-single digit. However, what this missed was the huge difference in profitability between a video subscriber and a broadband subscriber. Cable companies are distributors of content in video and therefore need to pay for that content. A typical video subscriber may generate $90 per month of revenue but the content cost of this subscriber will be c.$60 leaving a gross margin of only $30. This gross margin then needs to cover high customer equipment costs (much higher for video than for broadband) and servicing that customer leaving an operating profit per subscriber of only c.$10 per month. A broadband subscriber on the other hand is likely paying upwards of $60 per month but has no content cost associated with them so gross margin is $60. The equipment is also cheaper as is the servicing requirement so the operating profit per broadband sub is multiples of the video subscriber. This math's meant that despite fairly pedestrian overall revenue growth, earnings growth would be much higher (c.20% pa). At that cash flow level this growth would be augmented further as the capital intensity of the network declined (as a percentage of revenues) due to a shift to a more passive and lower maintenance network configuration (including more fibre optic cable). At the per share level, Charter further turbocharged growth by aggressively using their free cash flow to buy back shares, reducing the number outstanding by almost one third from our original purchase in 2015 from 314m to c.210m currently. This has resulted in a compound growth rate in free cash flow of 26% over our holding period.

Looking forward we remain confident in the opportunities still ahead for Charter. Broadband growth will continue with the company having only around 50% of houses subscribed to its service in the areas it operates. Given their economic lead (the infrastructure is already there) and the (medium-term) pathway to deliver 10Gb symmetrical service offering, we think they will continue to win customers from all but fiber optic cable and even here, they are well positioned given the infrastructure cost to lay fiber. Outside of broadband there are two further exciting areas of growth together with the continuing drag of "cord-cutting" of video subscribers. We believe that "cord-cutting" will remain manageable for the company as it has in the past despite the success of Netflix / YouTube / Amazon Prime / Disney+ etc. The growth areas are in commercial customers and mobile. In commercial customers the cable companies have historically not competed well against the telco incumbents but this is now changing as they prove that they can deliver both on the infrastructure requirements but also on the service levels required.

However, it is in the mobile arena that the greatest gains might accrue - the mobile market in the US is approximately double the earnings before interest, taxes, depreciation, and amortization (EBITDA) pool of the cable companies (c.$80bn vs c.$40bn). This is a huge market that Charter (and the other cable companies) can attack and once again, they seem to be serendipitously well placed. Charter and Comcast (another large cable company) have a multiple virtual network operator (MVNO) agreement with Verizon which allows them to piggy back off the Verizon network and thereby offer a full mobile service. However, most mobile usage is data and most of this is done over Wi-Fi. Here the cable companies have a huge advantage with a massive existing Wi-Fi network. Furthermore, they can cherry-pick the areas where they are offloading the most data / calls to Verizon and invest solely in those geographic areas using the latest technology (5G over mid band spectrum most likely). This will reduce the amount they need to pay to Verizon under the terms of their MVNO agreement. As a result of this, the cable companies might prove to be highly disruptive in the mobile industry, pricing their product well below that of the incumbents but at the same time generating a profit (and importantly increasing customer loyalty in broadband). The recent announcement from Charter reducing prices substantially (and well below the incumbents) underpins our confidence in this thesis. Significant success is not built into our models with an expectation of only modest earnings from mobile by 2026 but it is an area that we could well prove to be unduly pessimistic. Even absent success in mobile, Charter still seems good value. With continued growth in broadband subscribers (and some modest pricing benefits), improving capital intensity and continued share buy backs we estimate 2025 free cash flow per share around $70. Valuing the company on a forward multiple of 15x FCF gives an internal rate of return (IRR) of over 12%.

Alphabet is another long-standing holding – we first invested in Alphabet (parent company of Google) in June 2010. Whilst the company is known for Search, Android and YouTube, its primary method of revenue generation is advertising. When we initiated the investment, the company traded c.13x 2011 ex-cash earnings. Since that point both revenues and net income have risen at an impressive 23% CAGR. The market cap has increased at a 25% CAGR. This in itself is an interesting counterpoint to current technology valuations and embedded expectations. Around the time of investment, the market had concerns regarding the transition from Google's then dominant desktop search business to mobile. One of the issues was during the transition, pricing was far lower on mobile formats. This gave rise to a concern that pricing was getting impacted and mobile was going to eat the lunch of desktop. Google simultaneously faced an existential threat as to whether it would be as strong in the mobile world and Bing had recently launched. In hindsight investors at the time missed 3 points. One was simply the low penetration of online advertising, where Google has dominant market share, which in 2010 was $68bn, 14% of the $475bn global advertising market. Today, that figure stands at $457bn, some 61% of the global advertising market of c.$750bn. The second was the ubiquity of mobile phone usage driven by location, utility, personalisation and preference changes in consumption (e.g. YouTube) culminating in a better product for advertisers, which Google could price for.

The third was Google's position in the ecosystem as a gateway for intention, which continues to drive network effects. Whilst this all seems obvious today, it wasn't at the time. However, even with many unknowns you were not having to pay to take that risk, you simply needed to ask whether the business was sustainable. Google in 2010 was a classic 'fallen angel' and it should remind us that even the best companies can face doubt and scrutiny ("The Everything Store", charting the rise of Amazon, is instructive on this). Finally, as an investor, it highlights the continuing importance of patience (opportunities will arise), perspective based on facts (outside view) and a focus on the long term.

Alphabet maintains material competitive advantages and opportunity a decade later. One of the key aspects of Google's importance is the utility it provides for users. This is hugely understated. However, it can be measurable e.g. consumers being able to ascertain better price transparency or using Google Maps to find a location. It could even be free online guitar lessons on YouTube. The business model largely relies on advertising funding but the benefit/utility to users is significant. The second consideration is intention. Users go to Google when they have a need. Arguably, you share more information about intention with Google than any human. These factors remain enduring and highly valuable to its users. In terms of maintaining this position Google has both a competitive barrier and competitive strength. The competitive barrier is the network effect of search and honing of the algorithms. More data processed produces a more finely tuned algorithm which in turn drives better results and more usage. This is extremely hard to compete against, 'as good' on a product which is deemed free to the user simply isn't good enough. Competitor Bing speaks to the difficulty - it has been in business for 12 years and in 2010 had 3% market share, whilst this has grown over a decade it still resides at c.7%. Whilst this is a barrier, Google implicitly has a significant strength that is not widely articulated - agility. The company, given its scale and platform, can deploy new products or innovations in hours and get statistically relevant information on success or failure of its own product. It can alter or rescind in rapid time. This ability is extremely rare - think of how easily a manufacturing process can be altered and tested - it would take months at best.

Alphabet continues to have opportunities to deliver profitable growth, and this has been exhibited in its 2yr growth CAGR of 23% in high margin search/network revenues, which is its most mature business. It is driven in part by greater and better personalisation that should continue to reflect in pricing (given higher return on advertising spend) and significant parts of the economy that still aren't digitised (e.g. e-commerce is still only <20% of retail sales in the US). YouTube (growing at a 40% 2yr CAGR), which has taken share from traditional TV viewership whilst also being able to personalise advertising, unlike traditional formats. Over and above the core search business, the company has also invested heavily in its cloud business, autonomous driving and artificial intelligence using profit dollars generated in its core and redeploying them. AI in particular has potentially significant opportunities, where Alphabet is in a leadership position, but at present monetisation is nebulous (it will likely feature in its cloud business). Whilst different in context, there are parallels to 2010 in terms of asking what is being priced in? At present the company trades at 24x ex-cash earnings, but operating profit is impinged by c.10% on investments in Cloud and Other Bets which likely have positive value - effectively this places the core business on <22x, assuming no real positive value for those businesses. Alphabet has the ability to deliver mid-teens revenue and operating profit growth into the medium term which does not look expensive in absolute terms, or especially in the context of the S&P trading at 19x. We would argue given the market opportunity, the inherent competitive strengths of the business, better cost execution and the option value of some other newer businesses that this remains a compelling long-term investment.

2. Fund performance contributors & detractors for past quarter

Relative attribution by region

	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	6.3	-16.0	-1.1	3.3	-4.4	-0.1	-0.2	-0.8	-0.9
North America	68.4	2.0	1.3	70.9	0.2	0.2	0.0	1.2	1.2
Africa/Middle East	–	–	–	0.2	2.8	0.0	-0.0	–	-0.0
Europe ex UK	11.6	-1.0	-0.1	14.6	-1.9	-0.3	0.1	0.1	0.1
Japan	–	–	–	6.8	4.6	0.2	-0.3	–	-0.3
United Kingdom	8.2	-0.6	-0.0	4.2	-0.3	-0.0	-0.0	-0.0	-0.0
Cash and equivalents	5.5	n/a	-0.0	–	–	–	-0.0	–	-0.0
Total	100.0	0.1	0.1	100.0	-0.0	-0.0	-0.3	0.4	0.1

Relative attribution by sector

	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	3.5	-31.3	-1.3	11.9	-1.3	-0.2	0.2	-1.2	-1.0
Consumer Staples	4.2	-7.1	-0.3	7.0	-1.9	-0.1	0.1	-0.2	-0.1
Energy	–	–	–	2.9	1.3	0.0	-0.0	–	-0.0
Financials	6.4	-2.2	-0.1	13.4	2.1	0.3	-0.2	-0.2	-0.4
Health Care	29.4	4.0	1.2	12.7	1.0	0.1	0.2	0.8	1.0
Industrials	21.3	-2.3	-0.5	10.5	-1.9	-0.2	-0.2	-0.1	-0.3
Information Technology	10.9	1.0	0.1	22.6	1.4	0.3	-0.2	-0.0	-0.2
Materials	–	–	–	4.3	-5.0	-0.2	0.2	–	0.2
Communication Services	18.8	4.0	0.9	9.2	0.2	0.0	0.1	0.7	0.8
Utilities	–	–	–	2.8	-1.1	-0.0	0.0	–	0.0
Real Estate	–	–	–	2.7	-0.5	-0.0	0.0	–	0.0
Cash and equivalents	5.5	n/a	-0.0	–	–	–	-0.0	–	-0.0
Total	100.0	0.1	0.1	100.0	-0.0	-0.0	1.9	-1.9	0.1

Top 5 contributors and bottom 5 detractors

	Portfolio			**Index**			**Attribution**
Holding	**Average Weight**	**Total Return**	**Absolute Contribution**	**Average Weight**	**Total Return**	**Absolute Contribution**	**Total Effect**
Top 5 relative stock contributors							
Catalent	2.9	23.1	0.6	0.0	23.1	0.0	**0.6**
Alphabet	8.6	9.5	0.8	2.7	9.5	0.2	**0.6**
Thermo Fisher Scientific	3.3	13.3	0.4	0.4	13.3	0.0	**0.4**
BAE Systems	4.2	5.7	0.2	0.0	5.7	0.0	**0.2**
The Cooper Companies	3.3	4.4	0.2	0.0	4.3	0.0	**0.1**
Bottom 5 relative stock contributors							
Alibaba Group	2.5	-34.7	-1.0	–	–	–	**-1.1**
Canadian Pacific Railway	3.9	-15.2	-0.6	–	–	–	**-0.6**
Safran	3.2	-8.3	-0.3	0.1	-8.3	-0.0	**-0.3**
Unilever PLC	4.0	-6.8	-0.3	–	–	–	**-0.3**
Illumina	1.1	-14.3	-0.1	0.1	-14.3	-0.0	**-0.1**

Portfolio Attribution Commentary

Positive Contributors

Alphabet continued to perform well over the quarter and the position was trimmed. Google's sprawling ecosystem includes the world's most popular online search engine, mobile operating system (Android), streaming video site (YouTube), web browser (Chrome), and email platform (Gmail). These platforms all support Google's core advertising business, which sells search, display, and video ads across its platforms. According to eMarketer, Google will likely account for 28.6% of all digital ad spending worldwide this year. Additionally, Google Cloud's revenues surged 46% when last reported, as the usage of its Cloud services accelerated throughout the pandemic. Whilst Cloud is not profitable yet, and it still ranks a distant third place in the cloud infrastructure market, it continues to expand and secure a growing list of major partners, including Target, Home Depot and Twitter. Google Cloud's profitability should improve as it expands, but it can subsidise its growth with its higher-margin advertising business until that happens. There have been some concerns about valuation should interest rates rise but any pull back may make the shares attractive given the current 26 times forward multiple.

Thermo Fisher Scientific shares rose after the company said it anticipates total revenues of $40 billion for 2022, a 12 percent increase over its $36 billion in anticipated revenues for 2021. It has also increased expected earnings per share. The company's 2022 figures assume 8 percent core organic revenue growth and $750 million of COVID-19 testing response revenue, as well as $6.0 billion in revenue from clinical research services provider PPD, which Thermo Fisher Scientific is set to acquire by the end of 2021. Announced in April, Thermo Fisher Scientific is to buy PPD for $17.4 billion in cash and the assumption of $3.5 billion in debt. The acquisition is expected to add $1.50 to its adjusted EPS (earnings per share) in the first 12 months after the deal closes. PDD complements Thermo Fisher Scientific in being a leader in clinical trials management (80% of revenue) and lab services, which offers lab capability to support clinical trials. The company has 165 facilities in 50 countries and in the last 5 years has been involved in 400 drug approvals. The company also authorized the repurchase of $3 billion of shares of its common stock in the open market which replaces the company's existing repurchase authorization, of which $500 million was remaining. Amongst a number of announcements over the quarter, the company has announced a contract award from the US Department of Defence (DoD) to ensure reliable domestic production of pipette tips, which are used within research and diagnostic labs to dispense precise amounts of liquid. Laboratory consumables have been vital in global COVID-19 mobilisation, from sample collection vials for diagnostic test kits to lab plastics and materials for vaccine production and biobanking (biorepository that stores biological samples for use in research). Since the start of the pandemic, Thermo Fisher Scientific has invested more than $180m to expand its laboratory consumables production and another $600m to increase global bioprocessing capacity.

Catalent is a contract drug manufacturer which has been involved in the manufacturing of COVID-19 vaccines, including those from Moderna, AstraZeneca and Johnson & Johnson. As one of the world’s largest drug manufacturers, it makes 73 billion doses of drug and health products annually, with 83 of the world’s top 100 drug companies as its customers. Catalent spent much of the pandemic scaling its capacity to meet the massive demand for the production of COVID-19 vaccines and treatments (it’s on track to deliver over a billion vaccine doses this year alone) while also continuing to manufacture a broad range of other medicines (including over 130 products in its development pipeline). This demand was highlighted in the quarter (and its fiscal Q4 earnings), when it reported revenue rising 26% to $1.2 billion, while earnings per share jumped 29% to $1.16. Adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization) came in at record levels, driven by “robust growth” in its biologics segment, which accounted for 48% of net sales. Catalent has made a number of recent acquisitions to further its position in growth areas, buying Juniper Pharmaceuticals, Paragon Bioservices and MaSTherCell in a bid to cement its position as a leading biologics and gene therapy manufacturer. During the quarter under review, it acquired Bettera Holdings to expand its manufacturing capabilities for vitamins and supplements for $1bn. Bettera owns such candy brands as Jolly Rancher, Whoppers and Milk Duds but more importantly is also a manufacturer in the gummy, soft chew and lozenge segments of the nutritional segments market. Chewable forms of vitamins, such as gummies, are gaining popularity, especially among people who find swallowing pills difficult, and the market is expected to reach $9.3

billion by 2026, according to an independent report by Allied Market Research. The current market is less than $6bn. The acquisition will enable Catalent to expand its current consumer health technology platform with a wider range of technologies and ready-to-market product libraries, as well as a variety of packaging options to meet customers' branding needs. Given Catalent is the leading global innovator of softgel and oral technologies, the acquisition of Bettera will allow the company to significantly accelerate the growth of its consumer health business.

The Cooper Companies operates through two business units, CooperVision (mainly contact lenses) and CooperSurgical (mainly fertility treatment). Coopers reported a very strong quarter with record revenues at CooperVision and CooperSurgical, driving record earnings and robust free cash flow. CooperVision's growth was broad-based and led by daily silicone hydrogel portfolio of lenses and a solid rebound in the EMEA region. Consolidated revenues were $763 million, with CooperVision at $558 million, up 20%, and CooperSurgical at $206 million, up 58%. There was positive news as the Chinese National Medical Products Administration (NMPA), which regulates medical devices and pharmaceuticals in China, approved CooperVision MiSight 1 day contact lenses for use within the country. MiSight is the first Chinese NMPA approved soft contact lens with an indication relating to slowing the progression of Myopia in 8-12 year-olds. Myopia (near-sightedness or short-sightedness) progression has been linked to causing cataracts, retinal detachment, glaucoma and myopic maculopathy later in life. Within China, the prevalence of myopia among high school students is estimated to be around 80 percent. Coopers' myopia management portfolio grew 90% over the quarter, with MiSight up nearly 190%. The latter still only translates to $5m but given the lens is the only US FDA (Food and Drug Administration) approved myopia lens and now China approved lens, the first mover advantage could be huge. These things are precise scientific devices and do not take 5 minutes to develop strengthening barriers to competition. Outside of China, the pilot programs are live and expanding, and in-person training has resumed in many markets, including in the United States. Coopers now have over 40,000 children wearing MiSight worldwide, and that number is growing quickly. The average age of a new MiSight wearer is 11, So, this treatment is bringing children into contact lenses at a much younger age. Approval in China required the lens be manufactured post-approval so ramp up will be during 2022. The fertility segment of Cooper continued to perform exceptionally well, growing 72% year over year to $83 million. The company is benefiting from increased utilisation of its artificial intelligence-based genetic testing platform, which increases the doctor's ability to select the best embryos for transfer. Regarding the broader fertility market, the global landscape remains fragmented with significant geographic diversity but an addressable market opportunity of well over $1 billion and mid- to upper-single-digit growth. It's estimated that one in eight couples in the U.S. has trouble getting pregnant due to a variety of factors, including increasing maternal age. More than 100 million individuals worldwide suffer from infertility.

Global defence, aerospace and security company BAE Systems has launched a £500m share buyback scheme and raised its dividend after its half-year earnings topped £1bn. The buyback is the first for the company since 2014. The group confirmed its earnings totalled £1.03bn during the six months to 30 June 2021, a rise from £849m which it posted during the same period in 2020. The company also raised annual guidance. For the full-year, BAE Systems said it expected underlying earnings per share to grow by 3% to 5% over last year's result, even if the pound continued to strengthen against the dollar, representing an improvement on previous forecasts. The half-year results come as the group announced it had been awarded a £250m contract by the Ministry of Defence to progress the development of Tempest, the replacement fighter jet for the Typhoon. BAE Systems has seen a series of new and renewed contracts, as Defence has been largely unaffected by the pandemic, with governments sticking to military and security commitments, and in some cases raising them. Last year, the firm secured a £1.3bn deal to help produce 38 Typhoon fighter jets for the German Air Force. Meanwhile, its F-35 programme has begun catching up on the order backlog caused by COVID-19 disruptions. The other development during the quarter was news of the formation of a new military alliance between Australia, the UK and the US. The first major initiative is helping Australia build nuclear-powered (not nuclear armed) submarines for its navy. A nuclear-powered submarine can stay under water for up to five months and operate silently unlike the diesel-powered Collins submarines currently operated by Australia. BAE Systems owns a nuclear submarine building facility in Barrow-in-Furness, Cumbria, which completed its first submarine for the Royal Navy 120 years ago and which has been building nuclear submarines for the Royal Navy for six decades.

Negative Contributors

The largest detractor in the quarter was Alibaba, whose shares fell a third over the three-month period. There has been an onslaught of regulatory measures coming out of China, not solely aimed at Alibaba and the technology sector, but increasingly more broad reaching. President Xi Jinping promoted the ideal of letting some ‘get rich first’ before allowing others to catch up. President Xi Jinping is now looking to focus on this catch-up phase with ‘common prosperity’ for all. The Chinese Central Financial and Economic Affairs Commission, chaired by Xi Jinping, has emphasised the need to ‘regulate excessively high incomes and encourage high-income groups and enterprises to return more to society’. In fact Xi Jinping has mentioned the phrase ‘common prosperity’ over 60 times this year and whilst the focus has largely been on e-commerce and greater competition, there is increasing emphasis on fairer employment rights (health plans, pensions, pay, etc.) and with it clear implications for those sectors seen as discriminating against the poorer in society including online education, property and healthcare (drug prices). A non-exhaustive list of events that have taken place against this backdrop has included the suspension of the Ant Group IPO last November after Ant's founder Jack Ma criticized the country's banking system (Alibaba owns a third of Ant and uses its Alipay platform to facilitate customers' online transactions), China's State Administration for Market Regulation launching an antitrust probe into Alibaba’s e-commerce business and the company was eventually fined 18.23 billion yuan ($2.82 billion) and its e-commerce business forced to eliminate its exclusive deals with merchants (this impacted all the large e-Commerce firms). Alibaba missed its revenue forecast raising fears that the mounting list of new government regulations was taking its toll; this has been followed by an abrupt decision by Alibaba (again, not alone) to invest 100 billion yuan ($15.5 billion) into China's "common prosperity" initiatives for improving social equality over the next five years which has raised even more questions about its growth and subservience to the Chinese government. Additionally, they are being encouraged to sell the 5% stake in Mango Excellent Media Co., a TV shopping and entertainment network based in the central province of Hunan, only nine months after buying the stake. On top of this we have had the Didi IPO reprimand which has led to claims that China plans to propose rules that would stop companies from going public in the U.S. if they have large amounts of sensitive consumer data (and thus questioning the VIE (variable interest entity) structure). China launched an extensive overhaul of its online education sector, posted notices that online food platforms must respect the rights of delivery staff and ensure that those workers earn at least the local minimum income, China’s government quietly appointed a director to the Board of ByteDance Ltd’s key domestic subsidiary, the proposal that government is to stop treating some of its businesses as so-called Key Software Enterprises (KSE) - a designation that conferred a preferential 10% tax rate, meaning tax rates will rise for the e-commerce companies and on top of that a U.S. law that could delist shares of Chinese companies that don't comply with new auditing rules within the next three years. Against this drip feed of perceived negative news, Alibaba shares have been weak, as has the wider Chinese market. Setting aside that some of the actions of the Chinese government could be seen as fair and responsible, the short-term landscape has unsettled investors views on the likes of Alibaba. It’s highly probable the company will continue to play a pivotal role in supporting growth within the Chinese economy and benefiting from digitalisation in all aspects of life. One area likely to grow significantly is Cloud infrastructure, which is still in an early stage in China and an area in which Alibaba not only exceeds but is on the cusp of turning profitable. For context, cloud is the most profitable business segment at Amazon and helped transform Microsoft from a windows business. Alibaba currently trades at less than 15X earnings, the lowest in its history as a public listed company and management is raising the size of share buy-backs. Arguably, the barriers to entry have been raised and new entrants are likely to spend less amid the current regulatory environment. Alibaba will keep investing and pursue multi-app strategies that will further drive the user base across multiple initiatives which are in the early phase of growth (e.g. online bargain shopping platform Taobao Deals and a marketplace for second-hand goods (there is a growing ‘re-commerce’ trend) called Idle Fish).

Unilever shares dropped after releasing its results on 22 July. The underlying sales growth compared to a year ago beat analyst expectations, coming in at 5.4%. Most of this was attributable to its rapidly expanding e-commerce channel, which grew by a further 50%. Its online sales remain a small portion of the overall revenue stream (around 11%), but they are growing in importance. The food solutions business continued to recover, led by China, with the number of restaurants being served 5% higher than pre-pandemic. The US is also showing an improving picture with restaurants back open, although the hospitality sector in Europe remained severely impacted for most of the reporting period. At a global level, restaurant demand overall remains below pre-COVID levels. The concern was inflation of input costs. The firm's operating margin fell by a percentage point to 18.8% on an underlying basis, with underlying earnings per share down 2%. The company had expected to see percentage commodity inflation in the second half in the low to mid-teens. During the results they reported on further incremental price increases across many commodities which weighed on sentiment. The main impact is coming in materials, packaging and, most notably, in freight and distribution costs. Crude oil, which impacts ingredients used in home care products, as well as the resins for packaging material, have seen prices pick up rapidly from the all-time lows seen in 2020. The crude oil price is up 60% versus prior year and has risen 12% since the previous Unilever results. This is driven partly by demand recovery as countries exit lockdowns and OPEC keeping production supply tight. Soybean oil has been accelerating inflation. It's an important ingredient in dressings. Soybean oil prices have increased by a further 20% just in the last quarter and are now up 80% versus last year. The increase is driven by increased demand coupled with a poor US soy crop in 2020. The price of palm oil, a key ingredient for skin cleansing products, is now 70% higher than its long-term average with increased demand and lower harvest yields driving up the price. The large increases in freight and logistics costs are the result of demand outstripping supply on sea freight and labour shortages across the distribution industry, especially in the United States. Packaging has also seen further price increases in the last few weeks on top of already high levels, the result of high demand for packaging from online shopping and weather-driven supply shortages. Unilever continues to proactively evolve the portfolio with the recent acquisition of Paula's Choice, through the separation of the tea business, and also the separation of a number of smaller beauty brands and personal care brands with a dedicated management team under the name Elida Beauty. They also report very strong performance in the higher growth segments Prestige, Beauty and Functional Nutrition. Paula's Choice is a digitally led, cruelty-free skincare brand with a strong presence in key growth markets like the US and has excellent potential for further international expansion. The company has pioneered science-backed products and has a very strong direct-to-consumer e-commerce business. The operational separation of the tea business is now substantially complete and in the process of being sold. For the full year, Unilever expect underlying sales growth well within their multi-year framework of 3.5%. with margins to be around flat. The company announced a share buyback of up to EUR3 billion earlier in the year, which reflected the strong free cash flow delivery and balance sheet position. The first tranche of €1.5 billion was completed during the quarter.

Safran reported revenue and earnings that fell in the first half as expected from an aero-engine manufacturer, but it expects a better second half, and confirmed its 2021 outlook for sales and profitability. Adjusted recurring operating income came to 659 million euros ($778.8 million) in the period, down 30% on the previous year. Adjusted revenue came to €6.88 billion, down 22% from the previous year. Much of Safran's revenue is made up of servicing and parts which is charged on a per kilometre flown basis. As such its shorter-term figures are largely determined by the number of planes flying and distance flown. In China, for example, after being over 2019 levels between March and May and then down in June, flights are now back at 2019 levels. In the US, they are -15% below 2019 levels and Europe at -35% having been at -70% in May. Asia Pacific ex China is still the most impacted area at -70% to pre-pandemic levels. Safran owns an interiors business, supplying, amongst other things, the seating. Safran Seats business saw a strong decline in business class programs as airlines weigh up whether business class demand will return to pre-pandemic levels. In terms of engines deliveries, the combined shipment of CFM56 and LEAP engines reached 448 units in H1 2021 versus 534 units in H1 2020 (down 16%). The company has a backlog of more than 9,300 engines as at end June 2021 and 60% of the popular Airbus A320neo family. During the period, Indigo selected the LEAP engines for its fleet of 310 new Airbus A320 planes with a multi-year service agreement. Safran confirms its full-year 2021 outlook and its underlying assumptions in a context in which the level of uncertainty over the timing of recovery continues to prevail. A delay in the pace of civil aftermarket recovery during the second half of the year constitutes an element of risk to this outlook. Shares performed well in September as more routes were opening up. Safran expects adjusted recurring operating margin to increase above 100 bps, at least a 300 bps improvement versus H2 2020 and free cash flow generation to increase above 2020 levels.

Canadian Pacific Railway (CP) has won a takeover battle for Kansas City Southern (KCS) after Canadian National Railway declined to increase its offer, claiming an asset that would create the first railroad spanning the U.S., Canada and Mexico. Given the recent trade deal between the three countries, the onshoring of companies back to the US against trade tensions with China and the positive solution trains offer companies trying to lower their carbon footprint, the deal should be additive longer term. Kansas City Southern terminated its $30 billion agreement with Canadian National and agreed to CP's $27 billion merger proposal. The turning point in the deal was a ruling by the regulator, the Surface Transportation Board (STB), which decided unanimously against Canadian National making use of a voting trust, which CP had already been granted. 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. CP, 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 their cash as outlined in the merger agreement, even though CP would not yet officially own Kansas City Southern. The STB has already granted CP 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 CP 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, would have its bid judged under a higher standard that requires it to prove its proposal would actually benefit shipping customers. The STB turned down Canadian National permission to set up a voting trust and Canadian National has walked away from the potential merger. There is still an element of uncertainty as President Biden's executive order in July is aimed at anti-competition manoeuvres in the railroad industry and a host of others. The STB must still approve the KCS and CP deal with this new scrutiny in the backdrop. Regulators in Mexico and shareholders must approve it as well. This may explain the subdued share price despite the positive outcome and second quarter results that beat expectations coupled with reiteration of full year guidance of double-digit EPS growth.

Illumina manufactures gene sequencing machines. Its machines control 90% of the market in the US and were used to make the first sequencing of the COVID-19 virus genome which then enabled vaccine development. In 2016, it spun out a business it founded, called Grail which was a pioneering company focused on detecting cancers using blood tests before any symptoms have emerged. Illumina decided to buy back the business (first announced in September 2020) in a $8bn deal which completed during the quarter. Grail released a test that screens for up to 50 cancers from a sample of blood and Illumina can clearly see the potential market as the world moves increasingly to preventive medicine. The NHS in the UK is currently trialling the test in the over 50's age group. The global market for cancer gene-sequencing could be worth $75bn by 2035. The impact on taking cost out of the healthcare system could go far beyond that especially if insurers cover the cost of tests given the savings associated with early detection. The reason for the shares being weaker is that Illumina faces a showdown with regulators in America and Europe, who have some concerns on how similar early-stage acquisitions gave rise to the dominance of other tech giants including Alphabet, Facebook etc. Illumina has defiantly gone ahead with the transaction before regulators have given it the green light. Last year the Federal Trade Commission (FTC), America's antitrust agency, blocked Illumina's acquisition of another sequencer, Pacific Biosciences, on the grounds that it would be anticompetitive. Its current objection is that acquiring Grail will harm innovation in the nascent market for early detection of cancer. The European Commission (EC) has launched a parallel investigation, alleging Illumina could restrict Grail's rivals from accessing its gene-sequencing technology. On August 18th Illumina defied the Europeans, saying that because an EC decision was not expected until after the deal expires (which would incur a break-up fee), it would complete the transaction anyway and hold Grail separately. Through the Luxembourg court, Illumina is claiming the EC does not have jurisdiction over the merger since Grail does not operate in the EU. By closing the deal ahead of regulatory clearance, Illumina closed the door on the FTC's ability to file for an injunction preventing the transaction. This means Illumina is no longer on the hook for a breakup fee. The company can now accelerate Grail's development timelines. Part of the antitrust argument hinges on customers of Illumina who hope to compete with Grail in testing may worry that Illumina will charge them higher prices for sequencers.

That would give Grail (if it has lower sequencing costs) an edge. Illumina assures that it has no incentive to harm its clients, because it makes much more money selling sequencers than it does selling tests. It has also pledged to supply sequencers to them on the same terms as it does to Grail. Despite this, investors have been spooked by the merger which pits an acquisitive company on the technological frontier against regulators who may wish to rewrite the rules of tech competition. We are relatively relaxed with the transaction going ahead on the basis that a) the deal break fee would be higher than the potential maximum fine of 10% of combined revenues that the EU could make Illumina pay, b) we expect a small chance they gain approval to close the deal but it is more likely that it will not be approved by regulators in Europe. Illumina will appeal if they lose. This is likely to lead to several years of legal wrangling with the most likely outcome that Illumina are forced to divest Grail in 2024/25. The most likely way this would happen would be a spinoff to shareholders. In the time between now and then we would hope to see Grail make meaningful progress. So far this year Grail has continued to tick off the expected milestones. They launched the Galleri test in the US and they have partnered with Quest diagnostics to use their phlebotomy services for blood sample collection. In September the test was approved by the New York State Department of Health making the test now available by prescription in New York. And perhaps most importantly the NHS trial referred to above which is a 140 000 patient real world use study of Galleri. In summary, we believe we most likely end up owning Grail whatever happens from a regulatory perspective. If they are successful making Galleri the standard of care for early cancer detection then this acquisition, while not ideal how it was done, will work out well for shareholders and hopefully lead to many people surviving cancer that may not have if their disease was detected at a later stage.

3. Current Positioning

Top 10 Portfolio Holdings

Holding	Sector	Country	Portfolio %
Alphabet	Communication Services	United States	7.8
Charter Communications	Communication Services	United States	5.7
Microsoft	Information Technology	United States	4.5
Unilever PLC	Consumer Staples	United Kingdom	4.1
BAE Systems	Industrials	United Kingdom	4.1
Amazon.com	Consumer Discretionary	United States	4.0
Canadian Pacific Railway	Industrials	Canada	4.0
Facebook	Communication Services	United States	3.8
UnitedHealth	Health Care	United States	3.7
CVS Health	Health Care	United States	3.6
Total			**45.2**

Portfolio Breakdown

Region	Portfolio %
North America	67.6
Europe ex UK	11.7
United Kingdom	8.2
Asia Pacific ex Japan	5.6
Cash and equivalents	6.9
Total	100.0

Sector	Portfolio %
Health Care	27.6
Industrials	21.8
Communication Services	17.3
Information Technology	11.1
Consumer Discretionary	6.0
Financials	5.2
Consumer Staples	4.1
Cash and equivalents	6.9
Total	100.0

Currency	Portfolio %
USD	76.5
EUR	15.8
GBP	4.1
AUD	3.6
CAD	0.0
Total	100.0

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. In this scenario we provide rationale to justify our voting decision.

The first section of this report details the overall votes cast and the breakdown of these votes. In cases where we voted "AGAINST" management, rationale is provided.

During the period there was 1 meeting and 4 votable resolutions across the companies: Alibaba Group Holding Limited.

Voting statistics	
Meetings voted	1
Votes Cast	4
Votes "FOR" Management	2
Votes "AGAINST" Management	2

Votes by country	%
China	100.0

Votes by Industry sector [1]	%
Internet & Direct Marketing Retail	100.0

"FOR" Management
"AGAINST" Management

[1] Votes by Industry Sector uses the Global Industry Classification Standard ("GICs") coding level 3 "Industry" classification.
Source: Veritas Asset Management, ISS

Proxy Voting - Proposal Categorisation

The information provided below details the vote categorisation.

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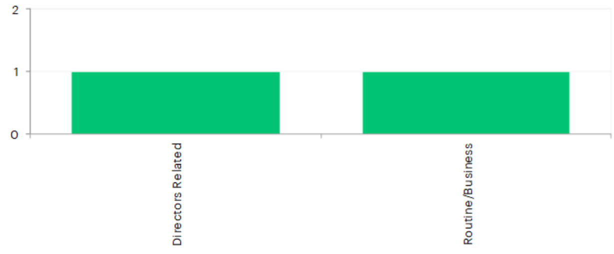
Vote categorisation [1]

Category	Votes "FOR" Management	Votes "AGAINST" Management	Total
Directors Related	1	2	3
Routine/Business	1	–	1
Total	**2**	**2**	**4**

Votes "FOR" Management Categorisation



Votes "AGAINST" Management Categorisation

Please refer to the glossary for descriptions of category classifications.
Source: Veritas Asset Management/ISS

Across the 4 resolutions, votes cast by VAM LLP resulted in 2 votes "FOR" management and 2 votes "AGAINST". Please see detailed below rationale examples where votes cast have resulted in a vote "AGAINST" management.

VAM LLP Rationale – Votes "AGAINST" Management Recommendation

Report Item	Company	Proposal	Management Vote Recommendation	VAM LLP Vote	Voter Rationale
1	Alibaba Group	Elect Director Joseph C. Tsai	"FOR"	"AGAINST"	A vote "AGAINST" the non-independent director Joseph C. Tsai was warranted for failing to establish a board on which majority of the directors are independent.
2	Alibaba Group	Elect Director J. Michael Evans	"FOR"	"AGAINST"	A vote "AGAINST" the non-independent director J. Michael Evans was warranted as he is the full-time director of the company and concurrently holds the chair of another public company or is a director of more than one other public company.

Proxy Voting - ESG Red Lines

The second part of the voting report focuses on the customised Red Line element of our policy. Across the 4 resolutions voted during the period, the overall number of resolutions which triggered the Red Line element of our customised policy was 1. We voted in line ("FOR") on 1 resolutions and contrary to ("AGAINST") for the remaining 0 resolutions. In keeping with the AMNT requirement to either comply or explain, please see below rationale examples where votes cast have resulted in a vote "Contrary to" the Red Line element of our policy. Should you require further examples of rationale please contact us.

Votes "FOR" and "AGAINST" VAM LLP Policy

Votes	Red line[1]	Total
Number of votes "FOR" Policy	1	3
Number of votes "AGAINST" Policy	-	1
Total	**1**	**4**

[1] Number of Red Lines triggered and votes "FOR" or "AGAINST".

[1] Number of Red Lines triggered and votes "FOR" or "AGAINST".

Portfolio Carbon Analysis Overview

The Carbon Portfolio Report provides a deeper understanding of a portfolio's position with regards to the transition towards a low carbon economy. It compares the portfolio with a benchmark across five carbon assessments: Carbon Risk Rating, Carbon Intensity, Fossil Fuel Involvement, Stranded Assets Exposure, and Carbon Solutions Involvement. The combination of these assessments provides a multi -dimensional view of the portfolio's performance versus the benchmark and provide useful insights about the portfolio holdings.

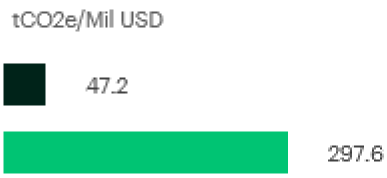
Portfolio   Global Developed Benchmark

Carbon Risk Rating

The Carbon Risk Rating quantifies the company's exposure and management of material carbon issues in its own operations as well as its products and services. Overall, the portfolio falls into the Low carbon risk category, and has 46% lower carbon risk than the benchmark.

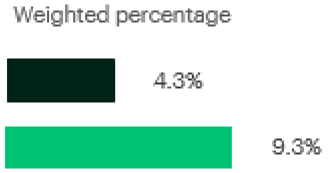
Carbon Intensity

Carbon intensity is a relative metric used to compare company emissions across industries. Sustainalytics divides the absolute emissions by total revenue, meaning the figure is expressed in tonnes of carbon dioxide equivalent per million USD of total revenue. Overall, the portfolio is 84% less carbon intensive than the benchmark.



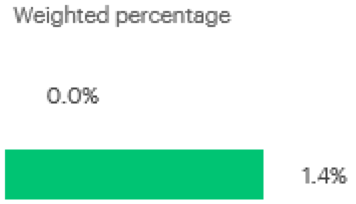
Fossil Fuels

Fossil Fuel Involvement measures the percentage of revenue that companies derive from thermal coal extraction, coal -based power generation, oil & gas production, oil & gas -based power generation, and oil & gas -related products and services. Overall, the portfolio has 54% less exposure to Fossil Fuels than the benchmark.



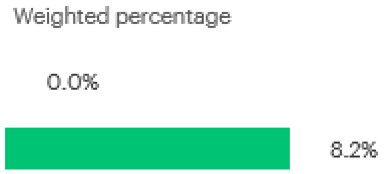
Stranded Assets

The Stranded Assets Exposure Score assesses the financial risk associated with fossil fuel production and reserves, and any specific involvement in high -cost fossil fuel projects. Overall, the portfolio has 100% less exposure to Stranded Asset Risk than the benchmark.



Carbon Solutions

Carbon Solutions Involvement measures the percentage of revenue that companies derive from green transportation and renewable energy. Overall, the portfolio has 100% less exposure to Carbon Solutions than the benchmark.



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This is a marketing communication. Please refer to the Prospectus of the UCITS Fund and the KIID before making any final investment decisions.

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UK investors should read the Appendix for UK Investors in conjunction with the Fund's Prospectus which are available from the Investment Manager. www.nedgroupinvestments.com

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