# COOPER INVESTORS FAMILY AND FOUNDER FUND

COOPER INVESTORS
AFS LICENCE NUMBER 221794
ABN 26 100 409 890

**ANNUAL PORTFOLIO REVIEW** | JUNE 2020

For the quarter, the fund generated 8.9%. For reference, the MSCI generated 6.0%.

The CI Family & Founder Fund has completed a year of investing, having commenced on the 2nd of July, 2019.

The commentary will be a broader review of the year as well as providing additional detail and insights into the strategy.

| | **Portfolio | #Benchmark | Value Added |
|---|---|---|---|
| **Since inception^** | 9.43% | 2.63% | 6.80% |
| **Rolling 3 months** | 8.85% | 5.98% | 2.87% |
| **Rolling 6 months** | 0.19% | -4.29% | 4.48% |
| **Rolling 1 year** | 9.43% | 2.63% | 6.80% |

^ Cumulative (2 July 2019) # MSCI AC World Net Divs in Australian Dollars
** Returns are gross of fees and expenses

## ANNUAL PORTFOLIO REVIEW

The Fund delivered a 9.4% return over the previous 12 months, and 0.2% for the six month period to June 30, 2020. The MSCI ACWI in AUD was up 2.6% and down 4.3% over the 12 and six month periods respectively. Point to point, these numbers appear quite mundane, despite the unprecedented level of volatility which has swept through financial markets.

The Fund's exposure to international currencies helped to mitigate the impact of equities market drawdowns in the March quarter as the Australian dollar, a pro-cyclical currency, also weakened. The June quarter saw the opposite effect as a stronger Australian dollar somewhat dampened the recovery in global equities markets.

It was pleasing that over the 12 months the Fund could generate a solid positive return as well as protect capital over the last six months as the pandemic battered global economies. More importantly, we expect the true benefits of the strategy to be experienced over the long term. Our companies are in attractive industries with management teams and owners committed to driving long term sustainable growth. It takes time to see this dynamic play out.

In order for the Fund to achieve enduring success, the stewards of the businesses in which we invest must also possess a long term mindset to investing in their businesses – our observations are that this is a unique characteristic of Founder and Family led businesses. This is especially relevant when compared to the typical listed corporate where the average CEO tenure has declined to less than five years. This has fostered a management cycle which revolves around hitting a near term EPS (Earnings per Share) target linked to bonuses. After five years, the eventual replacement CEO who typically wishes to make their own mark, sets a new strategy which comes with a new EPS target. This process often involves "kitchen sinking" numbers (i.e. releasing all bad information) to create a lower base against which to set those new targets. Leaving aside the problems with EPS as a measuring stick of company performance (we prefer Free Cash Flow and Returns), this whole charade is a great way for executives to maximise their remuneration and stature, but it is not a successful way to build an enduring business or create shareholder value over the long term. Our observations of the last six months show that many of the businesses managed with this myopic short-term EPS focus, were the ones who got into trouble due to a combination of inexperienced management teams, low conviction business strategies, poor customer relationships and "optimised" or over geared balance sheets.

In general, we expect the Family and Founder Fund to have low turnover. The intention is to leave our portfolio companies and let them execute on the opportunity set in front of them. In saying that, turnover for the year was a little higher than we would normally anticipate. As mentioned in the prior quarterly the world went from slowdown to shutdown. This necessitated a need to shift away from businesses which we perceived to have less certain operating trends as well as take advantage of opportunities to invest in attractive businesses which had become a lot cheaper. Stocks bought during this year include names such as Veeva, Eurofins and Estee Lauder, all of which were bought after they had fallen 25% - a rare occurrence for businesses of such quality.

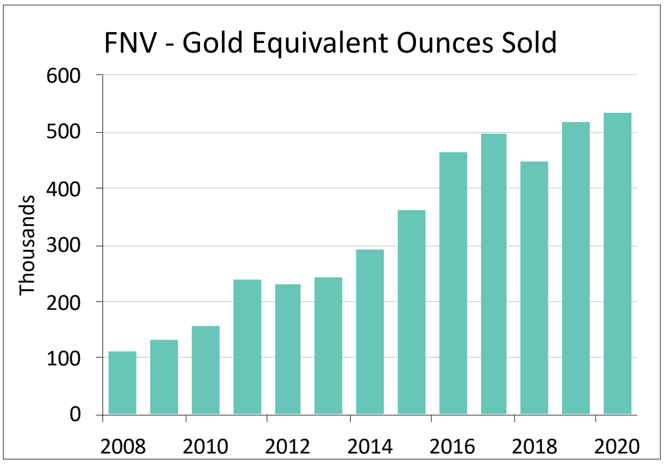
## STOCK CONTRIBUTORS

Stocks that generated strong returns over the 12 months came from a number of areas. There are those in the growth areas of software and healthcare that dominated markets. Strong performers also included companies in consumer products (Unicharm), financial services (Arthur J Gallagher) and even some industrial based businesses (Latour).

Having been in the portfolio since inception, gold royalty company Franco Nevada was the top performer for the year. Franco's share price increased 71% in local currency, benefiting as the gold price increased from $1400 to nearly $1800 over the year as well as increasing production rates across the portfolio. Note Franco also has an energy business that has suffered from the oil price decline so it was not all one-way traffic. Franco is a unique and highly profitable business model run by entrepreneurial managers and owners. The company generates ~$700m of profits with all of 35 employees.

Franco is not your typical gold company. It is in the royalty business. They do not operate or develop any mines but own a diversified portfolio of royalties and streams on mining projects. They have no exposure to the costs and capex. The history of the company dates back to the 1980s when Chairman Emeritus Pierre Lassonde and Seymour Schulich bought the first gold royalty in 1985. They grew the $2m of initial capital into $2.5bn when they sold the business to Newmont Mining in 2002. Franco management continued running the business inside Newmont and listed it again in 2007. The core team continue to run it today albeit with the next generation having greater operating responsibility.

We are attracted to the optionality in the Franco model. Firstly, the company has royalties over 56 producing gold (or gold equivalent) mining projects which are generating revenues for the company today. The nature of mining is that typically costs are greater than expected and the time to first production is longer than expected. However the mines often end up producing more than expected and last longer as technology improves. Franco are exposed to this upside without any of the costs. As such, the current 56 producing mines, which can already support the company's dividend for the next 30 years, will likely provide upside. Secondly, there is a further 241 royalties over projects that are not yet producing but that we expect to one day come on line. Thirdly, there is the reinvestment of cash flows into new royalties and streams. There are also 79 streams relating to their energy business. The Franco model of having a number of drivers delivering ounces and cash flow growth remains very attractive, beyond movements in the underlying gold price.




Source: Franco Nevada

Veeva Systems was another strong performer having been added to the portfolio during earlier in the year. This highlights the need to remain flexible and opportunistic in a long-term low turnover portfolio. Veeva is up 50% in local currency since acquiring the position while the market is down over the same period.

Veeva provides software to the life sciences sector and so far has seen minimal impact from the pandemic. We think Veeva is one of the best listed SAAS businesses we have found; it is growing its recurring revenues at 25% pa with 35% operating profit margins. During the quarter, the company announced the appointment of a new CFO in Brent Bowman, he is an experienced technology executive. Current CFO Tim Cabral had previously announced his retirement after 10 years in the role. Our interaction with Tim was important in building our conviction in the Veeva investment proposition. In our experience, having a reliable and experienced CFO often nicely complements the entrepreneurial character of Founder CEOs. Tim played that role well, complementing Veeva CEO and founder Peter Gassner. The continuation of strong growth trends combined with the appointment of an experienced financial executive to take over the CFO role saw the shares continue their strong run.

Along with Veeva the Fund owns another three software businesses that combined make up 18% of the portfolio. Information Technology is an important part of the portfolio but it is one part of the portfolio. The Fund owns a diverse range of attractive businesses. From toll roads to personal care, power tools and insurance brokerage. Our businesses continue to do well and have an attractive outlook. In saying that, the world is moving to digital and over time technology businesses will likely have a greater representation in the Fund.

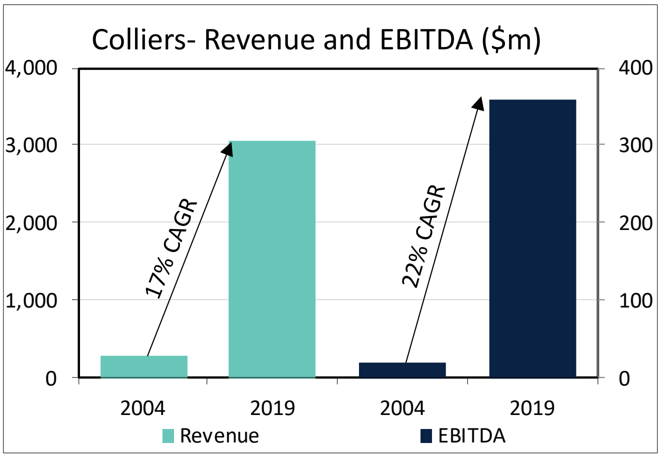
As is the case in a diversified portfolio, not everything worked during the year. The weaker performers were typically industrial, consumer discretionary and property related businesses, as they were most impacted by the pandemic.

Fortive and Colliers, which have remained in the portfolio since inception, generated negative returns of -17% for the year.

Both companies have great businesses and strong track records, but both are on a journey pivoting from cyclical to more recurring and predictable businesses. Given they are still in this evolution and are still exposed to some cyclical end markets, their earnings and share prices were hit by the lockdown impacts.

Colliers' journey started when FirstService (also a Fund holding) acquired the business in 2004. FirstService Chairman Jay Hennick founded the business nearly 30 years ago. However in 2015, when FirstService demerged Colliers as its own listed company, Jay stepped into the CEO role of Colliers, a position he still holds today. Jay along with the respective management teams owns greater than 15% of both Firstservice and Colliers.

Under Jay's stewardship Colliers has grown from $18m of EBITDA at the time of acquisition in 2004 to $350m in 2019, an increase of 20x. In 2004, Colliers was a group of franchises in the commercial real estate broking business. Jay has consolidated all the franchises into corporate entities, driving an entrepreneurial spirit and turning Colliers into a global operation. Through expanding the service offering 50% of the revenues today are in recurring revenue type businesses like property management, project management and investment management. These businesses are holding up well in the current environment. However, half the business is still broking and even though a business like leasing brokerage is a repeat business it is not pure recurring and any re-leasing activity is being pushed out given the lockdown impacts.




Source: Colliers

Whilst commercial real estate services is not a sexy industry, there is a large opportunity for Colliers and their shareholders. There is still a lot of room for Colliers to build out its service offering, grow recurring revenue streams and expand globally. They are one of only 5 global players in a $240bn market. The industry is professionalising as real estate trends to more institutional ownership, which serves the big global platforms like Colliers. Colliers earnings will be hit this year with the lockdown impacts but to highlight the earnings power and potential of the franchise, Colliers trades on 12x its 2019 free cash flow. We believe they can return to this level over the coming years and continue building out the business.

Fortive is another holding being temporarily impacted by the pandemic and associated lockdowns. This company was a spin off from Danaher, also a fund holding. Brothers Steve and Mitch Rales founded Danaher in the 1980s where they continue to own 12% of the company and remain directors. The brothers turned Danaher from an industrial business when it began in the 1980s to a leading life sciences and diagnostics company today. In 2016 Danaher spun out its legacy industrial assets as Fortive. The Rales brothers have retained a 10% stake and are board members of Fortive.

In four years as an independent company, Fortive has made meaningful moves to pivot the portfolio by selling and buying businesses to improve the growth and reduce the cyclicality of the top line. Fortive's business is now very much exposed to safety and testing themes, a growing and developing market. However with the lockdowns that have occurred, the remaining cyclical businesses are impacted. Even some of the more durable businesses have faced headwinds. For example, one of Fortive's larger businesses is supplying hospitals with sterilisation equipment and consumables. With many surgeries placed on hold to maximise hospital capacity for COVID-19 treatment, there has been a meaningful reduction in the use of surgical instruments and therefore the need for sterilisation also.

We strongly believe that Fortive's businesses will recover from these temporary headwinds, and that management will continue to high grade their company, as has been the case with Danaher for decades now.

The above highlights some of the last year's underperformers but more importantly the long term value latency opportunities in Colliers and Fortive.

## PORTFOLIO CHARACTERISTICS

At the end of June, The Fund owns 20 stocks with weights between 2.2% to 6.7%. Cash is 9.8% and held in Australian dollars.

The Fund is biased towards the smaller end of large caps with 15 stocks having a market cap between USD $1bn and $27bn. These are businesses and management with track records and successful organisations but still with opportunities to continue their geographic, product or market expansion.

We talk about investing in those companies with management teams with the skin and soul in the game. With regards to skin in the game the average insider ownership is 17%. This is a large and important number we will continue to monitor.

The quantitative figures are important, yet the soul in the game is just as, if not more important. Success and wealth can bring distractions, change of priorities and complications. Engaging with the companies is an important part of our process and helps us gauge the level of emotional investment of our management teams.

We spoke with all Fund holdings in the last six months. This was especially helpful given the turbulent economic environment but there have also been a few senior management changes across the portfolio. We are satisfied that these changes were a natural evolution in the lives of these companies.

The Fund owns businesses across the categories of subsets of value – Growth (Techtronic), Stalwart (Danaher), Bond like Equities (Equity LifeStyle Properties), Cyclicals (Colliers) and Asset Plays (Latour). This diversification in value latency drivers and appropriately allocating capital across them is a hallmark of Cooper Investors' portfolios.

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2020 is proving to be a unique year in many ways. The portfolio is full of companies with resilient and growing earnings, strong balance sheets, excellent track records and first class stewardship. These companies and more importantly, these founders and families have been through the ups and downs before. Our experience is that short term market movements are inherently difficult to predict, however we remain confident that the Fund is well placed to weather the storms and provide compelling long term returns to investors.

## SENIOR PORTFOLIO MANAGERS

**Allan Goldstein** B.Comm
Allan is the Lead Portfolio Manager for the Family and Founder Fund and joined CI in 2007, having been a foundation member of the CI global equities team. Allan has over 12 years of experience investing in international equities markets.

**Marcus Guzzardi** B.Comm, M.Comm (Hons), CFA
Marcus is the Deputy Portfolio Manager for the Family and Founder Fund. Marcus joined CI in 2012 and has 10 years of experience in equities research and investing, primarily in North American companies.

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