COOPER INVESTORS
GLOBAL EQUITIES FUND (UNHEDGED)
QUARTERLY COMMENTARY REPORT

Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

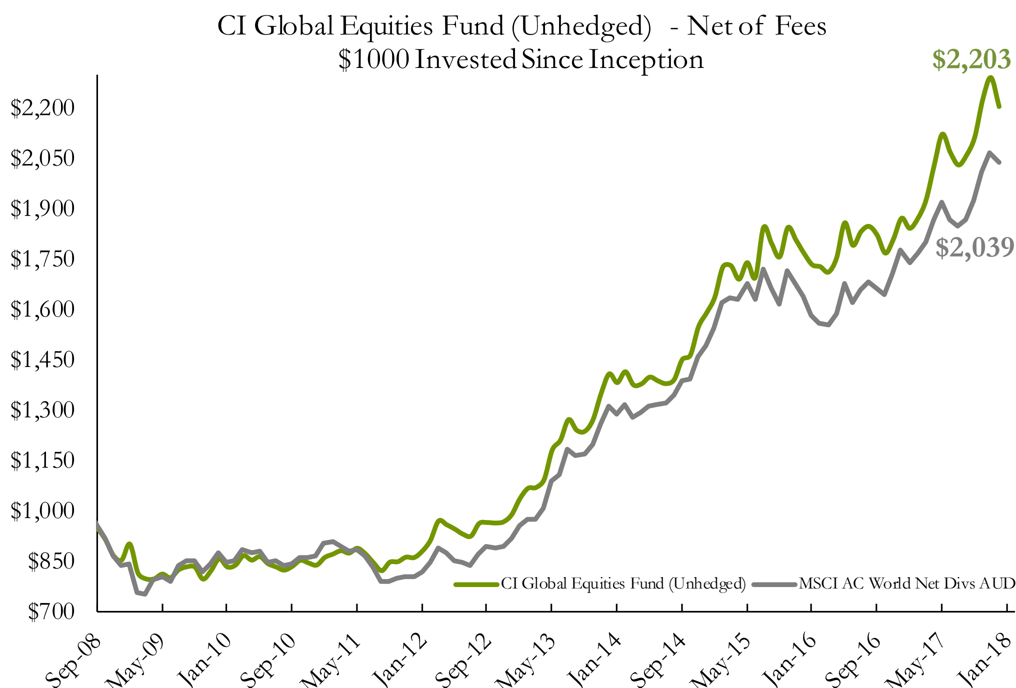
DECEMBER 2017

"Personally I feel better now we have no more allies to be polite to or to pamper." King George V, June 1940

"It is the responsibility of the individual. Don't come complaining to us if it goes wrong." Danish Central Bank Director Lars Rodhe on Bitcoin

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTHS	4.32%	6.07%	-1.75%
ROLLING 1 YEAR	17.73%	14.77%	2.96%
ROLLING 3 YEAR	11.48%	10.95%	0.53%
ROLLING 5 YEAR	17.34%	17.26%	0.08%
ROLLING 7 YEAR	14.75%	13.01%	1.74%
SINCE INCEPTION*	8.83%	7.93%	0.90%
SINCE INCEPTION^	120.26%	103.86%	16.40%

*Annualised
^Cumulative (1 September 2008).
MSCI AC World Net Divs in Australian Dollars
**Net of fees and expenses



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Market and Portfolio Performance

2017 marks ten years since the beginning of the Global Financial Crisis. In June of 2007 the bankruptcy of two Bear Stearns funds opened the door to the biggest financial crisis since the Great Depression. From the low of the subsequent bear market equity markets have enjoyed a remarkable and sustained rise. Indeed, 2017 has rewritten the history books with the *MSCI AC World Index* (local currency) recording a positive gain every single month, an extraordinary statistic never recorded since the index began.

Through the consistent application of the VoF process the portfolio has delivered mid-to-high-teens annual returns over 3, 5 and 7 years.

These investment returns were generated whilst delivering downside protection, with the portfolio out-performing its benchmark in 70% of down months, though as noted we have not seen one of those for quite some time. This is a common attribute amongst all CI Funds and is an outworking of our VoF process.

The portfolio operates with a long-term mindset. We spend most of our time researching our existing holdings and Watchlist and not jumping from investment fad to fad. Thus the portfolio turnover in 2017 has been 20% and over 3 years averages 27%. So too, the Watchlist has similar turnover characteristics to ensure a rich source of new ideas.

In the same way we view our stocks, the portfolio's short term returns (i.e. 1 year) are important to judge the near term execution of our strategy and process. However, the longer term 3 and 5 year returns are more aligned to our views and are reflective of our typical holding period.

In 2017 most large equities markets posted strong double-digit gains (S&P 500, Nikkei and Hang Seng all +20%, with Europe lagging at +13%). It was a year when growth stocks (technology related in particular) and cyclicals clearly outperformed while the more stable and rate sensitive Bond-Like Equities struggled.

Our Low Risk Turnaround stocks continue to deliver favourable risk reward characteristics as unique company specific investment propositions like **Brinks**, **OHL Mexico** and **Agilent** delivered large returns. As always, we like to remind our investors and ourselves to emphasise the 'low risk' component when assessing low risk turnarounds.

While Stalwarts underperformed in the face of strong markets, on a three-year timeframe this group has been the largest contributor to performance as stocks like **S&P Global**, **AON** and **Danaher** continue compounding shareholder returns as management realise the value latencies on offer.

In December the US tax reform bill was passed by Congress and signed by the President into law. We are not going to delve into the details of the bill however it is important to note the impact on the portfolio.

As background, our observations from many meetings over the last 12 to 24 months has led us to be more positive about end markets globally. This meant the portfolio favoured US stocks with global operations. For example, our purchases of US stocks this year include TE Connectivity which generates 65% of its revenues outside the US, while Baxter and Pentair are also both 50% ex-US companies.

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The main part of the tax bill was the reduction of the corporate tax rate from 35% to 21%. The month of December saw the share prices of US domestic retailers, telcos, banks and energy companies bounce higher in response and to lead the market. While the portfolio owns some stocks that benefit like Comcast, Costco and HEICO the portfolio is less exposed to these sectors than the benchmark given our tilt to those with global growth options.

For the three months to 31st December the portfolio returned 4.32% versus the benchmark which returned 6.07%. The AUD was flat against the USD and JPY, falling 1% and 2% to the GBP and EUR respectively.

For calendar year 2017 the portfolio returned 17.73% versus the benchmark return of 14.77%.

The biggest contributors to performance in terms of total shareholder return in AUD included:

1. **OHL Mexico** – Further developments with IFMs takeover of the concessions business, see **Stock News** for details.
2. **TE Connectivity** – Strong operating momentum.
3. **Costco** – Results continue to beat expectations – see comment in **Stock News**.

The biggest detractors to performance in terms of total shareholder return in AUD included:

1. **First Republic** – Guidance of a cost to income ratio next year.
2. **AON** – Lagged after a strong prior quarter and did not participate in the US tax reform rally
3. **Liberty SiriusXM** – The Copyright Royalty Board decided to increase the music royalty rate – Sirius will pay more than anticipated.

The Portfolio

The portfolio is positioned around Subsets of Value:

- **Growth companies** (33%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Costco).
- **Stalwarts** (29% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (AON).
- **Low risk turnarounds** (16%) – sound businesses with good management and balance sheets (Brinks).
- **Asset plays** (4%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (Liberty SiriusXM).
- **Cyclicals** (8%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ametek).
- **Bond like equities** (4%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Unibail-Rodamco).

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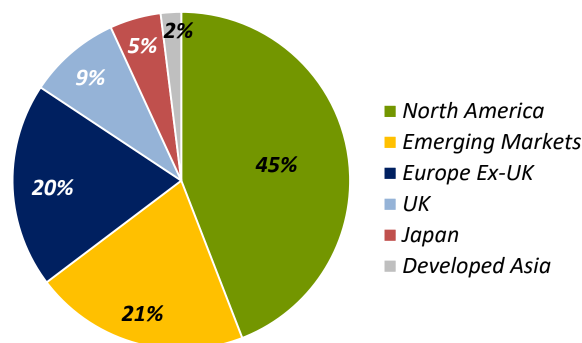
The portfolio is diversified by country and sector:

No. of Stocks	**42**
Region Weights	**US 53%**
(by listing)	**Europe 28%**
	Asia inc. Japan 7%
Most OW Sectors	**Industrials, Financials**
Most UW Sectors	**Energy, Materials**
Cash	**5%**



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

Buys

The portfolio made an initial investment in **Pentair**, a diversified industrial manufacturing company serving both Water (quality, flow, filtration) and Electrical (enclosures, fasteners, heat tracing) markets. Over the past decade or so, Pentair has embarked on an aggressive M&A/Divestment strategy, which thanks to a combination of weak end markets and poor integration has failed to create value for shareholders.

In Q2 2018 Pentair will separate into two companies (Water and Electrical). This spin-off represents the final step in unwinding the bloated industrial conglomerate structure. Following the sale of some assets earlier in the 2017, the new businesses will have strong balance sheets with minimal debt, in order to invest in their own strategic priorities.

The underlying Pentair assets are attractive, with the group generating strong returns on tangible capital. However it is likely that both growth and profitability have suffered with management distracted by M&A and integration as opposed to operations. The portfolio has successfully invested in several spin-offs – we see the energy release and focus dividend from these transactions as an attractive source of value latency for Low Risk Turnarounds.

The portfolio has re-initiated a position in Madrid-listed **Prosegur Seguridad** (“PSG”), a significant player in outsourced cash logistics with leading market share across South America. We have built up deep knowledge around cash in transit businesses as part of our investment in both Prosegur and Brinks and have a renewed appreciation for how attractive this industry can be. This is a growth business with cash use in South America growing double digits and PSG’s leading scale affording them best-in-class margins and returns. The entire region has had a tough few years but as macro conditions on the ground have stabilised operating trends are now showing strong improvement. PSG also has dominant positions in Germany, the Iberian Peninsula, South Africa, and is the number 2 player in Australia.

Management (overseen by the Gut family who own a little over 50% of the company) have recently listed part of the cash business as a separately vehicle, “Prosegur Cash”, whilst maintaining overall control. We like this move as it will increase the internal focus and accountability on the other group businesses (security and alarms) whilst representing possible funding for further value accretive M&A in what remains an attractive industry in need of consolidation.

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The portfolio has initiated a position in **Aalberts Industries** (“AALB”). Headquartered in the small Dutch village of Langbroek, AALB is a company we’ve visited regularly for over three years. The company exhibits many of the cultural attributes that are consistent with our Capital Allocator Champions (“CACs”) cluster and in particular we’re attracted by the drive and dynamism displayed by CEO Wim Pelsma.

We see AALB on a pathway from a diversified industrial to a CAC, with a portfolio of high quality niche businesses. As we have observed over many years of investing across our CACs universe, this journey typically unlocks value latencies from higher growth and increasing returns (as the portfolio quality and focus improves) as well as from capital allocation (from focused M&A). Despite a market cap of almost US$6bn, the company has scant investment coverage beyond local banks and only recently hosted its first capital markets day. Founder (Mr. Aalberts) maintains an interest of around 13% and the group’s largest end markets are in construction and general industry.

Finally, the portfolio also established a position in **Intercontinental Exchange** (“ICE”) a leading global operator of exchanges (NYSE, Energy/Financial/Ag/Metal Derivatives) and provider of data services for financial markets. The company is led by CEO Jeff Sprecher, who acquired the Continental Exchange for $1 in 1997 and through savvy capital allocation has built ICE into a US$40bn market cap entity today. Its privileged market position and track record places ICE in the Stalwart subset of value.

The company’s recent push has been to scale up its data business via acquisitions. While the exchange operations are oligopolistic and high returning businesses, revenues are derived from trading and volatility that is inherently unpredictable. In contrast people buy and use data every day and this trend is becoming more acute with increases in the automation of financial markets, compliance and regulation as well as the need for independent pricing and reference data. The data business allows ICE to deepen its existing customer relationships as well as create a more predictable revenue stream.

We see value latency stemming from the market recognising the quality of the data business as Jeff and his team execute on growth targets and cost synergies. Early progress has been solid on this front. Low volatility has also depressed trading volumes in some of ICE’s exchanges. Despite these sources of upside and management’s track record, ICE trades at a discount to its peer group, further underlying the attractiveness of the investment proposition.

Sells

We sold our position in **Agilent** as we could no longer make sense of the valuation after strong performance. We bought Agilent in 2014 soon after they announced their intentions to spin off their electronics measurement business to become a pure play life sciences company. Management have done a fantastic job refocusing the company on its core, gaining market share and expanding margins.

Whilst acknowledging **Svenska Handelsbanken** as the best run bank in Europe, the group’s recent growth engine in the UK has a difficult period ahead with a pause in branch openings coinciding with the complex task of restructuring into a full UK-based subsidiary to comply with Brexit. Meanwhile, recent meetings with banks in Stockholm revealed trend negative observations in the Swedish mortgage market, where macro-prudential measures are successfully slowing house prices but also hurting the largest and most profitable category of lending. At *minus* 50bps Sweden already has the 2nd lowest interest rate regime in the world after Switzerland. The recent re-election of the extremely dovish Riksbank governor Stefan Ingves for another 5 years makes it hard to see where earnings growth comes from in the near term and we see better opportunities to deploy capital elsewhere.

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Remgro was sold as operating trends at its largest asset Mediclinic continue to look downbeat, while a small position in Korean internet company **Naver Corp** was also sold to fund new positions.

Stock News

During the quarter IFM indirectly acquired an additional 56.85% interest in **OHL Mexico** following the acquisition of OHL's wholly owned subsidiary OHL Concesiones. As a result IFM will end up controlling approximately 84.86% with minorities owning 13.99% and the remainder as Treasury shares.

Given the indirect nature of the transaction it is unclear what price IFM paid for OHL's stake, but we believe it was materially in excess of the recent tender offer (which Cooper Investors did not accept) that took place at MXN27. This view is supported by the strong reaction in OHL Mexico's share price following the announcement of the transaction which is now trading over 20% above the tender price.

As the transaction will result in a change of control under Mexican securities law IFM must launch a tender offer for the remaining shares before the transaction can close, which the company has said they are aiming to achieve before the end of the first quarter 2018. Under IFM's governance framework and given their operational expertise in running toll roads, we believe OHL Mexico is substantially more valuable today and therefore, in the event the upcoming tender price is unsatisfactory to us, we are very happy to remain shareholders in an exceptional emerging market infrastructure asset.

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After a difficult 2016 of management transition and guidance changes, 2017 saw **Novo Nordisk** return to form with a strong period of clinical data readouts and regulatory approvals. This included the addition of cardio-vascular efficacy to the label of *Victoza* (heart attack is the leading morbidity for diabetics), which also became the first drug in its class added to the Chinese National Drug reimbursement list.

The key development however was December's FDA approval of *semaglutide*, set to replace *Victoza* as the prime earnings growth driver in coming years. Approved in the USA under the trade name *Ozempic*, the share price has risen around 50% from its February low in anticipation of this. Novo are now working on synthesising *semaglutide* into tablet form, which if successful could create significant further value.

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Costco reported its Q4 and Q1 results in October and December respectively (August fiscal year). The business continues to show strong operating momentum generating 8% in comparable store sales growth for Q1. Performance was strong across both North American and International markets. The strength of Costco's eCommerce business is particularly noteworthy. After being slow to fully embrace the online channel, recent digital investments are starting to bear fruit with a 40%+ growth number for the eCommerce business in Q1. We see this as further evidence that the Costco customer proposition of delivering exceptional value on a select range of goods and services translates well to online.

Along with other retail peers, Costco's share price came under pressure in the middle of year on the news of Amazon's acquisition of Wholefoods. Certainly many legacy retailers will struggle to compete in the new omni-channel world. However as the CI Way of "Observation not Prediction" dictates we saw Costco's results as strong and improving throughout 2017 (see chart below) and did not share the market's subdued

view on the company's prospects. The recent share price recovery is fair reflection of the strong execution by Costco's long-tenured management team.

Source: Company reports

Trip News

Many Australian-based investors see technology as dismantling the need to be physically present in international markets. We take a different view - our passion is in meeting with people at the coalface of industry and this is where we prefer to spend our time.

This quarter the Global team completed an extended period overseas in Europe visiting 20 different cities across 11 different countries while additional trips were made to the US (New York) and Japan (Tokyo, Osaka, Kyoto).

When meeting Watchlist companies in continental Europe there was a sense of business as usual at last, with the economic and political instability of recent years giving way to a period of progress. Nordic and Swiss companies have continued to operate unimpeded but for once the German, French, Spanish and Italian companies we met were also broadly positive on their plans for the future. One of the best meetings was with **Amadeus IT Holdings,** a position owned for a number of years. Management has exciting growth opportunities ahead through the expansion of their dominant subscription airline IT business into airport terminals and the hotel industry. Meanwhile the existing business is performing well and the improving free cash flow generation has de-geared the balance sheet to the extent that management announced a new EUR1bn buyback programme in December.

In Britain the tone was markedly more cautious. The political impasse (partly of Theresa May's own making) means corporates are now taking matters into their own hands and preparing for 'Hard Brexit'. Suddenly, March 2019 is not far away and the uncertainty around what regulations look like post-Brexit is becoming acute in certain regulated sectors such as airlines and financial services. A number of companies we spoke to are setting up European licenses, delaying investment decisions and spending time and money on increased regulatory compliance and 'Brexit committees'. At the same time the risk of Jeremy Corbyn becoming Prime Minister at some point seems higher than people realise and certainly isn't priced into markets.

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A significant topic of discussion among the local investment community was the impending implementation of MiFID 2. Simply put the intent of MiFID 2 is to increase transparency by forcing the 'unbundling' of commission paid by asset managers to brokers for execution and research. Historically equity research was typically provided as a loss leader by investment banks but the requirement to 'put a price on research' will have several unintended consequences:

- Brokers pulling out of peripheral markets where they're not among the dominant players
- Decreased research coverage of certain sectors and smaller companies ending up with zero coverage ('Orphaned stocks') or being thrown to newbies ('Juniorisation of coverage')
- Smaller managers that relied on brokers for corporate access via commissions having to build in-house capabilities from scratch
- A continued shift of talent to the buy-side.

While this is likely to cause pain for many smaller brokers and managers (one of the world's largest asset managers told us MiFID 2 would 'crush the Street') we see it as an opportunity. We have spent over a decade building up strong networks and relationships with our Watchlist companies and expect to see increased pricing inefficiencies in the market due to less well-researched stocks.

2017 saw an increase of in-bound activism from the US into Europe. This is unsurprising given the valuation discount of some European companies compared to their US peers. Examples from US activist funds include Third Point (Dan Loeb) in Nestle and Elliott Advisors (Paul Singer) in AkzoNobel and GEA. A related theme has been large in-bound M&A such as the Praxair merger with Linde, or the failed approach on Unilever by KraftHeinz. It will be interesting to monitor the success or failure of these kind of events in 2018 as typically European companies are more bureaucratic than American (several countries operate with dual board systems) and hesitant to make the rapid sweeping changes activists insist upon.

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Over to the US and we attended the investor days of our two largest holdings Danaher and TE Connectivity. It was a good opportunity, not only to hear updates but also to meet the next layers of management and view product demonstrations.

Danaher has been in the portfolio since 2010 and has been a consistent performer having gone up threefold over that time frame. Danaher is the original member of the "Capital Allocator Champion" cluster that makes up ~20% of the portfolio today. Founded in the 1980s by two brothers Mitch and Steve Rales, Danaher went about copying the Toyota lean production system for their brakes and tools business. Over the next 30 years, they have used that lean mindset in all facets of business and in particular M&A. Today Danaher is a US$18bn revenue business in healthcare and technology. They are leaders in diagnostics equipment, dental supplies and water treatment - businesses with strong brands, large recurring revenues and a global footprint.

The investor day was a good showcase of where their opportunities exist today. The good news is that future plans look very familiar to the past. Being in the growth areas of technology and healthcare, and having a large presence in emerging markets, Danaher has a strong growth outlook combined with margin and M&A opportunities, just as they have had over the past 30 years.

TE Connectivity ("TE"), a stock in the connector and sensor industry is a more recent buy from earlier this year. When initiating the position we saw it as a Low Risk Turnaround as performance had been good, but not much more, post its spin from the disgraced conglomerate Tyco over 10 years ago. In 2016 a new CFO arrived who was known to us from a prior investment. We had also previously invested in Amphenol, the number 2 player in the connector industry. We have found that investing in people and industries we know well makes for good Low Risk Turnaround candidates.

2017 showed TE is well out of its turnaround phase with revenues up 9% and margins expanding over 1%. The investor day was a good opportunity for the new CEO and CFO to lay out their thinking around the business and positioning. Rather than specific short-term EPS goals they provided a framework for shareholders, running through the levers on growth, margins and capital allocation. This felt very familiar given the background of the CFO and we like this long-term outlook that favours sustainable shareholder value creation.

TE has the benefit of some powerful tailwinds at its back given its leadership position in the connector and sensor markets. The electrification of all things in particular cars, planes, factories and consumer appliances is clear for all to see - a typical car now has US$62 of connector content up from US$50 five years ago. With an electric vehicle containing US$120 of content you can see where TE is headed. After 10 years of transformation as a standalone company TE now has the product set, customer relationships, margin structure and management team to capitalise on the opportunity set. We believe 2017 was just the beginning of the new TE.

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