Cooper Investors Global Equities Fund (Unhedged)

QUARTERLY COMMENTARY | JUNE 2024

AFS LICENCE NUMBER 221794 ABN 26 100 409 890

"The seeds of great victory lie in minor triumphs" – Toyotomi Hideyoshi

"Any man is liable to err, only a fool persists in error." – Cicero

MARKET & PORTFOLIO PERFORMANCE

The portfolio returned -7.5% in the June quarter, versus the benchmark return of 0.5%.[1]

For the year to 30 June the portfolio returned 7.5% versus the benchmark of 19.0%.[1]

The biggest contributors were **TSMC** (optimism around AI-driven demand for leading edge node volumes), **Alphabet** (solid results including better growth and profitability in Google Cloud) and **HDFC Bank** (recovered after a brief sell-off in relation to the Indian election results).

The largest detractors were **Eurofins Scientific** (shares hit by a short report late in the quarter), **Salesforce** (guidance for slower growth at the FY results) and **Ulta Beauty** (shares derated with US beauty market trends stabilising after a strong period).

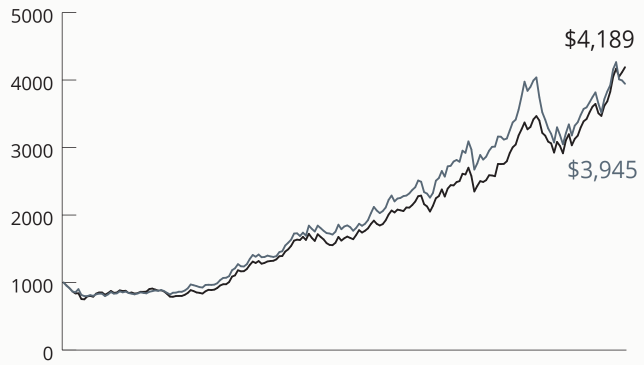
Markets fell sharply in April but recovered through the 2nd quarter of 2024 with renewed optimism that the 'inflation dragon' has been slain. Three central banks cut rates in June - the ECB and Bank of Canada made inaugural cuts for this cycle while the Swiss National Bank cut for a second time. The remaining holdouts, the Bank of England and the U.S. Federal Reserve, are expected to start cutting in August and September respectively as core inflation drifts down. Attention will shift to politics in the second half of the year with elections in the UK, France and the US. Polls in all three countries indicate swings in government from incumbent to opposition, meaning political risk to various sectors is higher than in typical years.

Returns in equities have narrowed further as the year progresses. Hype around generative AI has sucked capital into fewer and fewer perceived winners. The PHLX Semiconductor index was +12% in the quarter and is up almost a third in 2024 (in USD terms). The semis industry has expanded from a 2% weight of MSCI ACWI a decade ago to over 10% today, noting the last parabolic move from 5% to 10% occurred in just the last year.

	**Portfolio	#Benchmark	Relative
3 months	-7.50%	0.49%	-7.99%
1 year	7.52%	18.98%	-11.46%
3 year*	3.46%	9.62%	-6.16%
5 year*	7.70%	11.84%	-4.14%
7 year*	9.67%	12.21%	-2.54%
10 year*	11.00%	12.24%	-1.24%
Since inception*	9.05%	9.47%	-0.42%
Since inception^	294.49%	318.94%	-24.45%

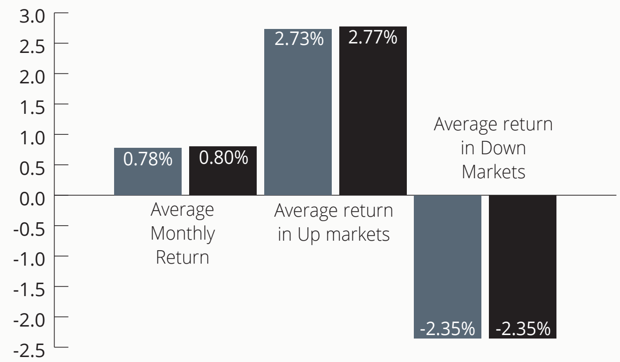
* Annualised
^ Cumulative (since inception on 1 September 2008).
# MSCI AC World Net Divs in Australian Dollars.
** Net of fees and expenses.
Past performance is not a reliable indicator of future performance.
Data Source: Internal CI data reports, 30 June 2024

Cooper Investors Global Equities Fund (Hedged) – net of fees and expenses $1000 Invested Since Inception (1-Sept-08 to 30-Jun-24)



Cooper Investors Global Equities Fund (Unhedged)
MSCI AC World Net Divs in Australian Dollars
Past performance is not a reliable indicator of future performance
Data Source: Internal CI data reports, 30 June 2024

Since Inception Net Returns In Up And Down Markets



Cooper Investors Global Equities Fund (Unhedged)
MSCI AC World Net Divs in Australian Dollars
Past performance is not a reliable indicator of future performance
Inception Date of the Fund was 1 September 2008
Data Source: Internal CI data reports, 30 June 2024

1 Past performance is not a reliable indicator of future performance.

Outside of semis not much else has participated in recent months. 'Momentum' (stocks that have gone up keep on going up) has been a major index factor. The MSCI World Momentum Index (USD) has returned more than double the standard MSCI World year to date. Interestingly, over 5 years annualised returns are almost identical. The S&P 1500 Composite is *down* 5% year to date, which arguably tells the true story of markets outside of the small number of mega-cap winners.

Unsurprisingly the portfolio's best performers in the very short term reflect this pattern, having narrowed to those most obviously exposed to the AI story – TSMC and Alphabet. While the portfolio has owned semiconductor companies for years it remains diversified and is underweight the group from an active risk perspective, dragging on relative performance in the last six months. The portfolio is currently positioned to take advantage of the Value Latency we see in smaller sized companies, and the performance of the quarter has been more aligned with those factors.

While this positioning is painful in the short-term, we see considerable embedded value in our portfolio. We also see considerable risks and uncertainties existing in the AI theme that are not reflected in the Value Latency on offer in many stocks that have surged.

The investment going into AI data centre capacity, whether that be GPUs, cooling, electrical components or power, is derived from spend coming from other parts of the economy (corporates, government, healthcare, academia) that have limited firepower and demand an attractive return on their investment. The adoption curve of GenAI may be slower than the market expects, or it may be more utility-like in terms of pricing power or monetisation.

Our observations and discussions with intermediaries in the IT supply chain (distributors like CDW and consulting firms like Accenture) indicate rising caution and reluctance from senior decision makers to commit additional capital into GenAI in the near term. Of course, it is reasonable to expect models and use cases to improve as we saw with the early internet or the first smartphones. However, like all capital cycles, we expect this one will eventually bend to economic realities: enormous capital spending at peak profits leads to excess capacity, new entrants, rising competition, innovation or substitution by customers, and falling returns on capital. That's not to say we aren't excited for the prospects around innovation in the AI space, but we will continue to invest as we would in any other area – using the VoF lens and looking for underappreciated or asymmetric investments with Risk-Adjusted Value Latency.

THE PORTFOLIO

The portfolio is positioned around six Subsets of Value that sit within three Capital Pools:

Compounding

- Stalwarts (40% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (LSEG).
- Growth (16%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Booking Holdings).

Reversionary

- Low Risk Turnarounds (18%) – sound businesses with good management and balance sheets that are temporarily mispriced (GE Healthcare).
- Cyclicals (15%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ferguson).

Real Assets & Income

- Bond-like Equities (3%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Ferrovial).
- Asset Plays (7%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (AERCAP).

We are very excited about the embedded value in the fund today. While the share prices of some holdings have not performed well in recent months, underlying revenues, earnings and free cash flows of our business *have* continued to grow nicely over both the quarter and year. Consequently, the weighted average price-to-free-cash-flow of the portfolio has now derated to ~17x, a multiple as cheap as we have seen it in many years, lower even than the COVID-19 trough in March 2020. We estimate the fund is a good 15% cheaper than the market on this measure, despite holding a portfolio of higher quality (as measured by ROE), higher revenue growth, earnings growth and cash returns.[2]

2 Please note that this is an estimate only, based upon Cooper Investors' current views and assumptions, and is not guaranteed to occur. Any estimates may differ materially from the results ultimately achieved.

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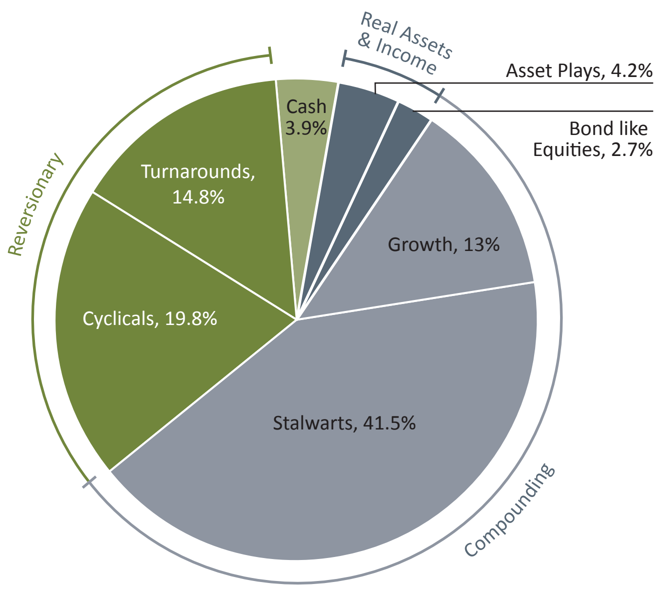
Portfolio by Subsets of Value

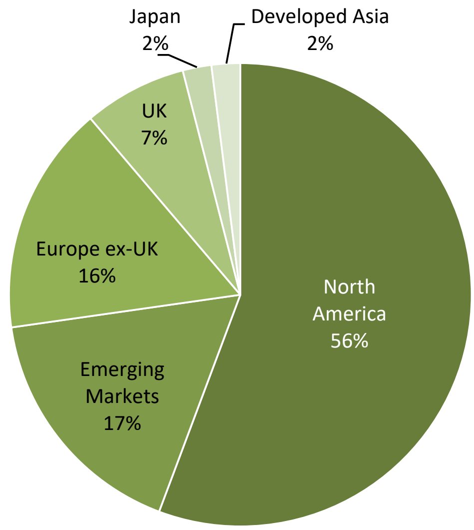


Source: CI Internal Data

No. of Stocks	37
Region Weights (by listing)	North America 63%
	Europe 29%
	Asia 7%
Most OW Sectors	Industrials, Financials
Most UW Sectors	IT, Energy
Cash	1%

Past performance is not a reliable indicator of future performance.
Source: CI Internal data, UBS Quant Answers, as at 30 June 2024

Geo Exposure by Source of Revenues#



Derived on a look-through basis using underlying revenue exposure of individual Fund stocks
Source: CI Internal Data

Weighted Average Metrics	Portfolio	Index
Price to Earnings [1]	18.7x	17.7x
Price to Free Cash Flow [1]	17.6x	21.5x
Net Debt to EBITDA [2]	1.2x	1.2x
Return on Equity [2]	27.2%	14.0%
Revenue Growth [2]	8.2%	7.6%
Earnings Growth [2]	14.3%	12.7%
Total Cash Yield [2, 3]	2.8%	1.9%

1 Next twelve months forward
2 Estimated, FY1 to FY2
3 Estimated, dividends plus buybacks

Returning to the AI story, today the portfolio has around 10% of capital invested across **TSMC** and **Alphabet**. We think TSMC has a tremendous opportunity to extract more value from the profit pool currently being enjoyed by its downstream customers. Meantime, Alphabet has multiple value levers to pull across AI-augmented search, YouTube (now the 'must-have' streaming platform for young people) and Google Cloud.

However, we are keen to highlight other Stalwarts and Growth businesses we own that should benefit in a more profound way than hardware makers currently enjoying an initial build-out phase. To paraphrase Salesforce CEO Mark Benioff, if hardware is the picks and shovels of GenAI then data is the real gold. Or as **LSEG** CEO David Schwimmer elaborates further, *'The quality of Large Language Models is entirely dependent on the quality of data going into them'*. We would posit the AI revolution makes companies with unique datasets critical to customer's needs more valuable on a sustainable basis as it **permanently improves their business model**.

Consider LexisNexis, the Legal business of fund holding **RELX**. Long considered the poor cousin to the group's higher margin and faster growing risk & analytics segment, Legal is now seeing a step change in growth and profitability because of advances in AI.

For many years LexisNexis provided physical case law books (and still does for old traditionalist silks) which eventually moved to an online search portal. Today this has advanced further through Lexis+ AI, an AI-driven platform providing large productivity and workflow improvements to legal firms of all stripes. Tasks that once took clerks and paralegals several hours (e.g. researching case precedents, settlement outcomes, or comparing differences in jurisdictional law) can now be done in 30 minutes. This is a permanent value enhancer for RELX. What was a 2–3% growing business is now a 5–6% grower which can permanently uplift margins on a recurring business.

Another example is GE Healthcare (GEHC), a global leader in diagnostic imaging equipment across multiple modalities. AI algorithms are making image quality better, assisting image analysis via computer vision, and enabling devices to be more accessible for new users. The next stage will be data-driven; via its many points of penetration into the patient journey, GEHC is accumulating large amounts of data across pathology, genomics, and imaging. Harnessing AI tools across that data to drive better patient outcomes should enable improved sales, margins and returns from a more competitive product offering.

During the quarter the portfolio exited Aon, an exceptional performer over our 11-year holding period but one where we have observed VoF trends deteriorating in recent times:

- Value Latency is not what it was; management have done a great job expanding margins and returns by over 1,000 basis points since our initial investment but that's unlikely to repeat.
- Operating and Industry trends have slowed with organic growth starting to lag peers and a hard insurance market starting to soften after years of a sweet spot for brokers.
- Focused Management Behaviour appears to be slipping – the acquisition of mid-market platform NFP may drag on free cash flow, limit balance sheet optionality and act as a distraction at a time when a highly rated CFO is exiting.

STOCK NEWS

Huge reactions to earnings have long been a feature of the quarterly EPS-driven US market, but today it feels wilder than ever. This was borne out in a recent WSJ article that noted 'dispersion' (how much individual stocks move versus each other) at its highest level in over a decade.

This quarter saw a bifurcation of share price performance in many of our holdings, with several 10%+ one-day swings up or down during the Q1 earnings season. It is worth commenting on a couple of examples, both on the positive and negative side of the ledger.

In the last newsletter we discussed a visit to US building materials company Louisiana Pacific that is progressing through a substantial commodity-to-specialty mix shift. Results in the first quarter saw better siding volumes and a margin step-up larger than expected, plus better realised OSB prices. Did the intrinsic value of the business improve by a fifth overnight? Unlikely. This transformation is multi-year in the making, and there will be bumps along the way. Nevertheless, it was a solid quarter of execution and the market saw fit to reprice the stock upwards by >20% on the day.

The market was not so kind to Rentokil Initial, the global leading pest control business undergoing a large integration in the US. Organic growth in North America of +1.5% in Q1 was half a point shy of management's guidance of 2% and the shares fell ~10%. This reaction is understandable as trust is shaky right now - management are working through execution challenges in the initial integration of Terminix which has dragged on local sales momentum despite a strong market (peers growing 6%+).

Yet the valuation was already reeling from recent trends with the implied value of Terminix now close to nil. Consider the market cap of Rentokil on 13th December 2021 (the day before Terminix was announced) was £11.5bn, valuing the combined group at ~18x EV/EBITDA – a fair price for a leading scale player in a recurring and growing business services niche (and undemanding relative to main peer Rollins at 31x).

Today the market cap of Rentokil is, reamarkably, £11.5bn, unchanged despite sales and earnings that have nearly doubled by the end of 2024 from a 2020 base. If we assume the attractiveness of the original Rentokil business is undiminished (as the dominant player in most cities in which they operate across the US, UK, Europe, Australia/NZ they have sustainable margins of ~20-24%), this implies virtually the entire value of Terminix has evaporated.

Independent subscale pest control business sell for 10-15x EV/EBITDA today on the open market. By comparison Terminix remains the most recognised pest control brand in the US with over 3mn customers, 300 branches and over $350mn of recurring EBITDA. This is not to mention synergies that will arise from combining branch footprints and increasing route density in existing duplicate locations. Clearly this business has value, and we think materially higher than what is currently implied in the share price.

The stock has been a poor performer thus far but we continue to see material Risk Adjusted Value Latency on offer. After extensive discussions with management (plus background referencing new US leadership hires) we're confident they recognise missteps in the initial integration phase and have acted with intentionality. In the meantime, the stock is radically mispriced within our Stalwart universe, something that has attracted activists, with Trian Capital emerging as a top 10 shareholder recently. Trian have a solid record with large consumer or B2B businesses (P&G, Sysco) and there is plenty for them to sink their teeth into with Rentokil's closest peer currently at all-time highs (Rollins has US$3bn of sales with a $24bn market cap versus Rentokil at ~$7bn of sales with a $11bn market cap).

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COOPER INVESTORS

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TRIP NEWS

During the quarter the investment team visited the UK, China and Japan.

In the UK we met four portfolio holdings and came away excited about the Value Latency on offer there. The UK is simply too cheap, in both an absolute and relative sense. While the gap has widened for years, it now feels close to some kind of tipping point with buyers moving in. Several companies said they'd seen a big uptick in incoming interest from the US, where the valuation differential to the S&P has become irresistibly large. Activists are getting involved with several stakes in UK listed corporates announced in recent months. Assets are changing hands – inbound M&A (both from corporates and private equity) is accelerating with activity intensifying in the area most on sale - small and mid-caps (Keywords/EQT, DS Smith/International Paper, Marel/John Bean, Virgin Money/ Nationwide).

Top down, the UK is muddling through. After a tough 2–3 years the economy has proven resilient and is accelerating away from a shallow recession despite the headwinds of inflation, rate hikes and 'Trussmageddon'. Full employment, disinflation and high immigration supporting the housing market has kept the wheels on, and the Bank of England is poised to cut rates. It remains to be seen if this picture changes with a Labour government likely incoming.

In terms of opportunity, we came away with several Stalwart ideas going through an industry Hubris to Humility (H2H) cycle. These are businesses that have lost their way: leaders in their fields with strong existing franchises, brand or asset value, that look to be emerging from periods of weaker Operating trends at the same time as Focused Management Behaviour trends are improving.

The market has had no patience for stories with any kind of blemish recently but our meetings led us to conclude there are clear and trackable roadmaps in place for overhangs on these stocks to diminish over the next 12–18 months. If this occurs, we'd expect growth in top-line momentum, free cash flow and cash returns to shareholders to start being reflected in valuations.

In Asia, we had over 30 meetings in Shanghai and Tokyo, across a multitude of industries including quick service restaurants (QSR), media content, video games, payments, and telecommunications. A highlight of the trip was a visit to nearly every QSR concept store within the Yum China portfolio. We sampled the menu from KFC, Pizza Hut, Little Sheep, Taco Bell, and Lavazza in various locations, from flagship stores next to HQ, all the way to regional malls.

Two observations stuck out. Firstly, KFC's ubiquity and distribution advantage are sizeable – the convenience of 10,000 stores can be felt as you are never far from a KFC in a Tier 1 city such as Shanghai. Secondly, the localisation of the menu has been done seamlessly with staples such as "KFC Original Recipe" served alongside Sichuan Skewers and bubble tea. The menu is designed to suit the Chinese palette to the extent it's no longer "American food" but the obvious destination for fried chicken and fast food in China.

Building conviction in our Sony investment we met most listed content players in Japan from film and animation studios, video game developers and manga publishers. The journey of Sony has been a slow but steady march toward content ownership. Where there were once Walkmans and MP3 players, Sony now owns the recording rights to Celine Dion, AC/DC, Doja Cat and recently acquired the catalogue of rock legends Queen. In gaming, PlayStation hardware revenues have been eclipsed by software sales, and in video, Sony has five million more subscribers to anime platform 'Crunchyroll' than TV's it sells.

As these trends continue, we think recognition by the market of a change in business mix is inevitable – after next year's spin-off of Financial Services, Sony will be a 75%+ content business (by earnings) with leading global franchises across music, movies and video games.