

# COOPER INVESTORS GLOBAL EQUITIES FUND (UNHEDGED)



AFS LICENCE NUMBER 221794  
ABN 26 100 409 890

QUARTERLY COMMENTARY | DECEMBER 2022

“With instant information available to all investors on their smartphone, the advantage one investor can have versus another is the ability to interpret that information better.”

**Bruce Flatt, CEO Brookfield**

“The greatest glory in living lies not in never falling, but in rising every time we fall.” **Nelson Mandela**

## MARKET AND PORTFOLIO PERFORMANCE

The portfolio returned 4.29% in the quarter, versus the benchmark return of 4.07%.

The biggest contributors to portfolio return for the quarter were **Ferguson** (completed re-list from UK to US market with possible inclusion to S&P 500 in 2023), **APi Group** (revised margin targets for Chubb at IR Day indicate material upside) and **Vantage Towers** (takeover offer came in at €32 a share – see Stock News section).

The biggest detractors to return for the quarter were **Brookfield** (volatile moves around December spin-off event), **Salesforce** (two senior executives announced exit in Q3 results) and **London Stock Exchange Group** (underperformed after a broker downgrade).

As the below chart from the FT shows, 2022 was a very challenging year for investors and unique in that the large draw-down in equities was matched by an equally awful year for the bond market. Other than holding US Dollar cash or Energy stocks, there were few places to hide.

Equities markets finished the year with a moderate last quarter bounce after runaway US inflation data showed signs of peaking in early November, indicating the Fed may slow or even pause rate hiking in the coming months. Yet the reality is the era of super-cheap money and zero interest rates is probably over. The accumulated tightening in financial conditions in Western economies this year, along with cost-of-living crises driven by high energy and food costs (exacerbated by the Ukraine War and ongoing supply constraints out of China) means the outlook for 2023 appears quite grim. A renewed slump in markets in December reflected this sentiment, with the MSCI AC World closing out its worst annual return since 2008.

	**Portfolio	#Benchmark	Relative
3 months	4.29%	4.07%	0.22%
1 year*	-21.28%	-12.48%	-8.80%
3 year*	2.87%	5.26%	-2.39%
5 year*	7.61%	8.27%	-0.66%
7 year*	8.76%	9.19%	-0.43%
10 year*	12.38%	12.68%	-0.30%
Since inception*	8.41%	8.05%	0.36%
Since inception^	217.93%	203.33%	14.60%

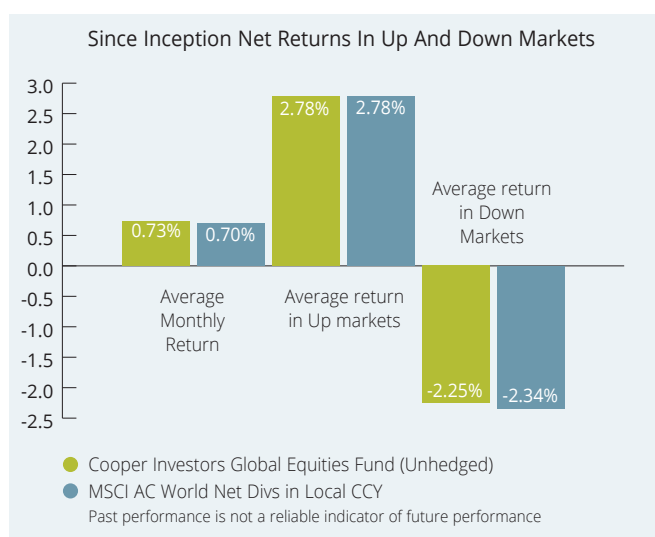
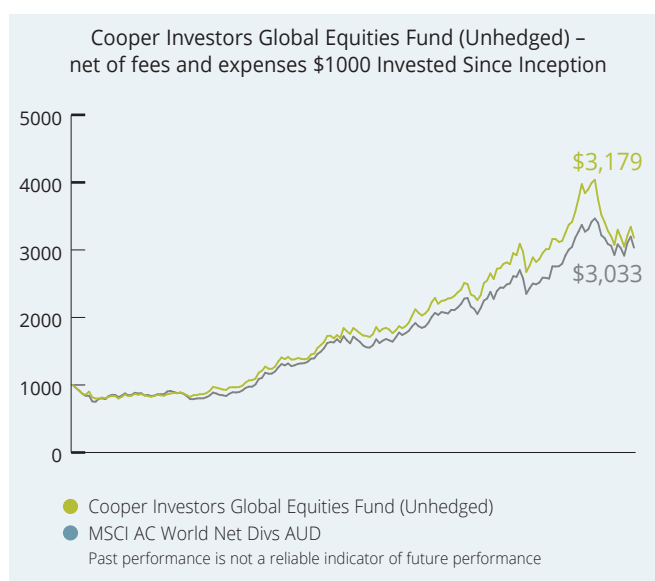
\* Annualised

^ 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.

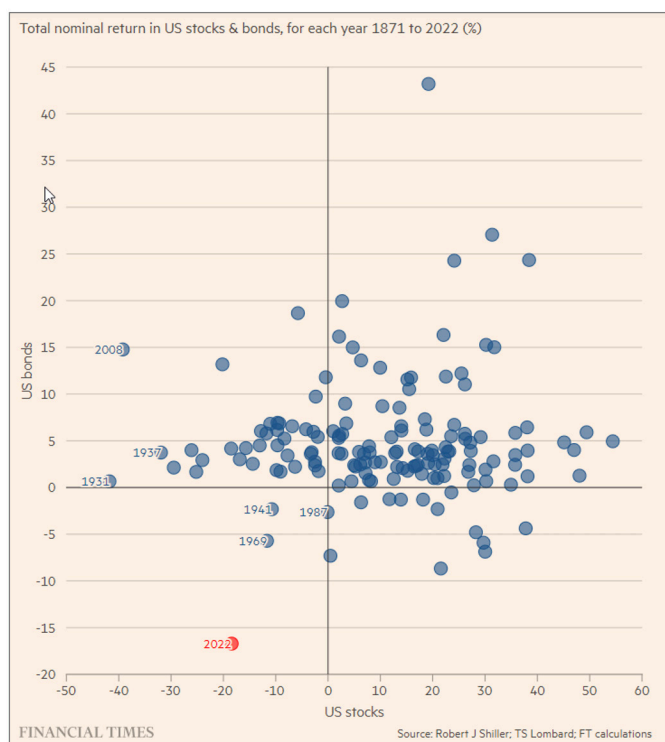


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As has been the case for much of 2022 benchmark composition of returns was quite varied in the quarter.

China and Europe (the most beaten down regions year to date) both outperformed and saw double digit returns for the quarter. Chinese markets in particular saw incredible volatility, slumping 20% in mid-November around the Party Congress only to surge +30% from their lows after a period of rare civil unrest which saw protesting on the streets of Chinese cities and a U-turn from the 'Zero COVID' policy.

Conversely the US lagged, especially NASDAQ which was down 1% over the quarter. Several index heavyweights and former leaders of the bull market in US tech continue to be heavily sold off.

Despite the bleak macro outlook, there are several signs we find encouraging as we look toward the investment landscape regarding our portfolio and watchlist for 2023.

**Firstly, more Value Latency is emerging.** As the market continues to digest higher discount rates and the implications for equities valuations, volatility and bouts of illiquidity have appeared in parts of the market. This is great news as the resulting dysfunction and pricing inefficiency is throwing up more opportunities than we've seen for years. We have been vigorously managing our watchlist to assess where Risk

Adjusted Value Latency is plentiful – in many cases share price declines are justified given high starting valuations and challenging operating trends ahead. Yet in a few cases the prices overly discount short term headwinds and genuine value has emerged. In recent months we've purchased stakes in several watchlist businesses on sub-market multiples; for between 11 and 15x Free Cash Flow we have been able to buy a leading discount retailer, a branded personal care business and a dominant technology platform business. We believe all three can grow double digits (even in a recession), return excess cash to shareholders and trade at meaningful discounts to peers. This is not to say everything is 'cheap' yet, there's still some crazy valuations out there - but mispriced businesses are starting to crop up.

**Secondly, discipline is returning to financial markets.** The period of zero interest rates encouraged and rewarded infinite risk taking – there were no consequences as cost of capital hurdles for financial returns were eliminated. This was on display in many areas (IPOs, SPACs, NFT/Crypto) but became clear to us when a growing number of companies we met seemed less and less anchored on the relevance of capital returns. We'll never forget one meeting where, in response to our question on capital allocation the company insisted return on capital is 'an accounting gimmick'. With risk-free rates (and borrowing costs) at 4 or 5% the need for a business to be sustainably profitable and generate an actual stream of cash flows has regained importance. Capital allocation matters as do balance sheets. A benefit of this should be increased dispersion of returns rewarding good stock selection. Better businesses and skilled management who are wise stewards of capital (once again scarce and precious) should get compensated, whereas in the final years of easy-money we saw correlations rise and the value of everything go up indiscriminately.

**Thirdly, our companies are doing well.** Businesses owned in the fund continue to execute well and many of them had an exceptional year. Despite a tough 12 months for the portfolio in terms of price returns (largely multiple driven) we have little complaint and much to praise with the management teams of the businesses we're invested in. For example:

- **Ferguson** has completed its journey to become a fully US-domiciled and NYSE-listed entity, with the business led by CEO Kevin Murphy continuing to pivot towards higher growth and less cyclical end markets such as water infrastructure and HVAC. The shape of the group looks very different to the UK-listed plumbing distributor we first started following years ago, with the improvements in liquidity and coverage of a US listing just starting to be reflected in the valuation.

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- **Fortive** completed several acquisitions and had probably its best year operationally since the 2016 spin-off from Danaher, reporting several quarters in a row of double-digit organic growth and margin expansion that beat market estimates. The business has now unlocked the potential we always saw in it, with software almost a quarter of revenues today, providing a nice element of recurring cash flow to support the more cyclical industrial parts of the group.
- **Agilent** finished a great year with +12% organic growth after a +15% year in 2021. As a supplier of liquid chromatography/mass spectrometry instruments into the life sciences industry, Agilent enjoyed a period of super-normal growth over the 2020-2021 COVID pandemic. Like several of our healthcare and diagnostics investments Agilent de-rated quite sharply in the first half of 2022 as the market 'faded' the decline in COVID testing revenues. In our view this short term volatility obscures the high quality of Agilent's business and long term growth opportunities. One example is environmental testing as mandated by the US EPA where US\$4bn of funding in the infrastructure bill has been put aside for PFAS testing. As CEO Mike McMullen noted on the last call, *'it's the first time in my career we've seen this kind of government money coming in'*.

## THE PORTFOLIO

We made several additions to the portfolio, taking advantage of the volatility and some stock specific events.

**Haleon** is one of the largest consumer healthcare businesses in the world, selling non-prescription products that address a therapeutic need like *Sensodyne* toothpaste, *Panadol*, *Advil*, *Voltaren* pain relief, and Centrum vitamins. Haleon's portfolio of household brands are time-tested and have significant scale advantages in marketing, research and development and distribution. In this category having trusted relationships with healthcare professionals like dentists and pharmacists is critical - Haleon has one of the largest networks of relationships globally. Next time you get sick in a far-flung tropical country on holiday, chances are *Panadol* will be available in the local drugstore.

While Haleon's brands have been around for many decades, Haleon the company is relatively young, the result of a long-planned combination of the consumer health portfolios of Novartis, GlaxoSmithKline (GSK) and Pfizer. It was created through various transactions and asset swaps and the final form was spun-off on the UK exchange from GSK just 6 months ago. We have been tracking the progress of this story and meeting the executives involved for several years, waiting for this spin-off.

The new group is run by CEO Brian McNamara and CFO Tobias Hestler, both long serving executives of the former parents and experienced consumer products operators. The strategy of simplifying Haleon's product portfolio around key power brands (the old Reckitt Benckiser play-book) and demonstrated operational execution under their leadership are strong proof points of focus.

After the spin negative news flow emerged regarding a potential liability associated with a product sold by the former parents. Having done our due diligence our view was the risk of an adverse outcome was particularly remote and took advantage of share price weakness to establish a position. We see a long-dated opportunity for Haleon to continue growing its top line through penetration and geographic expansion within its product categories, while the business should be resilient in a recession given healthcare brands are relatively less sensitive to down-trading.

We also established a position in **Tokyo Electron** (TEL), a leading semiconductor production equipment (SPE) company. Tokyo Electron is the third largest SPE company globally, with strong market share in the areas of coater/developer, etching, deposition and cleaning equipment. In simplistic terms, SPE companies sell the tools to foundries like TSMC to manufacture microchips.

We have been tracking the semiconductor industry more intensely in recent years but ramped up our interest in 2022 given significant share price declines. This culminated with several visits to Japanese SPE makers in June.

Semiconductors are increasingly ubiquitous and the need for efficiency has driven complexity. The industry has typically seen large cycles based around consumer products like PCs combined with ruinous levels of competitive behaviour and sporadic supply responses that hurt profits and returns. Yet the outlook today is far more constructive. In terms of rationality of supply the industry has consolidated with a series of duopolies and oligopolies existing across most areas of the value chain. On the demand side there is seemingly insatiable appetite for both leading edge and mature nodes driven by new use cases as technology penetrates further into modern society.

With this, the equipment to produce semiconductors has also become highly specialised and as one of few players who can innovate at this level, TEL earns the trust of major customers to collaborate and design leading edge technology as far as four generations ahead. TEL's equipment is known for its exceptional quality and reliability, even compared to a formidable peer set; traits that are befitting of a top Japanese company.

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As the semiconductor industry becomes more critical from a geostrategic perspective, countries such as the US and Japan are planning to onshore semiconductor production to ensure continuity of supply, which will lead to inefficiency (i.e., capacity duplication) in global SPE investment. This is likely to drive further demand for SPE across various geographies. Peer ASML believes this inefficiency could be up to 10% of global supply.

For over 25 years, former CEO Terry Higashi and former Chairman Tom Tsuneishi led Tokyo Electron, establishing a “bottom-up” culture with respect to innovation and expanding TEL’s global presence. A turning point in TEL’s history was the failed merger with Applied Materials in 2015 that raised TEL’s financial focus after many years of achieving lower margins compared to peers. From then, TEL made a concerted effort to close the gap and margins are now comparable to peers, exceeding 30% operating margin in the last fiscal year.

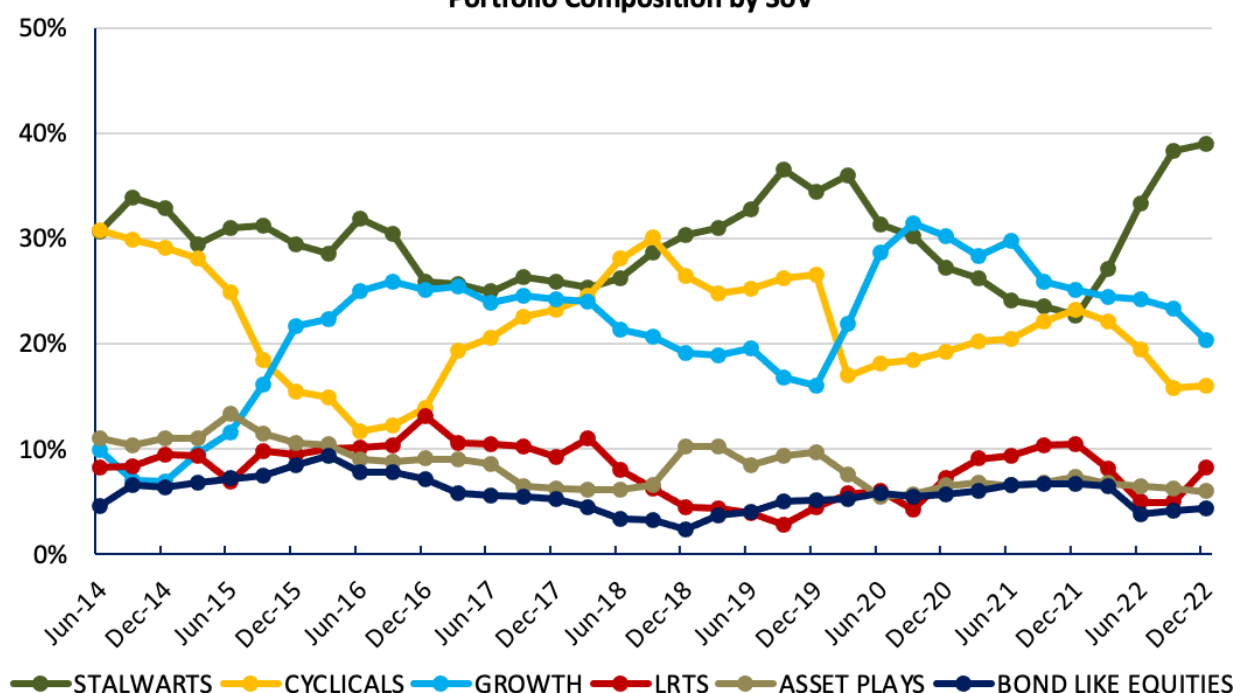
In summary TEL is a better company than it’s ever been, in an industry that is fundamentally more attractive than before. Despite all this, TEL’s share price has halved over 12 months, with a large sell down across the industry as smartphone/PC volumes have weakened and an inventory oversupply corrects. TEL now trades on 16 times forward earnings, with almost 7% of market cap in net cash. Unusually for a Japanese company, TEL pays a handsome dividend that today equates to a ~4% yield. Whilst we recognise that TEL remains a cyclical company, the share price today already accounts for a significant decline

in earnings next year. We see this as an exciting opportunity to own a global leader in an increasingly important industry over the next decade.

The portfolio is positioned around Subsets of Value.

- **Stalwarts** (39% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (AON).
- **Growth companies** (20%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Synopsys).
- **Bond like equities** (4%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Ferrovia).
- **Low risk turnarounds** (8%) – sound businesses with good management and balance sheets. (APi Group).
- **Asset plays** (6%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (Sony Corp).
- **Cyclicals** (16%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ferguson).

Portfolio Composition by SoV



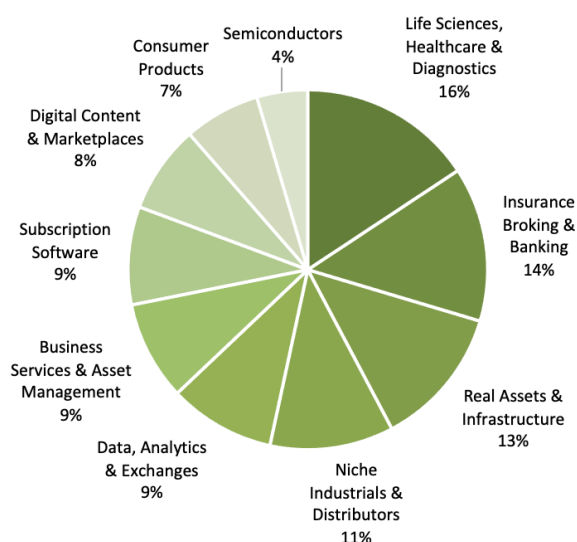
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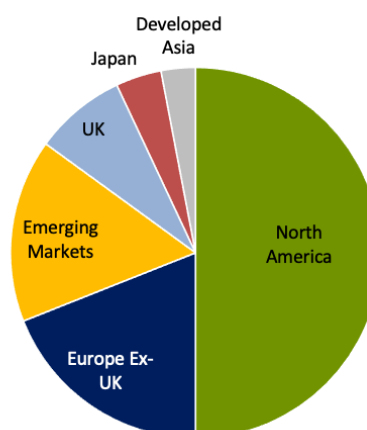
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**Portfolio by Business**



**Geographical Exposure by Source of Revenues#**



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

<b>No. of Stocks</b>	41
<b>Region Weights</b>	North America 59%
<i>(by listing)</i>	Europe 24%
	Asia 11%
<b>Most OW Sectors</b>	Financials, Industrials,
<b>Most UW Sectors</b>	IT, Consumer Disc.
<b>Cash</b>	6%

## Portfolio Metrics

Price to Earnings <sup>1</sup>	18.4x
Price to Free Cash Flow <sup>1</sup>	16.5x
Net Debt to EBITDA	1.0x
Return on Equity	20.8%
Revenue Growth <sup>2</sup>	7.3%
Earnings Growth <sup>2</sup>	8.3%
Total Cash Yield <sup>3</sup>	2.2%

<sup>1</sup> Next twelve months forward

<sup>2</sup> Estimated, portfolio weighted average FY1 to FY2

<sup>3</sup> Estimated, average dividends plus buybacks

## STOCK NEWS

During the quarter the much-rumoured privatisation of **Vantage Towers** was confirmed. A consortium comprised of GIP and KKR will enter a co-control partnership with Vodafone and acquire 50% of the business, representing 31.7% from Vodafone's current stake and the 18.3% of outstanding public free float. Vodafone retains the balance of 50%.

A strong element of our thesis was that the quality of these assets, being Europe's 2nd largest portfolio of cell towers, would be highly attractive to private equity and pension fund investors. This, in addition to Vodafone's stated desire to

sell down more to de-gear their balance sheet indicated a transaction of some sort was likely. We felt the listed share price in the mid €20's was undercooking the true value of the business and material Risk Adjusted Value Latency existed. This was confirmed in the transaction with a voluntary tender offer at €32 which we consider reasonably fair. While the deal has not yet been finalised, the share temporarily traded above the offer price, so we took the opportunity to exit at €32.50, representing a total return of +40% across our 20 months of ownership, having participated in the March '21 IPO at €24. This is a particularly good outcome during a time when most Bond Like Equities have fallen 20-30%.



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Indeed, the liquidity event coincided with a sell-off in US-based towers businesses leading to the bizarre situation where US towers (fundamentally better businesses) briefly traded at a discount to their European counterparts.

Given that we still really like towers as a defensive exposure to data growth we have recycled the capital from Vantage into **Crown Castle**, a US-focused towers business with clear value latencies.

Crown Castle owns and rents out a network of 40,000 towers, 115,000 small cells and 85,000 miles of fibre across the US. Customer carriers Verizon, AT&T and T-Mobile utilise and share this critical infrastructure to operate their mobile networks and expand their capabilities. A stable US\$7bn a year rental stream is underpinned by an ever-growing demand for mobile data which is projected to grow at 25% per annum to 2027. As data demand grows, capacity must grow to accommodate it which in turn requires a higher density network leading to structural growth in the number of cell sites.

Year to date the share price has fallen 35% and underperformed the S&P 500 by 15%, driven by two factors. The 2020 merger of Sprint and T-Mobile will result in the consolidation of several sites across the newly merged entity, to be implemented across 2023 to 2025 and so impeding growth rates over the next two years. Secondly, as a Bond Like Equity Crown Castle's valuation has proven sensitive to the rapid rise in global interest rates.

Despite this, Crown Castle's management team have a strong track record, delivering 7-8% dividend per share growth since 2017 and have committed to continue returning capital to shareholders through a growing dividend stream underwritten by network rollouts and built-in price increases. The share today offers an ~5% dividend yield which we expect to grow over time.

### TRIP NEWS

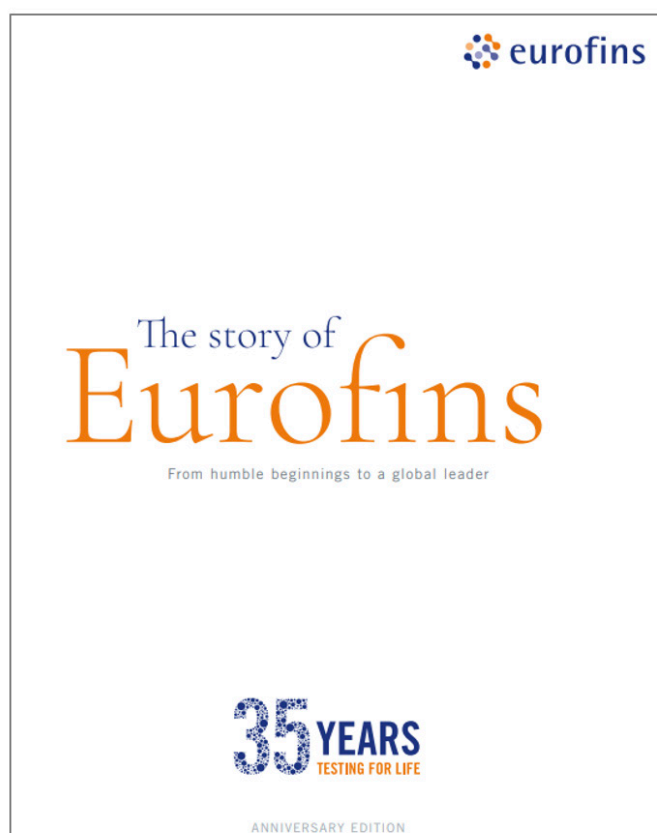
During the quarter we returned to the US and met several industrial, cyclical and distributor companies in the mid-West, including excellent meetings with management at Ferguson and Techtronic.

The main purpose of the trip was the day we spent in Madison, Wisconsin attending the Investor Day for portfolio holding Eurofins Scientific (ERF), a global leader in lab-based testing for food, environmental and pharmaceutical samples.

The event was held at one of their state-of-the-art laboratories that also happens to be the largest food testing lab in the US.

It was invigorating to attend an investor day at the coalface rather than a corporate HQ or external venue as it gave us the opportunity to speak to many staff working in operational roles.

Directly engaging with the chemists engaged in the day-to-day testing of samples, watching them demonstrate automation innovations and describe new growth opportunities was fantastic. Eurofins is a services business first and foremost. While their physical lab network and well invested IT systems give them an advantage over competitors, it's their people that will ultimately determine the magnitude of the company's future success. Most of the people we met on the day have a science background, are domain experts in their field and exude a passion for their work. ERF notably runs a decentralised operating model, which we believe increases employees willingness to take ownership over their work. We came away impressed and suspect that the market probably underappreciates the quality, energy and drive of Eurofins people.



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The business is run by its founder and major shareholder Gilles Martin. He has always taken a long-term approach to building the business, willing to forgo some cashflow today to create significant future value. This was on display in Madison. The lab we visited was formerly part of Covance, a large US clinical services business (ERF acquired the lab in 2018). At the time, this food testing business was underinvested and was seen as non-core by its owner but after ERF took over they developed a new state of the art facility, which increased sample throughput significantly. ERF have patiently built a leading market position in the North American food testing industry and are now in a position to take further market share in a very profitable way.

Eurofins is another diagnostic and testing business where the market is concerned by 'COVID hangover' and the short term impact on margins as highly profitable COVID test volumes evaporate. Yet the long-term trajectory for this business is crystal clear – increased regulation will drive more testing of almost everything humans interact with, and the need for a trusted, reliable and cost effective partner for governments and businesses to do this for them will only increase. We think Eurofins can keep growing mid-to-high single digits for a long time while margins should benefit from increased scale and testing automation. Eurofins have just celebrated 35 Years in business (the accompanying anniversary booklet linked below is recommended reading) yet from our observations Gilles remains a humble and energetic leader who should be around to drive the business to even greater success for many years to come.

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