COOPER INVESTORS ENDOWMENT FUND
QUARTERLY COMMENTARY REPORT

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

JUNE 2020

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	13.11%	16.53%	-3.42%
ROLLING 1 YEAR	-1.11%	-6.56%	5.45%
ROLLING 2 YEAR	5.38%	2.93%	2.45%
ROLLING 3 YEAR	9.09%	6.69%	2.40%
ROLLING 5 YEAR	8.83%	7.50%	1.33%
SINCE INCEPTION*	9.46%	7.35%	2.11%
SINCE INCEPTION^	77.28%	56.71%	20.57%

*Annualised
^Cumulative (3 March 2014)
**Before fees and expenses and adjusted for franking credits
#S&P ASX200 Accumulation Index – adjusted for franking credits

The purpose of the Cooper Investors Endowment Fund (the "Fund") is to provide a conservative equities portfolio that may be suitable for investors who are in the pensions/decumulation phase. The portfolio may also be suitable for charities, foundations and others who are looking for a conservative equities exposure.

Whilst return is important the portfolio also aims to perform much better in down markets and to exhibit lower than market volatility.

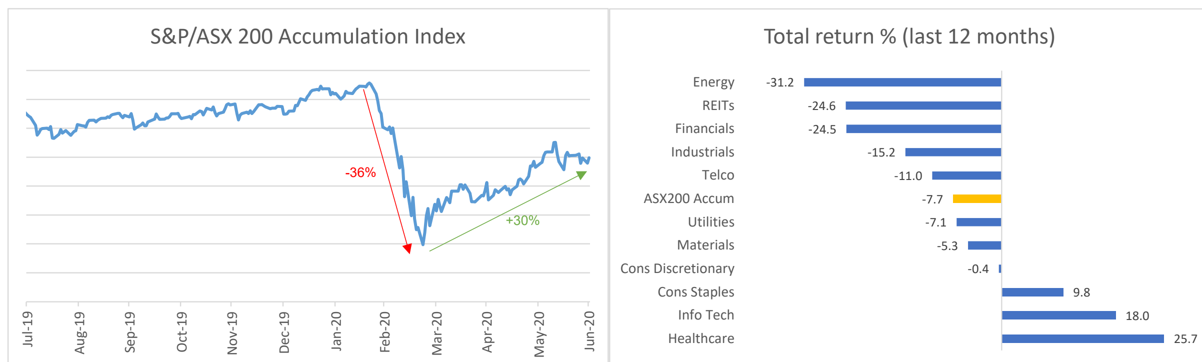
The Fund commenced in March 2014. Over the ensuing six years the portfolio has achieved its objectives of delivering a higher return than the market with a lower level of risk. These objectives have been achieved through stock selection and portfolio construction. The strategy is unchanged since the commencement of the Fund.

Market and Portfolio Performance

The ASX 200 Accumulation Index (adjusted for franking credits) rose by 16.5% over the June quarter but over the past year still fell by 6.6%. The model Endowment Fund portfolio returned 13.1% and -1.1% for the quarter and year respectively.

While the March quarter delivered one of the most severe bear markets in history falling 36% peak-to-trough, the June quarter saw an equally rapid recovery with the market now having rebounded ~30% from the lows of March 23. However, despite the strong performance in the June quarter, the ASX 200 Accumulation Index still fell 7.7% over the year and remains ~17% below the peak reached in February.

The market was propelled higher in the June quarter by the extraordinary monetary and fiscal stimulus implemented by central banks and governments around the world, improving trends in COVID-19 infection rates and deaths, and nascent signs of economic recovery as countries emerged from lockdown. The resurgence in COVID-19 cases around the world since April is a concern and we will continue to monitor its progress closely.



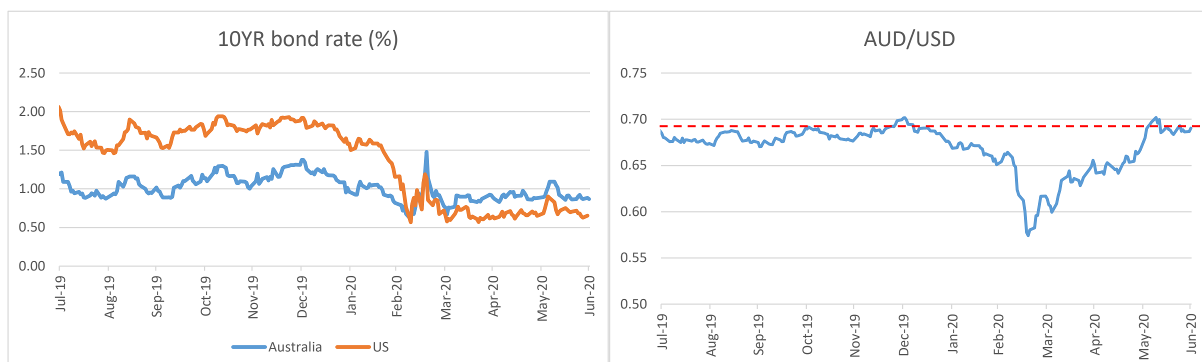
Source: IRESS

Over the past year Energy (-31.2%) was the worst performing sector followed by REITs (-24.6%) and Financials (-24.5%), which have all been heavily impacted by COVID-19. It is also worth noting that the Banks sector fell 28% and was already facing regulatory and operating headwinds before COVID-19 hit.

The best performing sectors were Healthcare (+25.7%) and Information Technology (+18.0%), which benefitted from providing defensive growth in a low interest rate environment. The Consumer Staples sector (e.g. Woolworths, Coles, a2 Milk) also performed well rising by 9.8% over the year, benefiting from increased consumer buying during the pandemic and proving to be a safe haven in volatile markets.

Bond yields remain low and central banks are likely to keep them that way, which in part helps to justify current valuations in light of the significant earnings uncertainty facing most companies. The Australian 10YR bond yield is now back above the US again.

The A$/US$ has ended the year relatively flat but it has been a volatile year touching as low as 0.55 mid-March before rallying strongly with the market recovery. Oil prices have also recovered from their US$20 per barrel lows to around US$40 per barrel currently, albeit they are still well below where they started the year in the mid-US$60 per barrel range.



Source: IRESS

Stocks that performed well over the quarter included **Lifestyle Communities (LIC)** (recovery from March sell-off, acquired a new site in Clyde), **Seek (SEK)** (ongoing evidence of business recovery), **Macquarie Group (MQG)** (solid FY20 result and positive exposure to market recovery), and **Qube (QUB)** (successful equity raising and announced significant Woolworths lease at Moorebank).

The poor performers for the June quarter included **Insurance Australia Group (IAG)** (CEO transition and near-term operating headwinds), **CSL** (COVID-19 impact on plasma collections and increasing

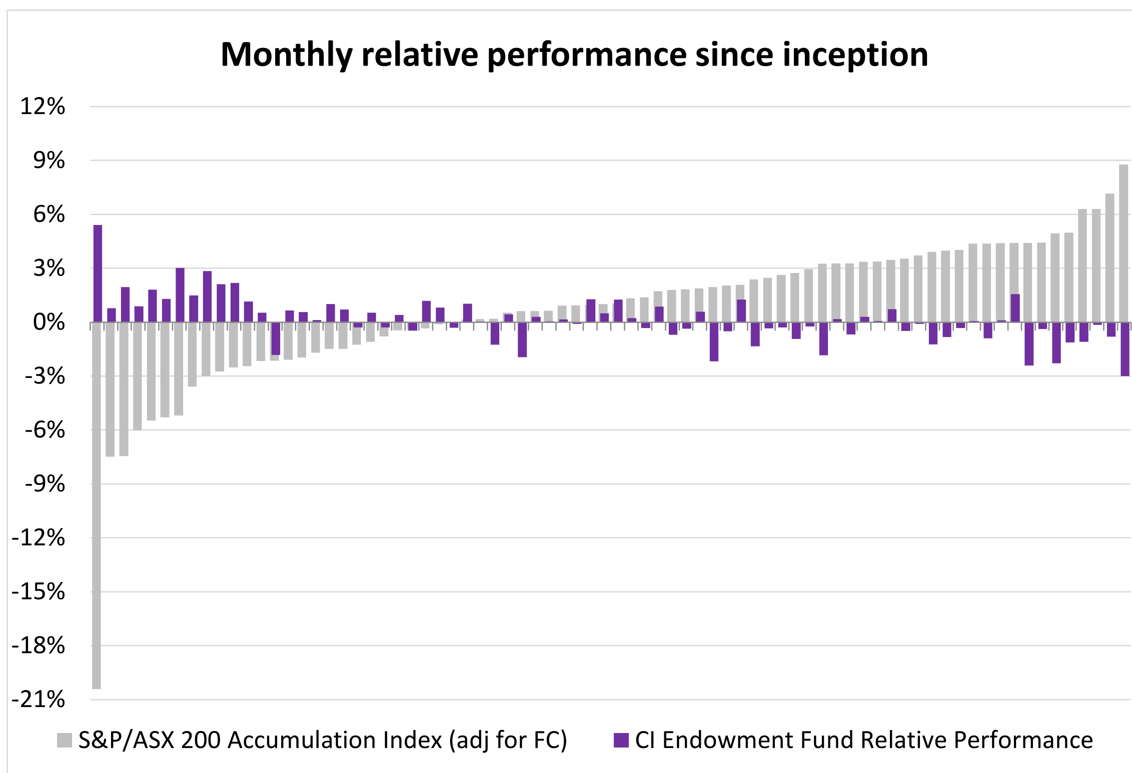
news flow on disruptive threats to core franchises), **Sydney Airport (SYD)** (COVID-19 impact on travel), and **Telstra (TLS)** (no news but 'defensives' lagged in the June quarter).

Over the last 12 months the key contributors to outperformance have been Lifestyle Communities, Chorus, a2 Milk, Unicharm and Danaher Corp. The portfolio has also benefited from being underweight banks (no exposure to ANZ or Westpac) as well as having a higher than normal cash weighting. Contributors to underperformance were Oil Search, Regis Healthcare, Alumina, GPT and FMG (not owned).

The international stocks in the portfolio (7 stocks, 13% of the portfolio) performed very well over the year, particularly Unicharm, Danaher and Costco which all delivered strong positive returns in a down market. Performance over the June quarter was solid but impacted by the A$/US$ rising over 12% (5 out of 7 stocks are listed in the US), as well as a couple of the defensive names not keeping up in the market rally (e.g. Costco and Unicharm).

The volatility of the portfolio over the quarter was 67% of the market's volatility.

The chart below shows the Fund's monthly relative returns. The grey bars show each month's market return sorted from the worst to best month and the purple bars show the portfolio's return relative to the market for each month.



Since inception the market (adjusted for franking credits) has shown a monthly negative return 29 times and in these months the portfolio has performed better than the market 23 times. When assessed using monthly data the portfolio has captured 70% of the market's downside and 88% of the market's upside.

In summary, it has been a remarkable 12 months for global financial markets which have been seared into our collective memory by the ravages of COVID-19, and one cannot help but to pause and reflect on the vicissitudes of financial markets and life.

The Portfolio

During the quarter we added Synopsys to the portfolio and increased our positions in ASX, BHP, GPT and Telstra. We reduced our holdings in Sydney Airport given the exposure to air travel is increasingly challenging. We sold small portions of Costco, Danaher Corp and Unicharm after a period of strong performance which we used to fund Synopsys. We also participated in the equity raisings for Qube, Ramsay Healthcare and National Australia Bank.

Synopsys (SNPS) is one of the two dominant players providing software to the semiconductor industry. Founded by current co-CEO Aart de Geus in 1986, Synopsys has a history of creating value and growing with the client base, and importantly generating very attractive margins and free cash flow for shareholders.

As a vertical niche software provider SNPS has deep domain expertise around what chip designers require to perform their roles. Its products are mission critical tools for the semiconductor industry as it continues to strive for greater speed and power efficiency in chips. This results in very sticky customer relationships, significant barriers to entry and attractive growth tailwinds.

SNPS typically sells software on a subscription basis, serving as the R&D function of customers who are unlikely to cut product development even in hard times. We saw that in the 2018-19 down cycle, SNPS is relatively insulated to these industry fluctuations.

We see value latencies around continued expansion of the suite of tools it provides its clients who increasingly want software solutions to streamline the design process. The company has also committed to significant margin expansion as some of their more recently developed tools reach critical scale.

SNPS sits in the Growth subset of value and increases the portfolio's exposure to technology. The company has established a strong track record over three decades and increases diversification via exposure to the software and semiconductor sectors. SNPS is highly focused and enjoys a market leading position within an industry experiencing long term secular growth trends. In addition, earnings quality is excellent and the balance sheet is net cash (pristine). Overall SNPS is a very high quality addition to the portfolio.

The portfolio owns 38 securities including seven global stocks (13% portfolio weight) and four New Zealand stocks (8.8% portfolio weight). The cash weighting is around 7.5%.

Stock News

COVID-19 has continued to dominate the headlines but the last quarter has also delivered a raft of company news including equity raisings, management changes, earnings results and even company name changes.

The a2 Milk Company (A2M) provided a favourable 3Q20 update noting revenues over the last quarter were above expectations due to consumer behaviour arising from COVID-19 (pantry stocking) and favourable FX movements (NZD depreciated against the USD). Management were confident enough to guide to sales revenue of NZ$1,700m-NZ$1,750m and EBITDA margins of 31%-32%. While the update represented only modest upgrades to market estimates (~+5%) it nonetheless suggested operating momentum in the business was strong, and was consistent with management's conservative approach to guidance.

In late June there was press speculation that A2M was on the short list to acquire the $NZ400m Mataura Valley Milk company in NZ, a dairy producer based in the South Island, and owned by China Animal Husbandry Group, Bodco Dairy and some local suppliers. Management wouldn't comment other than to say that A2M does look at potential strategic options relating to manufacturing capacity. It should be noted A2M holds a 19.84% strategic stake in Synlait Milk which is A2M's key manufacturer and supplier of infant milk formula.

At the end of the quarter, **Ampol (ALD)**, previously known as Caltex (CTX), appointed Matthew Halliday to the permanent position of Managing Director and Chief Executive Officer (MD&CEO), a position he has held on an interim basis since March 2020. We believe the appointment of Matthew Halliday as CEO (and even prior as CFO) further adds to an already improving trend in focused management behaviour.

This gives us increased conviction that ALD can execute on a number of value latencies including the retail network review, the proposed property IPO / trade sale (and accompanying capital return), cost out initiatives and other organic growth opportunities. In addition, ALD has a large unutilised franking balance which has potential to be utilised via any form of additional capital return, which would be very attractive to investors on a low or nil tax rate.

CSL had a busy end to the year with a number of announcements on the acquisition and management front. In early June CSL announced it had agreed to exercise its right to acquire Vitaeris which CSL has had a strategic partnership with since December 2017. The partnership has been working on a treatment for rejection of solid organ kidney transplant patients (Clazakizumab). CSL noted the acquisition price is modest and will not change FY20 profit expectations, however there will be additional R&D expenses of US$30m-US$50m in FY21. This transaction adds to CSL's emerging portfolio of products in late-stage development to address unmet needs in the transplant market, which is estimated to be a US$750m revenue opportunity.

In mid-June CSL announced the resignation of CFO David Lamont effective from 30 October 2020 with a global search commenced for his replacement. David has been appointed CFO at BHP effective 1 December 2020 and will also join their executive leadership team. This is disappointing for CSL as David has been a commendable CFO for the company.

In late June CSL announced it had agreed to acquire from UniQure the exclusive global rights to commercialise a gene therapy program (AMT-061) for the treatment of haemophilia B. CSL will make an upfront payment of US$450m followed by regulatory and commercial sales milestone payments and royalties, which we understand will take the total acquisition price up to US$2b. The deal is subject to the usual regulatory clearances and approvals. This gene therapy product will be highly complementary to CSL's existing product portfolio and is strategically sound as CSL is acquiring a technology that has the potential to be very disruptive to their existing haemophilia B franchise.

Danaher (DHR) announced Executive Vice President Rainer Blair will be taking over as CEO in September from current CEO Tom Joyce. Tom has been with DHR since 1989 and CEO for nearly six years. Rainer joined DHR in 2010 and has been running the life sciences platform (DHR's largest business) as well as playing an instrumental role in key acquisitions this decade. The CEO succession has been well planned out and we are confident DHR is as strong as ever qualitatively which is backed up by their financial results.

By way of background, DHR is a stock our global fund has owned for the last 10 years and is one of the leading global players in diagnostics and life sciences with $20bn of revenues, 60,000 employees and more than 20 operating businesses. DHR was started in 1984 by two brothers Mitch and Steve Rales who remain on the Board and own 12% of the company. While DHR looks very different today to 10 and 20 years ago, the company has built up a largely recurring revenue base that consistently grows mid-to-high single digits with ~25% EBITDA margins that are expanding.

In April **Insurance Australia Group (IAG)** announced that CEO Peter Harmer would retire at the end of 2020 including a flexible 9 month transition period while the Board searches for a new CEO. Early May IAG provided another market update that highlighted a number of headwinds being faced by the business, and the general insurance industry more broadly, including COVID-19 related challenges, deteriorating economic conditions and the direction of investment markets.

Large losses on IAG's investment portfolio and expected FY20 Insurance Profit led the company to guide to there being limited scope to pay a dividend in 2H20, although given the market recovery since the beginning of May IAG should be better placed to pay a 2H20 dividend. While reported insurance margin guidance was maintained the update implies that underlying margins are deteriorating. Rising reinsurance costs and higher natural perils allowances may also drag on margins as it will be harder to quickly reprice premiums in a tougher economic environment.

Mainfreight (MFT) reported its FY20 result highlighting ongoing solid performance (Sales +5%, EBITDA +9%, NPAT/EPS +13%). While top-line growth was below MFT's expectations, the group continues to deliver margin expansion across a number of geographies.

MFT operate in a highly competitive market (freight & logistics). Despite this, MFT has delivered consistently improving performance over time resulting in strong shareholder returns (TSR in the mid-20%'s over 5, 10, 20 year periods). Key to this performance in our view, is MFT's culture and management team, which we have observed over many years through our interactions with the company.

MFT remains an attractive compounder, offering both growth and defensiveness. Growth comes via winning market share underpinned by MFT's quality offering, consistent execution and increasingly scaled network. The defensiveness comes from MFT's underlying customer exposures (DIY, Food and Beverage), which provided some buffer to COVID related weakness.

In April **Ramsay Health Care (RHC)** conducted a $1.4b equity raise at $56 per share (a 13% discount to the last closing price), which we participated in given the reasonable value latency on offer for a quality Stalwart business. The proceeds will be used to reduce debt and enhance their financial flexibility to pursue M&A opportunities that may arise in the current environment. Bank covenant tests have been waived by lenders up until 31 December 2020, and accordingly RHC has temporarily suspended the dividend. Ultimately, the capital raised will allow RHC to navigate through COVID-19 and resets the balance sheet to a much stronger position.

During the quarter **Qube (QUB)** raised $500m via a 1-for-6.35 entitlement offer priced at $1.95 per share (an 11.8% discount to the last closing price), which we participated in given the large discount to our assessment of value. The raising will reduce gearing well below their target range and provides the flexibility to continue to invest in their business, mainly the build-out of the Moorebank Logistics Park (Moorebank), and make strategic acquisitions that may arise in the current environment.

QUB also announced that Woolworths (WOW) will become a major tenant at Moorebank signing a long-term lease for 20 years (plus 6 x 5-year options). Qube will spend $420m-$460m of capex to build the warehouses and receive $30m in rent per year, equating to an attractive 6.5% yield on cost. This deal is an important validation of the strategic value of Moorebank and we expect this agreement will bring forward negotiations with other potential tenants.

Ryman Healthcare (RYM) reported their FY20 result delivering a reasonable performance despite the significant impact of COVID-19 (Sales +11.6%, EBITDA +7.8%, NPAT/EPS/DPS +6.6%). RYM has an excellent track record of earnings growth but in recent years this has slowed to below their targeted 15% compound annual growth rate (or doubling Underlying Profit every five years). This was due to consenting issues in Australia, investment in the cost base to support a doubling of the build rate over the medium term (800 units pa going to 1,600 units pa), as well as funding pressures on aged care earnings in both NZ and Australia.

Positively, management highlighted that after 18 months of hard work they now have 60% of their land bank consented which de-risks the development pipeline and delivery of their build program. This will re-accelerate earnings growth and manage elevated gearing levels as capital is recycled from new unit sales. Importantly RYM's brand and reputation has been enhanced following their performance during COVID-19, further entrenching their market leadership and competitive advantage. The mission remains to provide care that is "good enough for mum" and the building blocks now finally appear to be in place to deliver on the company's ambitious aspirations.

Viva Energy REIT (VVR) announced at its Annual General Meeting in May that it would internalise management and change its name to **Waypoint REIT (WPR)**. This is part of the internalisation of management arrangements following Viva Energy Group (VEA) divesting its 35.5% holding in VVR. This is a positive development for WPR as it simplifies the corporate structure and provides greater optionality around growth opportunities and strategic decision making.

As part of the internalisation agreement, WPR secured from VEA until 1 January 2030, the right (subject to the terms of the relevant lease) to be offered properties tenanted by VEA where the owner wishes to sell the property and VEA does not wish to exercise a pre-emptive right it might have to acquire the property. WPR has also agreed to make an internalisation payment to VEA of $2.5m.

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