VT Tyndall Global Select Fund Commentary

May 2019

"In the midst of chaos, there is also opportunity." – Sun Tzu, The Art of War

And so, it came to pass, after months of threats (and tweets) about tariffs and trade deals, President Trump found himself up against his self-imposed deadline and did what the market least expected, implementing 25% tariffs on a wide range of Chinese goods. The Chinese, so not be outdone, retaliated with their own menu of charges; global equity markets baulked at this development. Ironically instead of benefiting the US economy, it is the US consumer who is likely to face the consequences of the trade war as cheaper imports become more expensive, but as goods in transit are not liable for the new tariffs, this squeeze on wallets will not be felt for a few months yet. Another side effect of the imposition of tariffs has been the depreciation of the Chinese renminbi, which in effect dampens the impact on the Chinese; perhaps the next tweet will be about currency manipulation.

Source: TIM/ Bloomberg

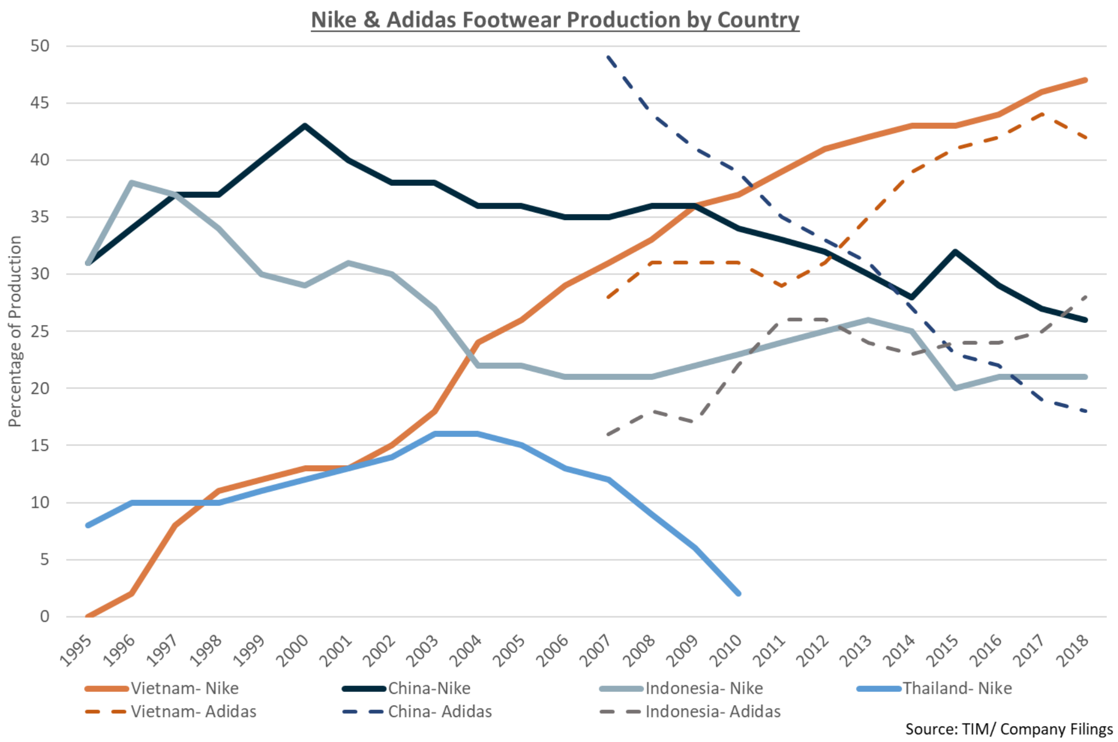
Over what proved to be quite a turbulent month the VT Tyndall Global Select Fund (B Inc) fell by 0.45% reducing the year-to-date returns to 13.46%. By way of comparison the MSCI World Index is up 10.90% and the Investment Association Global Fund aggregate increase is 11.61% year-to-date.

Despite our inability to predict what the next output from President Trump's iPhone may be, we continue to assess the impact on our holdings and whether the situation really has changed with regards to the investment case. Of our holdings the four most exposed to a slow-down in China and anti-US rhetoric are 3M, Apple, Nike and Kone (China accounting for 11%, 20%, 15% and 28% of sales respectively). All four companies have production facilities in China and therefore are less impacted by Chinese tariffs, however Apple & Nike produce a significant proportion of their US sales in China[1]

[1] According to the International Trade Center, Apple imported $45 billion worth of mobile phones into the US from China.

and therefore are exposed to the US tariffs; these companies have to decide whether to pass on the increase in costs to the US consumer. 3M warned of slowing growth in China while reporting its first quarter results and has de-rated as a result. we believe that given the diversified nature of its products, strong Return on Invested Capital and 91% Free Cash Flow conversion enable it to withstand these geopolitical scuffles in the long-term.

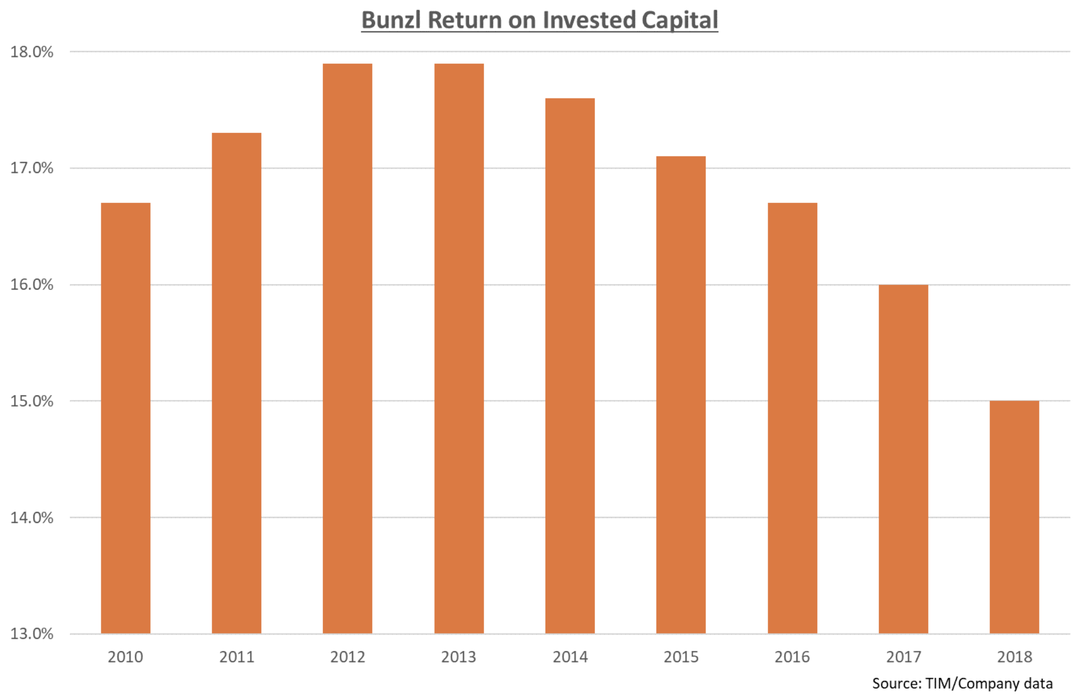
Although Nike obtains almost 15% of its revenues from China, tariffs are more likely to be incurred from importing to the US, which accounts for 43% of revenues, as almost all its manufacturing is Asian based. Like its German rival, Adidas, Nike has been decreasing its percentage of product sourced from China in recent years, however they are both still significantly exposed to the impact of tariffs, so it comes as no surprise that they were two of the 173 companies that signed the open letter to President Trump asking for footwear to be excluded from the increase in duties. Nike remains a core holding in the Fund.



Having held a stake in Bunzl since October 2008 we have experienced a more than fourfold increase in the value of our holding. We decided, however, to close the position this month owing to changes in the competitive landscape that we fear are not short-term in nature.

Bunzl ships a large amount of plastic and disposable products. Post David Attenborough's Blue Planet, which created a backlash against pollution by plastic products, we see that consumers and companies are rapidly adopting alternative solutions. Bunzl's management claim that this shift is beneficial for the company as alternatives such as paper straws are higher margin than the existing plastic products. Currently 35%-40% of the group's products are plastic based and in Europe & the UK around 15% of revenues come from single-use plastic products. While we believe that management are correct in their views on margin differentials, however, we are more bearish about the impact on profit levels given the reduction in volumes of products ordered. Taking plastic bags as an example, replacing single-use bags with bags for life may result in a one-time lift in profits but in the long-term orders for bags are likely to become negligible.

A key element of Bunzl's growth strategy is to seek acquisitions in order to expand geographic reach, product offering and customer base. Since 2004 the company has made 157 acquisitions and we expect that the Amazon effect will result in an acceleration of targets appearing as the Seattle goliath targets the order books of smaller volume players. Our concern here is that the returns on invested capital (using management's own definition) have been declining, partly because the higher capital requirements of own-brand acquisitions are not being fully compensated for by the benefits of higher margins. Although the ROIC is well in excess of the Cost of Capital and thus the cash generation can fund opportunities as they arise, we believe this trend limits the attractiveness of this stock



As mentioned above Amazon Business is becoming more active in the space. While large foodservice and retail customers (and to date grocery) are not in presently in Amazon's crosshairs (80% of Bunzl's North American and 50% of their UK & European operations) the smaller verticals are not so immune. We believe that Amazon's designs in Healthcare and Safety do present a realistic threat. Although Bunzl has no presence in US Healthcare, the division accounts for 7% of group revenues as it represents 20% of UK revenues and 25% of those from the Rest of the World, so there is plenty of opportunity for Amazon in this space.

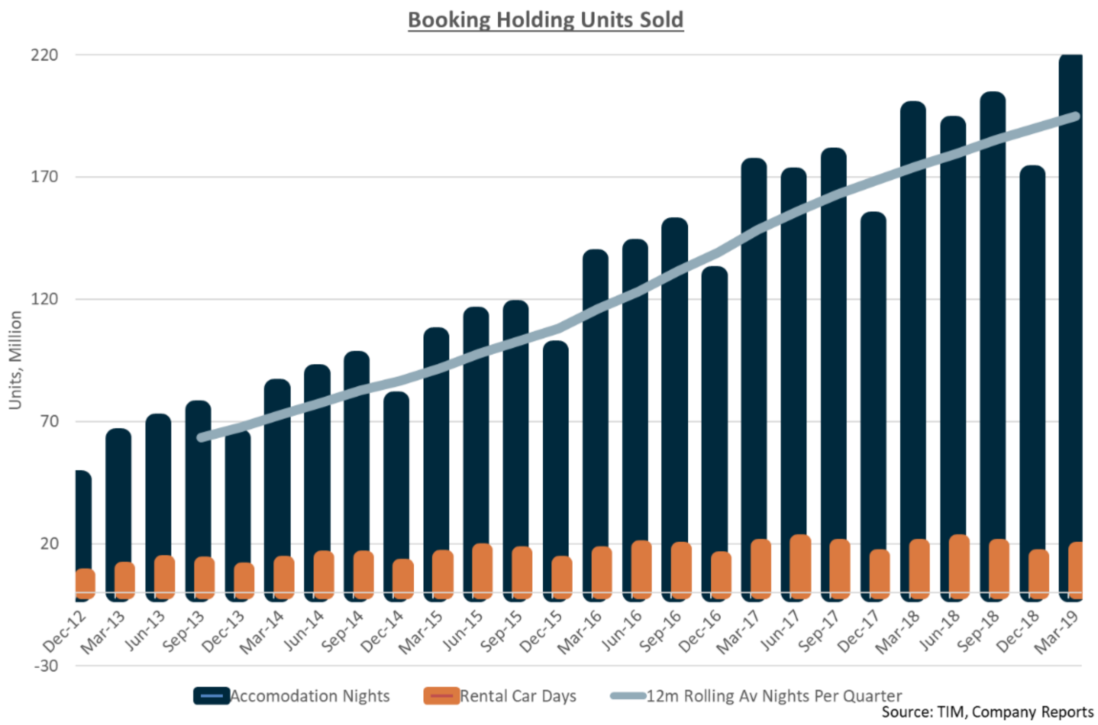
While we believe the slowdown in US grocery is partly due to uncertainty in the wider economy, as evidenced by US peers, we are also concerned that the company may be experiencing greater pressure from their largest customer, Walmart. Taking all these factors into account, we believe that Bunzl is facing a rapidly changing backdrop and that as such the investment case no longer holds.[2]

We invested in the online travel agent (OTA) Booking Holdings (formerly Priceline.com) in September 2017 after the share price fell heavily post a quarterly update where the management guided that they were to invest in future growth; a move that we applauded, but the short-term focussed investor did not. Booking Holdings is the largest OTA worldwide operating under the trading names of Booking.com, OpenTable.com, agoda.com, KAYAK, Priceline.com and Rentalcars.com.

Upon presenting their full-year numbers the management once again advised the market that they would be investing in brand awareness in order to entice traffic to their platforms in order to drive future growth, and a similar result occurred. This month the company reported their results for the first three months of 2019, registering 10% booked room night growth, well ahead of their guidance of 6%-8%. The shares rose significantly as a result. The company's investment in growth was demonstrated by a 61% increase in marketing spend compared to the same period last year, but this time the market did not seem to care.

The company is also investing in alternative accommodation which currently represents 20% of revenue ($2.8bn) and is second only to Airbnb (which had $2.6bn in revenue in 2017 but has yet to disclose their 2018 figure) in market share. Booking Holdings has 5.7m alternative accommodation listings and aims to add supply, especially outside Europe given their current concentration in European cities; US beach and ski locations were singled out in particular as areas of focus.

[2] Post the decision to sell the holding, Brian May, the CFO for the past 13 ½ years of his 25-year tenure at Bunzl announced his retirement and is being replaced by the CFO of Inchcape PLC. As the longest serving C-Suite member his departure will be a significant loss at these uncertain times. In addition the Chairman, Philip Rogerson is due to retire in April after 10 years in the post.



Weakness and concerns over Europe, Booking's largest market, continue to weigh upon the shares, however world travel remains a growth market and online continues to gain wallet share of the spend on travel and as such the long-term thesis remains intact.[3]

Given the capital-light business model the through the cycle Return on Invested Capital is in excess of 40% and Free Cash Flow of $5bn represents a FCF Margin of 33.7%, resulting in an underleveraged balance sheet of Net Debt/EBITDA of less than 0.5x. Despite not paying a dividend, the company buys back shares on an opportunistic basis, and last year bought back 4.3% of the shares outstanding. The board has approved a further $15bn repurchase program to be used over the next 2-3 years, equating to a retirement of a further 20% of market cap. The company remains a core holding in the Fund.

[3] The recent tragedy of the Ethiopian airline crash and the subsequent grounding of a significant proportion of the 737 MAX air fleet has weighed on OTA share prices, however we see this as a temporary short-term reaction and should not undermine the secular growth in the market.