# VT Tyndall Global Select Fund Commentary

October 2019

*"Nowadays people know the price of everything and the value of nothing."- Oscar Wilde*

The twin headwinds of Brexit and Elizabeth Warren has caused global equity markets to fall in sterling terms this month (albeit that they rose in their local currencies). With Boris Johnson managing to thrash out a deal with Brussels (but not with Parliament) and No Deal supposedly off the table through the Benn and Letwin amendments, sterling has appreciated significantly over the month. The outcome of Brexit remains a binary decision as too does a General Election, and we do not attempt to second guess it by hedging currencies. We have always left currency naked and rely on the fundamental growth of the companies to drive growth, meaning that from time to time we get currency benefits and currency headwinds, most of which even out over time.

Investors are beginning to see the news that Elizabeth Warren is now the front runner to secure the Democratic nomination for next year's Presidential election as a serious headwind. She proclaims to have a 'plan for that' at every possible opportunity, most of which are worryingly anti-business. Banning all fracking on private and public land, Medicare for all, or breaking up large tech companies are some of the ideas on her agenda. Equity markets would take her winning the Presidency poorly, although she if she does so she is unlikely to have a majority in both houses of congress, and perhaps in neither so enacting many of her policies will likely prove to be difficult; even with a majority in both houses Barack Obama took almost his entire Presidency to enact his healthcare reforms. We will continue to monitor our exposure to her long list of targeted areas as to how they might affect our underlying holdings, especially those policies that she might be able to enact through executive orders.

Although the underlying stocks had a resilient month, in sterling terms the VT Tyndall Select Fund B Inc (Total Return) fell by 2.17% bringing the year-to-date returns to 21.29%

## Musical Chairs

We witnessed a certain amount of management change during the month, and as 'Do we trust the management?' is one of the initial screens that we put all underlying companies through, assessment of the new management teams has been a theme this month.

**Nike:** CEO Mark Parker to be replaced by John Donahoe.

Mark Parker has been CEO since 2006 and has guided Nike through the transition from a brick and mortar/ third party distributor model to a company where Direct-To-Consumer now accounts for 1/3rd of the sales, so it seem apt that his successor should have an IT background. Of late he has been at the helm as some of the senior management have come under fire for discrimination and harassment, most notably the now ex-brand president Trevor Edwards, who was widely tipped to be the next CEO. Last month Mark Parker also had to change his mind over supporting Alberto Salazar and the Oregon Project after Salazar received a doping ban. Mr Parker will be remaining as Executive Chairman and a board member focussing on innovation and brand positioning post the transition in January.

John Donahoe is the current CEO of ServiceNow. Previously he was a Bain consultant for 20 years rising to become CEO and subsequently CEO of eBay. He is Chairman of the PayPal board and has been a board member for Nike since 2014. He comes with a good reputation from his tenure at ServiceNow where he has consistently met or exceeded targets and been a good allocator of capital.

**SAP:** CEO Bill McDermott to be replaced by Jennifer Morgan and Christian Klein as joint CEOs.

Bill McDermott will replace John Danahoe as CEO of ServiceNow, having spent the past nine years as CEO of SAP; prior to becoming global CEO he was CEO of SAP North America for eight years. He had a mixed reputation at SAP as he made 62 acquisitions during his tenure, not all of which were integrated as successfully as they should have been. SAP gained the mantra 'where good companies go to die' on his watch. He has, however, overseen the company move to a more cloud-based, high margin and recurring revenue platform and maintained SAP's positioning as the world's leading (Enterprise Resource Planning) ERP platform. SAP's market value increased almost fourfold during his tenure.

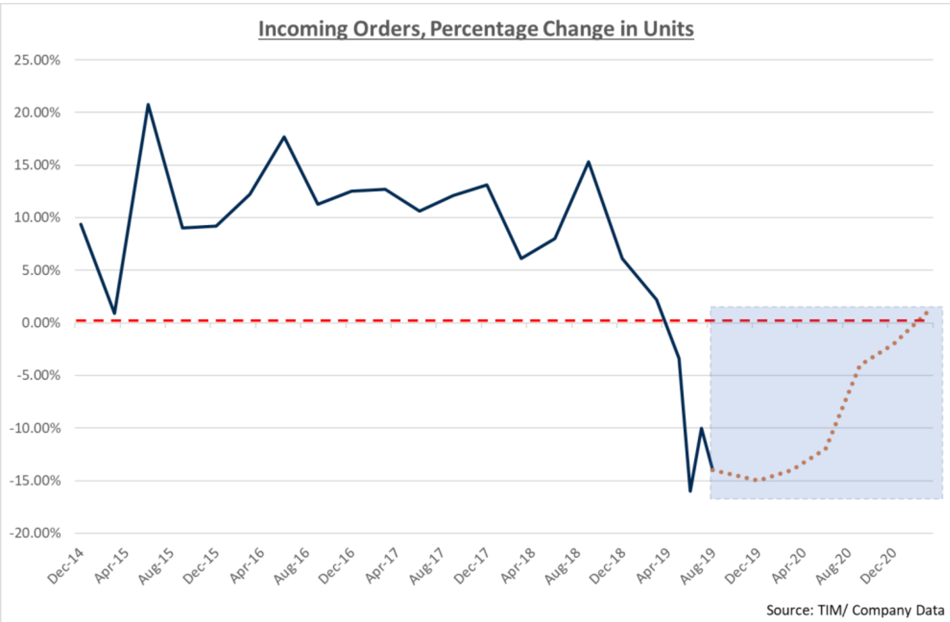
After a career at Anderson Consulting, Jennifer Morgan joined SAP in 2004, and rose to President of Americas and Asia before joining the board in 2017 and rising to become President of SAP Cloud Business Group. She has won numerous leadership awards and has been regarded as a rising star within the company. Christian Klein has worked at SAP his entire career, joining as a student in 1999. His career has included time as CFO of SAP Success Factor and has been the company COO for the past three years. He joined the board last year.

**Jungheinrich:** Discussed in more detail below

**Rational:** Alex Kaufmann joined Rational as CFO, after roles at Deutsche Bank, Nokia Siemens Networks and time as CFO of Koenig & Bauer. He has been in the post since 2015. This month he surprisingly announced his resignation with effect from December and has been appointed as CEO, CFO and COO of Nemetschek, which may cause a few corporate governance eyebrows to rise. His replacement is yet to be announced, but the CEO will take over his role until a new candidate is appointed.

## Fund Activity

During the month we sold our remaining holding in the forklift truck manufacturer, Jungheinrich. Despite being a beneficiary of the growth of e-commerce and its position as the leading manufacturer of electric forklift trucks, the macro economic environment in Europe has fed through to their order book.



With almost 24% of sales coming from their home market of Germany and 86% of their total revenues coming from Western and Eastern Europe, the economic troubles in these regions weighs heavily on the company. We have also seen, more recently, a shift within the order book towards more smaller trucks away from the more profitable internal combustion and larger electric trucks, thus the future order book will become margin dilutive.

Presenting at the Berenberg conference in Munich the CFO stuck a sombre tone, saying:

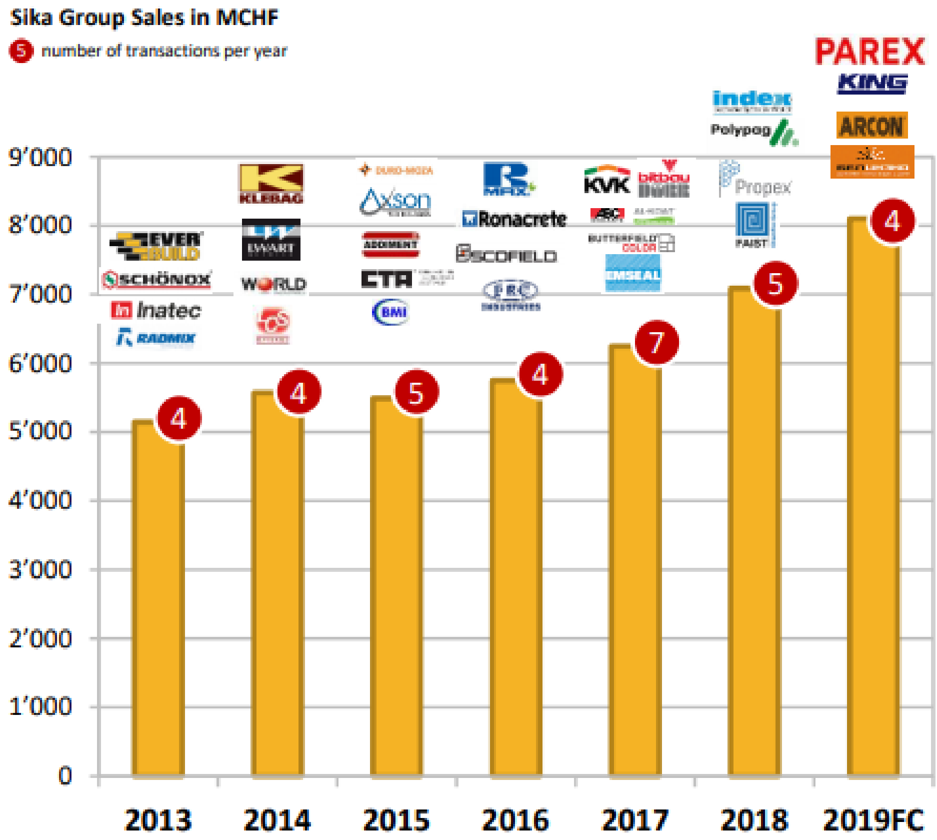
*"We are in a new reality in the last couple of months....Year-to-date to the end of August the EU forklift market has fallen -8% YoY with July down -10% and August down -14%. We are in recession now from our point of view and 2020 will be more difficult than 2019. The recession will likely stay for 12-24 months from my point of view. There are so many things creating uncertainty at the moment with Brexit, Trade Wars and Italy refi issues. We are now preparing the company for this recession and have learnt from 2009 that we can create a leaner company"*.

During the last recession, the company saw an uplift in sales of used equipment and rental orders. Although this creates a slight buffer, it resulted in lower margins, and as rentals during a downturn tend to be shorter in term than in more normal environments and visibility is reduced. The difference to 2008/09 is that the company has a higher percentage of temporary workers in the production arm (500 vs 3,500 permanent employees) which provides some flexibility. We expect, however, that the firm is more likely to resort to short-term hours rather than layoffs, especially given that they have reiterated their capex intentions for digitalisation and lithium-ion investment.

At the same time as these headwinds, the company is changing its CEO. Dr. Lars Brzoska, who has worked for Jungheinrich since 2014 in both marketing and engineering will take up the reins, with Hans-Georg Frey, who had been CEO of his family business since 2007, moving to the supervisory board. While it is encouraging that Mr Frey is remaining within the fold, we have concerns over the timing of this change given the backdrop and relative of experience in his 47-year-old successor. We do not believe that the headwinds will abate soon and therefore we sold the remainder of our holding.

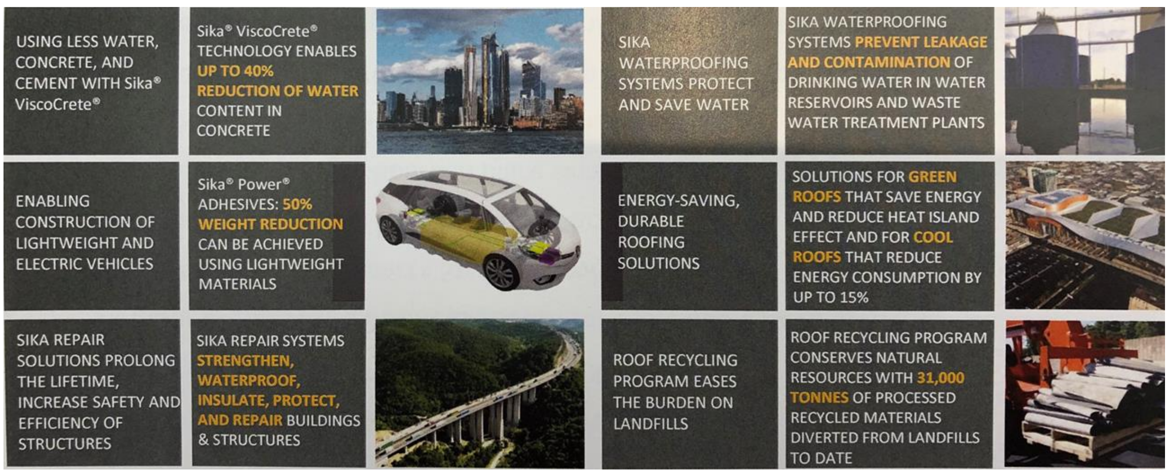
We also took the decision to sell our small position in Nokia, which will be explained in more detail in next month's commentary.

On a more positive note we initiated a position in the Swiss construction chemical company, Sika. The company is the global leader in speciality chemicals with a nine percent market share. The market is highly fragmented with the next 10 players accounting for 30% of the overall market, resulting in plenty of opportunities for small scale acquisitions to add on top of their market leading 6-8% organic growth; by way of comparison the peer group has averaged 3-4% organic growth over the past 10 years. The company targets 12% market share by 2023.




Source: Sika Company Presentation

Although exposure to the construction sector optically appears highly cyclical, Sika's product offering is so margin accretive and essential to their end users that even in the depths of 2008 they managed to grow by 1%. Somewhat surprisingly, given its end markets, Sika scores well in ESG terms. Their products can reduce water consumption used by construction companies by up to 40% per tonne (amounting to over 25 billion litres per year) and $CO_2$ emissions by 12%, while at the same time increasing durability and workability.



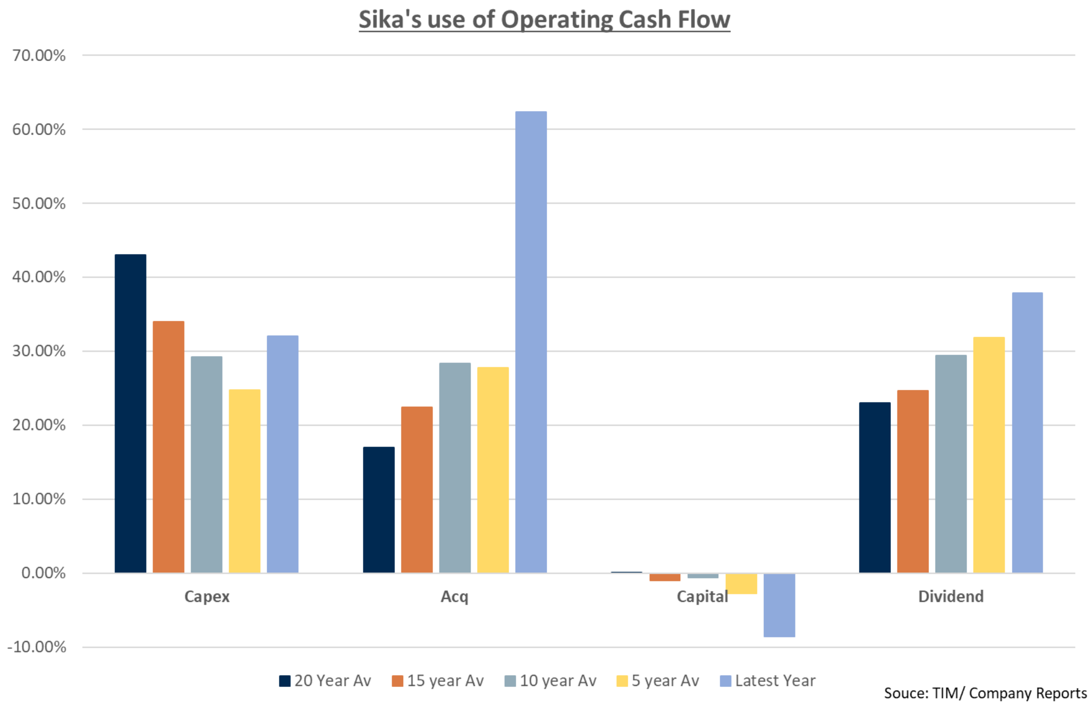

Source: Sika

Stakeholder welfare, social responsibility, sustainability and empowerment are embedded into everything they do, and probably explains why the Bill & Melinda Gates Foundation is one of their largest shareholders.

After the failed St Gobain takeover that lasted from 2014-18, the company simplified its share structure, cancelling outsized voting rights that St Gobain bought from the founding Burkhard family, which we see as a positive move. Nonetheless, St Gobain remains the largest shareholder with a 10.75% stake.

Sika is highly cash generative and has historically had little if any leverage on its balance sheet, easily financing the acquisitions through operating cash flow. The through-the-cycle Return on Capital Employed has steadily increased over time from 10% a decade ago to such a level that it is confident of it being in excess of 25% by 2020, proving how successful the current management team have been in allocating capital. Innovation is at the heart of the company and helps to sustain this profitability with 25% of sales from products released in the past five years.

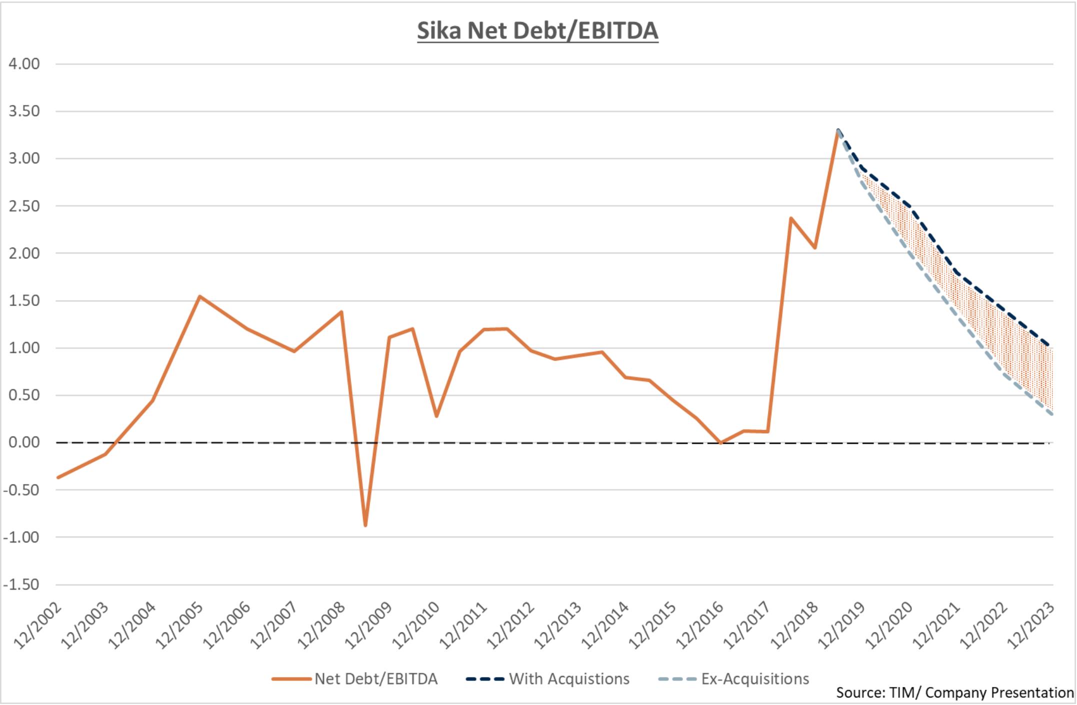
Having met with management this month, we are confident that they can reach their new targets and believe that they may well be being conservative with them.




By integrating these bolt-on acquisitions and driving operational efficiencies the company has gradually increased its EBIT margin for the past eight years from 7.6% to 13.4% and targets a range of 15%-18% by 2020. This year has seen the company make the strategic acquisition of Parex which gives them exposure to mortars and adds an eighth business line.


Source: Company Presentation

Parex was is an uncharacteristically large acquisition by Sika's standards, however the cash generative nature of the company means that having increased leverage to 3.3x net debt/EBITDA, this is likely to have reduced to 2.7x by the end of the year and we believe that the company's estimates of reducing this by 0.4x each year to be very conservative.




Source: TIM/ Company Presentation

The acquisition brings a company with a long-term CAGR of 7% and a EBITDA margin of 16%. It has little overlap with Sika's existing portfolio but brings with it the potential for Sika to increase its exposure to distribution as 80% of Parex's sales are through their advanced network. Currently management expect CHF 80-100m of synergies per annum which we believe is conservative as it does not consider any savings in Capital Expenditure which could increase this amount by 30-35% per annum. Procurement savings of CHF 12m have already been achieved within three months of closing the deal. In addition, the complementary nature of Parex's expertise in mortars to that of Sika generates a large cross selling opportunity (estimated to be in the region of CHF 230m in over 100 projects; 3% group sales).

We believe that the company exhibits the characteristics that we look for in an investment and given the share price fell by almost 20% post the first half numbers; organic sales growth appeared to be lower than the group long-term average, we took the opportunity to invest. At the Capital Markets' Day this month the company reiterated their 6-8% organic growth rate and the price started to recover some of this loss.

Although Sika has many specialist products a brief summary of their product categories are listed below:

| **Construction** | | | | **Industry** |
|---|---|---|---|---|
| **Build** | **Protect** | **Finish** | **Repair** | Automotive |
| Concrete Admixtures | Firestop Systems | Floor Systems | Roof Repair | Transportation |
| Cement Additives | Roof Systems | Wall & Façade Systems | Concrete Repair | Marine |
| Grouting | Building Envelope Systems | Tile Setting Solutions | Injections | Home Appliances |
| Rigid Bonding | Waterproofing Systems | Construction Adhesives | Structural Strengthening | Building Components |
| Admixtures for Mortar & Gypsum | Industrial Coatings | Joint Sealing | Anchoring | Textiles & Consumables |
| | Concrete Protection | | | Renewable Energies |
| | | | | Advanced Resins |