VT Tyndall Global Select Fund Commentary

February 2020

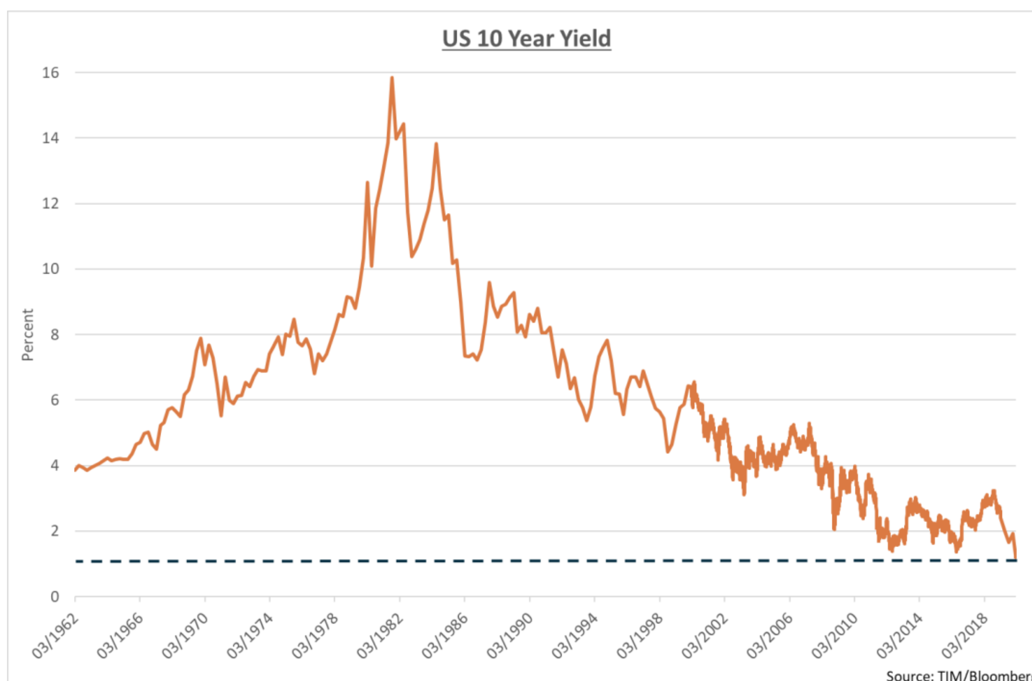
"A well-informed mind is the best security against the contagion of folly and vice." – Ann Radcliffe

The twin market forces of fear and greed have been out in force over the last month. Post the signs of COVID-19 spreading to Italy, Japan, Korea and Iran, investors rapidly changed their rather complacent views about the impact on the global economy to one of panic. Having continue to climb despite a growing number of cases in China and onboard the Diamond Princess, global markets plummeted in the final week of the month, with the S&P500 experiencing the fastest ever 10% drop, falling 12.3% in just 5 days.

We view the increase in volatility as an opportunity, as the correction in share prices in the wake of the spread of COVID-19 may lead to opportunities for us to add to existing positions or even find new investments. Although we continue to evaluate the investment case of all of our holdings, with particular interest towards the demand and supply constraints caused by temporary shop and factory closures, we believe that our process of holding for the long-term will be rewarded as in time the virus will pass and markets will once more find their mojo.

We know no better than others as to how long it will take to contain the virus or find a cure, so trying to time the market can be dangerous to investors' capital. We may well see depressed earnings for a couple of quarters as, owing to the just-in-time nature of global supply chains, even when the cogs of the global economy start whirring it will take time for the bottlenecks and inventory shortages to filter through. We do, however, see that when COVID-19 is under control, pent up demand is likely to lead to earnings increasing, and consequently, share prices will rebound.

While the move in equity markets has been severe, we have been paying close attention to the bond markets, as often they portend things to come ahead of equity markets, and the recent drop in US bond yields to all time lows is worrying.



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This fall in bond yields would suggest that equity markets may have further to fall, however, we are active stock pickers, and thus not buying the overall market. By remaining nimble enough to add to existing holdings, or initiate positions in companies that are on our watch list, which are overly discounting the impact of COVID-19 we believe we can continue to add value for investors. We agree with Warren Buffett who recently commented "we think the 20- and 30-year outlook is not changed by the coronavirus" although we believe that he would also be correct looking at the 2-3-year time horizon as well.

Not falling foul of heuristics, patience and remaining true to the mantra of "common sense investing" is particularly important at these times, and as we did in 2016, buying quality companies with structural long-term growth, that have been overly discounted as the rest of the market is selling is key to finding the building blocks for future growth in investors' capital. In the past we have found that business with the characteristics we look for have managed to adapt and ride out most of the short-term noise and economic hurdles, even if their valuations can become temporarily impacted by the initial indiscriminate selling; the rise in passive investing accentuates the indiscriminative nature of selling in times of panic and thus should provide active investors with opportunities.

The VT Tyndall Select Fund B Inc (Total Return) ended the month 7.47% lower over the month, despite President Trump, realising that a strong stock market is his ticket to a second term later this year, trying to reignite investor confidence by berating US health officials for scaring investors.

Fund Activity and News.

Becton Dickinson (BDX) has been a key holding for the past 10 years, however this month we witnessed a 13% fall in the share price when it released its quarterly update.

Management was advised by the FDA a few days before their first quarter report that they were required to submit a comprehensive catch-up 501(K) to cover the upgrades to their Alaris pump software updates. This caught us and management by surprise. Since acquiring Carefusion in 2015, Becton Dickinson has implemented numerous software upgrades and has worked closely with the FDA in doing so. The volte-face to decide that now these past upgrades need 501(K) retrospective submissions is confusing. As a result, BDX has halted shipments of the pumps until submitting a 501(K) to cover all the upgrades in the summer.

As a result, Becton lowered its full-year 2020 guidance from 4.0%-5.5% to 2.0%-3.5% to reflect the halt in shipments of the Alaris pumps (approximately a $400m headwind). We think that the share price reaction was overdone as the BDX Pyxis and Alaris syringe & pump system is best in class and has a 70% market share as a result and is also highly connected to the hospital ecosystem.[1] Therefore, doctors switching to alternative products such as those currently sold by Baxter is unlikely in the near term. Contracts are typically 10 years in nature and the consumable part of the business should not be impacted by this time out of the market. We see that forgone orders in 2020 will simply be postponed to 2021 and become a tailwind once FDA approval is obtained and are relieved that this is simply a paperwork rather than a hardware issue.

[1] A video synopsis of how the Becton Dickinson End to End Medication product suite fit into the hospital ecosystem can be seen at https://www.bd.com/en-us/company/video-gallery?video=5825029666001

Obviously how quickly it can submit the filing to the FDA will determine whether this has an impact on FY21 earnings, and whether the long-term 5-6% organic sales growth returns. As an aside FY21 should see BDX finish paying down the debt from the CR Bard acquisition and significantly increase its FCF at its disposal and possibly see them return more cash to shareholders.

Having trimmed our position in Microsoft on the grounds that it had hit our position size limit, we used some of the proceeds to add to our position in BDX after the market correction, as the remainder of the business remains performing well and the business investment case remains intact.

Our holding in Kone was also in the news this month as their joint bid with CVC Capital Partners for ThyssenKrupp's elevator business was ruled out of the shortlist for the final stage bidding by ThyssenKrupp, despite having submitted a significantly higher offer than either of the remaining parties. We saw the potential sale or IPO of ThyssenKrupp's elevator business as a once in a lifetime opportunity for any of the large elevator businesses (OTIS, Kone, Mitsubishi and Schindler) given the concentrated nature of the market, where the Top 5 companies control almost 75% market share.

We reviewed the benefits of a merger between Kone and ThyssenKrupp in last June's newsletter; a copy can be re-sent upon request. Despite Schindler's complaints about such a merger would be bad for competition, when we analysed the merger on a country by country basis, their combined market share is below that of Otis, (soon to be spun off by United Technologies, and thus is also a holding in the Fund), in most markets.

Units under Maintenance Market Positioning

	Kone		Thyssen		Combined		Otis		Schinlder	
	Share	Position	Share	Position	Share	Position	Share	Position	Share	Position
Spain	4%	5	19%	2=	23%	2	**30%**	**1**	12%	4
Italy	13%	2	3%	4	16%	2	**20%**	**1**	7%	3
Germany	12%	4	13%	3	**25%**	**1**	15%	3	**20%**	**1**
France	16%	3	11%	4	27%	2	**36%**	**1**	17%	2
Brazil	1%	5	17%	3	18%	3	22%	2	**30%**	**1**
China	8%	1	3%	4	**11%**	**1**	4%	**3**	5%	2
US	13%	4	18%	2	**31%**	**1**	**25%**	**1**	17%	3

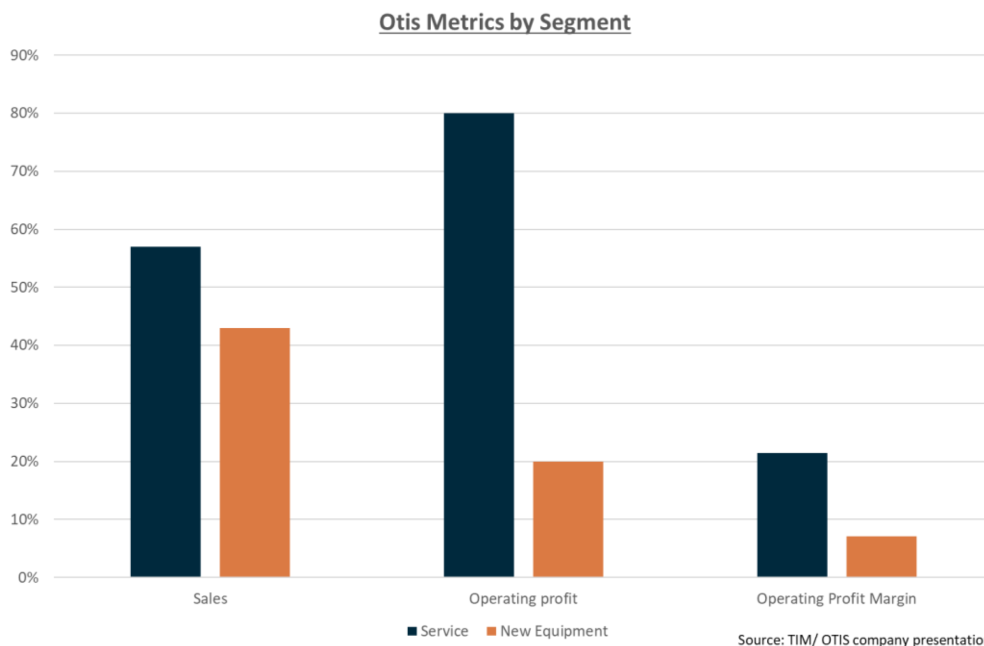
Source: TIM/ Berenberg/ Company Data

We believe that ThyssenKrupp's urgent need for cash and the concerns of the influential German trade unions eventually swung the decision to exclude Kone from the bidding process, as both the remaining Private Equity bidders would be able to provide instant cash payments, without the need for anti-trust approvals.

Although the deal would have been beneficial for Kone, the fact that the unit is not going to any of its rivals has resulted in a status quo and has the benefits of Kone not having a large debt balance to deal with; it had offer to pay €17bn in conjunction with CVC. Kone currently has a net cash position on its balance sheet with a net debt/EBITDA ratio of -1.1x and generates over €1bn of free cash flow each year.

Escalator and Elevator (E&E) companies have significant barriers to entry given the regulation and safety standards imposed by national bodies, giving those who have the scale to invest a natural advantage. The sector also sits on the crest of the multiple waves heading towards urbanisation, a growing middle class and digitalisation, all of which drive long-term underlying growth. The service part of the business is high margin, cash generative and recurring in nature, underpinned by improving conversion rates globally from a growing installed base and an aging fleet requiring modernisation; of the 16m unit global installed base 5.5m are more than 20 years old. New equipment to service conversion rates outside China are typically in excess of 90% (China averages 60%, but has been increasing as reliability, speed of callout, increased digital content and remote monitoring become more highly valued by building agents and tenants).

Schindler and Kone do not disclose the service margin versus their new equipment margin, however Otis does, albeit that the service margin is depressed by the inclusion of modernisation contracts within the segment.



Source: TIM/ OTIS company presentation

Although COVID-19 presents a near term headwind to the Chinese market, which by unit size is the largest global market, we believe in the fundamental long-term opportunity that Asia embodies once normal service resumes. Kone is the largest E&E company in China with an 8% market share, highlighting the fragmented nature of the market in the region, however, their army of service engineers surpasses that of their peers giving them an advantage when bidding for service contracts.

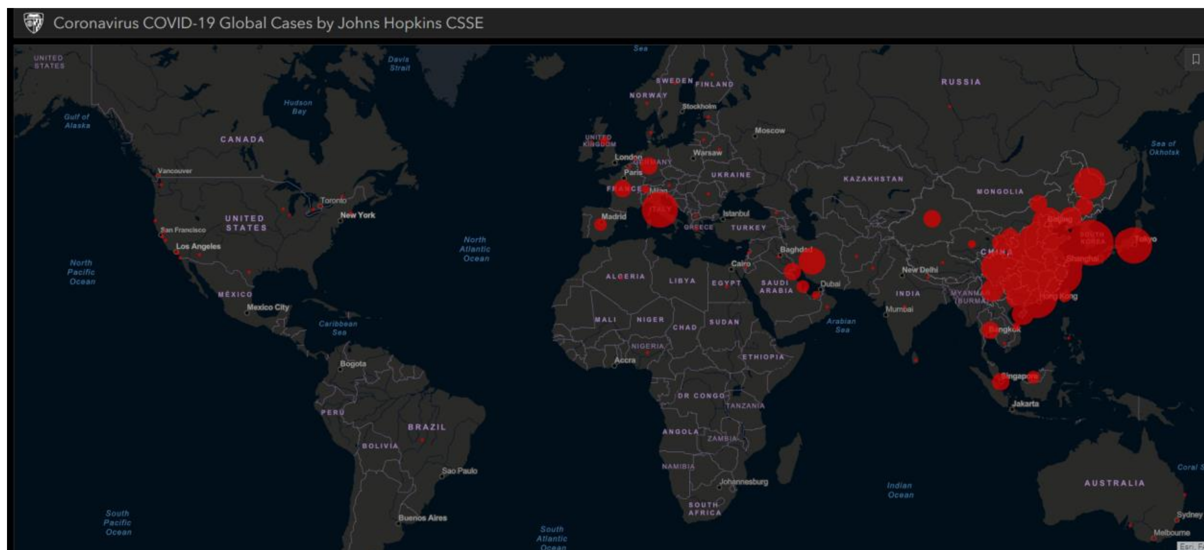
Amongst the numerous changes in company managements this month, we saw Bob Iger step down as CEO of Disney having spent 15 years in the role, handing over the reins to Bob Chapek, who has previously been head of the theme-park division. Bob Iger had been clear about the fact that he was going to retire once Disney+ was up and running, having twice postponed his retirement to ensure the smooth running of the business post the takeover of Fox's entertainment assets and the move to

streaming. However, many investors expected that he would hand over to someone intimately involved in the streaming business and not so suddenly after the launch of Disney+; he will, however, remain intimately involved as Chairman of the board for the next two years.

Bob Iger's tenure has seen Disney completely change its ethos and focus, being the driving force behind the acquisitions of Pixar, Marvel, Fox, Lucas Films, Hulu and the re-energising of both the Theme Parks and Studio divisions. We would recommend his recent biography "*Ride of a lifetime*"[2] to all investors as not only does it give readers a potted history of the changes within the entertainment industry over the past 40 years, but, he also draws out ideas in leadership that he has learnt during his careers at ABC and Disney, and in doing so gives you an insight into the culture of Disney. We do not expect any significant change in direction as Bob Chapek claims that he will continue exactly where Bob Iger left off and work closely with him to ensure a smooth transition. Having worked at Walt Disney for the past 27 years, the company ethos should be ingrained in his DNA, and being focussed on Disney's theme parks for the last five years, he has also worked for the studios and home entertainment divisions, so the other parts of the business should not be alien to him and with Bob Iger's help we expect that he will continue to drive Disney on the right path.

Post Note

For those wanting to track the spread of COVID-19, the Johns Hopkins Centre for Systems Science and Engineering provide an interactive map depicting the location of all reported cases as well as the data related to each case.



Source: https://www.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6

[2] https://www.penguin.co.uk/books/111/1114253/the-ride-of-a-lifetime/9781787630468.html