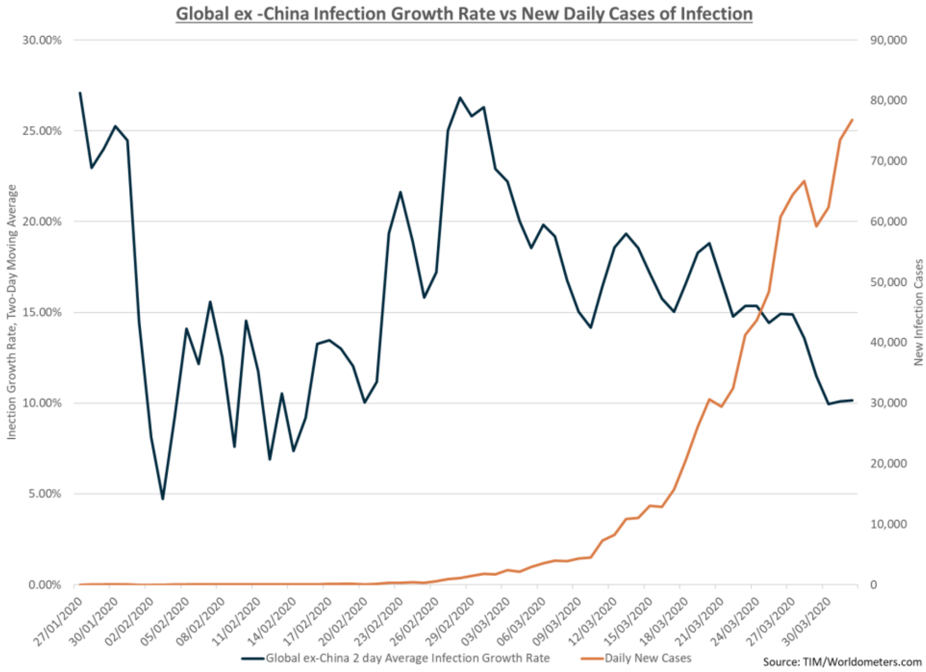
VT Tyndall Global Select Fund Commentary

March 2020

TYNDALL

"Delay is the deadliest form of denial" – C. Northcote Parkinson

We are now writing weekly updates for investors on our thoughts and observations about the developments in markets as COVID-19 spreads across the world. For those who have not received them but wish to do so, please contact us to be put on the distribution list, or alternatively they can be found on our website at: https://www.tyndallim.co.uk/news-insights/. In a world where headlines are full of doom and gloom, it is worth remembering that statistics can be manipulated to tell you a version of events that fit your base case. Although the numbers of infections look dreadful, the growth rate appears to be moderating for now; possibly lockdowns and quarantining are starting to work.



Although we are now working remotely, our systems work as seamlessly as they did in the London office. Should any investor wish to contact me to discuss the Fund or our thoughts and actions in these markets we are happy to do so either by conference call, be it by voice or video medium.

The VT Tyndall Select Fund B Inc (Total Return) ended the month 4.22% lower over the month, while global equities fell by 10.62% over the month, with the S&P500 posting a quarterly fall of over 20% for only the 5th time since WW2.

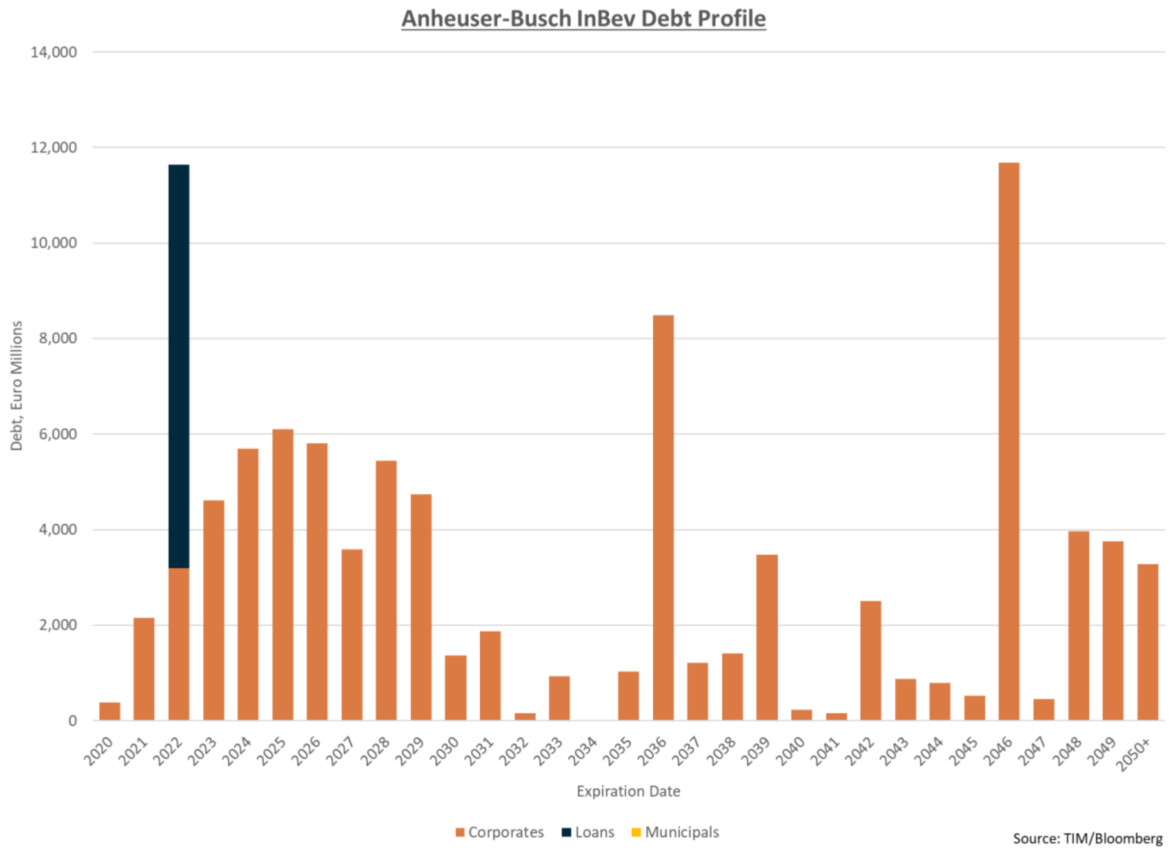
Fund Activity and News.

We have been more active than normal this month in order to take advantage of the opportunities thrown up by the rapidly changing market; the past few weeks saw the quickest 30% drawdown of the S&P500 in history, taking only 22 days. We have added two new positions and sold our small holdings in Anheuser-Busch InBev and Compass. We also slightly reduced our weighting in Microsoft as it reached our self-imposed position size limit of 5.25% of the Fund.

As COVID-19 engulfs the world, the increase in off-trade alcohol consumption is unlikely to be offset by the decline in on-trade sales. We see this, however, as a temporary factor as once restrictions on public houses and movement lighten the market will return. Almost 40% of Anheuser-Busch's sales comes from public houses, bars, restaurants and hotels, although this varies considerably on geography, with Africa and South America relying much more on the on-premise sales, while the US is predominantly an off-trade market.

Our decision to sell our holding, however, was based upon our concerns over ABI's ability to grow margins further, having been the frontrunner in Zero Based Budgeting (ZBB) and depressing working capital through its scale, exerting better payment terms from both its customers and its suppliers. We no longer see this as sustainable given that it faces growing competitive pressures in some of its higher growth regions (Brazil, South Africa, Colombia and Argentina) in which it sells a disproportionate amount of its premium products.

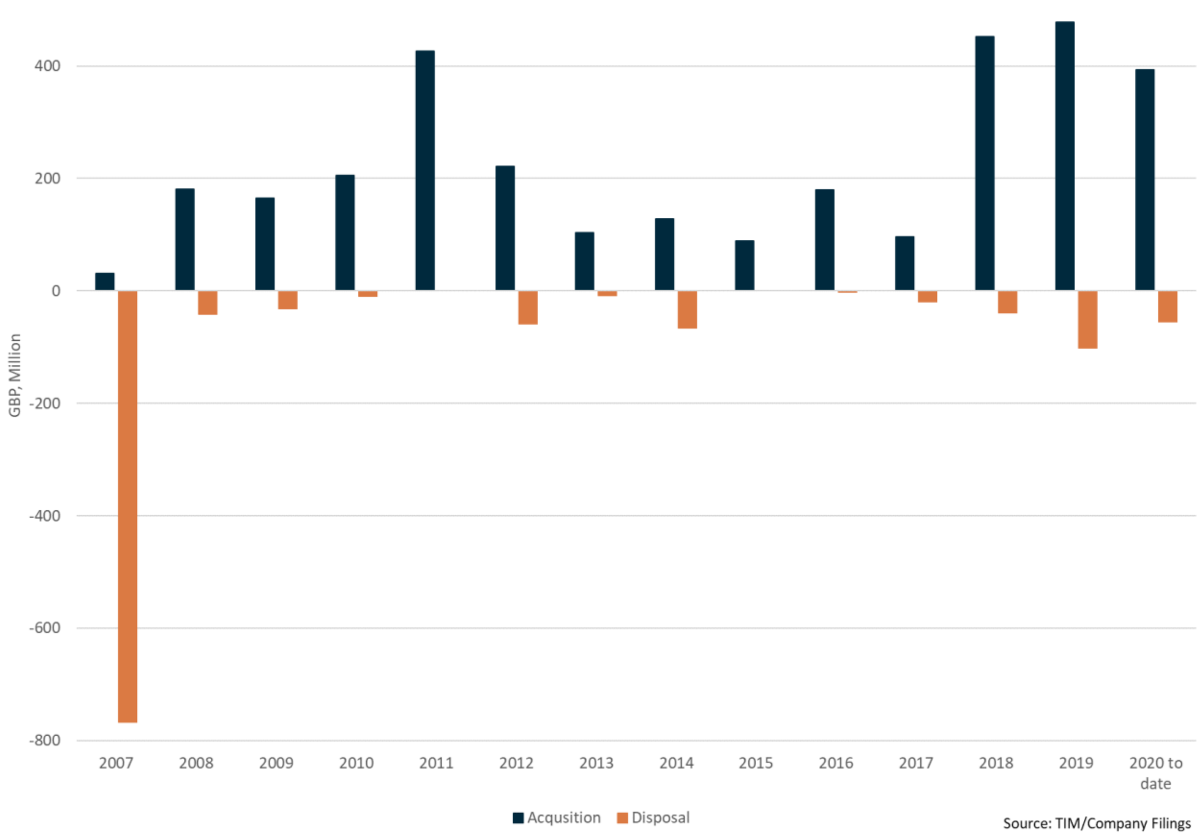
We also became concerned that the deal with Asahi to sell its Australian Carlton and United Breweries operations might be under threat as the Australian competition authorities review the transaction. This deal was to reduce ABI's debt by $11 billion. Given that ABI still has a net debt/EBITDA of 4.4x and post the APAC IPO management spoke of further M&A opportunities, we are concerned that the debt burden will persist despite the debt being well spread over the next 30 years with a weighted coupon of 4%. Last week the company drew down its entire $9bn loan facility to maintain its financial flexibility amid the COVID-19 pandemic.



We also sold the remainder of our position in Compass. We had been reducing the position after analysing the trend in the multiples that they have been paying for acquisitions. It appears that multiples have been increasing as well as undertaking an increasing number of large deals, which was a change from the strategy of multiple small bolt on deals undertaken under the tenure of Richard Cousins. We had slightly reduced the position after the untimely death of Richard Cousins in a plane crash on New Year's Eve in 2017. However, having served as CEO since 2006, he was already due to make way for Dominic Blakemore in 2018, so we continued to hold a position. In January this year it was announced that the Chairman, Paul Walsh, who had been expected to serve until 2023 is to part ways with the company in the next 12 months. Paul Walsh joined Compass in 2014 and has high regard within financial circles having previously served as CEO of Diageo and is a board member of Fedex, Unilever, McDonalds and Centrica. The loss of two of the key stalwarts of Compass's meteoric rise added to the sell/reduce case.

The onset of COVID-19, however, has expediated our exit of the position as it became evident that as companies were forced to shut down, or employees being encouraged to work from home, Compass would be directly in the firing line as the demand for contract catering would decline significantly in all of its end markets.

Compass Acquistions & Disposals



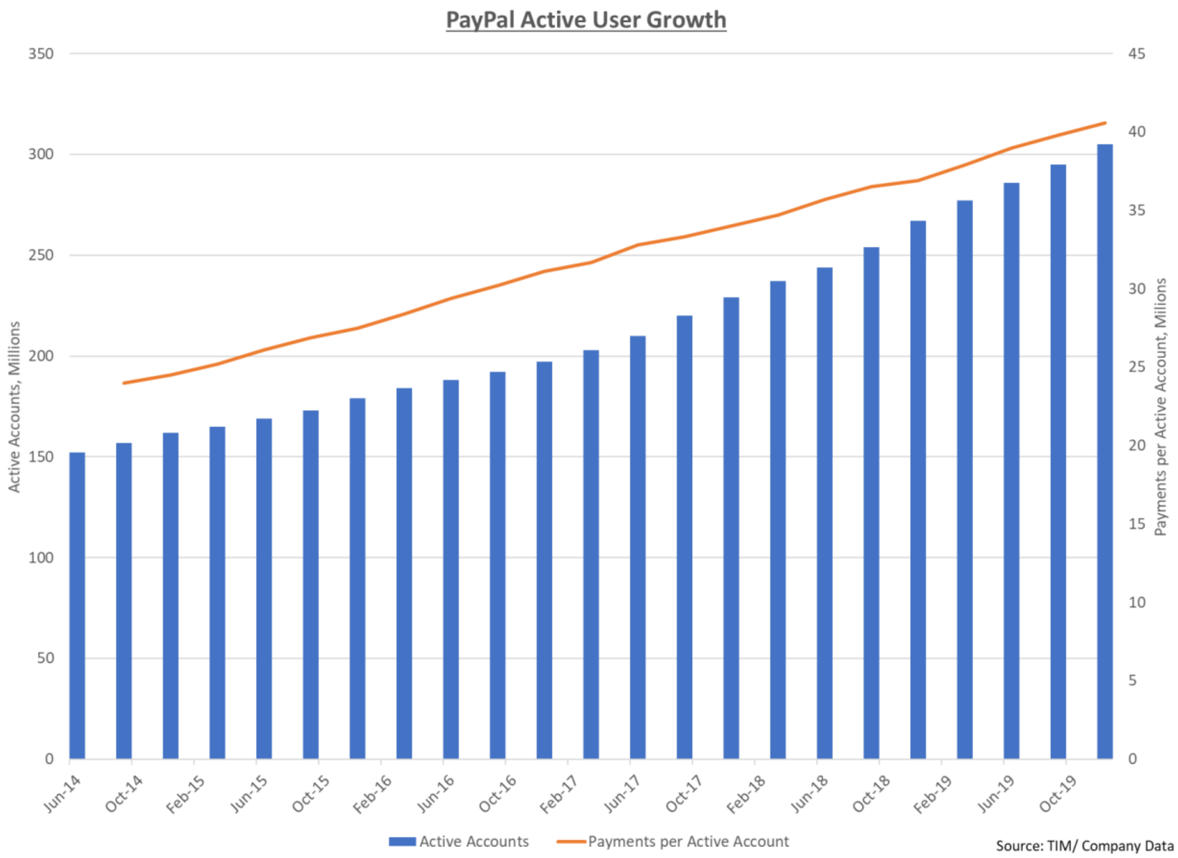
Source: TIM/Company Filings

We took the opportunity of the market correction to add two new positions that had been on our watch list for many years, namely Diageo and PayPal.

With 305 million active users, PayPal is the largest online payment platform with a leading e-commerce and mobile commerce market share. It sits at the centre of the secular trend to digitalisation of money and the increase in usage of mobile devices as a medium for shopping. The company estimates that 50% of transactions will come from mobile devices in the coming years. As the platform continues to add market share it will become ever more embedded in both consumer and merchant ecosystems, and thus the outlook for future growth looks healthy.

Today it generates in excess of $520m in annual transaction volumes, which equates to $1 in every six spent online. It has 24m merchant partners worldwide that benefit from the high conversion rates that PayPal provides. Payment friction is a key hinderance to consumers not completing transactions online, and PayPal resolves this issue. Merchants also experience greater spend volumes with the average PayPal customer spending twice that of a non-PayPal customer.

PayPal user rates, although growing at a rate in excess of 20%, remain less than once per week, so we see considerable room for growth both in transactions as well as user numbers as it expands geographically and adds strategic partners such as Uber, Amazon and Mercado Libre.



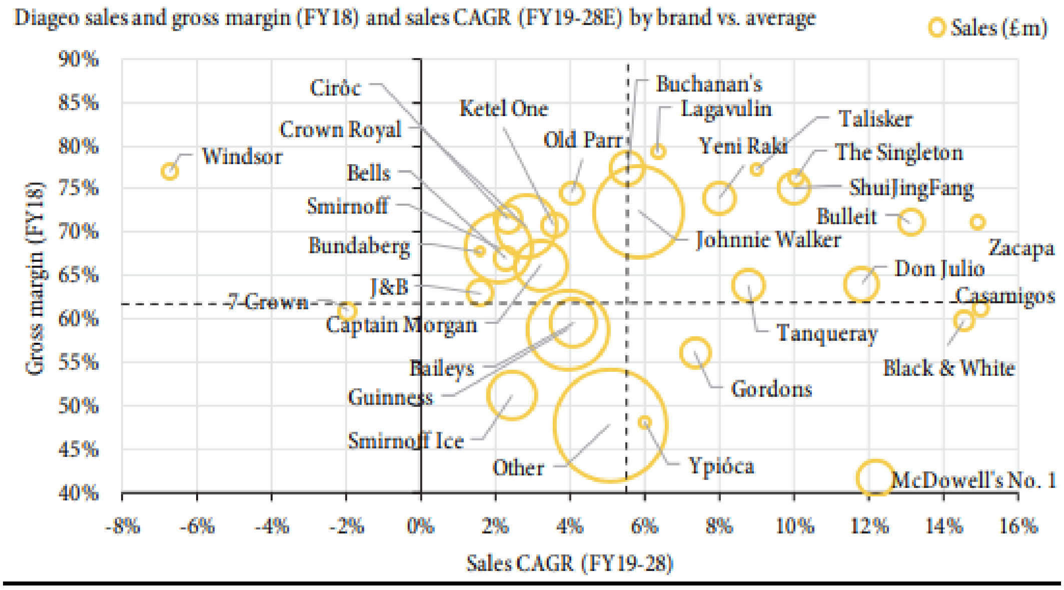
Source: TIM/ Company Data

The Venmo social mobile payment app continues to grow at a rate in excess of 80% with the younger audience it targets, contributing almost $20bn in revenues to its parent company. We believe that this could grow to 5% of group revenues this year and will help expand PayPal's user base in the long run. PayPal also uses its strong net cash balance sheet of over $10bn and Free Cash Flow (FCF) generation to make strategic acquisitions to further enrich the offering to users. Last year the company generated $3.9bn of FCF, equating to $0.22 of FCF for every dollar of revenue earned.

With the shares over 30% lower due to the market correction and the company trading on a FCF yield of over 4% we decided that the growth opportunity and future cash generation warranted us establishing a position in the company.

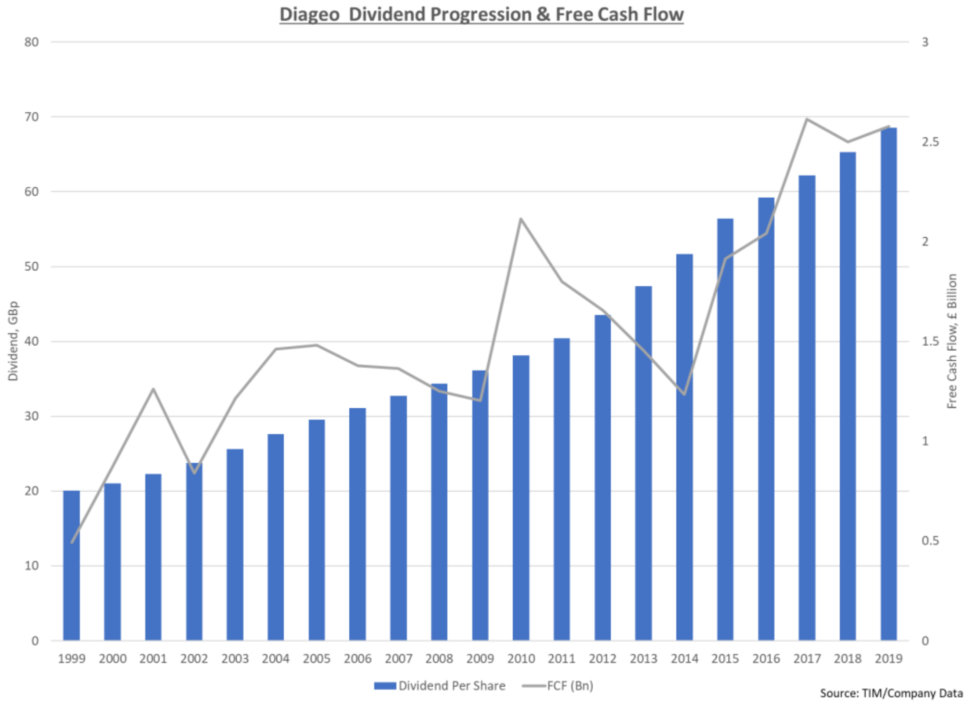
Over the past decade the world's largest distiller, Diageo, has undergone a period of sizeable investment in ageing Scotch inventory as well as expanding capacity in Africa and improving its route-to-market in India and China. We are now entering a phase of lower capital deployment and should start to reap the rewards from these investments as cash generation and operating margins improve. The company guides for mid-single digit organic sales growth and sustainable operating profit growth of 5%-7% going forward (although COVID-19 will result in 2020 dropping below this range).

The ageing process may tie up capital, but it also creates a large barrier to entry, giving those like Diageo a sustainable competitive advantage and pricing power. Approximately 45% of Diageo's sales come from branded products that must age. Given the lack of best before dates on Vodka and Whisky, it can be globally distributed without a detrimental effect on quality, indeed this creates a further barrier to entry as region of origin is seen as a premium quality if your product must come from a region specific to the product.



Source: Redburn, company

Unlike the beer companies the spirits companies have been able to consolidate their distributors, reducing their reliance on third-party importers or regional wholesalers. The ability to do this depresses margins initially, however, gives greater visibility and control over inventory and thus drives margins in the long-term. Through the acquisition of Seagram in 2002, Diageo gained enough scale to be able to consolidate is distributors in the US to one per state, each with a dedicated Diageo sales team. Diageo now has approximately 95% of its sales through its own sales and distribution channels.



Diageo has delivered an increasing dividend to shareholders in every year since 1999, generates around £2.5 in free cash flow every year and has a through the cycle Return on Invested Capital of 15%. Although sales will be disrupted by COVID-19, the fundamental shift from beer to spirits remains intact and Diageo has invested in a portfolio of leading brands that will drive margins through mix once the current lull has passed. Having declined by 40% in the past six months, resulting in the company trading at over 5% FCF yield, we decided to initiate a position in the company.