JANUARY 2022

VIEW

Happy New Year

VERITAS
INVESTMENT PARTNERS

A message from our Chief Executive

To all of our clients,

May I wish you, your family and colleagues a very happy and healthy new year.

The past two years have brought immeasurable change to the way we live and work. I wanted to take the opportunity to thank all of you for your loyalty and the trust you have continued to show in the team during these challenging times.

As many of you will know, this year we took the decision to close our business in Zurich as a result of new regulation in Switzerland. Given that this is where our business was started and that we owe so much to our founding clients in Switzerland, it was not an easy choice to make. But we believe it is the right one for our clients as it will allow us to remain focused on delivering investment performance and high levels of client service. We are absolutely delighted that so many of our Swiss clients have chosen to continue their relationship with us through our UK business and I would like to acknowledge and thank our colleagues in Zurich and London for ensuring a smooth transition.

Maintaining our focused business model has also been the driving force behind investments we have made this year in technology and in our team. They will allow us to preserve our culture of partnership which we all value so greatly. It was therefore a great relief for the London team, after the dual challenge of Covid-19 restrictions and a flood, to move into our new offices. We have loved being able to hold face-to-face meetings again – it has brought a real buzz back to the team.

We look forward to welcoming many more of you to our new home on the South Bank soon but in the meantime, I hope you enjoy reading the following update from our Investment Team.

Caroline Stokell

Come and see us at Riverside House

QUALITY OVER QUANTITY

"Nothing is more addictive than the past". These words are spoken by the actor Hugh Jackman's character in the 2021 film *Reminiscence,* but they could also explain some real-life behaviour. Many retailers have reported increasing demand for nostalgic items that remind people of seemingly more stable times in the past, especially the 1990s. UK department store John Lewis noted that sales of retro make-up, such as blue eye shadow, have increased more than 260% in a year[1] while sales of vinyl records in the UK reached the highest levels since 1991[2].

As The Economist noted recently, it is no wonder people are craving a return to times when the world seemed more predictable. With the ever-changing myriad of Covid-19 restrictions, supply chain constraints, inflation, the Great Resignation[3], geopolitical rumblings and extreme weather events, 2021 did not bring the much hoped for return to normality. In one of our engagement calls this year, label maker **Avery Dennison** commented that in many ways 2021 was more challenging than 2020, especially when it came to recruiting and looking after its workforce.

Quality over quantity

The pace of change in technology has continued at breakneck speed, as highlighted in the Collins Dictionary choice for 'word' of the year: "NFT" (non-fungible token[4]) saw an 11,000% increase in use in just 12 months[5]. Our confidence in the long-term growth prospects for our investee companies is anchored in the structural changes taking place, such as this acceleration in the shift to digital. These are what keep us so excited about the future.

Legendary investor Seth Klarman reminds us that the key to successful investing is to balance this confidence with humility - to remember 'but I might be wrong'[6]. This is why when it comes to choosing investments for portfolios, exposure to long-term growth trends alone is not enough. Companies must have certain characteristics if they are to make it through our 'quality of business' checklist and earn a place in client portfolios. Real return investing

1. https://www.telegraph.co.uk/beauty/make-up/friends-reunion-show-sparks-90s-make-up-revival/
2. https://www.bbc.co.uk/news/entertainment-arts-59808695
3. The Great Resignation is an informal name for the widespread trend of a significant number of workers leaving their jobs during the Covid-19 pandemic
4. NFT is a unique digital certificate, registered in a blockchain, that is used to record ownership of an asset such as an artwork or a collectible

emphasises the 'protect' alongside the 'grow'. Hence our exposure to the rapidly growing electric vehicle market comes from semiconductor firm **Infineon Technologies,** and not from Tesla. Half of all electric vehicles produced globally in 2021 contained Infineon's chips[7], increasing the likelihood of success whether consumers choose the Tesla Model X or the Nissan Leaf.

As we only hold 25-40 equities at any one time, we need to be picky. Characteristics we look for include predictable, growing revenues – crucial if we are to beat the predictable problem of inflation – as well as a financial track record which demonstrates historical resilience during tough times.

Consumer goods was traditionally seen as the most predictable sector: after all, people need to buy food whatever the interest rate or debt to GDP ratio. But changing tastes and local challengers threaten the dominance of the staples giants. Luckily, companies with staples-like characteristics, providing indispensable services and products which are in demand regardless of the macroeconomic backdrop, can be found in many sectors.

ADP (Automatic Data Processing) and **Broadridge Financial Services** are two such companies. They provide payroll and HR services, and proxy voting and post-trade security processing respectively. 90% of revenues at ADP and 80% at Broadridge are recurring, in both cases thanks to long-term contracts with customers. Bluntly, these are critical services that it makes sense to outsource and where, once installed, switching provider would be disruptive and expensive.

Both companies sit in the technology sector, contributing to the perception that our portfolios are more concentrated today in some sectors than others. We continue to recommend looking 'under the bonnet' and perhaps ask what company today is not a technology company?

'It's not a choice between our environment and our economy'[8]

For some companies, the predictability of revenues is receiving an extra boost from the increased focus on environmental sustainability. The jury is still out on whether the plethora of pledges made at the COP26 climate conference in Glasgow will translate into concrete action. But with extreme weather events on the increase and temperatures in the Arctic reaching the same level as the Mediterranean[9], businesses and consumers are taking action regardless of how governments act.

Distributor **Bunzl** has been proactively encouraging customers to switch to more sustainable options, providing data to show the benefit to customers' own sustainability efforts of doing so. These switches also benefit Bunzl as its sustainable own brand ranges tend to be higher margin. As the leading provider of critical software used in the design of semiconductor chips, **Synopsys**' revenues already have very high levels of predictability. Virtually every electronic device in the world with a semiconductor chip has, in some way, been touched by the technology the company provides, from smartphones to electric cars and robots. Now companies are turning to Synopsys to help them meet energy efficiency targets and do more with less, for example, through its low power technology which delivers longer battery life and lower power consumption[10].

Character is revealed when pressure is applied

While past performance is no guarantee of future success, looking back to see how companies fared during difficult economic times gives a good indication of just how sticky their sales can be. As part of our research process, we always review companies' performance during the global financial crisis (GFC) of 2008-09 and, more recently, during the height of the Covid-19 pandemic in 2020. Most companies in portfolios were able to maintain revenues during the GFC, such is the importance of their products and services to customers, and some even saw revenues increase. **Intuit**'s revenues grew 4% in the GFC and 13% during the pandemic thanks to demand for its consumer tax and small business accounting products[11]. Even in a downturn, tax returns and accounts still need filing.

In contrast, IPOs[12] cannot provide transparent,

5. https://www.theguardian.com/books/2021/nov/24/nft-is-collins-dictionary-word-of-the-year
6. Seth Klarman Interview by Charlie Rose 2011 (Value Investing) - YouTube
7. https://www.infineon.com/dgdl/2021-10-05+Infineon+CMD+IFX+Day+2021+-+2+-+Electrificationpdf?fileId=8ac78c8b7c498de1017c50a9c4cb0003

8. Barack Obama
9. https://www.bbc.co.uk/news/science-environment-59649066
10. https://www.synopsys.com/company/corporate-social-responsibility.html
11. https://investors.intuit.com/financials/annual-reports/default.aspx
12. Initial Public Offerings

auditable evidence of performance under pressure so we avoid them, however exciting they may seem. While 2021 was a record year for the number of IPOs, data published in November showed that of the 43 companies that had raised $1 billion or more initially, almost half were trading below issuance price several months later[13].

Of course, making it through choppy waters would not be possible without the right leadership team at the helm. Ensuring companies have governance structures and a culture which focus on long-term success is an important step in our initial review of potential investments, and something we continuously monitor as shareholders. Without these, even companies with stellar sales fail our 'quality of business' checklist, including many listed in emerging markets and China. That does not mean we have no exposure to these areas where demographic shifts and fast-growing middle classes are transforming consumption patterns. But our exposure is indirect, through the revenues of companies listed in developed markets. For example, **Kerry** has been providing its taste and nutrition products to customers in emerging markets and China for decades and is well-established on the ground, with 33 sales offices and 27 research and development centres in emerging markets alone[14].

'The times they are a-changing'[15]

As appealing as the past may be, being too wedded to it is dangerous in the business world. Companies need to adapt to changing markets and innovate if they are to survive. Culture is key here too, one of the reasons why we spend so much time talking to companies. Research by **Accenture** found that in more inclusive organisations, the average "innovation mindset score" of employees is more than seven times higher than in less inclusive companies[16]. Accenture itself embodies this culture: it frequently ranks as one of the world's most inclusive companies and its innovation is second to none. Its Industry X initiative, which helps companies adopt the myriad of technologies that make up the Fourth Industrial Revolution (5G, automation, AI etc), was only launched five years ago and now generates $5 billion annually while growing at 36% a year[17].

Meanwhile, **Tractor Supply** was already the largest operator of rural lifestyle stores in the US, selling everything from clothing to pet supplies and power tools. But despite strong sales growth the company is not resting on its laurels, investing in digital technology and a new loyalty programme which now has over 22 million members and customer retention is at an all-time high[18].

Heralding the new year tends to combine the traditions of the past with wishes of luck and good fortune for the year ahead. Will any succeed in bringing more certainty in 2022? Of course, it is still too early to say although the travel industry will be hoping that the South American tradition of walking with empty suitcases to bring a year of adventure and exploration pays off. With no crystal ball, we have no more certainty than anyone else. But holding high-quality, predictable companies in portfolios means we should be well-placed to continue delivering for our clients whatever the year ahead brings.

 

Written by **Philippa Bliss** and **Catriona Hoare**
on behalf of the Investment Team

13. https://www.fool.com/investing/2021/11/29/half-of-2021s-ipos-are-trading-below-their-debut-p/
14. https://www.kerrygroup.com/investors/events/Virtual-Capital-Markets-Day-Opening-Presentation-.pdf
15. Bob Dylan
16. https://www.accenture.com/gb-en/about/corporate-citizenship/who-we-are-research
17. https://www.accenture.com/gb-en/services/industry-x-index
18. https://s23.q4cdn.com/539497486/files/doc_financials/2021/q3/TSCO-Q3-2021-Slides-Final.pdf

VERITAS
INVESTMENT PARTNERS

Veritas Investment Partners (UK) Ltd
Riverside House, 2a Southwark Bridge Road,
London, SE1 9HA
T +44 (0) 20 3740 8350

If you no longer wish to receive View, please contact us on the above number.

Signatory of:
STEWARDSHIP CODE | 2021