INTERMEDE INVESTMENT PARTNERS

Global Equity Strategy

Five year anniversary

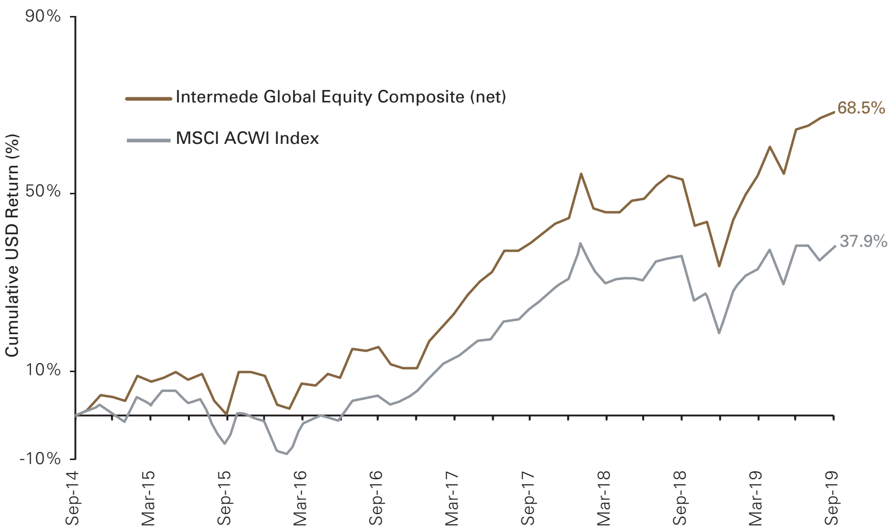
Barry Dargan
Portfolio Manager & CEO
35 Years Investment Experience

Since launching on October 1st 2014, Intermede's Global Equity Strategy has outperformed the MSCI ACWI index (USD) by 4.4% per year, net of fees. This places the strategy in the top quartile of its Lipper Global Growth Equity peer group.

At the five year milestone, Portfolio Manager Barry Dargan discusses the global strategy's progress since inception.

Investment performance (%)

5 Year Performance of Intermede's Global Equity Strategy[1]



Periodic performance %	Intermede Global Equity composite (net)	MSCI ACWI benchmark	Relative performance
Since inception (p.a.)	11.0	6.6	+4.4
Five Years (p.a.)	11.0	6.6	+4.4
Three Years (p.a.)	13.4	9.7	+3.7
One Year	10.1	1.3	+8.8
Year to date	25.9	16.2	+9.7
Q3 2019	2.3	0.0	+2.3

As of 30 September 2019
Source: MSCI, Intermede Investment Partners.

What was your goal when you set up Intermede?

When we came together to form Intermede, we wanted to combine the best aspects of our previous firms, while also sidestepping the diseconomies of scale that can arise in larger organisations.

To illustrate, we wanted to combine the collegiality and team-based ethos of MFS, with the investment autonomy and focus of Artisan Partners while also harnessing the power of simplicity and aligned incentives that is arguably only possible in a smaller organisation with a single focus.

Can you briefly outline Intermede's investment philosophy?

We believe that a sensible path to long term capital appreciation, without excessive risk taking, is to own a moderately concentrated portfolio of around 40 well-managed growth businesses with durable competitive moats that should allow them to earn attractive returns on capital for a prolonged period, and to have the patience and discipline to establish these positions at discounts to their intrinsic value.

1 Investment returns for the Intermede Investment Strategy are based on exit prices, and are net of management fees and assume reinvestment of all distributions. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with changes in the market.

If we allow these companies the time to compound their earnings and cash flows over the long term, while also avoiding situations like excessive leverage, poor management, unattractive industries, or over-reliance on a single product that are likely to lead to permanent impairment of capital we believe a good outcome is likely.

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Intermede's track record demonstrates a material level of downside protection in volatile markets. This seems counterintuitive for a growth-oriented strategy. How have you achieved this?

Valuation discipline is central to what we do, and the high bar we set for inclusion in the portfolio means that the growth characteristics of the portfolio should provide an increasing level of earnings support over time.

A working example illuminates the issue.

We might expect a typical investment to deliver 15% EPS growth over 5 years, and to hold its EPS multiple over that time as the attractions of the investment case become more widely understood, thereby potentially doubling our clients' money over a 5-year holding period.

However, it's also possible that our analysis of the firm's competitive strength could be misguided, and it might also be the case that the multiple the market assigns to a business can contract.

This is where a margin of safety comes into the picture. We take comfort from the fact that if EPS was to slow by a third, falling from 15% to 10%, and the multiple the market applies to the stock falls by around 40% — the 5-year return would be flat.

The margin of safety here is built into the fact that both our growth projections and the market's valuation multiple would have to be out by more than a third for our clients to lose money, which we think is a reasonable level of risk to take in pursuit of long term capital appreciation.

How does a small investment team such as Intermede's cover a global universe?

Firstly, we focus on an elite group of businesses, very roughly the top decile of listed firms when ranked by basic growth and return characteristics. Realistically, 90% of listed businesses are unlikely to be of interest to us, owing to our investment criteria.

We run a 40 name portfolio, and have had an average holding period of around four years since inception. What this distils down to is that each of our analysts needs to come up with 1-2 investible ideas a year, which has proven very doable since we started running client money in 2014.

Our investment universe is made up of businesses with a market cap over US$1 billion which are also delivering 5% top line growth, 10% EPS growth, and maintained a ROE of 15%.

We also employ a very simple growth and return screen, filtering the global universe of businesses with a market cap over US$1 billion to see which have delivered 5% top line growth, 10% EPS growth, and maintained a RoE of 15%.

While not all businesses in our portfolio will pass the screen, it provides a helpful and constant reminder of our most fundamental, shared investment beliefs.

We focus on an elite group of businesses. Realistically, 90% of listed businesses are unlikely ever to be of interest to us, owing to our investment criteria. After that, we ask our analysts to come up with 1-2 new investible ideas each year.

Speaking of which, many investment teams organise as generalists nowadays. Why do you favour the sector specialist model?

A central premise of our investment approach is that we need to have a deep understanding of the businesses in which we invest. A big part of achieving that lies in also understanding the competitive ecosystems in which they operate, as well as having an adequate grasp of the technical aspects of their operations.

We think that we stand a better chance of achieving this as sector specialists. However, we are also cognisant of the risks of getting trapped in analytical silos. One way we mitigate this risk is by requiring a 'Devil's Advocate' counter-thesis for each new idea that gets formally presented at our weekly investment meeting.

Do you meet with the management teams of the businesses you invest in?

Yes, and when we do, we are looking for a specific set of traits and behaviours. We tend to like managers who are (or think like) owner-operators, who display integrity and consistency in their dealings with shareholders, and have proven themselves (ideally over many years) to be thoughtful and prudent allocators of capital.

The last point is particularly important for an investment approach like ours, which is strongly biased towards companies that produce abundant levels of internally generated capital, which then presents management with an ongoing capital allocation challenge.

It's quite possible to meet managers who are operationally excellent, but are subpar as capital allocators. We test for both qualities.

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What kind of edge do you think you can have as a small firm, versus much larger competitors many of whom have research budgets that are multiples of Intermede's annual revenues?

We think Intermede's key advantages include organisational and behavioural sources.

Organisational, because the simplicity of our investment approach, and the organisation that we have built to apply it, allow us to benefit from clear thinking and a lack of clutter, which we believe is quite rare in an era of information overload.

We believe another advantage we possess could be summarised as a 'time horizon' advantage. Our clients have a deep understanding of our investment approach, which places no emphasis on attempting to predict the next quarter's EPS numbers, and instead prefers to understand deep structural factors that will sustain or erode competitive moats in the long term.

Finally, we believe that we have a behavioural advantage in that our investment team consists of independently minded individuals, with high levels of curiosity, and low levels of ego, which allows for continuous improvement through constructive feedback and reflection.

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Are you investing on a purely bottom up basis, or is there a top-down aspect to your thinking?

Portfolios are constructed on a stock by stock basis. However, we also make sure we do some portfolio-level thinking as a means of recognising patterns of insight that are being expressed throughout the portfolio, as these can often be useful sources of additional ideas.

Can you give an illustration?

We like to see material ownership by company management and/or family shareholders.

Here we'd include Heineken, Comcast, Facebook, Google, Alibaba, Samsung, LVMH, Eurofins, Danaher and Keyence, to name a few. There are also companies in the portfolio that don't have significant founder ownership, but which are run by management teams that have a long-term record of thinking like owners. Mastercard and Nestle, comes to mind.

Second, we like businesses with strong network effects. The obvious examples here are Facebook and Google, but we also like CME for this reason, and note that Apple's IoS ecosysytem (including the App store), and rising use of wearables (watch/ Airpods) among customers, is developing into an increasingly powerful network effect.

Thirdly, we like situations where a business is providing a low-cost but critical input into the processes of another business that is in effect a captive customer. Here we'd mention Linde, Ecolab, Eurofins, Ansys, Kerry Group and Fidelity Information Services.

Fourth, we tend to like businesses that operate in an industry that could be described as a rationally structured, that allows for steady growth (a little bit of volume, a little bit of price) over time, with operational gearing providing the sort of double digit EPS growth that we like to see from our portfolio companies. Here we might point again to Linde, Kerry Group and Mastercard.

We like business with significant ownership by company management and/or family shareholders.

Can you talk through how your thinking in a particular sector has evolved over time?

One change is that we now spend less time than we did five years ago thinking about large pharma companies. Issues that have driven this change include an uncertain regulatory and pricing environment, and a revenue profile that, due to patent drop-offs, doesn't fit our preference for stable, long term growth in earnings and cash flows.

We have positioned ourselves in companies such as Eurofins, which benefits from the outsourcing of work from pharma companies and provides services to start ups or virtual biotech companies, and Danaher and Bio-Rad, which provide many of the tools needed for researchers.

Becton Dickinson and West Pharma are other quality companies, in our view, as they allow for the industry to package increasingly complex drugs. In all these cases, we are largely agnostic as to who is developing the drugs, as the businesses benefit from growth.

These businesses typically provide, 'low cost, but mission critical' products that often have very high switching costs for the end customer, as the products are often integrated in a regulated process that would need re-approval if the product was changed.

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Mega trends like the adoption of biosimilars, whilst negative for large pharma companies, are positive for our portfolio. Companies like West Pharma charge higher prices to the biosimilar manufacturers and the cost of a stopper remains small.

We also find the animal health pharma industry very attractive. Development in this market generally lags the human health market by 10-15 years, and often drugs which have worked in humans also work in dogs or other animals. This significantly reduces drug development risk. The industry also has attractive fundamentals with increasing pet ownership, and growing propensity to spend on pet health.

It's also a highly consolidated industry with around 80% of sales coming from four companies and whilst they compete quite aggressively in certain categories, there is generally enough room for innovation for each to focus on differentiated products.

ESG factors are important to many investors. What role does ESG play in your investment decision making?

A focus on ESG comes quite naturally to us. This derives from the fact that our portfolio is focussed on innovation and creativity.

We've always applied an environmental filter to our holdings. We never included rust-belt industries or the big polluters, they didn't fit our investment thesis, nor does tobacco or armaments.

On the issue of governance, we set a high bar for companies we invest in. In a practical sense, for us, this requires a deep level of engagement, and that means lots of meetings. We hold around 340 meetings with companies every year.

If companies are hoarding cash, we'll engage. Similarly, if we identify a lack of diversity on boards we'll engage to discuss the risk that entails. We'll also use our proxies and we'll vote for what we think is best for the company and its stakeholders.

Finally, we're signatories to the UN backed Principle for Responsible Investing (PRI). They have a good mission and each year we put in the effort to answer their questions about our approach.

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What is the capacity of Intermede's global equity strategy?

The guiding principle is the need to maintain the ability to express our best ideas fully for clients' benefit. We're at US$3 billion today and will remain disciplined with respect to capacity.

We'll close the strategy well in advance of the point at which asset growth constrains us from delivering attractive returns to our clients.

Detailed liquidity analysis suggests that the current portfolio could scale comfortably to US$10 billion, at which point a typical portfolio position size of 1-4% would equate to a dollar investment of US$100-400 million, which is a very manageable range given the strategy's focus on liquid large-cap and mid-cap public equity securities.

> *We will close the strategy well in advance of the point at which asset growth constrains us from our ability to deliver attractive returns to our clients.*

Any final thoughts why investors should consider Intermede's global equity strategy?

Perhaps because we maintain an unusually clear focus on a single task – to identify and understand high quality growth businesses in possession of defensible competitive moats, and to purchase them at attractive valuations. We believe this remains the most prudent path to capital appreciation in the long term.

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