

Evenlode Global Investment View

July 2022 – Notes from the East Coast



The commentary below applies to the TB Evenlode Global Income, TB Evenlode Global Equity, Evenlode Global Dividend and Evenlode Global Opportunities portfolios. Market data is from FactSet and FE Analytics.

After months of mounting Zoom fatigue and Teams torment, the Evenlode team was delighted to (finally) be able to hit the road again at the end of May. Six of our analysts and fund managers met with management and investor relations teams from 48 companies on the East Coast of the US, traversing nine states in ten days.

We believe that undertaking such research is integral to understanding the companies that we invest in on our clients' behalf. There is little substitute for seeing a company's working environment, getting a read on the internal culture, or being able to discuss longer term strategy face-to-face with management teams. Complementing this first-hand research, we also met with competitors, partners, customers, and suppliers of Evenlode portfolio companies. This enables us to build a rounded view of companies and gain insight into the markets and macro-environment they operate in.

From each meeting, we produce a detailed research note that is discussed in our investment meetings and stored in our proprietary research system (EDDIE). These notes directly affect our risk scoring for individual companies, maximum position limits, and investment decisions. The detail below is a (mercifully short) taster for the notes that we prepare, and will hopefully give you, our clients, an insight into the detailed research being undertaken at Evenlode. For each company below, we answer two key questions; 1. What does this company do?, and 2. What did we learn?

Marriott – Chris Moore in Maryland

What does the company do?

Marriott is the largest global hotel business operating 1.5 million rooms across 30 brands, such as Sheraton, The Ritz-Carlton and the eponymous Marriott. It operates a capital light franchise model, earning fees from hotel owners which benefit from its strong brands and scaled distribution platform.

What did we learn from this meeting?

Covid caused unprecedented challenges for the hotel industry with Marriott's revenue decreasing 50% in 2020. Marriott survived without requiring additional equity capital and leverage is on course to be within or below its target range (3-3.5x net debt/EBITDA) by the end of this year. Revenue from leisure customers, which accounts for around 40% of the total, was above pre-pandemic levels in the first quarter, as consumers made up for two years of disrupted travel. However, business customers account for around 60% of the group and revenue remains 15-20% below pre-pandemic levels. With covid restrictions still in place in some markets, management expect business revenue to recover further over the next year or so as these measures ease. However, it remains unclear whether the shift to virtual meetings has resulted in a permanent impairment to business travel. Management are confident medium-term growth prospects are strong, pointing to the pipeline of hotel openings, which is at pre-pandemic levels due to an uptick in "conversions" (independent hotels moving to a Marriott franchise). Management also highlighted how attractive Marriott is for hotel owners, with a growing proportion of room nights, now three quarters booked through direct channels (mainly its website), avoiding travel agency commissions, and driving higher occupancy. The model is also attractive for

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investors in Marriott. Hotel owners sign up to long-term contracts, typically 15-30 years in length, and attrition from Marriott's system is low, with only around 1-1.5% hotels exiting the system annually.

At Evenlode, we'll admit to being on the fence on this one at the current time. We've also met with Intercontinental Hotels management recently, and view the franchise business model as attractive, but would like to see further proof of a business travel recovery before checking in.

Mastercard – James Knoedler in New York

What does the company do?

Mastercard is one of the two leading payment scheme networks. Their core business is managing the issuance and fee schemes for credit and debit cards issued by third parties (usually banks) to clients (usually individual consumers) for usage at merchants. As the credit risk is assumed by the issuer and almost all major merchant acquirers are licensed to accredit merchants to the Mastercard network, this is an 'open loop network' in payments jargon, as opposed to a 'closed loop network' like American Express or PayPal. Mastercard has 2.6bn cards in issue and 92m merchants accredited to its network in 210 countries and territories, and its credentials facilitated \$6trn in payments volumes in 2021.

What did we learn from this meeting?

The main engine of growth for Mastercard continues to be the conversion of consumer-to-business (C2B) transactions from cash and cheque to card. The accelerated penetration of ecommerce after the pandemic has been a material tailwind as Mastercard's share in ecommerce is materially higher than in face-to-face commerce. We also learned more about Mastercard's increasing activity in business-to-business (B2B) payment flows. Historically these have been dominated by payments between bank accounts either via wire (direct instant transfer) or automated clearing house (ACH), a (typically) end of day batch netting transaction between banks. These suffer from irreversibility, low information content, and either high cost (for wires) or slow settlement (for ACH) or both. Cross-border payments add a layer of complexity and cost as they tend to hop between intermediary banks via the SWIFT messaging system. Mastercard now has the capability to initiate and receive payments using both card and bank account credentials, and importantly can create a layer of chargebacks, fraud protection, and rich information context around them. These are as valuable to corporate treasurers as they are to consumers. As the C2B market becomes increasingly mature and digital, we are excited about the potential for the payments schemes to provide increasingly sophisticated payments solutions in the B2B market.

Mastercard is currently held within the Evenlode Global Equity portfolio.

Analog Devices – Rob Strachan in Massachusetts

What does the company do?

Analog Devices is one of the two largest makers of analogue semiconductor chips and components, processing continuous variables like temperature, power and radio or Wi-Fi. The analogue market is fragmented beyond Analog and their main competitor, Texas Instruments, and the technology is less cutting-edge than in the digital semiconductor market. Analog focus on high-value, complex solutions, meaning it is critical they keep innovating ahead of competitors to maintain their competitive advantages.

What did we learn from this meeting?

There are significant switching costs for customers. Product life cycles are very long (up to 20 years) and most current revenue is generated from technology that is c.10 years old. Once Analog's products are designed into customer systems, they are costly to replace, and this could have unforeseen effects on the reliability and performance of the end-product. Direct sales relationships account for half of revenue, based on intimate collaboration to solve complex customer problems. Customers are becoming more dependent on Analog and business is becoming more direct. Innovation is made more challenging due to working with the physical world (e.g. heat or light), which increases the development failure rate. This is coupled with a shortage of engineers with adequate domain expertise in analogue analysis. To ensure their supply of experts, Analog operate a training programme that takes 10 years to complete. Talent retention is aided by Analog's commitment to research and development and the culture of innovation, which encourages and empowers employees to solve interesting problems.

Long-term demand for Analog's products is driven by global trends such as digitisation and automation. When we discussed the current global semiconductor shortages, it was noted that insufficient wafer supply is in part driven by lack of manufacturing equipment, which is also driven by the lack of wafers, a challenging dynamic. Analog have announced a significant uptick in capex to internalise more of their own manufacturing. Before considering the company for inclusion in our investable universes, we will need to understand the steady state capital structure of the business.

Gartner – Chris Elliott in Connecticut

What does the company do?

Gartner provides clients with specialised research and expertise that is integral to strategic business planning and c-suite (senior executive) decision making. The research Gartner offers was initially focused on information technology but has more recently expanded to equivalent services in HR and supply chain management. Gartner's information is sourced from a network of over 2,200 analysts, who have developed expertise in their field through practice. It is this network that creates the real value to clients, as the experts offer one-to-one explanations of technical subjects and expected market trends.

What did we learn from this meeting?

The culture at Gartner prioritises expertise and information quality ahead of client acquisition. This provides a limiting factor for growth, as the restricted availability of suitable experts in turn constrains the number of new clients that can be onboarded. This effect was highlighted in the early stages of the pandemic (2019) when Gartner froze the hiring of new analysts in response to macro-uncertainty. This suppressed growth in FY20, despite client demand remaining resilient. Management explained that if they were put in a similar position, then the decision would change to continue investing in their analytical capabilities through uncertainty. This is an excellent example of adjusting corporate strategy after learning from past actions. The lack of available experts also provides a significant barrier to entry and explains Gartner's high client retention rate (over 80%). Combined with low market penetration, these factors provide an extended runway for growth and will allow Gartner to maintain high returns on invested capital over an extended period.

Tradeweb – Cristina Dyer in New York

What does the company do?

Tradeweb operates an electronic over the counter (OTC) marketplace through which users submit buy and sell orders for fixed income securities. Fixed income securities represent the largest capital market segment in the financial ecosystem and the primary means by which institutions and governments raise capital. Although some government and corporate bonds are traded on stock exchanges, different bond issues even from the same issuer will have distinct and non-fungible characteristics which works against liquidity, meaning that most bonds historically have traded via phone transactions (known as voice). Tradeweb's multiple trading protocols leverage a global two-sided network between the buy-side (e.g. asset managers, central banks, financial advisors) and liquidity providers (e.g. investment banks) and offer key benefits for thinly traded securities.

What did we learn from this meeting?

Tradeweb has leveraged its first mover advantage in rates trading to establish a deep US Treasuries liquidity pool. This facilitates certain differentiated trading protocols to those offered by competitors that provide costs and time savings for Tradeweb users. In addition, Tradeweb believes that its ability to balance complex relationships with fixed income market participants creates a competitive advantage. They aim to innovate equally across multiple trading protocols to provide platform users with choice and maintain a balanced ecosystem in the market.

Tradeweb's protocol innovation has resulted in market share gains and led to significant growth in both trading volumes and revenue. The fixed income market is estimated to be less than 30% electrified, illustrating the long growth runway potential for the company. This outlook is further supported by regulators encouraging the use of centralised platforms to increase market transparency and reduce systemic risk.

Snap-On – Gurinder Samra in Wisconsin

What does the company do?

Snap-On designs, manufactures, and markets tools, equipment, diagnostics and repair systems for vehicle dealerships and repair centres. 70% of sales are via franchisees, directly serving vehicle repair technicians via mobile vans. Snap-On also derives income from financing programs designed to facilitate the sales of its products and support for its franchisees, who must invest in equipment to operate effectively.

What did we learn from this meeting?

The value proposition offered by Snap-On is in 'customer connection' more than product development. Snap-On offers uniformly high-quality tools, but they live and die by franchisee proximity to the end-client. Snap-On prospers where the cost of system failure is high, technician expertise is respected, and the decision-makers are the same people who use the tools. The company recognises the importance of a broad catalogue, with reliable access to a wide range of quality tools instrumental in building trust with the client. Greater complexity of vehicles, longer car lives (the current average car age stands at 12.2 years), and the need for new tools and products to service more complex EV's provide an extended runway for growth and a sustainable outlook for returns on invested capital.

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The Evenlode Global Income and Global Equity Teams 31 July 2022

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