

NOTES FROM THE ROAD

PAUL MIDDLETON, PORTFOLIO MANAGER ON MIRABAUD'S GLOBAL EQUITY TEAM, OUTLINES SOME OF HIS OBSERVATIONS FOLLOWING A RECENT TRIP TO THE US

AT A GLANCE

- Paul visited 28 companies in five days, spanning at least 6 of the Global Equity team's 10 themes.
- At this stage of the economic and stock market cycle, we believe it is more important than ever for companies to be exposed to secular growth tailwinds, and for investors to focus on high quality companies.

INTRODUCTION

We continue to see recurring macro themes across the globe, which have been reinforced by the third quarter corporate results season. In particular, inflation is here, especially in wages, raw material prices, and freight. In many cases companies are struggling to pass these costs to their end customers (especially in the short term), and are having to cut costs to offset some of the inflationary pressures. As we have mentioned previously, at this stage of the economic and stock market cycle, we believe it is more important than ever for companies to be exposed to secular growth tailwinds, and for investors to focus on high quality companies.

MILLENNIAL CONSUMER THEME

Our research indicates that millennials are now the largest demographic of pet owners, and they are more conscientious owners (or "pet parents"!) than other generations. I met with two companies benefitting from the increasing spend on pets, **Trupanion**, and **Freshpet**.

Trupanion is the leading provider of pet insurance in the US. The market is under-developed in the US relative to other developed economies: 1% of pet owners have insurance versus 25% in the UK¹. Historically consumers did not trust the US insurance product as it was expensive and vets were incentivised to do more treatments. Trupanion has worked hard to remove this stigma, and as a result, the company is picking up more support from consumers and vets. Part of this has been achieved by targeting the new born segment of the market, which removes complications around pre-existing conditions. The company will end 2018 with a revenue run rate of \$300m. Each 1% increase in penetration may equate to \$1bn in revenues².

Freshpet is disrupting the pet food industry, providing natural, refrigerated food for dog owners to feed their dogs. They are currently in hyper growth phase, with increasing awareness of the product (35% to 40% in 12m), increasing penetration of households (1.4% to 1.8%), and more spend per customer (+6% to +13%) translating into an expected 25% revenue growth rate in 2018 and in 2019. This is a mid- to high-end dog food product, with annual costs to feed a 30lb dog at around \$1,200 versus the top end at \$2,700 (low end is \$180!). Dog owners reported their pets showing increased "enthusiasm for eating". We were hoping for something more scientific but this analysis has not started yet³.

¹ Source: Trupanion

² Source: Bloomberg

³ Source: Freshpet

AUTOMATION THEME

We have a position in **Accenture** in the Mirabaud - Global Equity High Income Fund. We view the company as agents for change. Management noted that all industries need to rotate to the **"New"** (Digital/ cloud/ analytics), but that they all need to continue funding their existing operations in the traditional way. For example Auto OEMs (Original Equipment Manufacturer) need to pivot to electric and address car sharing, they need to completely transform the core, whilst maintaining sales and margins and keeping shareholders happy. This balancing act is beneficial for Accenture: At the front end, they fuel growth by advising on this transition to the **"New"**, whilst at the back end they are advising clients on zero based budgeting and robotic process automation (RPA) to strip out costs. For Accenture, revenues in the **"New"** now represent 60% of total revenues. The **"New"** has consistently grown double digits for the last 3 years⁴.

Booking.com, formerly known as Priceline, has a vision that at some point in the near future they will become a virtual travel agent. Customers will visit their website and input their desired dates, and they will be presented with a list of suggested holiday destinations, with hotels, flights and experiences all suggested based on the customer's profile and data. This is where AI (Artificial Intelligence) is taking them. The near term constraint on this approach is that historically, they have not had enough direct traffic. The company has partnered with Google and meta-sites who have directed traffic to them. This traffic has a low lifetime value as the data that they have on the person that has clicked through is limited. The CEO spoke of the need to be like Amazon in that people go straight to the app, and not via Google. This is a difficult pivot in terms of topline growth, but the company is managing the transition well, with room bookings re-accelerating in Q3. They are also using AI on the back end, to speed up customer service and automate answers to common questions.

EXPLOSION OF DATA THEME

Iqvia is the product of a merger between the former Quintiles (Clinical Research Outsourcing, CRO) and IMS Healthcare (Healthcare information solutions). The CRO industry is built around conducting independent clinical trials for new Pharma and Biotech compounds. The market is highly fragmented, with Quintiles the leading player at 14% market share. 25-30% of the market is already outsourced, and this penetration increases 2-3% pa. This is a large market, at \$230bn⁵. The market is attractive but inefficient: Most contracts are awarded on a "cost plus" contract basis, and most pharma companies have "preferred provider" agreements. Trial costs are inflated, and trial delays are common. The delays are caused by patient selection issues, because even if you can identify the correct potential candidates, only 5% will volunteer for trials because the travel burden on them can be significant. Iqvia is trying to disrupt the industry using IMS' data to solve some of the common issues. For example, a typical trial may specify 40-50 patient criteria. IMS has by far the broadest data set in the industry, processing 2 trillion data items every year. They are therefore better able to identify people with the correct characteristics, and crucially if there are not enough targets in the database, they have the data to make predictive analytics that enable them to identify other potential candidates. They are rolling out this "next gen" CRO at the moment, and their success is reflected through winning preferred provider contracts with new companies.

⁴ Source: Accenture

⁵ Source: Iqvia

PLATFORM COMPANIES THEME

A keynote from **Paypal's** CEO, Dan Shulman, re-emphasised a couple of the long term structural trends that they play into. Firstly, 85% of transactions still use cash. Second, the explosion of mobile: There are around 6bn smartphones globally, enabling mobile banking. Progress is quick – payments have seen more change in the last 5 years than the previous 35 years. The CEO also emphasised the power of platforms and emphasised that platforms need to be open. For example, the best platforms need to work together, such as Uber or Airbnb, where their payments process is operated predominantly by Paypal. This is a shift in tone relative to the social media giants, who have spent much of the last 10 years trying to be all things to all people. Paypal continues to launch solutions where they believe they have a superior product. For example, they are now one of the top 5 lenders to small businesses in the US, and they never look at FICO scores as their internal measures are 35% more accurate. We have a position in Paypal in the Mirabaud – Equities Global Focus Fund.

REAL ESTATE AND INFRASTRUCTURE THEME

Xylem is a global leader in Water Infrastructure. The company span out of ITT in 2011, and at the time, was focused on selling pumps and other equipment into water utility companies. This is a slow growing, defensive end market. The key pain point for the Water Utilities is “non-revenue” water: even in the US, 1/6th of all clean water is lost through leaky pipes. Unfortunately, it is difficult to locate the leaks: contractors would just dig up a pipe after 30 years to determine what condition they were in. Through a series of acquisitions in consultancy, smart metering, and leak detection, Xylem has accelerated its growth and returns profile. They can now offer Water utility companies a total water solution, which enables the utilities to better identify and resolve issues in their networks. No one else can provide this. The limiting factor to even faster growth is that the utility companies cannot look to be prioritising individual companies, which means they cannot give all their infrastructure work to one provider. We expect that Xylem gets around this by moving further up the value chain, and de-emphasising the hardware part of the business over time. The company outlined that they need the hardware portion to maintain the specific knowledge base from which to build their solutions, but we expect growth to be faster elsewhere. We have a position in Xylem in the Mirabaud – Equities Global Focus Fund.

AGEING DEMOGRAPHIC THEME

We saw **Cantel Medical** in New Jersey. 50% of revenues are related to endoscopies, the majority of which are specifically colonoscopies. Colorectal cancer is the third leading cause of cancer related deaths in the US but the death rate has been dropping from better screening and treatment. The company is the market leader in automated endoscope reprocessors, which clean parts of the endoscopes after use. The company is leading the market away from cleaning and re-using equipment to single use, where there is less contamination risk. As this evolution occurs, the business model shifts away from capital equipment purchases towards recurring revenue sales from consumables. Single use valves now have a 30% penetration rate, with the company saying that there is no reason why this does not go to 100% over time. The rest of the business relates to water purification (30% revenues, mainly for dialysis, slow & steady growth), and dental consumables (20% revenues, focusing on infection prevention, again slow and steady growth).

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