Summary - BrightTalk Conference call
BL Sustainable Horizon

Strategy update

BLI - Banque de Luxembourg Investments S.A.
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Strategy overview

BL Sustainable Horizon applies an active and conviction-based investment approach geared towards the generation of above-average risk-adjusted returns over a full market cycle. In addition to this financial objective, the Fund Manager also aims to achieve impact objectives that are clearly defined and quantifiable; these objectives cover environmental, social, governance and human rights aspects.

The BL-Sustainable Horizon portfolio results from the combination of 2 pockets:

- **A quantitative pocket** of rather traditional companies, benefiting from strong ESG ratings from MSCI's extra-financial analysis, and
- **A thematic pocket** of companies that carry out an activity contributing to the achievement of one or more of the United Nations Sustainable Development Goals (SDGs).

The solidity of this ESG process has been recognized by independent organisations since the Fund was awarded the Luxembourg ESG label LuxFlag last December and more recently (in March of this year) the French SRI label.

Portfolio positioning

In recent months, **the Fund Manager has initiated two new positions**, the Swiss company *Geberit* has joined the thematic pocket and the Dutch company *Wolters Kluwer* has been integrated in the quantitative pocket of the portfolio.
In addition, the manager closed out his position in *BIC*, whose financial and ESG profile appeared to be disappointing.

At the end of September, the portfolio held 26 companies and still had a **relatively defensive positioning** with a significant exposure to the Consumer Staples sector and a liquidity pocket of 19%.

The thematic bucket of the portfolio currently represents only 11%, which is below the targets set when the investment strategy was reformulated in 2018. Indeed, it is currently **difficult to identify companies whose valuations are not considered, according to our criteria, too excessive within a relatively small universe of companies perceived as particularly sustainable and responsible.**

In terms of **impact measures**, the Fund exhibits superior characteristics to the ones of the MSCI All Countries World.

Performance review

On a YTD basis, the Fund has performed in line with its peer group as well as the MSCI All Countries World NR Index. At the end of September, performance was still slightly better, although the Fund lost some ground at the end of October.

The Fund's performance during the year was in line with expectations, showing great resilience in the first quarter and participating much less in the rebound thereafter.

Indeed, **in terms of the risk/return ratio, over 10 years, the Fund's very defensive approach led to volatility that was significantly lower** than that recorded by both the MSCI World and the peer group average, with these two universe showing similar volatility.

Strategy overview

BL Sustainable Horizon applies an active and conviction-based investment approach geared towards the generation of above-average risk-adjusted returns over a full stock market cycle. In addition to this financial objective, the manager also aims to achieve impact objectives that are clearly defined and quantifiable; these objectives cover environmental, social, governance and human rights aspects.
The approach implemented combines the rigorous fundamental financial analysis typical of BLI's "Business Like Investing" investment philosophy with a proprietary ESG policy.

After an exclusion strategy excluding sectors subject to intense controversies, the ESG policy combines two complementary approaches: a quantitative screening based on MSCI ESG ratings and a thematic pocket that aims to include companies whose products or services contribute to the achievement of the United Nations' Sustainable Development Goals.

The robustness of this ESG process has been recognised by independent organisations as the Fund was awarded the Luxembourg ESG label LuxFlag last December and more recently (in March this year) the French SRI label.

The final portfolio consists of approximately 25 to 40 companies with a solid financial profile and an above-average sustainability profile.

Portfolio positioning

Recent portfolio changes

Over the last few months, the Fund Manager has initiated two new positions, the first in the thematic pocket and the second in the quantitative pocket of the portfolio.

The Swiss company *Geberit*, Europe's leading manufacturer of sanitary products, is mainly active in three areas: flushing systems, piping systems and, for some years now, classic sanitary equipment in bathrooms.

- **Financial analysis**: The company has a various competitive advantages, the main one being the close relationship it has with architects, plumbers and installers who, given the high costs associated with poor flush-mounted installation, do not risk favouring competitors who are often less reliable. Furthermore, with two-thirds of its sales coming from the renovation market, the cyclical nature of its business is limited. The company benefits from stable and high profit margins and holds a dominant position, particularly in Europe, with significant growth potential outside the Old Continent.
- **ESG profile**: Geberit's business model is fully in line with SDG's n°6 of universal and equitable access to water, hygiene and sanitation. Indeed, the systems developed by the company enable efficient water use, which is important when you consider that, on average two thirds of the water consumed in a household comes from personal hygiene needs (flushing, bathing/showering, etc.). The impact of the installation of Geberit systems is therefore easily quantifiable. In addition, the company has other advantages in terms of ESG: low consumption of resources during the manufacturing process, very long lifecycle of the products developed, backward compatibility of the products (i.e. partial reuse after dismantling).

The **Dutch company *Wolters Kluwer (WK)*** has entered the quantitative pocket of the portfolio. This company is one of the world's leading providers of information and software for business customers. It enables them to maintain their level of information up to date in four main areas (Healthcare; Tax & Accounting; Governance, Risk Management and Compliance, and finally Law & Regulation).

- **Financial Analysis:** WK has successfully transitioned from a paper-based information provider to a digital subscription-based information and software provider. As a result, the

share of recurring revenues has increased to 80%, with software accounting for 40% of turnover. The company also benefits from other competitive edges, mainly: a strong loyalty of its professional customers who are looking for quality and up-to-date information, a solid international footprint, good innovation capabilities (with investments of 8% to 10% of turnover) and an experienced management team.

- **ESG profile:** The company is distinguished by excellent ESG ratings (MSCI) in all areas: no controversy, the company has been run by a woman since 2003 and has gender diversity at all hierarchical levels, independence of the board of directors, favourable social climate, low carbon emissions. In addition, the company's main mission is integrated with SDG n°9 aiming at a resilient infrastructure, sustainable industrialisation and the promotion of innovation. In a context where access to quality information is made difficult, providing the professional world with up-to-date and reliable information is a real source of added value.

In addition to these purchases, **the Fund Manager sold his position in *BIC***. The relatively low weighting of the position limited the overall loss for the Fund. With hindsight, the inclusion of this company in the portfolio was a mistake for two reasons:

- **From a financial point of view**, the company's competitive advantage proved to be too fragile, as lighters, pens and shavers are highly competitive product categories with a limited pricing power for the manufacturers.
- **In terms of sustainability,** most of the company's products are designed for single use and are rarely recycled. Yet MSCI's ESG ratings are excellent, with the company receiving an AAA rating based primarily on favourable opinions on governance practices and efforts to reduce the use of chemicals and CO2 emissions in the production process.

Portfolio structure

At the end of September the portfolio held 26 positions; the three largest positions, *Unilever, Essity* and *Kimberly-Clarck*, all belong to the Consumer Staples sector and have strong brands, are selling products that are recurring purchases and offer significant dividend yields. They also have a higher ESG profile than their competitors do.

In terms of **sector allocation**, consumer stocks remain strongly represented while the weighting of the Industrials sector has increased to 20%. The moderate weighting of the Health Care sector is mainly the result of the numerous controversies affecting most of the major pharmaceutical companies while, at the same time, niche players often trade at higher valuations. The situation is quite similar for tech stocks where the giants of the sector do not meet our ESG criteria and where the stock market prices of niche players (digital players, online sales) are currently often supported by the lockdown and social distancing measures taken in the current sanitary context.

The strong cash position (19%) is maintained as the Fund Manager did not anticipate such an increase in valuation multiples given the extent of the economic damage caused by the current economic crisis.

In terms of ESG profile, the quantitative pocket accounts for 70% of the investments while the thematic pocket represents 11% of the portfolio.

Focus on the thematic pocket

The thematic pocket currently includes 5 companies :

- *Canadian National Railway*, one of Canada's two major rail transportation companies, which is far more energy efficient than road transportation ;
- The American company *Waters*, one of the specialists in chromatography and spectrometry techniques that are essential for innovation in health, industry or fundamental research.
- The Swiss company *Sonova*, one of the world's largest producers of hearing aids
- *Geberit,* the manufacturer of water-saving sanitary solutions
- *l'Occitane*, the retailer of natural cosmetic products.

The 11% weighting of this pocket is lower than the objectives set during the reformulation of the investment strategy in 2018.
The main reason lies in the difficulty to identify companies whose valuations are not considered, according to our criteria, too excessive within a relatively small universe of companies perceived as particularly sustainable and responsible.

Thus, since the market rebound at the end of March, the popularity of SRI products has propelled many thematic stocks to valuation levels that are difficult to reconcile with the Fund's objective of generating long-term capital growth with moderate volatility.

Below are 4 examples of companies that meet our investment criteria but which could not be included in the portfolio due to their valuations:

- *TOMRA* is a typical example of a company at the heart of the circular economy concept. Founded in 1972 in Norway by two brothers, the company has become the world's leading supplier of deposit collection systems. It has also diversified over time through acquisitions in the manufacture of sorting systems in the food industry, in the waste sector and in the mining industry for material separation. However, as an industrial company exposed to economic cycles, a multiple of almost 60 times the estimated earnings for 2021 seems exaggerated.
- *SolarEdge Technologies*, an Israeli-based company listed on the NASDAQ in 2015, has developed a smart inverter solution that should be able to offer a better return on investment for photovoltaic installations by maximising energy production while reducing costs. Given the uncertainties regarding the sustainability of such a competitive advantage, a multiple of 55 times the earnings is not compatible with an investment approach based on the concept of margin of safety.
- The American company *Trex*, a division of Mobil Corporation in 1996, manufactures composite decking by combining the durability of recycled plastic with the natural beauty of wood. Approximately 95% of the raw materials used by Trex come from recycled plastics or from dust or pieces of wood that are destined to be thrown away. The company is one of the big beneficiaries of the Covid-19 crisis, with households investing more in their homes because they cannot travel. Its share is now trading at 45 times earnings.
- The fourth example is the American company *Xylem*, which was part of the portfolio in the past. Xylem is a water management specialist offering a complete portfolio of solutions throughout the water cycle, from the delivery of drinking water to the collection and treatment of wastewater to the return of water to the environment. With organic growth averaging around 4% per annum in a cyclical sector, we do not believe that a PE above 30 is sustainable.

Impact measures

The Fund has superior characteristics than the ones of the MSCI All Countries World.

The relatively high level of carbon intensity in the portfolio is due to the important weighting of *Kimberly-Clark, Essity, Air Liquide* and *Canadian National Railway*, all of which are active in energy-intensive sectors.
In the social field, we no longer have any companies on the UN Global Compact watchlist following the sale of the US company *3M*. Measures concerning the independence of the Board of Directors and the percentage of women directors have improved slightly since the beginning of the year.

Performance review

On a YTD basis, the Fund has performed in line with its peer groups as well as the MSCI All Countries World NR Index. At the end of September, performance was still slightly better, although the Fund lost some ground at the end of October.

The Fund's performance during the year was in line with expectations, showing great resilience in the first quarter and participating much less in the rebound that followed.

The low weighting of the thematic pocket did not allow the Fund to benefit from the explosion in valuation multiples in this limited universe of stocks.

Over a longer-term horizon of 10 years, despite a much more defensive investment approach, the Fund's performance was in line with the universe of comparable funds, but still lagged far behind a global equity market driven mainly by large monopolistic technology groups.
Indeed, **in terms of risk/return ratio, over the same period, the Fund's highly defensive approach has led to a much lower volatility than that recorded by both the MSCI World and its peer group, with both benchmark universe indices showing similar volatility.**

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