

Sifter Global Fund

# Quarterly Report Q3/2020

“We do not buy stock price returns  
– we buy business returns.”

Hannes Kulvik / Founder of the Sifter Fund

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During Q3  
Sifter Fund  
outperformed  
the index by  
1.0 %.

## Geographical allocation

	United States	59.5 %
	Japan	11.6 %
	Sweden	8.0 %
	Taiwan	7.3 %
	Canada	7.0 %
	Germany	4.6 %
	France	2.0 %

## Fund Performance

**During Q3 2020, Sifter Fund's total return was 4.6% vs 3.6% for the Index (MSCI ACWI Eur), as depicted in table 1.**

→ Annualized return since inception of the Fund is 8.7% (2003/6 - 2020/9).

→ The Fund has performed better than the comparison Index which has an annualized return of 7.8%. On an annualized basis, Sifter Fund has been 0.9% better than the Index.

→ Since Inception, Sifter Fund R class has returned 320.9% in total, which is 53.2% better than the index.



Graph 1. Sifter Fund Global NAV changes Q3/2020 (I-class)

## Fund Performance

	Sep 2020	Q3 2020	YTD	2019	2018	2017	Annualized since inception (2003-)
Sifter Fund Global	-0.2 %	4.6 %	3.2 %	31.3 %	-4.1 %	8.5 %	8.7 %
Benchmark index	-1.3 %	3.6 %	-3.0 %	28.9 %	-4.9 %	8.9 %	7.8 %
Difference	1.1 %	1.0 %	6.2 %	2.4 %	0.8 %	-0.4 %	0.9 %

Table 1: Sifter Fund (R/I-class) performance vs Index (MSCI ACWI, Total return EUR).



## Best & Worst performers in Q3

### Top 3

return in EUR

Taiwan Semiconductor	+37.4%
Varian Medical Systems	+34.4%
The North West Company	+20.9%

### Bottom 3

return in EUR

Cisco Systems	-18.5%
Intel	-16.6%
iRobot	-13.4%

North West benefitted greatly from changed shopping behaviour due to Covid-19.

**The best performers of the quarter were TSMC, Varian and North West.** TSMC, the world's largest semiconductor foundry, has performed well during the crisis. Demand for TSMC's manufacturing services has remained high and the company has avoided significant supply chain issues.

**One of our newest investments, Varian Medical Systems,** was sold after Siemens Healthineers offered to acquire the company at a 24% premium. Although we dislike losing a great business from the portfolio, Sifter investors enjoyed a hefty premium.

**North West,** a Canadian retail store chain, continues to benefit greatly from changed shopping behaviour caused by travel restrictions due to Covid-19. The management is optimistic that they'll be able to retain parts of the increased volume even after Covid-19 is gone. The company is currently generating significantly more cash than is required for operations.

**Cisco's** quarterly results implied that the weak economy continues to limit investments on corporate networking infrastructure. In addition, the company's long-term CFO is leaving.

**Intel** announced a delay to its next generation production process (7 nm node) in July and is now considering outsourcing some of its chip production process.

Uncertainty regarding company specific tariffs gloomed **iRobot's** short-term outlook. However, the share is still valued some 59% above our initial investment which took place in mid-April.



## Portfolio changes in Q3

**During the quarter, we did not add any new companies.** However, we significantly increased our investments mainly in our newest businesses. Meanwhile, we sold our entire position in Varian Medical Systems and Laboratory Corporation of America.

### Additional investments in fresh Sifter portfolio companies

→ **Old Dominion Freight Line** operates an efficient network of trucks and terminals in the US and has demonstrated superior performance over its peers. The company's long history of high-quality service and excellent on-time performance, partly thanks to its dense network of terminals, has allowed it to maintain favourable pricing during contract negotiations.

→ **iRobot** is an American manufacturer of consumer robots and is best known for its Roomba robotic vacuum cleaners. It was the first company to successfully bring a commercial robovac to the market and is still today the industry leader with a market share exceeding 50 %. The company's competitive leadership is protected by an extensive patent portfolio and global name recognition which is supported by outsized scale advantages in R&D and marketing.

→ **Costco** operates the leading warehouse club in the United States, Canada and a select few other countries. The company has a differentiated earnings model where the income to the business is derived from annual membership fees rather than actual retail sales. The company has a loyal customer base in all countries it operates as the prices on retail goods are the lowest in the sector.

### Companies exited in Q3

→ **Varian Medical Systems** is an American medical equipment company that sells and maintains linear accelerators (linacs) - equipment that destroy cancer cells with radiation. Varian's installed base of linacs is the largest

## 10 largest holdings

Representing 52.9% of total portfolio (30.09.2020)

<b>Taiwan Semiconductor-SP</b> ADR ASIA-PACIFIC
<b>Microsoft Corp</b> NORTH AMERICA
<b>Lam Research Corp</b> NORTH AMERICA
<b>S&amp;P Global Inc</b> NORTH AMERICA
<b>Canadian National Railway Co.</b> NORTH AMERICA
<b>Atlas Copco AB</b> EUROPE
<b>Texas Instruments Inc</b> NORTH AMERICA
<b>Deutsche Boerse AG</b> EUROPE
<b>Verisign Inc</b> NORTH AMERICA
<b>Alphabet Inc</b> NORTH AMERICA



It's not in our investment strategy to gamble with M&A situations.

in the world (~55% of total) and generates steady service revenue. Varian has maintained a stable market share, likely supported by technological entry barriers, training needs and disruption risks.

In August, Siemens Healthineers offered to acquire the company at a 24% premium. While we would have liked to remain long-term shareholders, the premium was acceptable, and it's not in our strategy to gamble with M&A situations.

→ **Laboratory Corporation of America** is a life sciences company, that provides diagnostic and drug development services. The company has too high leverage for our liking and has achieved weak returns on invested capital.

In the drug development business, LabCorp has resorted to large M&A to fuel growth. Meanwhile, the diagnostics business has failed to impress us, given its weak top line growth and margin development, despite the consolidation opportunity in the US diagnostic market.

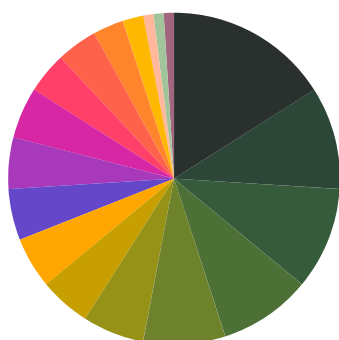
The company has benefitted from COVID-19 related testing volumes, but we see that as a temporary boost and decided to exit LabCorp from the Fund's portfolio.



## Corona crisis: Winners and sufferers

**During the past Corona year**, the role of portfolio diversification played a crucial role as companies in the travel, tourism and restaurant industries suffered quite severely. Although Sifter fund did better than the benchmark index, Corona has left an ugly scar on some companies. Others got more wind on business sails.

We listed a few Corona sufferers and winners in Sifter's portfolio. Once again, it was critical to study a company's ability to make money (profit) in the long run and not stare at changes in stock prices in the short term.



### Sector allocation

Semiconductors	16.2%
Financial Exchanges & Data	9.8%
Semiconductor Equipment	9.7%
Systems Software	8.8%
Industrial Machinery	8.2%
Auto Parts & Equipment	5.9%
Railroads	4.8%
Internet Services & Infrastructure	4.5%
Interactive Media & Services	4.5%
Pharmaceuticals	4.4%
Hypermarkets and Super Centers	4.4%
Restaurants	3.9%
Communications Equipment	3.6%
Household Appliances	3.0%
Trucking	2.3%
Food Retail	2.2%
Drug Retail	1.9%
Aerospace	1.9%

### Corona sufferers

We can see that three companies in our portfolio were hit hard by the pandemic and lockdowns. These are the Swedish Autoliv, the French Safran, and the American Starbucks. However, we estimate that the damage to the companies will be short-lived.

→ **Autoliv** is a manufacturer of passive cars safety devices such as airbags and seat belts. As factories around the world were forced to shut down, and demand for new cars fell significantly, so did Autoliv's profitability.

We re-examined the strength of the company's balance sheet and competitive advantages and decided to remain a shareholder. We believe that Autoliv, as the market leader in its field, is the strongest company. As the new car production is expected to grow towards normal levels, and cars continue to become even safer, we see Autoliv being well positioned to benefit.

**From the bottom of March, the stock has risen 81% but is still 18% cheaper than at the beginning of the year (YTD).**

→ **Safran** builds the world's best aircraft engines. Before the Corona crisis, demand for new aircraft was growing and the order backlog for engines built by Safran lasted for years. Due to the quarantines, the number of flights departing around the world came crashing down.



From the bottom of March, the Safran share price has risen 59% but is still 39% cheaper than at the beginning of the year (YTD).

Starbucks' sales and earnings growth has been convincing year after year.

Uncertainty regarding future demand for air travel is also reflected in fewer aircraft being manufactured, by Boeing or Airbus.

However, Safran's earnings model is largely based on engine maintenance contracts that have to be made regularly for aircraft engines. Safran has a multi year order backlog for servicing existing engines, and a very dominant position in this market.

The engines Safran manufactures are typically used on short and medium length flights. These flights have been less affected by the pandemic compared to long range international flights. We estimate that Safran's business will gradually recover as normalcy is restored.

**From the bottom of March, the share has risen 59% but is still 39% cheaper than at the beginning of the year (YTD).**

→ **Starbucks** has more than 32,000 cafes, making it the world's largest coffee chain. Over half of these are in the United States and there are already more than 4,400 cafés in China.

Starbucks' sales and earnings growth has been convincing year after year but COVID-19 made a nasty dent in the beautiful growth curve. Starbucks had to close most of its cafes first in China and then in the United States. Fortunately, the closure of the cafes was short-lived and limited to one quarter. The company faced the problem head-on and was able to develop safe ways to offer coffee and other products to its customers in both cafes and take-away models.

We believe Starbucks will continue to grow, particularly in the Chinese market, where it aims to open a new Starbucks cafe every fifteen hours for the next few years. Also expanding the product range e.g. snacks and food products should bring further growth (same-store-sales growth) to existing cafeterias.

**From the bottom of March, the share has risen more than 50% and is almost at the same level as at the beginning of the year (-2 % YTD). Sifter increased its Starbucks holdings slightly during Q3.**



We believe in Microsoft's earnings model, competitive advantages and its ability to make money in the future.

## Corona Winners

**Most Corona winners are from either the technology or retail sectors.** Quarantine forced people to do both work and food at home. Naturally, the "saved" restaurant and tourism money were used for purchases at home or in cottages.

## Example companies from Sifter's portfolio:

→ **Microsoft** has been a cornerstone of our portfolio for over 10 years. Weaker spending among small and medium businesses has been a negative driver in 2020. However the company has achieved uninterrupted top-line growth, as consumers have been forced to work, play and study at home, supporting revenue from Surface devices, Windows licenses and gaming.

Meanwhile, Microsoft's strongest growth stream continues to originate from cloud services, where its Azure offering is estimated to be the second largest after Amazon's AWS (source: IDC).

The public cloud services market (infrastructure and platform) has grown rapidly, increasing 40% year-on-year in 2019 (source: IDC). In 2020, Azure's growth decelerated somewhat but remained strong, increasing 47% year-on-year in the latest quarter.

Meanwhile, the number of daily active users for Microsoft's Teams service increased more than five-fold in July 2019 – April 2020, as online meetings became vital and Microsoft successfully transitioned its customer base from Skype to Teams.

We like this tech giant for many reasons, partly because Microsoft can innovate itself and create new services on top of the old. We believe in Microsoft's earnings model, competitive advantages and its ability to make money in the future.

**From the bottom of March, the share has risen 55% and since the beginning of the year by 33%.**





From the bottom of March, the TSMC share price has risen by some 85% and since the beginning of the year by 40%.

Costco is different from competing retailers as they operate on a membership model where you have to be a paying member to access the store.

→ **TSMC** is a semiconductor foundry headquartered in Taiwan. The company manufactures chips for its customers that include large tech companies like Apple, Nvidia and AMD. As manufacturing technology has advanced, it has become increasingly capex intensive, which has raised entry barriers for smaller manufacturers and strengthened TSMC's competitive position.

TSMC's leading edge production nodes are particularly suited for highly advanced chips which are in growing demand due to the increasing use of 5G, AI and other applications that require high computing power. In 2020, the demand for such technologies seems intact if not strengthened.

**From the bottom of March, the share has risen by some 85% and since the beginning of the year by 40%.**

→ **Costco** is the world's second-largest retailer after Walmart. Costco is different from competing retailers as they operate on a membership model where you have to be a paying member to access the store. The company makes its main profit from membership fees and offers its members very affordable products in return.

During the Corona spring, customer's demand for Costco's retail products and the number of new members increased significantly. In particular, the growth of new members will enable the company to offer its products even more cheaply, as the company achieves economies of scale in sourcing and distribution.

we grew exponentially due to customers changing shopping behaviour during the pandemic. We believe that the growth in demand seen during the spring will not be temporary, but Costco's position as the number one shop of its members will only be strengthened.

Costco has also opened its first store in Shanghai, where the addition of more than 200,000 new members in just one quarter surprised even Costco's management.

**From the bottom of March, the share has risen by 27% and since the beginning of the year by 21%.**



## We do not buy stock price returns – we buy business returns

**We never promise any stock price returns** – However, we promise that you and we own very good companies. For this reason, we closely monitor the four indicators of our companies' quality (Table 2.) We compare these indicators against the S&P 500 companies.

### Main changes in key performance indicators (KPIs)

- **Return on Invested Capital** has remained strong – No changes – clearly better than S&P500
- **Operating margin** improved a bit – clearly better than S&P500
- **Sales growth** – declined a bit from 2019 – clearly better than S&P500
- **Net debt/EBITDA** – remained very low (0.2x), which is good vs S&P500 companies (2.3x)
- **EV/EBITDA** valuation metric elevated from Q2 figures – However, in line with S&P500

15% ROIC is one clear indication that we own quality companies.

KPIs	2014	2015	2016	2017	2018	2019	Sifter Current	S&P 500 Current
ROIC	14%	13%	14%	15%	16%	15%	15%	8%
Operating margin	20%	20%	22%	26%	26%	25%	26%	14%
Sales growth	2%	4%	8%	9%	9%	6%	4%	0%
Net debt/EBITDA	0.4x	0.6x	1.0x	-0.1x	0x	0.5x	0.2x	2.3x
EV/EBITDA (Current)							16.3x	16.1x

Table 2. Key Performance Indicators (KPI's) for Sifter businesses vs S&P 500.

\*Trailing. 12 months, median (30.09.2020)



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## People behind the Sifter Fund

This report has been produced by Sifter's Investment Committee (IC) and Advisory Team.



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### Do you need help?

If you have any question regarding our investment strategy or want to place an investment in Sifter, please contact Mr. Santeri Korpinen or check [www.sifterfund.com](http://www.sifterfund.com)

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