FundCalibre.

investing ON THE go

TRANSCRIPT: EPISODE 92
10 September 2020 (pre-recorded 9 September 2020)

Below is a transcript of the episode, modified for your reading pleasure. Please check the corresponding audio before quoting in print, as it may contain small errors. Please remember we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at your time of listening. For more information on the people and ideas in the episode, see the links at the bottom of the post.

[INTRODUCTION]
Darius McDermott (DM): Hello I'm Darius McDermott from FundCalibre and this is the Investing on the go podcast. This morning I'm joined by Stephen Yiu the manager of the Blue Whale Growth fund, which has its third anniversary this week.

[INTERVIEW]
[0:17]

DM: Firstly, congratulations Stephen three years is a big benchmark in the life of the fund. It's been an interesting three years to put it mildly. What have been your highs and lows over that period?

Stephen Yiu (SY): Thank you, Darius. Yeah, I would love to expand a bit more. So, when we first started three years ago in 2017, obviously we started with a very small sum of money, but what has been quite interesting over the last three years, we've been through many different mini cycles over the last three years. If you, if people now recall back in 2018, the Fed was raising interest rates in Q4 and the market was down a couple of percent. And we did, at Blue Whale, we did manage to acheive a positive return in 2018. And then obviously in 2019 - it seems to be quite distant memory now - the market was very strong, everything went up and Blue Whale did outperform again, and then this year we have the Covid, the market was very down at the beginning of the year and we did still manage to outperform the market in a positive manner this year. So, so we just feel that it's three years it's gone on for quite long, rather than just a normal three years, maybe enough multi-conditions that we could have experienced.

DM: Yeah, it really has been I suppose one would describe it as a crazy period for life as well as investing. One of the things you look at when picking a stock for the fund is disruption, either how a company can disrupt it or how it can disrupt other firms. And how does that sort of feed into your process and have your views on these things been changed by the pandemic or what consequences have you seen in stocks?

SY: Yeah, so on a high level, we like high quality businesses with very strong competitive positioning. And typically that means that the company would have a very strong market share in terms of what they do, a very good product with pricing power, et cetera, but from time to time with the rise of technology, or penetration of technology into the consumer hands, that you will see a lot of new startups coming into the market to disrupt the status quo or the incumbents, and so for the companies that we have, most of our companies are disrupted in their own right, so they are kind of the pioneer in terms of what they do. They have the latest technology in terms of the product, they then roll out, they have the scale, et cetera. But at the same time, that's from time to time, we could see our companies getting disrupted from some of the new, more newer companies. So I think the key for us is to really, to monitor, to stay on top of the development and make sure that our company doesn't get disrupted at the same time.

But to answer your question in terms of what the pandemic has done to a lot of other companies is I think firstly for the company that we have, who already started off as a disruptor, they are actually a net beneficiary on a back of the Covid because they have now become now elevated to a much stronger position that people, other company, that would be more difficult to catch up. But I think on the other hand, there are many sectors of businesses in a market that were being disrupted before the pandemic. And obviously now with the pandemic that is become a more, a headwind for them to invest into their business for the next stage. And what we have learned is I think that gap has basically widened quite a lot over the last six months or nine months.

[3:47]

DM: You mentioned high quality companies, you know, businesses that can have sustainable growth in their earnings and they're innovative. This has naturally led you to a bias in technology. So I thought it might be a useful to touch on that maybe in a little bit more detail: you had a big technology waiting at launch, but an even bigger technology waiting now, sort of approximately 60%. Is it just because of performance of those companies has done so well that you've got a big weighting or have you seen new opportunities in that sector?

SY: So we are at Blue Whale, we are sector and company agnostic and country agnostic as well. So we don't, we don't take a top down view to say, oh, we want to have a certain level of exposure to the US, we want to have certain exposure to our technology sector, per se. And, but what we do is we're bottom up investors, we do a lot of research, a lot of reading on companies and since we started in 2017, obviously the market, or maybe the economy was in a kind of a different state compared to now. But at the time we were also interested in companies that are outside of tech. Let's say maybe consumer-facing, maybe some brands such as Adidas for example, we had a top 10 holding in Adidas for quite a long period of time until last year, we did quite well out of that.

But as the more we learned about technology business that we managed to find much high quality businesses within the technology space. For example, I think one area that we have been quite positive on would be the software provider. So to come down and give you a one is Adobe and other one is Autodesk, both of them are technology per se. But then if you look at that underlying customers that they serve, Adobe serve the creative professional in terms of digital content creation, while Autodesk serve customers in the manufacturing and construction markets. So the beauty of these two businesses are that they, because they are both a software provider, they are the market leader, but at the same time, they have a recurring revenue stream and hence this year, I think we have, they have proven themselves that they have managed to cope with Covid much better than a lot of other companies who are not having that technology or the platform to sell to their customers.

[6:24]

DM: Just sticking with technology because it's obviously with Covid been a very topical sector and very buoyant on the stock market and certainly, well till the last 24, 48 hours anyway. How do you define technology, to you it's more than just a sector. I think technology is such a wide definition. How do you define it and talk about maybe some of the companies that you actually would avoid in that space and why that is?

SY: Yeah, thank you for that. I think this is quite an important question that we have tried to… basically we have to do well. We have done well over the last 18 months on the back of this probably a lot of investors recognising the opportunity in technology. But we have always said that we are not a technology fund and we are very selective in terms of what we like and don't like within the technology sector. And things that we don't like, would be a company that doesn’t have a strong competitive positioning, the switching cost is very low, and names would be the likes of the Zoom video conferencing company, that has done extremely well. I mean, we would not touch it because we don't feel that the by the time they need to ask company or consumer to pay for the service, that people would be willing to do it.

I mean, we would never consider like Uber, not on as high quality businesses. And I think to the extreme, like we also disliked the likes of Netflix or Apple, which we feel Netflix, they are in a market that's very competitive in terms of paying out for content continuously, versus a lot of other giants like YouTube, Amazon Prime, HBO, et cetera. And at the same time, Apple while yes, I think I can see the investment case for Apple. If you are, you can buy it at a very attractive price few years ago, but it's still a hardware company trying to evolve into a software or services provider. And so at the moment, I think they have a press release, a product release next week, then people will be looking at Apple. Are you going to come up with a new product that the consumer like us, are willing to spend a few hundred dollars, or a few thousand pounds for a new iPhone and if they're not that happy and they're not going to have the services that they, they think that they're going to get from us.

[8:55]

DM: Another thing, just looking at your portfolio and given we've already touched on technology. I think some of this is sort of obvious, but you have a big chunk invested in the US and some in

Europe as well, but only a couple of percent in Asia, why is that? Or were you not able to find those high quality companies in Asia or is there a valuation or what's the issue there?

SY: Yeah, I think it's a bit of a both. And so I in my previous career I've done quite a lot of work on a Chinese companies listed in Hong Kong, companies in Asia. And I do speak the language myself, but I think all the work that have that I've done in the past, I've led me to the conclusion that the quality of business in general in Asia are much lower than you can find in the Western world. And there's two things I would point out in terms of how we perform analysis. One would be a corporate governance, typically the corporate governance in Asia, the Asian companies are lower and secondary transparency is also lower. So, which means that it's quite difficult to get to the bottom of how businesses make money when you are not listed in the Western world.

And I think at the end of the day for us at the moment at Blue Whale, we do see a lot of interesting opportunities in the US and we feel that the quality bar that we set for our companies are pretty high, and those are meeting. And then last but not least the valuation of some of the companies that we have seen in Asia, even technology, alike to the counterparts in the US they are not that cheap. So basically for us to be interested in Asian companies, they probably would need to be trading at a big discount to the Western counterpart rather than on the same valuation. So if they're trading on a similar valuation, they are a bit lower quality, so that would be expensive in our view.

[10:56]

DM: And that then leads you back to the developed market equivalent because of the corporate governance. So, we touched on briefly the fact that you've launched your fund, and you’ve as you said had been through many cycles. How do you look forward for maybe the next three years? What do you think we might have in store and what is exciting you, what themes, what is your research and your reading taking you to, what are you looking at for maybe the three years ahead? Given that with Covid, I'll do the disclaimer for you, everything can and possibly will change. But how do you see the world going forward today? What's interesting you?

SY: Yeah I think obviously, I mean, we are constantly forward looking in terms of when we think about a portfolio. So we, I think you already mentioned that three years ago when we first started our exposure to technology related names are at a much smaller position compared to recently. So that has evolved, and I think for us it’s all about the valuation of our companies relative to the rest of the market. And I think the Covid has definitely posed some interesting opportunities, maybe over the next 12 to 18 months, and we are already looking, they are probably the victim of the Covid, they have suffered and then a lot of those businesses they could definitely revive given enough time to make the transition to the new world. And obviously it's all about valuation. If the valuation become right, then we will be very interested to consider those opportunities.

But I think at the same time that we do feel that for the companies that we have in the fund, they are still at a very early stage in terms of the opportunities that they can grab from the market. Given the pace has been accelerated by Covid, that some companies talk about that Covid basically accelerated digital transformation for the next two years in two months. So that's a lot of opportunity in the space as well, but we're constantly looking for new ideas and I will be very surprised three years from today our portfolio would be the same as what we are, what we have today.

DM: Stephen, thank you very much for your time. And as I say, congratulations on touching your third anniversary later this week.

SY: Thank you Darius.

DM: For more information on the Blue Whale Growth fund, please visit fundcalibre.com and to subscribe on the Investing on the go podcast also please subscribe at fundcalibre.com