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[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. This week we discuss a selection of global names, their competitive advantages, and how they adapt to evolving market dynamics while maintaining robust growth.

Chris Salih (CS): I'm Chris Salih, and today we are joined by Candida DeSilva, portfolio specialist at Morgan Stanley Investment Management. Thank you for joining us today.

Candida de Silva (CdS): Thank you.

[INTERVIEW]

CS: So today we are here to talk about the Elite Rated Morgan Stanley Global Brands fund, which is a high conviction portfolio of high quality companies, and they're designed to be both defendable and have high visible future earnings. So, with that in mind, I wanted to start with a quote on the website which says, "we don't rent stocks, we own businesses for the long term." So, maybe just give us some insights into the type of companies you hold beyond what I've just mentioned there and you know, what these quality businesses actually look like in the fund.

CdS: Yes, indeed. So, in fact, we like to say that quality is worth the wait. Charlie Munger talked about the big money is not in the buying or the selling, but in the waiting. And we look for high quality, well-managed companies, which can compound their earnings steadily across market cycles. But the art is being patient enough to allow them the time to do so. And as quality managers, we have the luxury of a long investment horizon. As an illustration, over a third of the companies we hold in our Global Brands portfolio have been held for 10 years or more.

In terms of our philosophy, it dates back 28 years and the companies we like have the following characteristics. So, first of all, difficult to replicate intangible assets. What do we mean by that? We mean things like network effects, strong brands, licenses and recurring revenues. We also look for a sustainably high return on operating capital employed on an un-levered basis. High gross margins, pricing power - crucial in this inflationary environment - and low capital intensity and a reliably recurring revenue stream. In all of this, effective management is crucial. These are highly cash

generative businesses and we want to see a history of disciplined and efficient use of that free cash flow; that makes sure the franchise is protected and can grow.

CS: You mentioned these businesses are well-established companies and they typically have significant barriers to entry, but obviously things evolve, industries change. I mean, when these things evolve and you have challenger brands that are sort of threatening these established names, does the fund have to adapt? Do the themes behind it adapt? Does the methodology of the fund change? Maybe just explain how it sort of thinks on its feet over the longer term.

CdS: Yeah, so you are right. The well established companies that we like have deep, well managed moats or high barriers to entry, thanks to their intangible assets. And these moats can offer long-term durable competitive advantages. I'll give you a couple of examples.

So, for instance, we own a banking software business that's so entrenched in its client's infrastructure that its clients tend to be extremely reluctant to switch provider. A joke in the industry in fact is that a senior bank manager would rather retire than oversee a core banking software transition. As a result, about 90% of their revenues are recurring. And a similar deep moat applies for a holding that's the leading provider of proxy voting services - it has about 95% market share - and it's such a complex and, frankly, quite difficult area administratively that it's recurring revenue retention is an extraordinary 98%. I think actually over the last 10 years it's low has been 97% and it's high has been 98%. It takes too much effort and cost for its clients to take on the work themselves or to switch provider. So intangible assets are a vital ingredient against those challenges in the first place.

But we recognise that things can change and one of the key risks we look to manage, of course, on an ongoing basis is competition risk. And this is where management comes in. We want to see effective and sustained investment by management to maintain these moats. And this can be in the form of advertising and promotion, R&D and innovation. We have a good example of this in a leading beauty company we own, which spends about 30% of its revenues on marketing alone. Within staples, new brands make up about 10 to 15% of any category. And within that, there is huge churn and of course occasionally a challenger brand will succeed in breaking through. But thanks to its continued investment and its diversification because it trades across all categories, this company has shown an ability to defend against them and add to that it's invested in extensively in innovation and technology and that includes AI.

So in terms of how companies adapt over time, generative AI is a very good example where we believe that the moats of many of our holdings are strong, thanks to what we call their walled gardens. What we mean by that? We mean the extensive proprietary data that they can mine for more customer insights to increase efficiencies and enhance customer service. So we're already seeing that at work today. These companies therefore aren't standing still, but continue to invest in order to protect their high barriers to entry.

But finally, I'll give you an example where we sold out of a business. This is a leading sports apparel business which lost its US leadership position to challenger brands in a key category. And this was because of a change in its strategy. It shifted away from wholesale to direct to consumer and this didn't deliver the economic benefits and effectively opened up the space for competitors to gain share. But as I said, we have sold that position.

CS: Okay. I wanted to focus on one sector, which perhaps has risen in popularity in the past few years. Obviously it's got big tailwinds behind it and that's sort of healthcare and that's an area you've added some names to recently. Is that essentially a growing area of the portfolio in lieu of those tailwinds that we're talking about?

CdS: Yeah, it's a very good question, but just to quickly highlight, it's our bottom up research that's the driver of how we identify new names rather than any sector allocations. But that said, the healthcare sector is indeed one of the three key sectors where we more commonly find high quality names. And as you say, our weighting has grown over the last seven years or so often thanks to new quality opportunities becoming available thanks to M&A activity.

What do we like? We particularly like life sciences leaders and businesses offering diagnostics, medical devices and hospital supplies. Why? Because these have mission critical offerings such as sterilisation, which is mandated by regulation. They have pricing power and, as we've talked about already, high barriers to entry. For instance, many products are written into regulatory filings, including the ingredients from life sciences companies.

We also believe these businesses are strongly positioned for future growth given the ageing population, the shift to more complicated drugs and gene therapies and unmet medical needs. And in the market's AI-fuelled rally, defensive sectors such as healthcare have lagged on a relative basis more recently and that's given us a great entry point to add a couple of new healthcare names, as you said, at a submarket multiple. Let's take one of them: it's a market leader in women's health, particularly molecular diagnostics and breast health in the US. It has a 90% share of mammography machines, which it successfully pairs with a strong servicing network. In other words, it has a strong moat, which we talked about earlier.

CS: Okay. Anyone who sort of looks at your factsheets will see some of the names that are on there are sort of well known global names, you know, popular in most countries across the world. But obviously there's been a rise of this growing rhetoric around anti-globalisation and economies becoming a bit more nationalistic. From your perspective, is that a threat or maybe an opportunity for new companies to enter the portfolio?

CdS: So as I said, we're bottom up stock pickers and we don't make investment decisions based on a top down view. But I think it's fair to say there's been a shift towards re-shoring and away from just in time complex supply chains.

First of all, many of the companies we own don't physically make anything, for example, software or professional services companies. Of the companies that do, the big multinationals tend to have a 'local for local' approach, for example, in healthcare and consumer staples. That's probably with exceptions such as spirits where provenance matters. So in addition to helping mitigate supply chain issues, a local approach can also help them reduce big currency mismatches. But even in industries where we might be witnessing a shift towards homegrown, for example, pharmaceuticals in China, the Pharma companies there still need the expertise and ingredients of the leading global life sciences companies that we invest in.

And finally, I would say that the businesses we like tend also to be diversified, which enables them to better weather storms if one market switches off.

CS: And, I guess, just lastly, the past couple of years we've seen a sort of change in the environment with inflation sort of appearing quite prominently. I mean, I guess for a lot of these companies, that's one of the things that factors in this sort of barrier to entry, you know, managing costs, et cetera and sort of, you know, being able to maybe pass it on to the consumer. Is that something you've found that you've been able to manage with these larger companies in this environment? I guess it's kind of a bit of an acid test for them.

CdS: It is indeed. I've already said it's a crucial kind of aspect we're looking for, pricing power. So, as I said, we look for these natural compounders that can compound through market cycles. They tend to be resilient because they're more non-discretionary in nature. So whether that's mission critical software, must have medical products, or very strong brands that are often in everyday must have arenas such as washing powder or shampoo. So this in itself sustains customer demand regardless of the market backdrop. And it also arms them with pricing power.

So perhaps if we are talking about inflation, if I take the the key sectors where we find high quality companies one by one. So first of all, software and services; they tend to have incredibly high margins, so don't need to put up prices that much. And the cloud transition has also provided them with that robust recurring revenue through subscription services.

With staples, any prolonged inflationary environment shouldn't be too difficult for them to handle. More challenging has been the short, sharp inflationary environment which we've experienced where frankly, everyone has put up prices and our companies have of course put through price increases. Their top line overall has been strong and profit growth solid, even though there's sometimes been a hit to volumes. And let's take an example of a soft drinks manufacturer we own, they have managed to rebuild their gross margins. They're now higher than where they were in 2019 before the pandemic.

And then finally in healthcare, many of our businesses are selling low margin products at the consumables end. So, for example, a company that's a leader in supplying syringes and needles.

And for them it's been a bit tougher to put through price increases to hospitals, but they have succeeded given the critical nature of their trusted products.

So I think all in all the last few years have seen an exceptional set of headwinds for companies, whether that's Covid-19, war in Europe, supply chain disruption or rampant inflation and tighter monetary policy. But through this we've seen remarkable resilience in our holdings along with continued investment to drive onward growth.

CS: On that note, Candida, thank you for joining us today.

CdS: Thank you very much, it's been a pleasure.

SW: We really like the high level of concentration of this fund, which has only 25-30 holdings and roughly half of its assets in the top ten names. It shows real conviction from the managers and is a good example of how active management can really add value. To learn more about the Morgan Stanley Global Brands fund please visit **fundcalibre.com**

The fund mentioned herein is available to UK investors only. All investments involve risk, including the loss of principle. Full details and risks associated with the fund can be found in the fund's Prospectus at ***www.morganstanleyfunds.co.uk****. The fund is available through your Investment Adviser and applications for shares in the fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi Annual Report ("Offering Documents"), or other documents available in your local jurisdiction. This content has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.*