31 March 2024

HAVELOCK LONDON

HAVELOCK GLOBAL SELECT

FUND PERFORMANCE

Cumulative Returns

1 Month	YTD	1 Year	3 Years	5 Years	Since Launch
5%	2.6%	9%	23.9%	53%	53.2%

Calendar Returns

Year	Q1	Q2	Q3	Q4	Annual
2019	6.2%	2.9%	1.9%	3.5%	15.3%
2020	-20.9%	13.9%	1.7%	11.8%	2.4%
2021	11.0%	2.8%	2.4%	-1.4%	15.2%
2022	1.9%	-4.7%	-4.6%	14.3%	5.9%
2023	3.4%	-3.0%	-0.1%	9.6%	9.8%
2024	2.6%				

This performance information refers to the past. Past performance is not a reliable indicator of future results. This information is denominated in GBP: returns may increase or decrease as the result of currency fluctuations.

FUND DETAILS

Fund Size	£170M
Fund Manager	Matthew Beddall
Fund Structure	OEIC (UK UCITS)
Fund Domicile	UK
Launch Date	21st August 2018
Base Currency	GBP
ISIN	GB00BFM7DN78
SEDOL	BFM7DN7

The Key Investor Information Document (KIID) and prospectus are available in English from:

Havelock London
19 Eastbourne Terrace
London, W2 6LG
Tel: +44 (0)20 3637 7300
www.havelocklondon.com

Waystone Group
PO Box 389
Darlington, DL1 9UF
Tel: +44 (0)345 9220044
www.fundsolutions.net

COMMENTARY

The fund's unit price increased by 2.6% during the first quarter of the year.

The headline grabbing themes in markets remained unchanged, namely the pace at which central banks will cut interest rates and the potential for artificial intelligence related companies to profit from rapid disruption. By comparison, news of geopolitical tensions and conflicts appeared to cause little concern.

The consensus view has been that inflation would cease to be a problem, but expectations around the pace of rate cuts have been moderating. The IMF, and other prominent commentators, have publicly voiced concerns about the lack of financial discipline of those governments with both high debt levels and ongoing current account deficits. The old fashioned "monetarist" perspective, that funding these debts with printed money will create inflation, stills appears to be disregarded by most market participants.

The consensus view on AI, as judged by market prices, is that companies like Nvidia will continue to see a rapid growth in profits. In the past, new technology has often been a disrupting force for public companies, but markets generally have a poor history of anticipating who the winners and losers will be. Opinions seem split between those who view the current bull market in tech companies as based on "hype", versus those who believe it is obvious that these incumbent companies will be the main beneficiaries.

Reaffirming our vows

The fund has been operational since 2018, and has delivered positive returns in each of the five full calendar years that it has been running. We have been fortunate to have the support of a growing number of investors in this time, and are grateful for the trust that they have placed in us. This quarter felt like a good moment to reaffirm our investment philosophy to our investors, alongside how we view the structure of the portfolio.

Whilst our approach has remained unchanged, I feel that the passage of time has given me a greater appreciation for which aspects are the most important, and greater clarity as to how to communicate them.

Our Investment Approach

We are "quality value" investors, meaning that we look to invest in strong businesses at prices that do not require undue optimism to think that they can produce an attractive return. This is not a controversial aim, but does not convey any detail.

We see both "quality" and "value" as more than just narrowly defined numerical measures, which is how they are viewed within much of the investment industry. We see them as multi-faceted, and use a combination of qualitative and quantitative considerations to form our view of them.

We see "quality" companies as those that earn a healthy return on invested capital without the need for too much balance sheet leverage or financial complexity. We want to own companies that also have a strong and durable competitive position, and an honest and capable management team. These are easier to say than to assess, as they involve subjectivity. There are many secondary factors that we also consider, for example the alignment of incentives between management and shareholders, and the simplicity of the underlying business.

We see both a company's ability to generate earnings and cashflow, and its balance sheet assets, as potential sources of "value". Whilst we look at historic valuation ratios, our final assessment is based on forming a view about the future. We construct a valuation model, which produces a "range" rather than a spuriously precise single target price. These models form a framework that forces us to be explicit about why we think an investment is cheap, and helps us to compare their relative attractiveness.

We are happy to own companies with limited growth prospects, provided they have the discipline to send excess capital back to shareholders via dividends or buybacks. Conversely, we like companies with good growth prospects, provided that an expectation of this is not already reflected by a high valuation. We are happy to own companies that do not deliver their earnings smoothly, provided that we think they have the ability to endure for the long term and across entire business cycles.

We see investing as a trade-off between what you pay, in terms of valuation, and what you get, in terms of quality. We believe that many investors place a disproportionate emphasis on the quality of the business, which means that many "consensus" companies look expensive to us. Conversely, we think there are overlooked companies that are higher quality than they might first appear.

For every investment that we make we wish to have a thesis as to why we disagree with the current market price. We are happy to be contrarian, but not for its own sake. Our theses are often based on the opinion that other investors are too focused on short term earnings, or that a company is not well understood by others. This corresponds to a belief that being long term, and doing thorough research, provide us with meaningful sources of investment "edge".

Our entire philosophy is underpinned by an awareness of the role of uncertainty. We know that our ability to foretell the future is very limited, and that not all of our investment theses will play out as we would wish. We believe that our valuation discipline helps ensure a "margin of safety", such that even under pessimistic assumptions we are not overpaying for an investment. When an investment doesn't work as we would hope, we want to understand if and how our views were wrong, and if we can learn from it.

My background was in the "quant" industry, and although it has influenced our approach, we do not make investment decisions based on following an algorithm or rule. We believe that the best investors are objective and structured, and these are characteristics that have been built into our investment process. Despite this we believe that our style of investment contains much subjectivity, and as such human judgement is a part of our process.

When we started the fund, we had no engagement with management and paid no attention to the research of others. Our stance on this has changed from one of outright cynicism, to healthy scepticism. For the smaller companies in our portfolio, we have found benefits from speaking to management, but for the larger companies where we do not have direct access, we see little benefit. We spend more time considering the views of others, and are not shy of plagiarising ideas from those we respect, but will always undertake our own research and form our own views.

Our holdings broadly fall into three categories that we refer to as "core", "asset based", and "special situations" based on both the nature of the underlying businesses and our investment theses. Like all classifications, they are imperfect, but provide a helpful lens through which to view our portfolio.

The core category represents our "bread and butter", which are niche businesses that we believe to be of higher quality than their valuations suggest. They are often operating in cyclical industries whereby their share prices are "anchored" to short term weakness, rather than long-term prospects. They are also typically mid-caps, with a low level of research coverage and understanding.

The asset-based category reflects companies such as banks, energy producers, or miners that are capital intensive businesses that rely on owning a scarce resource and or using financial leverage. We find this area appealing because it has been unilaterally out of favour with investors, which means that it contains some high-quality businesses with comparatively modest valuations. They do however entail a greater understanding of balance sheet risk.

The special situations category represents companies where there has been a "bump in the road", such as a merger, change of management, or change of strategy. We are attracted to companies that we think are fundamentally sound, but where the current valuation is anchored on concerns about these short-term challenges. These situations often appear to coincide with a rotation of ownership, which creates price volatility as one set of shareholders depart, and a new set arrive.

We typically have 30-40 investments in our portfolio, with the top ten representing up to half of it. We think that this provides sufficient diversification, whilst making us different enough from the broad market indices to have a chance of outperforming them. We do not think our approach is the only way to invest, but it is differentiated, as many global funds have a significant exposure to the more popular areas of the market that we do not own.

This entire approach is underpinned by a culture of humility, and a desire to keep learning.

Portfolio Update

The majority of our portfolio companies reported year end results in the first quarter, and so I provide a longer portfolio update that encompasses some of the highlights of these.

Core Holdings

Within our core holdings we own several consumer businesses, such as the UK home goods retailer Dunelm, Associated British Foods who own the Primark business, and Shimamura, who are a leading Japanese clothes retailer. These holdings are focused on companies at the "affordable" end of the market, where their resilience to a general downturn is helped by new customers "trading down" from higher-end competitors. This has been born out in their results for last year, with the companies generally having been able to pass on cost increases without meaningful drops in sales volume.

We sold our holding in Toyo Suisan, which is the largest supplier of instant noodles to consumers in the US and Mexico. Like most of our Japanese holdings our investment thesis partly rested on the high amounts of excess capital that it holds on its balance sheet. The company benefited from both

exchange rate moves, and historically large price increases, and like many Japanese companies had seen a very large rally in its share price.

We added a new UK retail business, Card Factory, that fits the mould of operating in the "value" segment. The company has been subject to something of a turnaround under its current CEO, and through a vertically integrated approach where it designs and prints cards in house, we see it as the "lowest cost producer". The company is at the bottom end of the market capitalisation spectrum for us, but sits comfortably within our overall portfolio liquidity constraints.

Our core holdings are dominated by a number of mid-size niche industrial businesses, such as the engineering conglomerates Bucher, Aalberts, Schouw and, CNH Industrial. It is hard to unilaterally summarise their results, but in general terms they have shown resilience despite the impact of "destocking", as customers reduce their inventories that were built up during the COVID pandemic.

Aalberts has benefited from the drive to build more semiconductor fabrication plants, as it owns a niche businesses that supplies specialist components to this industry. This pleasingly offset the weaker results in their various businesses that make heating and ventilation components.

We sold our holding in the Japanese industrial business, Horiba, after its share price converged on our valuation. Like Aalberts, the company makes components for semiconductor fabrication plants, alongside automotive testing instruments. We also sold our holding in the memory semiconductor manufacturer, Micron. The company benefited from a rebound in memory prices fuelled by the demand for AI computing resources. Similarly, we sold down our holding once it converged on our valuation.

We sold our holding in the German bottling machinery business, Krones, in the quarter. The company has benefited from a very strong order book coming out of the COVID pandemic. It is a business that we continue to like, but with a share price that converged on our valuation, we decided to seek opportunities elsewhere.

Our holding in the Japanese industrial business, Nabtesco was also sold. The company make, amongst other things, the precision gearboxes that are used in robotic arms and construction machinery. The decision to sell it was based on the view that our initial thesis was too optimistic, and that we saw better opportunities elsewhere.

CNH Industrial is a new holding for the portfolio, and is one of the three large global manufacturers of tractors. It is an industry with high barriers to entry, because customers place much importance on their proximity to the nearest dealership. When a farmer is ready to harvest his crops it is imperative that problems with their machines are quickly fixed, which requires a large dealer network. Furthermore, it is an industry that has a surprising level of brand loyalty, with buying allegiances often spanning over multiple generations of family-owned farms. We bought the shares in the belief that the current market price was more anchored to short term headwinds, than long term prospects.

Asset Based Holdings

The Swedish bank, Handelsbanken, saw the benefit of higher interest rates, with the second year in a row of delivering all time high profits for shareholders. The bank is already well capitalised, and so decided to reward shareholders patience with a special dividend. Because of their use of debt markets to fund loans, higher rates have had an immediate benefit on earnings.

In direct contrast to Handelsbanken our other bank holding, Prosperity Bancshares, has a balance sheet that is structured such that higher interest rates only flow through to earnings with a lag. What unifies the two companies is that they both have very strong track records of making good lending decisions, and exemplary cultures. It follows that it was particularly jarring to see Prosperity, along with other US Banks, have to then make additional payments to the Federal Deposit Insurance Corporation last year to help cover the losses incurred at Silicon Valley Bank.

Our holding in the Airplane Leasing business, Air Lease, benefited from the delivery problems at Boeing and Airbus, as it meant that its large fleet of modern planes are in demand by airlines. Furthermore, because it placed its orders for planes many years ago, it now has coveted delivery slots for this year and beyond. Their planes are partly funded by debt, but the scarcity of new aircraft, and

their investment grade credit rating, has put them in a strong position to pass higher interest rate costs onto their customers.

Hiscox is a global insurance business and a longstanding holding in the portfolio. The company delivered record high earnings last year due to a combination of very strong insurance pricing and higher interest rates lifting their investment income. It is an example of a business that I see as high quality, but operating in an industry that is relatively out of favour with stock market investors.

Within the asset-based part of our portfolio there were no companies added or removed.

Special Situations

The biggest disappointment within this part of our portfolio has been our holding in Warner Brothers Discovery. Since Discovery merged with Warner Brothers, advertising revenue has declined and we have seen a pattern of negative earnings, but high levels of "free cash flow". This is mainly due to the company writing down media assets (TV shows and films), where there is no cash charge.

The company's free cashflow for 2023 was $6.1Bn, on a market capitalisation of $21Bn, which equates to a very high free cashflow yield of 29%. Netflix had a similar free cashflow of $6.9Bn, but has a market capitalisation of $244Bn. Hence, despite similar levels of free cashflow, Netflix is judged as being 10 times more valuable! The caveat is that Warner Brothers Discovery has a high level of debt, but is well structured with maturities stretching out as far as 2062. If we factor in this debt, by looking at their respective "enterprise values", Netflix has a valuation that is still 4 times higher.

We exited our holding in the Swedish education business, Academia. This followed an unusual sequence of events where the dominant shareholder agreed to sell their shares to a charitable entity, who immediately announced that they wanted to stop the company from being able to pay dividends to shareholders. The proposed transaction almost immediately collapsed, but we were left of the view that it was a situation from which it was best to walk away.

We added two new Japanese holdings, both of which are companies that operate sound businesses, but are saddled with heavily overcapitalised balance sheets or investments in assets that we judge as tangential to their core business. All of our Japanese holdings fit this mould, but those that we classify as special situations are the ones where our thesis is dependent on this situation changing.

The first of these two new companies was Nippon Television Holdings, which operates the second largest TV network in Japan. It indirectly owns part shares in the online recruitment businesses Indeed and Glassdoor, via a shareholding in Recruit Holdings. The company is highly cash generative, and a move to simplify its balance sheet would unlock considerable value for shareholders.

The second new Japanese company is Tsubakimoto Chain. As you might guess the company makes chains, which are used both for internal combustion engines and for other end applications such as robotics. With a price to book ratio below 1x, and much excess cash on the balance sheet, we think that there is lots of scope to return capital to shareholders as part of the current drive in Japan to make companies more shareholder friendly.

The final new holding is the FTSE 250 biotech investment company, Puretech. It has a small weight in the portfolio and represents a situation where we see it priced well below the value of its cash and cross holdings. Additionally, the company plans to use the proceeds of one of its investments having been sold (to a large pharmaceutical business) to fund a share buy back.

Turnover

The turnover in terms of the number of names was relatively high in the quarter. This was mainly driven by the combination of large price moves and our valuation discipline. Many of these holdings had smaller weights, and so the turnover in percentage terms was less extreme.

Performance

The five largest positive contributors to fund performance in the quarter were:

- Air Lease, the US airplane leasing business.
- Bakkafrost, the Faroese and Scottish salmon farming business.
- Berkshire Hathway, the famed US conglomerate.
- Hiscox, the global insurance business.
- TP Icap, the global inter-dealer broker.

The five largest negative contributors to fund performance in the quarter were:

- Warner Brothers Discovery, the global tv and film media business.
- Fresenius, the European and US Healthcare conglomerate.
- Future Plc, the global publishing and advertising business.
- Moller Maersk, the global shipping business.
- Argonaut Gold, the North American gold miner.

Going forward I intend to limit a fuller explanation of our performance to the half year and year end quarterly letters. This is inline with our view that short term performance is relatively meaningless, and allows the focus to be on the most meaningful developments in the portfolio companies each quarter.

Matthew Beddall
CEO, Havelock London

IMPORTANT INFORMATION

This is the opinion of the author at the time of writing and it may change. The company examples used are for illustrative and information purposes only. Every attempt is made to ensure this information is correct or up-to-date. This is not a recommendation or investment advice and you must not use it to make investment decisions.

Investment Risks

The value of investments in WS Havelock Global Select (the fund) may fall as well as rise. Investors may not get back the amount they originally invested. Investments will also be affected by currency fluctuations if made from a currency other than the fund's base currency. Past performance is not a reliable indicator of future results.

Potential investors should not use this document as the basis of an investment decision. Decisions to invest in the fund should be informed only by the fund's Key Investor Information Document (KIID) and prospectus. Potential investors should carefully consider the risks described in those documents and, if required, consult a financial adviser before deciding to invest. The fund can invest more than 35% of its value in securities issued or guaranteed by an EEA state listed in the prospectus.

Performance Data

All performance information is for the A-Accumulation share class, which is the longest running share class for the fund. This performance information refers to the past. Past performance is not a reliable indicator of future results. This information is denominated in GBP: returns may increase or decrease as the result of currency fluctuations.

The data in this document is sourced from the fund accountants unless otherwise specified. The data used to calculate the price to earnings ratio is sourced from Bloomberg.

Other Information

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