TROY
ASSET MANAGEMENT

Trojan Global Equity Fund Newsletter

The strategy of the Trojan Global Equity Fund is to deliver capital growth over the long term (at least 5 years) without taking excessive risks. We aim to do this by investing in exceptional companies with high returns on their invested capital, run by sensible management teams and sustained by durable competitive advantages and strong balance sheets. We intend to buy them at better than fair prices.

An extraordinary year

The Fund's recent returns are much better than we might have expected at the start of the year as many aspects of the Fund have pulled in the same positive direction. Less economically sensitive companies that enjoy dependable earnings growth have tended to outperform. These are a mainstay of the Fund. In addition, lower bond yields have lent support to many dividend-paying companies, including the Fund's holdings in healthcare and consumer staples. Finally, sterling's decline against most major trading currencies has boosted the reported returns from the Fund's overseas stocks, which are denominated in foreign currencies, as well as the holdings of U.K. multinationals that have substantial domestic costs but generate the vast majority of their sales in other geographies.

A deliberate balance

The Fund deliberately aims to strike a balance between businesses that face different opportunities and risks. Some companies are growing fast and often appear more expensive according to traditional measures of value. Others grow more slowly and may appear cheaper. In each case we seek companies that generate abundant cash flows from their operating assets whilst being run by managers that allocate capital for sustainable growth in value per share. This Newsletter highlights two of our more highly rated holdings that have performed strongly over the last three years. It does so to explain why we continue to own them, despite their richer valuations, and how we treat them in the context of the wider portfolio.

PayPal

The international online payments business PayPal became part of the Fund when it was fully owned by eBay, a company we first purchased in December 2013. Since PayPal was spun out of eBay to become independently listed in July 2015, it has become one of the Fund's largest holdings. PayPal is among the portfolio's fastest growing companies. This year, for instance, the company expects revenues to grow organically (excluding the impact from acquisitions, disposals and foreign exchange) in the high teens and profits should grow faster than this. The company made a free cash flow (FCF) margin of around 20% last year and it has over $10bn in net cash (including close equivalents) on its balance sheet. It expects to generate over $3bn in additional FCF in 2019.

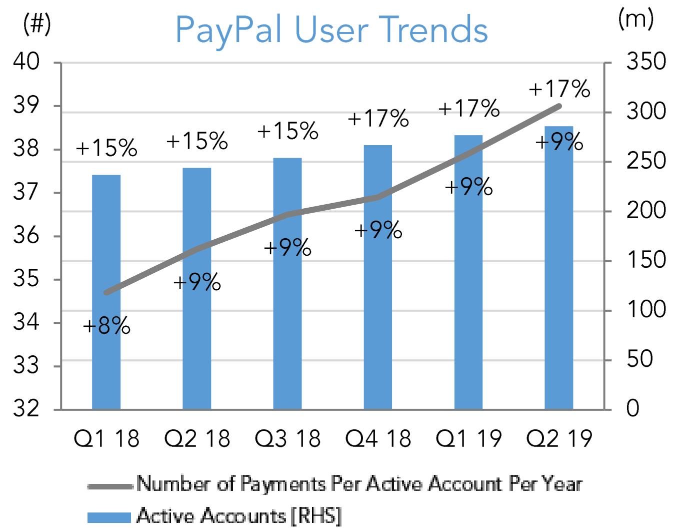
The company has a unique royalty on global e-commerce, increasingly conducted via mobile phones, an area in which PayPal excels. Online payments, particularly on mobile, remain a major source of friction for many consumers and merchants, resulting in low payment authorisation rates and high checkout abandonment. PayPal removes much of this friction with its secure, branded payment button, giving merchants twice the rate of conversion at checkout when compared to rival mobile payment wallets. We think the growth

of mobile e-commerce remains in its early stages in all parts of the world outside of China.

"I do believe that the drivers of the business are not just sustainable, but we've got the potential to do better… If you're a merchant, we have so many consumers that want to use PayPal or Venmo now as a way to pay. You almost have to be part of the network. And the same thing from a consumer perspective. We've got merchants everywhere accepting us. And so that network effect is continuing to kick in."

Dan Schulman, President & CEO of PayPal
July 2019

PayPal is already large and highly profitable and yet we clearly see the company becoming stronger as it gains in scale. This is unusual to observe. Businesses typically experience moderating growth rates as they expand because of the mathematical challenge of expanding an ever-increasing revenue base. Diversification into other, faster growing areas, a strategy often used by corporates to sustain their progress, will often come at the cost of lower margins and returns on capital. Neither pattern is happening at PayPal. Powerful network effects are taking hold to make the service more valuable to both consumers and merchants. At the same time, the company's unit economics remain robust as PayPal leverages its fixed costs. New active accounts have grown at a year-over-year rate of +17% in each of the last three quarters, an accelerated pace. Even more impressive is the number of annual payment transactions per active account which has grown very consistently too, at +9% year-over-year. This implies that the accelerated trend of new account acquisition has not diluted average user engagement, despite so many additional users being relatively new to the service.



Source: PayPal as at 24 July 2019

There are many more potential users to come. The absolute number of PayPal's active users is big at 286m, but it remains small compared to MasterCard's 2bn cards (across debit, credit and pre-paid) or over 3bn at Visa. PayPal users transact using their accounts on average less than once a week. There is enormous upside to both user numbers and user engagement and PayPal is investing aggressively to broaden its product offering and geographical presence. The company has recently expanded its relationship with Facebook as Facebook itself accelerates its own payments strategy to facilitate commerce across its properties. PayPal has struck further strategic deals with Uber and the Latin American online marketplace MercadoLibre, as well as added to its financial service capabilities. These include the enablement of person-to-person payments, including Venmo, the social mobile payments app, offline point-of-sale terminals, online marketplace merchant disbursements, bill payment and cross-border money transfers. From mid-2020 PayPal's five-year agreement with erstwhile parent eBay will end. This will immediately cost PayPal in lost business, but more positively it will free the company from a slower-growing customer to become a payment option at eBay's large online rivals, including Amazon. The

development of these emerging partnerships, the potential for others, and PayPal's excellent record for product innovation, can all combine to sustain and perhaps even add to the company's momentum.

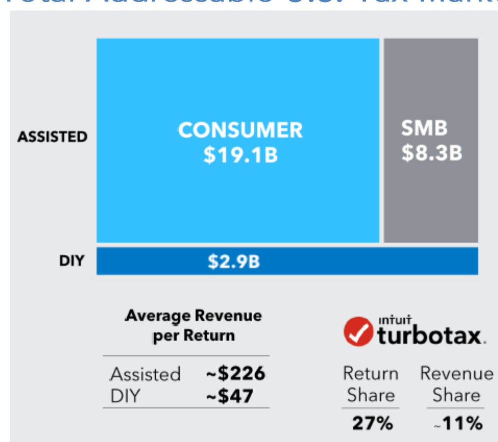
Intuit

Intuit has been held in the portfolio since July 2013 and it is another of the faster-growing companies whose shares are highly prized by the stock market. Intuit has two distinct business lines that make a roughly equal contribution to group profitability. TurboTax is the direct-to-consumer online software business that helps U.S. citizens to complete and file their annual tax returns. QuickBooks is an international accounting software business that helps small businesses manage their finances. These are in no way glamorous services and yet both perform essential functions for their customers. In each case, Intuit's products are sold at relatively low prices when compared to their competitors', and they represent a tiny cost when compared to the failure to complete an accurate tax return, or the penalties for mismanaging a small business. Intuit is by far the leader in each of its chosen fields. TurboTax is responsible for roughly two-thirds of all tax filings made via online self-assessed ('DIY') tax-filing software. QuickBooks has approximately 80% of all dedicated financial management software in the U.S.

The wonderful thing about Intuit, like PayPal, is that it still has a relatively small share of the overall opportunity that lies ahead of it. Across all tax-filing methods, TurboTax is responsible for ~27% of U.S. tax filings and collects just ~11% of the revenue generated by U.S. tax-filing service providers. QuickBooks has around 7m customers globally out of a potential ~85m small businesses based in markets where QuickBooks is currently available (there would be ~10x this amount were QuickBooks available worldwide).

Whilst these massive opportunities are also theoretically available to Intuit's smaller rivals, none have the resources, know-how and very long track record for innovation that Intuit possesses. Indeed, the scale of Intuit's indicated markets are a direct result of the company's enduring ability to carve out large new opportunities for itself. In the past couple of years Intuit has launched a version of TurboTax that integrates live, on-demand human assistance from tax professionals. This is aimed at those filers that continue to pay almost 5x the average cost of a TurboTax filing to have someone do their tax return for them. This 'assisted' tax preparation market alone generates ~$20bn in annual sales, ~7x the size of TurboTax today.

Total Addressable U.S. Tax Market



Source: Intuit as at 27 September 2018

The internet has removed the barriers to distribute software and transformed Intuit's ability to sell its software globally as a monthly online subscription. QuickBooksOnline (QBO) is already scaled in the U.S., Canada, the U.K. and Australia. Many more countries will follow. QBO has a total of 4.5m subscribers, up by +33% in the last year. Much of this is 'white space'; rather than displacing rival accounting software systems, the vast majority of QBO's new customers are converted from using

Microsoft Excel or paper-based accounting methods. Intuit has successfully launched a version of QBO specifically designed for the self-employed, and in the last year it has launched a cloud accounting software product aimed at the mid-market (those with 10-100 employees). As with TurboTax, the revenue opportunity in Intuit's Small Business Group, which includes QuickBooks, is many multiples the size of its current business.

QuickBooksOnline Global Opportunity

COUNTRY	TAM	SAM	FY'18 QBO SUBS	QBO SUBS GROWTH
U.S.	65M	48M	2.6M	38%
U.K.	5M	5M	305k	84%
Canada	3M	3M	212k	41%
Australia	3M	3M	161k	55%
Brazil	34M	17M	40k	83%
France	4M	3M	9k	372%
India	100M+	7M	34k	60%
Rest of World	600M	NA	54k	43%
Total	**800M+**	**85M**	**3.4M**	**43%**

Source: Intuit as at 27 September 2018

Intuit is one of the most profitable companies in the portfolio and generates FCF margins over 30%. The company has over $2bn in net cash on its balance sheet. We are confident that Intuit can continue to grow its revenues >10% p.a., perhaps even accelerating as the faster-growing Small Business Group becomes a bigger part of the total. Intuit's profits should also expand faster than its sales thanks to a well-invested asset base and low incremental costs.

What to do with highly-rated stocks?

There can be no doubt that Intuit and PayPal's attractions are better appreciated today and their shares are more richly valued. Both have FCF yields of around 3%, significantly below the Fund's weighted average. We liked them better when they were cheaper. Whilst it is tempting to sell our shares and hope to repurchase them at lower valuations, we doubt our ability to perfectly time our trading. Valuation alone is usually a poor reason to sell a business whose operations are performing well, and we are loathe to abandon great businesses once we own them. In our experience, these companies have an unpredictable propensity to deliver their owners pleasant surprises, the compounding of which is essential to achieving the returns we target. Our practice, therefore, is to retain the shares of companies that appear temporarily expensive so long as the fundamentals remain exceptionally compelling. We have not added to the holding of Intuit since October 2016 and we have not added to the holding in PayPal since February 2017. Since these dates Intuit's shares have returned +177% (+42% p.a.) and PayPal's have returned +160% (+46% p.a.), slightly more when these returns are translated into sterling.

We acknowledge that the near future for these individual investments may be bumpier than the average in the portfolio. The stock market will be especially sensitive to their flow of news, both positive and negative, and we are particularly vigilant for any competitive and regulatory threats that might diminish our positive view of these companies.

There is always something else to do

There is a prevailing assumption that all good quality businesses are priced in the same way as PayPal and Intuit. This is not our experience. We continue to be encouraged by the availability of very cash generative businesses at what we believe to be appealing valuations. This is where we have added to the Fund's holdings. Cheaper valuations often occur in unison with more controversial circumstances than those in which PayPal and Intuit find themselves. We have described investments in Alphabet and Facebook in previous Newsletters and we have continued to add to the holdings in these two companies in the last 12 months. Elsewhere, we have added to our healthcare investments over the past year –

Becton Dickinson, Medtronic, Novartis and Roche. These are more mature businesses growing steadily at around +5% p.a. organically. They also have FCF yields that are closer to the Fund's weighted average, and in the case of the pharma companies, Novartis and Roche, well above it. Likewise, the investment in Booking Holdings, the owner of online travel agent booking.com, has increased at what we believe to be an attractive FCF yield. We believe the company can grow its earnings per share at low double-digit rates with FCF margins over 30% and net cash on its balance sheet.

Outlook

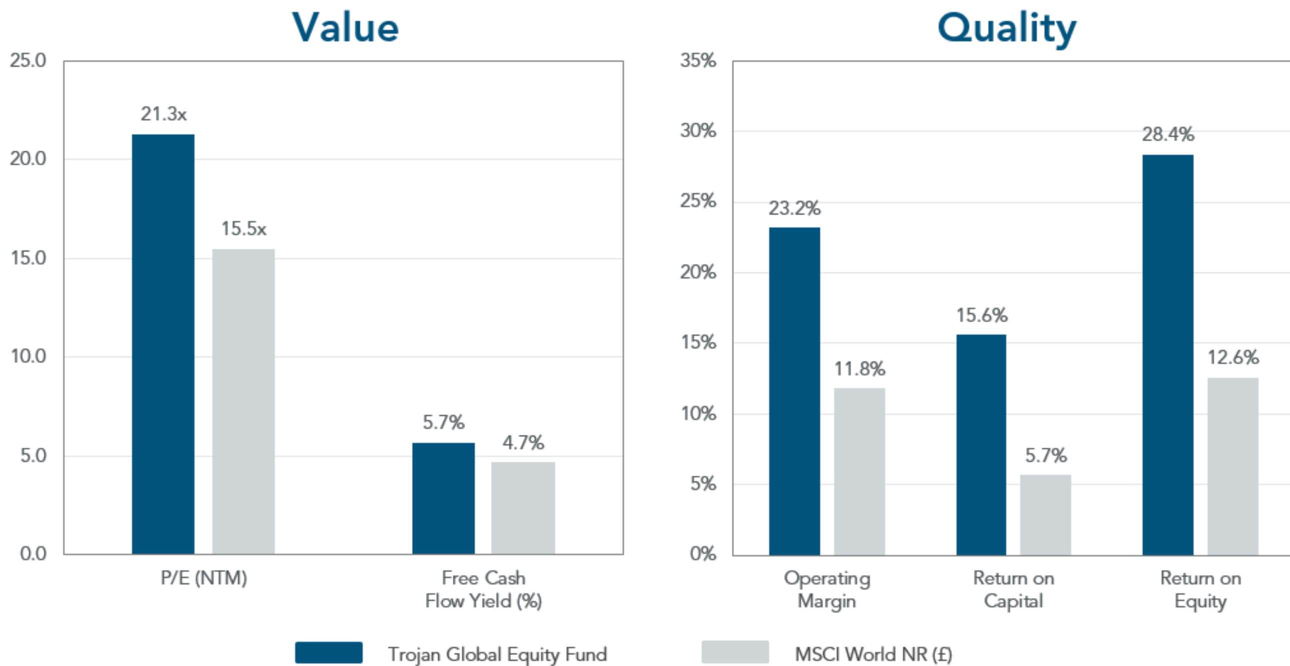
The Fund's strong returns in recent months give us pause for thought, particularly in the context of mixed economic and political news. The stock market volatility during the last year reminds us that equity returns are lumpy, and there will, of course, be occasions when reported returns are significantly lower than they are today. The strategy would probably fare less well if the benign conditions described earlier were to reverse – should investors take a more positive view on the business cycle and inflationary forces, show greater acceptance for companies with more variable earnings growth, or gravitate towards the cheapest stocks as measured by earnings multiples, dividend yield or book value. A sustained bout of strength from sterling would also likely hurt the Fund's results.

Over longer stretches of time we continue to believe that investors are well served by a tight collection of globally diversified companies that predictably produce tremendous amounts of cash as they grow. The march of technological change continues apace, leaving no company or industry unaffected. Managing this disruption is an increasingly urgent component of our investment thinking. We aim to avoid capital-intensive, cyclical or levered companies, or those that are experiencing material technological disruption to their business models.

The average valuation ratios for the Fund have moved higher with share prices. We are, however, encouraged that the FCF yield for the Fund remains fair in aggregate and above that of global equities in general (as measured by the MSCI World Index NR (£)). The overall financial productivity of the companies held in the Fund is as strong as ever.

Gabrielle Boyle and George Viney
September 2019

Appendix I – Valuation and Returns



Source: Bloomberg, 31 August 2019. All references to benchmarks are for comparative purposes only.

Appendix II – Fund Statistics

Performance (net)	2014	2015	2016	2017	2018	2019 YTD	1 Year	3 Year Ann.*	5 Year Ann.*
Trojan Global Equity O Acc	**+15.0%**	**+12.3%**	**+19.2%**	**+13.2%**	**+1.1%**	**+28.2%**	**+17.9%**	**+14.6%**	**+16.2%**
MSCI World NR (£)	+11.5%	+4.9%	+28.2%	+11.8%	-3.0%	+20.4%	+7.0%	+12.3%	+12.9%
IA Global (TR)	+7.5%	+4.1%	+24.4%	+13.8%	-5.6%	+19.5%	+5.2%	+11.1%	+11.4%

Past performance is not a guide to future performance.

*Annualised Return

Source: Lipper – O Accumulation shares total return net of fees since launch to 31 August 2019. All references to benchmarks are for comparative purposes only. The Trojan Global Equity Fund became a constituent of the IA Global Sector from April 2012. Previously, the Fund was in the IA Flexible Investment Sector from launch.

Portfolio Summary	
No. of Holdings	31
Total Equity Exposure	94%
Top 10 Holdings	50%
Top 20 Holdings	78%

AUM	£m
Strategy	404
Fund	295

Sector Breakdown	
Consumer Staples	24%
Information Technology	23%
Health Care	21%
Communications Services	9%
Financials	7%
Consumer Discretionary	6%
Industrials	4%
Cash	6%

Top 10 Holdings	
Microsoft	6.5%
Alphabet	6.1%
Medtronic	6.0%
Visa	5.6%
PayPal	5.3%
American Express	5.1%
Novartis	4.4%
Becton Dickinson	4.0%
Experian	3.7%
Roche Holdings	3.6%

Top 5 Contributors YTD	Contribution to Return*	Total Return
Microsoft	+2.6%	+43.6%
Visa	+2.2%	+44.0%
PayPal	+2.0%	+35.6%
American Express	+1.8%	+33.5%
eBay	+1.5%	+51.8%

Country Breakdown	
North America	65%
Europe	16%
UK	12%
Asia (inc. Japan)	1%
Cash	6%

Bottom 5 Contributors YTD	Contribution To Return*	Total Return
Reckitt Benckiser	+0.2%	+9.1%
Alcon	+0.1%	+11.5%
Johnson & Johnson	+0.1%	+6.2%
Altria	-0.0%	-4.6%
Japan Tobacco	-0.0%	-4.1%

Liquidity[#]	
1 Day	98.1%
5 Days	100.0%

Source: Factset, Bloomberg and Troy Asset Management Limited, 31 August 2019. Asset Allocation and holdings subject to change.
*Stock contribution to return is provided as gross absolute returns and does not include the Fund's charges and fees. The reference to specific securities is not intended as a recommendation to purchase or sell any investment.
[#]Liquidity is monitored by calculating what proportion of the equity portfolio can be sold, assuming trading at 20% of the previous 30 days' average daily volume.

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