



Trojan Global Equity Fund Newsletter

The strategy of the Trojan Global Equity Fund is to deliver capital growth over the long term 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.

Performance review

We often say to investors that the Fund's historical pattern of performance, broadly, keeps up with markets when they rise and performs better when markets retreat. The last 12 months are a good illustration of this. From the end of February last year to the MSCI World Index (net TR, £) peak in August, the Fund returned +12.4%, just under 1 percentage point ahead of the MSCI World Index (net TR, £), which returned +11.5%. Then, from the peak in August to the low in December, the Fund performed better than the market by a margin of 6 percentage points. In the 12 months to the end of February, the Fund has returned +9.3%, comfortably exceeding the return of +4.0% for the MSCI World Index.¹

Troy's founder, the late Lord Weinstock, stated at the firm's outset: 'our aim is to protect investors' capital and to increase its value year on year'. This very simple proposition gets to the heart of what we are trying to do – preserve capital and grow it, in that order, over many years. Over shorter periods, there will be some volatility for any full-invested equity fund, but

the capital preservation part is achieved by trying to avoid the common errors that frequently lead to permanent losses; weak business models, excessive debt and egregious prices. Over longer periods, however, 'winning by not losing' will only get us so far.² To achieve capital growth year-on-year we need to be invested in companies that consistently grow their value. The remainder of this newsletter addresses this second part of Weinstock's mission.

The quality and duration of growth

There are two important aspects to the way we think about growth that distinguish our approach from others. First, most investors and corporate managers will focus on sales and earnings as indicators of growth, however, these measures don't say an awful lot about the quality of that growth or its durability. Many industries, including autos, energy or telecoms, will enjoy expanding demand for their products and services, leading to rising sales and earnings, only to result in a modest increase in cash once all costs are paid. We believe growth here creates little lasting value for owners. By contrast, the companies we prefer tend to produce high levels of cash because they have sustainably high profit margins which allows them to fully fund their growth and still have plenty of cash left over. The weighted average free cash flow (FCF) margin for the Fund is 24%, which compares to just 9% for the MSCI World Index.³ This cash-flow advantage means that our companies have the flexibility to make further highly attractive investments back into their

¹ Source: Lipper

² The phrase 'winning by not losing' when applied to investing is most closely associated with the writing of Charles Ellis. See, for instance, *Winning the Loser's Game, 6th edition: Timeless*

Strategies for Successful Investing (McGraw-Hill Education, 2013)

³ Free cash flow is defined as operating cash flow after interest, tax and capital expenditures. Free cash flow margin is free cash flow as a percentage of revenue.



businesses, reduce their debt or return excess cash to shareholders.

The other distinguishing aspect of our method is to target companies that operate in large and growing markets. It's no good having wonderful cash margins if there are few places to reinvest and grow at similarly high rates of return. Traditional TV companies and certain retailers are two such sectors where growth has stalled.

Over the last five years, the Fund has increasingly invested in a carefully selected group of software, payments and digital advertising companies that all enjoy high rates of profitability and runways for expansion that stretch long into the future. In each instance, the global development of the digital economy is having a profound and positive impact on these industries' growth rates. Smartphones connected to high-speed internet connections have lowered the costs of distributing their services and increased their reach around the world. Already big companies have the potential to become much bigger. Visa, Alphabet and Microsoft, three of the Fund's largest holdings, best illustrate a phenomenon that is having an impact on all the companies in the portfolio.

Payments: Visa

Between Visa, American Express and PayPal the Fund has 16.2% invested in the payments sector. For all three companies, e-commerce is accelerating with the conversion of cash and cheque payments to digital transactions. Visa is twice as likely to be a payment method in an online transaction as it is for an offline transaction and e-commerce is growing three times faster than offline retail. In the US, Visa's biggest single market, the company has recorded accelerating US debit volumes for the last five quarters, helping Visa generate +13% revenue growth in the last three months.

And whilst stronger economic conditions certainly help, it would be wrong to dismiss Visa's strength as cyclical. There is huge opportunity for Visa to outgrow consumer spending, even in more developed economies such as Japan and Germany where the use of cash remains stubbornly high. E-commerce is only 12% of consumer purchases globally and cash and cheque payments represent as much as 80% of all global transactions. In emerging markets, the opportunity for Visa is nascent. In India, for instance, where Visa has more than half the market for debit and credit payments, cards are a small percentage of total transactions, growing for Visa at over +30% year-on-year. Around the world, technology is a tailwind for Visa's growth in other ways. Entirely new digitally-enabled services such as Airbnb and Uber ride on established payment rails, including Visa's, whilst contactless ('tap and pay') payment terminals are helping to penetrate smaller everyday transactions, including bar bills and parking meters. Contactless payments are only set to get going in the US by the end of this year.

"The amount of cash that exists on the planet today has grown. So the resources that we tap into that fuel our growth as it relates to cash conversion is a greater opportunity than it's ever been... I think what's emerged, and I think is at times underappreciated, is we've seen in the digital economy consumer behaviour shifting more rapidly away from physical world commerce to virtual commerce. And it's not just happening in the most developed economies of Western Europe and in North America; it's happening globally... and with that, when you move from physical world to virtual, we by definition pick up market share."

Bill Sheedy, Visa's SVP of Strategy
December 2018

The beauty of Visa's business model is that it costs very little to process every additional

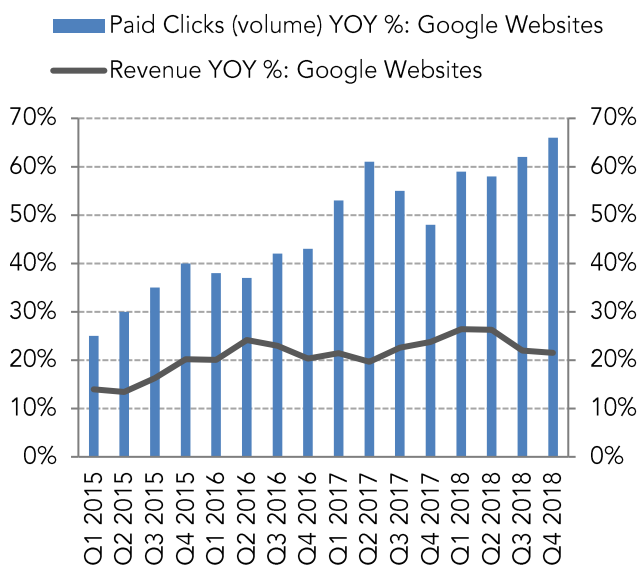


transaction taking place over its network. At 58%, the company has by far the highest free cash flow margin of any company in the portfolio, whilst carrying minimal amounts of net debt on its balance sheet.

Digital advertising: Alphabet

Digital advertising follows and anticipates the flow of money and attention online, supporting the growth of Alphabet (the holding company of Google) and Facebook, the world's two dominant digital ad leaders. These two companies are another 8.7% of the Fund. Conventional analysis assumes that digital advertising (search, banner ads, video ads) will inevitably mature as it displaces traditional forms of advertising (print, radio, TV). This line of thinking is increasingly challenged by Google's accelerating volume growth, despite already having over \$100bn in annual advertising revenue. In the latest quarter, paying traffic on Google's own properties (led by search and YouTube) grew +66% and its revenues grew at +20% or more for the 13th quarter in a row.

Google Sites Volume & Revenue



Source: Bloomberg, 28 February 2019

Google's incredible growth at such scale only makes sense if digital advertising, particularly

search, is conceived in far broader terms. Google's search engine gives retailers of all sizes visibility on the web, much in the same way as a shopping centre hosts retailers in return for rent, and retailers give manufacturers physical shelf-space in return for volume-related discounts (a form of marketing called 'trade spend'). Mobile phones allow users to shop wherever they are, around the clock, and in marketplaces for both goods and services. The integration of Google search and maps also blurs the distinction between online and offline commerce. These markets for advertising, retail real estate and marketing mean that Google's core properties participate in global industries that are collectively valued in the trillions rather than billions. This is to say nothing of Alphabet's more recent efforts to apply advanced computer science to other huge industries, notably enterprise computing, autonomous vehicles and healthcare. A heavy rate of investment to hire more people and build out infrastructure is weighing on Alphabet's profits and cashflows, a cause for concern among some analysts. In our view, these investments give Alphabet the opportunity to grow at high rates for many years to come, and they are made from a position of great financial strength. In the latest quarter, Alphabet's FCF margin was still a very healthy 15% after capital expenditure almost doubled in the last year. The company has as much as \$105bn in net cash on its balance sheet.

Software: Microsoft

Microsoft is the Fund's largest single investment, representing 6.2% of assets, and investments in other enterprise software companies (Fiserv, Intuit and Sage) account for a further 6.5% of the portfolio. Microsoft has been held in the Fund since 2010, and our confidence in the company's prospects has grown as we've come to appreciate the vast opportunities that still lie before it. The delivery



of software services in the cloud improves Microsoft's capacity for growth along two dimensions. First, it renews existing business relationships with enterprise customers on improved terms. Selling Microsoft's Office suite as an online subscription lowers piracy rates, helping volume growth and pricing power, and enables the seamless integration of new services for collaboration, security and data analysis. Office is generating higher average revenues from each user at a time when the base of commercial users continues to grow in the high-single digits. As the number of white-collar workers requiring Microsoft's tools grows around the world, led by emerging markets, Microsoft is developing software for a far larger pool of workers that are not typically found in carpeted buildings. Postal workers, retail assistants and residential gas engineers, among many others, are adopting a stripped-down version of Office, dramatically increasing the division's potential.

Second, the cloud creates entirely new opportunities for Microsoft to grow. Cloud computing represents a generational shift away from enterprises owning their own data-hosting infrastructure and towards an outsourced, rental model that is centrally hosted. Microsoft's Azure cloud services platform, together with Amazon Web Services, is one of only two public cloud providers that operate at global scale.⁴ Azure is already over a \$10bn business, but growth of +76% in the last quarter indicates its immaturity in a worldwide enterprise computing market that is estimated to be worth as much as \$1.8 trillion.

"It's a tectonic shift. 26 years at Microsoft and I've lived through DOS to Windows and I lived when Office was created. This might be the biggest one I've ever seen even with that kind of background. So the TAM [Total Addressable

Market] is absolutely huge and we are no question taking share and growing."

Jason Zander, EVP of Azure
November 2018

Azure powers all Microsoft's other cloud services, including Office and the gaming business. This is important because Azure's improving economies of scale benefits unit profitability for all of Microsoft's cloud applications, underpinning overall group profit margins. For this reason, Microsoft's double-digit revenue growth is translating into double-digit gains in profits. And whilst Microsoft is another company, like Alphabet, which is investing heavily in physical infrastructure, weighing on the growth of FCF, it has the FCF margins (29%) and balance sheet (\$42bn net cash) to comfortably afford this elevated level of spending.

The price for growth

Some of you reading this might wonder if all this growth is already captured in these companies' share prices. Visa, Google and Microsoft are well-known and popular companies and we don't pretend they're a bargain. Our enthusiasm instead derives from an appreciation of their capacity for durable and cash-generative growth. This persistent quality is rarely fully captured in popular measures of value, which tend to look forward at earnings by just a year or two. Visa's performance over the last five years is instructive.⁵ The company's shares have never been optically cheap, but that hasn't stopped them being a wonderful investment over this period. They have returned +27% p.a. and over 225% in total, and whilst some multiple expansion has certainly aided returns, just over 80% of it has come from compounded growth

⁴ Google Cloud Platform aims to be the third, but it currently lags the other two by some distance.

⁵ The Fund has not owned this stock for the whole duration, first purchasing in September 2016.



in earnings, cash and dividends.⁶

VISA	5 Year CAGR*	
Revenue	12%	
Earnings Per Share (Adj.)	19%	
Quarterly Dividend per Share	25%	
Total Shareholder Return	27%	
	2013	2018
FCF Margin**	59%	58%
ROIC	16%	18%
P/E (NTM)	21x	27x
FCF Yield**	5.7%	4.0%

*From 30/09/2013 to 30/09/2018, corresponding to Visa's fiscal year

**Excludes litigation expenses for 2013

Source: Bloomberg, 28 February 2019

We believe Visa, together with the other two companies profiled here, has the potential to continue its fine record of operational growth. And even if we were to experience some modest contraction in valuation multiples, the company can still generate attractive double-digit prospective returns for its investors.

Outlook

The outlook for the global economy and stock markets is as confusing as ever, and we acknowledge that many risks remain capable of compressing stock markets in the near term. Yet we are also encouraged by the resilience of the companies in the Fund. They enjoy growing patterns of demand for their essential products and services, whilst generating tremendous amounts of cash. These are features that take on protective qualities at times of uncertainty. Over longer periods, the Fund's capital growth will depend on companies that include Alphabet, Microsoft and Visa taking advantage of the many big opportunities that lie ahead of them. We see

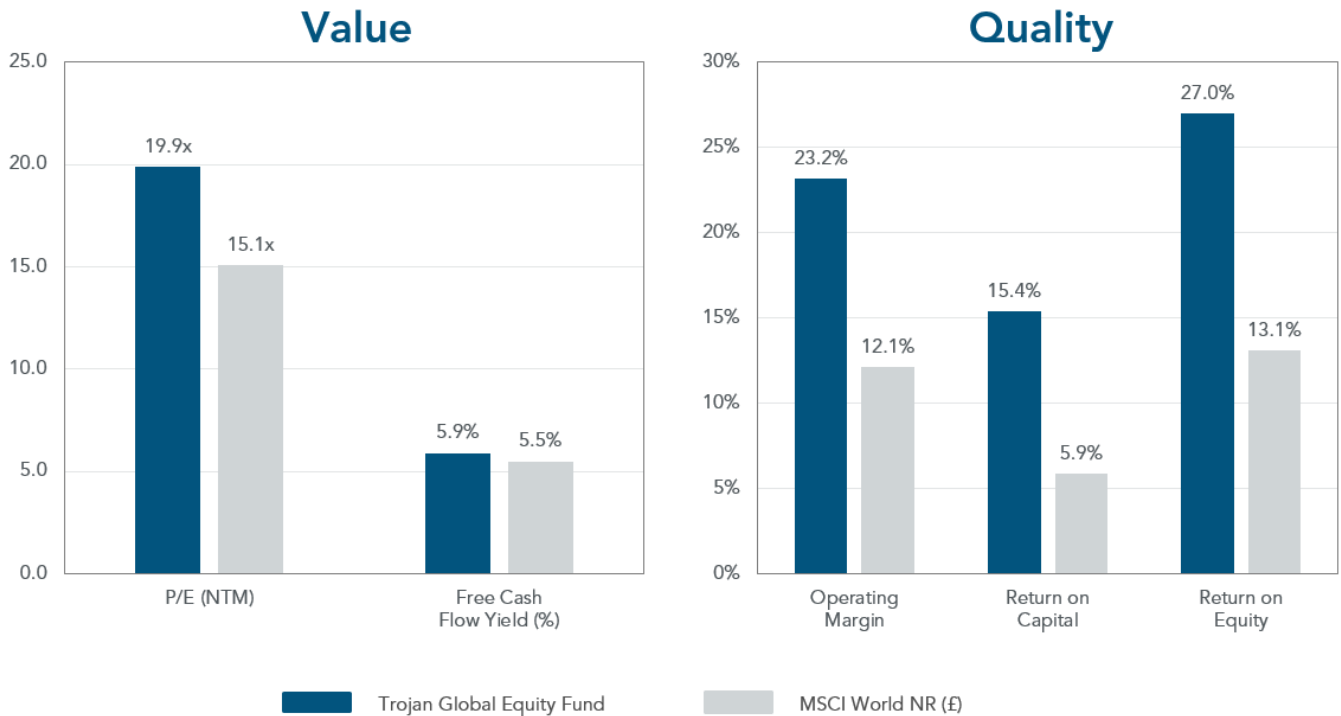
this portfolio of exceptional businesses as capable of performing both roles; protecting investors' capital and increasing its value year on year.

Gabrielle Boyle and George Viney
March 2019

⁶ Share price returns in US dollars. Currency movements during the period have increased returns for sterling-based investors, returning over 300%.



Appendix I – Valuation and Returns



Source: Bloomberg, 28 February 2019. All references to benchmarks are for comparative purposes only.

Appendix II - Top 10 Holdings

Top 10 Holdings	% Fund
Microsoft	6.2
PayPal	5.6
American Express	5.3
Alphabet	5.3
Visa	5.2
Medtronic	4.9
Novartis	4.7
Becton Dickinson	3.9
Experian	3.7
Roche Holding	3.4
Total Top 10	48.2
21 other holdings	45.0
Cash & equivalent	6.8
Total	100.0

Source: Troy Asset Management Limited, 28 February 2019. Asset Allocation and holdings subject to change.



Disclaimer

All information in this document is correct as at 28 February 2019, unless stated otherwise. The document has been provided for information purposes only. Neither the views nor the information contained within this document constitute investment advice or an offer to invest or to provide discretionary investment management services and should not be used as the basis of any investment decision. The document does not have regard to the investment objectives, financial situation or particular needs of any particular person. Although Troy Asset Management Limited considers the information included in this document to be reliable, no warranty is given as to its accuracy or completeness. The views expressed reflect the views of Troy Asset Management Limited at the date of this document; however, the views are not guarantees, should not be relied upon and may be subject to change without notice. No warranty is given as to the accuracy or completeness of the information included or provided by a third party in this document. Third party data may belong to a third party.

Fund performance data provided is calculated net of fees unless stated otherwise. Past performance is not a guide to future performance. All references to benchmarks are for comparative purposes only. Overseas investments may be affected by movements in currency exchange rates. The value of an investment and any income from it may fall as well as rise and investors may get back less than they invested. Any decision to invest should be based on information contained in the prospectus, the relevant key investor information document and the latest report and accounts. The investment policy and process of the fund(s) may not be suitable for all investors. If you are in any doubt about whether the fund(s) is/are suitable for you, please contact a professional adviser. References to specific securities are included for the purposes of illustration only and should not be construed as a recommendation to buy or sell these securities.

The fund(s) is/are registered for distribution to the public in the UK and Ireland but not in any other jurisdiction. The distribution of shares of sub-funds of Trojan Investment Fund ("Shares") in Switzerland is made exclusively to, and directed at, qualified investors ("Qualified Investors"), as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended, and its implementing ordinance. Qualified Investors can obtain the prospectus, the key investor information document(s) (edition for Switzerland), the instrument of incorporation, the latest annual and semi-annual report, and further information free of charge from the representative in Switzerland: Carnegie Fund Services S.A., 11, rue du Général-Dufour, CH-1204 Geneva, Switzerland, web: www.carnegie-fund-services.ch. The Swiss paying agent is: Banque Cantonale de Genève, 17, quai de l'Île, CH-1204 Geneva, Switzerland.

In Singapore, the offer or invitation to subscribe for or purchase Shares is an exempt offer made only: (i) to "institutional investors" pursuant to Section 304 of the Securities and Futures Act, Chapter 289 of Singapore (the "Act"), (ii) to "relevant persons" pursuant to Section 305(1) of the Act, (iii) to persons who meet the requirements of an offer made pursuant to Section 305(2) of the Act, or (iv) pursuant to, and in accordance with the conditions of, other applicable exemption provisions of the Act. This document may not be provided to any other person in Singapore.

Issued by Troy Asset Management Limited, 33 Davies Street, London W1K 4BP (registered in England & Wales No. 3930846). Registered office: Hill House, 1 Little New Street, London EC4A 3TR. Authorised and regulated by the Financial Conduct Authority (FRN: 195764).

Copyright © Troy Asset Management Ltd 2019