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GLOBAL EQUITY SHAREHOLDER YIELD – STRATEGY UPDATE AS OF 5/8/20

New Holdings

- A global technology company that released a solid earnings report demonstrating strong growth in its services business in a flat handheld environment and announced the second iteration of one of its lower price point phones, which should drive growth. The company pays a dividend, repurchases its shares and consistently generates strong free cash flow.
- A multinational telecom company serving Europe, Africa and the Middle East that is expected to generate single-digit organic growth and has demonstrated the ability to grow in a highly competitive market environment. Free cash flow is growing faster than operating cash flow and could increase if the industry consolidates. The dividend is well covered and has been reiterated.
- A large ski resort operator (re-initiated) that had suspended its dividend for two quarters in April, but that we believe the company is well positioned to navigate the downturn, given its strong balance sheet and liquidity position. We are confident the company will reinstate an attractive dividend policy once conditions normalize.

Closed Positions

- A large bank who's competitors in its home country announced modifications to their dividend policies, given the challenging operating environment for banks focused on the local/regional market(s), we became less confident in the bank's ability to sustain its dividend.

Health Care Review

Our exposure to the sector has increased since the beginning of the year as we continue to find compelling companies that exhibit shareholder yield attributes. We are currently slightly overweight relative to the MSCI World Index, an outcome of our bottom-up research-driven investment process.

- We seek companies with strong, consistent and growing cash flow that allocate the cash flows through capital distributions to shareholders and reinvestment to support future cash flow growth.
- Free-cash-flow coverage of the dividend is the primary metric we look at across the sector.
- We favor companies that are driving growth through unit volume rather than price increases as well as those that are addressing unmet medical needs and improving access and quality of care.

Pharmaceuticals (~80% of our health care weight)

- Business fundamentals and capital allocation policies align well with our investment philosophy.
- Cash flows are robust and sustained by brand equity, drug efficacy, multi-year patent protection, product innovation, business-line diversification and scale-based cost advantages.
- Moving toward volume growth rather than raising prices.
- Cash flows can grow at a mid-to-high single digit rate over the next few years, driven by solid revenue growth and operating leverage on fixed costs.
- These companies often return a significant portion of cash flows to shareholders through attractive and well-covered dividends, buybacks and debt reduction.
- Some tailwinds and revenue growth drivers include: aging and growing populations; rising income levels and improving access to health care and medicines; progress and focus on rare and specialty diseases; regulatory processes in key markets becoming more accommodating, with faster approvals
- Several companies in the portfolio (GlaxoSmithKline, Pfizer, Merck, Sanofi and Takeda) have vaccine businesses that complement their core pharmaceutical business, allowing the COVID-19 pandemic to be an opportunity for these companies to appear as heroes instead of villains.
- The majority of our pharmaceutical holdings reiterated their guidance for 2020.

Biotechnology

- Biotech companies primarily develop medicines from living organisms, a large difference from pharma which deals with chemical compounds, though the lines have become blurred.
- Most biotechs do not pay dividends as they require significant capital spending for R&D.
- We look for companies that have made it past the proof-of-concept phase and generate strong cash flows supported by a diversified portfolio of on-market drugs.
- We focus on monitoring patent expirations for key drugs and their potential impact on cash flows as well as product pipeline opportunities to drive future growth.
- Amgen and AbbVie are examples of biotech companies held in the portfolio.

Health Care Equipment and Services

- Includes firms that operate a wide range of business models throughout the health care value chain, including drug distribution, lab testing, equipment manufacturing and managed care among others.
- We look for companies that are improving the quality of patient care; improving the health of the population; and reducing the per-person costs of health care.
- UnitedHealth Group (UHG) is a diversified, U.S. managed care company with two businesses – UnitedHealthcare (health insurance benefits) and Optum (health services); it is held in the portfolio.
    - Uses the scale of its insurance business to negotiate lower drug prices and other concessions from providers to lower premiums for members.
    - Doctors are incentivized to provide value-based care rather than volume-based care.
    - Optum has vast amounts of data it uses to engage with patients.
    - We expect double-digit cash flow growth with increasing Medicare and Medicaid payers.
    - The dividend has been growing by 20%, and the company buys back shares.

Portfolio Example: Johnson & Johnson

J&J is the world's largest health care company, with a diversified group of global businesses – pharmaceuticals, medical devices and consumer products, which account for approximately 50%, 40% and 10% of earnings respectively.

- J&J generates annual sales of over $80 billion, which are growing and geographically balanced.
- The ~3% dividend yield is well covered by free cash flow at two times.
- J&J generated ~$20B of free cash flow and paid ~$10B in dividends over the past twelve months.
- The company declared a 6.3% dividend increase in April, demonstrating the board's confidence in the sustainability and growth prospects of their cash flows.
- Its high-single-digit cash-flow growth is primarily driven by its innovative pharmaceuticals business, which is expected to account for ~75% of the forecasted revenue growth over the next five years.
- Oncology and immunology therapeutic areas are expected to drive growth over the next several years – oncology is a huge opportunity for the company and is the industry's fastest growing area.