EQUITY STRATEGY REVIEW
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International Equity

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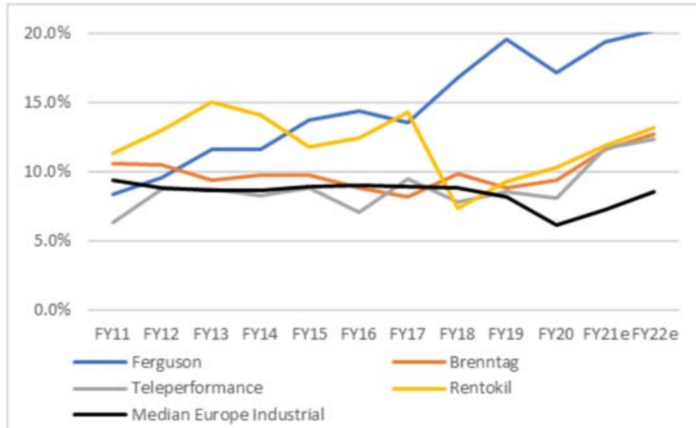
The series of supply chain disruptions that have impacted various end markets over the course of the year have become a noteworthy consideration in equity investors' assessment of post-pandemic recovery prospects and inflation risks. The interplay of deferred demand with labor market bottlenecks and weather-related production upheavals has provided an additional layer of uncertainty around companies' operating leverage. The trade tensions of prior years had already highlighted the degree to which a multi-decade wave of intricate globalization had stretched many supply chains geographically. Currently the focus is more on the ability of these diffuse, long distance networks to react to shifting or volatile patterns of consumption. It is the potential duration, as much as the severity, of these supply side struggles that has given investors most pause for thought.

The ability to manage complexity—both strategically from an organizational perspective and with flexibility at the operational level—is a hallmark of many high quality or best in class companies. This is especially true of the businesses whose very purpose is to act as productivity-providing and cost-saving intermediaries in the areas of commercial services and distribution. The ability, through focused expertise and scale advantages, often in fragmented end markets, to simplify, safeguard, and supplement operational factors for a broad array of customers can be a lucrative business model. The end result, from a financial viewpoint, is often investible companies that boast healthy and sustainably compounding returns on capital, along with high levels of cash conversion.

Examples of "complexity champions" within our portfolio include plumbing and heating products wholesaler Ferguson, diversified chemicals distributor Brenntag, customer service outsourcer Teleperformance and pest control/sanitation specialist Rentokil. These companies are leaders in their fields and offer appreciable and cost-effective productivity solutions specific to their categories. For example, in chemical distribution the "value added" proposition does not just stop at reliable and timely supply of feedstocks and materials. Embedded services include customized batching and blending to meet customer-specific production needs thereby reducing working capital requirements and safety/certification overheads on a permanent basis.

Scale, of course, always matters within a sector context. Investors love an oligopoly and while, at first glance, the all-weather solutions providers may not appear to enjoy dominant market shares on traditional metrics, the extent to which they are privileged by relative size should not be ignored. The initial barriers to entry at the local level in such end markets are quite low and many small privately held, family firms can thrive by fishing in small but stable profit pools. However, such "mom and pop" entities rarely have the capital or risk tolerance to expand beyond their own back yards. In many cases, as technologies shift and inter-generational ownership changes, they eventually provide M&A opportunities for the established players to accelerate their own growth via bolt-on deals.

EXHIBIT 1: RETURNS ON CAPITAL EMPLOYED (%)



Source: Redburn Ideas

Looking forward, it appears likely that the competitive moats will only become wider as the fruits of full digitization—an investment that only the largest operators in their specific end markets can afford—emerge. We expect a widening gap between the digital haves and have nots in many service industries, and the prime movers are already exhibiting the ability to accelerate market share gains as a result. Existing scale advantages and network effects are likely to be enhanced by AI-enabled optimization tools and real-time digital integration with key customers. So while the likes of Teleperformance and Rentokil may only have market shares of <10% in their primary end markets, the fact that much of their competition is so fragmented means that in effect they bring a gun to a knife fight from financial and operating perspectives. Likewise, Ferguson's ability to provide multi-channel (i.e. both instore and online) fulfilment to tradesmen and homebuilders over the past 18 months has seen them outgrow a resilient market for plumbing fixtures and enjoy cross-selling gains within heating/cooling equipment.

Given that the dynamics of such businesses lend themselves to recurring and profitable capital allocation profiles with Returns on Capital Employed [Exhibit 1] that are consistently above the median level seen among the broader industrial/cyclical cohort in Europe. With inherent and hard-earned advantages that have structural and digital opportunities to become self-reinforcing over the next few years, the healthy ROCE trajectories appear poised for re-acceleration versus the broader market—irrespective of lingering economy-wide supply chain scrutiny.

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About our firm:

DuPont Capital Management is an SEC registered investment advisor based in Wilmington, Delaware. Since the firm's establishment in 1993, we've had a long history of developing global investment opportunities in both traditional and alternative strategies across equity, fixed income and alternative investments. Our investment team structure gives us the ability to be flexible and adapt to changing market conditions. DuPont Capital's focus is delivering consistent investment management results for our clients. Our history of institutional asset management is rooted back to 1942 when our former parent company, DuPont, established a pension plan for its employees. Corteva Inc. succeeded DuPont as sponsor of the DuPont Pension Plan in 2019. DuPont Capital is a wholly owned subsidiary of Corteva and continues to manage the legacy DuPont Pension Plan.

DuPont Capital's President and CEO, Valerie Sill believes in education and diversity of experience as represented in our investment teams which are comprised of PhDs, engineers, medical doctors, and scientists. We believe their global expertise creates a portfolio implementation edge that benefits our clients.

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