EDGEPOINT®

WHAT HELPS US SLEEP AT NIGHT - PART 6

March 6, 2020

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At moments of fear in the market, we regularly receive questions about how we can sleep at night given all the market volatility. In response to these inquiries over the last 12 years, we have written notes that walked through examples of businesses we owned and explained why we thought they would thrive over time. In fact, we have written five such notes over the 12 years. These notes coincided with the 2009 financial crisis (twice), the 2010 European sovereign debt crisis, the 2011 U.S. debt downgrade and the 2018 market pullback on fears that the U.S. Fed was hiking rates too quickly. These notes can be found here and were entitled, "*What helps us sleep at night*."

With all the negative headlines recently about the COVID-19 virus, we've received a few requests to update our "*What helps us sleep at night*" series. As our partners know, we don't get too fussed by noisy headlines. No one knows answers to questions like this. Instead, we focus on the performance of the businesses that make up your Portfolios. The reality is nobody knows if the markets will experience a further pullback from here, how sharp it could be or how long it might last. However, the media is full of people willing to give you their opinion. We don't waste our time (or yours) trying to forecast such things. Rather, we consider the facts surrounding the underlying businesses we own.

Five businesses that help us sleep at night

Below are some quick thoughts (with numbers based on our internal investment research) about five businesses that represent approximately 19% of EdgePoint Global Portfolio as at December 31, 2019. These are the things that we think about as we drift off at the end of the day.

- You own a stake in a 225-year-old pump and valve company. These pumps and valves help companies bring water to your tap, electricity to your outlet and natural gas to your furnace. The stock is at half the price it sold at a few years ago. It has an exceptional balance sheet and over half its profits are based on servicing more than five million of its pumps working all around the world today. Another 35% of its profits is based on the replacement of existing pumps – and when your pump needs to be replaced, you replace it no matter what's going on in the world. The company has a strong backlog of orders being executed this year regardless of what's happening in the economy. The business is growing into new markets and margins are expanding. We believe we're buying the business at less than 10x the earnings we'll see within a couple years. We think this is far too undervalued for this business and believe capital appreciation awaits the owner of this business.

- You also own a Japanese company that is one of the world's largest manufacturers of agriculture equipment and tops in rice farming equipment. In Japan, rice farming has become highly mechanized, yet in the rest of Asia much is still cultivated by hand. There are approximately 50 times more rice combines in Japan, per hectare, than the rest of Asia and 17 times more tractors per acre. If the rest of Asia matched Japan's mechanization level, the company would be more than five times larger! In a world where population is growing and both arable land and rural populations are declining, mechanization will become mandatory to drive productivity and ensure food supply. As the rest of Asia mechanizes its farming practices, the long-term growth available is unlike many companies we can find. At 11x earnings, a rational business owner would say you're getting all of this growth for free. And that's before we talk about the company's move into larger tractors in North America, expanding its construction equipment line or its autonomous tractor products. As an added bonus, the company has the best-possible colour for a tractor on the market!

- Furthermore, you own a stake in one of the world's largest connector and sensor companies. A connector is what allows signals/electricity to flow between components. A sensor detects changes in pressure, temperature, position, humidity, vibration, etc. For example, the windows, engine and steering in your car (or the Uber you use) wouldn't work without this company's connectors. Nor would autonomous driving, climate control or air bags work without sensors. Everything in the world is becoming more electronic, which means this company is growing faster than the underlying economy. Sticking with the car example, when we first bought this business, the average car on the road would use about $50 worth of the company's products. Today that number is $66 and in less than five years we believe it should be $84. Electric cars on the road today have between $120 to $500 in your company's content for each car. So, the more electric or hybrid vehicles on the road, the better for your company. The company's balance sheet is exceptional. The owners of this business take great comfort owning a business they know will continue to grow for many years to come, even in the face of many challenges. Similar companies with this type of long-term growth prospects are trading at 25x to 40x earnings, which makes no sense to us. On the other hand, you own this business at 13x next year's earnings. A rational business owner would say you're getting growth for free.

- You also own a stake in a company that makes food packaging, the plastic liners on diapers, components of surgical masks and protective medical clothing (yes, those masks and suits you're seeing all over the news). These are just a few of the hundreds of products it makes every day. This company doubled its sales over the last five years and more than doubled the earnings per share over the same time. Right now, this business has a free cash flow yield of 18%. That means if the company doesn't grow, its owners should still receive a return of 18% a year. If the company can continue to grow like it has in the past, then annual returns should be even higher than 18%.

- In the last of our examples, you own a stake in one of the world's largest railroads. Much of the raw material for the stuff you consume moves by truck or rail at some point in its life. Moving stuff on a rail is cheaper, but, from a delivery time perspective, rail has historically been less reliable than trucks. Your railroad's management team increased the reliability of its trains and the company is beginning to take share from trucks. This matters because the trucking industry is nine times larger than the rail industry, so there's a lot of market share for it to take. Even if it only captures a small fraction of the trucking market share, we think this business can double in value over five years.

Rest easy – you own great businesses

The bottom line is that we aren't losing sleep at night over headlines related to the virus, the Fed cutting interest rates or what GDP growth will be next quarter. Our focus is firmly on the long-term fundamentals of the businesses that we own. In our opinion, the long-term fundamentals of your businesses remain strong. As many of you know, we invest behind our convictions. The internal partners at EdgePoint collectively hold $322 million in company-related Portfolios – the same Portfolios you own. These attractive fundamentals help us sleep well at night and they should help you, too.

Thank you for your trust.

Tye & Geoff

For those wondering, here's the performance of our Global Portfolio since the publication of each of the previous "*What helps us sleep at night*" notes:

What helps us sleep at night	Publication date	Annualized returns Publication date to Mar. 5, 2020	Growth of $100,000 investment
Part 1	Feb. 26, 2009	14.02%	$424,978
Part 2	Dec. 7, 2009	11.31%	$299,889
Part 3	Sep. 14, 2010	12.64%	$309,162
Part 4	Aug. 9, 2011	13.76%	$302,179
Part 5	Jan. 4, 2019	1.95%	$102,278

Source: Fundata Canada. EdgePoint Global Portfolio, Series A. Total returns in C$. As at March 5, 2020.

Performance as at Feb. 29, 2020 Annualized, total returns, net of fees, in C$.	Since inception*	10-year	5-year	3-year	1-year	YTD
EdgePoint Global Portfolio, Series A	13.56%	11.40%	6.06%	3.89%	-5.03%	-9.20%

* November 17, 2008.

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Published March 6, 2020.