Barrantagh
Investment Management

Strategy Update

COVID-19: THE CHANGE CATALYST

The global pandemic has imposed significant near-term challenges on people, governments, and businesses across the globe. Looking beyond the immediate future, we outline our views on how COVID-19 may act as a longer lasting change catalyst across several industries, and how some of the companies held by our clients are well positioned to benefit.

THE CHANGES

- Containment measures used to combat the pandemic have accelerated the shift towards e-commerce for consumer purchases due to “shelter in place” requirements.
- Companies have had to rapidly deploy work from home (WFH) capability to protect their employees and continue to service their customers.
- The healthcare industry has had an enormous burden placed on it, with limitations in capacity becoming quickly apparent.
- Environmental, Social and Governance (ESG) issues will continue to rise higher on investor’s and societies’ minds as we navigate through the current crisis.

THE IMPACTS

TECHNOLOGY is a key enabler of e-commerce and WFH. Companies focusing on offering e-commerce solutions, digital payments, video conferencing applications, cyber security, data analytics, and cloud computing offerings will see demand accelerate longer term. A quote from Microsoft’s CEO last month stating, “we have seen 2 years’ worth of digital transformation in 2 months” is particularly relevant.

- Global Payments is a key enabler of digital payment technology for small and large businesses who want to accelerate e-commerce and go cashless.
- Microsoft will continue to see significant demand growth in cloud computing and remote desktop applications such as Office365 and Teams.

HEALTHCARE spending is expected to accelerate in certain areas, as the industry ramps up capacity in ICUs/urgent care to an adequate level to deal with future outbreaks. As a result, we expect to see an increase in research funding and diagnostic and testing equipment along with less political scrutiny on drug price inflation. Telemedicine and home care are also expected to play a greater role.

- Thermo Fisher is a leader in biopharma solutions, diagnostic equipment, analytical instruments, and R&D lab consumables, all of which are drivers of scientific innovation.
- Jamieson Wellness and Andlauer Healthcare are two small cap holdings benefitting from increased consumer demand for medicine, vitamins, minerals, and supplements, particularly as economies open and people resume social activities.

TRAVEL/TRANSPORTATION - An increase in working from home and a technology led reduction in business travel could result in less kilometres travelled by land and air with a direct impact on airlines, auto/air manufacturers, and mass transit. On the leisure side, families may take advantage of “drive-to” rather than “fly-to” vacations and may decide to spend more on home renovation and leisure games as they shift towards “cocooning”.

- Hasbro is the world’s largest toymaker that has built many popular brands and fictional characters over the years, allowing it to capitalize on work from home trends and the “cocooning” mindset to entertain kids.

ENERGY demand is expected to be impacted by lower than previously expected transportation requirements, which should result in a reduced break-even price for oil production. Future growth in gasoline demand could be impacted should WFH trends accelerate, and jet fuel could suffer from a communication technology led reduction in business travel needs.

RETAILERS are rushing to implement e-commerce capability to provide the full “omni-channel” offering for consumers. Even grocers have accelerated their home delivery and in-store pickup capability. Retailers not able to adapt may face long term hardship in the new environment and margins will be negatively impacted.

RESTAURANTS will have a difficult time post pandemic unless they can migrate quickly towards take-out and delivery offerings. Trends towards fast-casual/fast-food may accelerate as dine-in only becomes even more challenged.

- McDonald's has an iconic worldwide brand for quality food and beverages at value price points. It will emerge stronger due to its mobile apps, digital drive-thru menus, delivery, and in-store self-order kiosks.

REAL ESTATE companies with a retail focus are likely to be the most impacted, though asset and tenant quality will be a point of significant differentiation. Office space may face demand pressure as more people work from home, while the need for less density in office buildings to accommodate social distancing may be a slight offset. Industrial real estate should benefit from an increase in demand for more warehouse and data center space.

- Granite REIT, focused on industrial assets, has a large percentage of their properties exposed to warehousing, fulfillment and logistics which is closely tied to e-commerce and will benefit coming out of the pandemic.

TELECOMMUNICATIONS companies should benefit from increased demand for greater bandwidth to facilitate working from home, and greater streaming of home entertainment (video, gaming). An acceleration in 5G deployment by wireless carriers will enable greater usage of wireless services, which should also benefit wireless equipment suppliers.

- Telus has a strong competitive position in both wireless and wireline offerings along with some non-traditional telecom businesses related to digital customer service and healthcare technology that are well positioned for a future society more accepting of digital solutions.
- American Tower owns and operates telecommunication towers worldwide, which are leased to wireless carriers to install antenna equipment that enables efficient wireless signals.

FREIGHT TRANSPORT companies should see a benefit from e-commerce parcel delivery services via air and ground, particularly since airline passenger capacity will likely remain subdued for an extended period which represents a meaningful portion of freight hauling capacity.

- Cargojet, a small cap company with ~90% of the overnight airfreight ("middle mile") market in Canada, is seeing huge demand tailwinds from the acceleration of e-commerce, particularly as it continues to grow its strategic relationship with Amazon.

ESG issues are expected to become more important as pictures of bright blue skies or wildlife roaming the streets provide a glimpse of a world with a lighter human influence. Furthermore, companies that look out for their employees, customers, and communities can see benefits over the medium-term through improved employee and customer retention and brand equity. Lastly, executive compensation practices will come under greater scrutiny given the hardships faced by many during these challenging times, and boards that adjust bonuses to senior management will score higher going forward. A significant proportion of our holdings are well positioned here.

- Despite its small capitalization, pure-play, independent power producer Boralex, is a direct beneficiary of the continued environmental push to reduce carbon emissions and continues to see strong growth opportunities for wind power development in both North America and its largest market France.

MACROECONOMIC IMPACTS

On the macroeconomic front, with the significant amount of jobs lost to the pandemic thus far, governments have had to borrow substantial amounts to support the healthcare system and the broader economy. However, this level of spending is intended to bridge a gap and cannot be sustained longer-term. Eventually the economy will be on stronger footing, and governments will then shift towards deficit reduction. With inflation and interest rates expected to remain lower for longer, governments should be able to successfully navigate their budget situation by reducing their spending and increasing taxes. However, they will not try to pay the debt immediately but rather allow economic growth over the next decade to help offset the heavy debt load. Spending initiatives such as infrastructure have long been a focus for governments during recessionary periods, but a difficult balancing act must be navigated this time around with potential budget constraints that will remain.

Global trade had been impacted prior to the virus because of the trade war between the US and China, with this risk likely to worsen during the current recession. However, there will be a larger emphasis placed on diversifying supply chains which will result in less reliance on China and more from other emerging market countries, particularly as companies migrate from "just in time" to "just in case" with respect to their inventories and managing supply diversification.

While equity valuations remain elevated at the broader index level, there exists a notable dichotomy in markets today. Well run companies with exposure to structural growth continue to trade at high multiples while the more volatile and cyclically exposed companies remain much cheaper. In addition, profit margins have reached record levels, and therefore remain at risk of a reset to a lower level in the current environment. However, companies with the strongest business models and best management teams should see less risk to margins and be able to sustain higher multiples as a result. Furthermore, a structurally lower rate environment will also be supportive of higher valuations.

Navigating the current investment environment has become particularly challenging for investors. Our bottom up, individual stock picking is increasingly focused on the “new emerging environment”, that has been catalyzed by Covid-19. By remaining disciplined on our investment process, we look to take advantage of opportunities to invest in quality companies that are trading at reasonable valuations and are expected to come out stronger from the current downturn.