Ash Park on crystal ball gazing

The strange and frenzied investment environment of the last few years has not been the ideal setting for the steady virtues of Staples companies to shine, and the speculative climate in several asset classes seems to be distorting a generation's idea of what constitutes normal financial returns. Consumer Staples have now underperformed for six straight calendar years, the longest period in 50 years, taking their share of the market down to levels only seen at the height of the dotcom boom in the late 1990s. As we gaze into the Ash Park crystal ball, we predict this unusually rich source of compounders will start to reverse that decline in 2022, one of several trends that we've identified for the next 12 months and beyond. We also expect to see the successful navigation of inflationary pressures and a major pick-up in industry M&A. By category, we predict a Beauty sector recovery in Japan; Tequila sales to overtake American Whiskey in the US and; Tobacco valuations to re-rate on the back of share repurchases. We are excited by the prospects for our strategy this year.

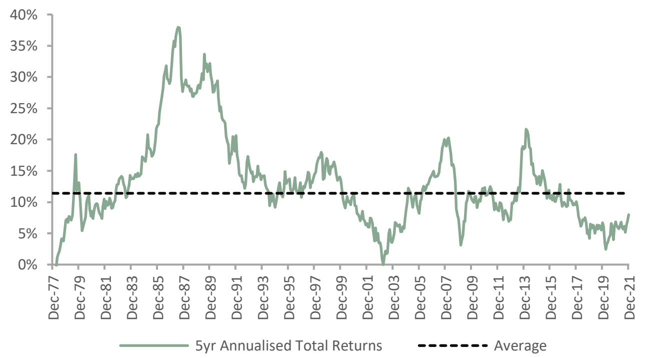
The Ash Park proposition

- Concentrated portfolio of high-quality consumer franchises
- Attractive long-term returns with lower downside risk
- Managed by experts in the Consumer industry
- Team co-invested with over 90% of their available assets

What Ash Park stands for

1. Excellence: Intellectual rigour in everything we do
2. A partnership approach: Sharing knowledge and networks
3. Shared ownership: Fully invested in the business and fund
4. Transparency: As open about mistakes as successes

Global Staples have never lost money in any 5yr period



Returns in USD for Ash Park Global Consumer Staples index, since 1977. This is a proprietary index we created to include the Food, Beverages, Tobacco and Household & Personal Care sectors but to exclude Food Retail. Source: Ash Park, Refinitiv Datastream

ASH PARK *MONSTERS OF TOMORROW*

- **High-quality smaller company franchises**
- **Long runway for growth and outsized returns**
- **Investing in ESG leaders for sustainability and social responsibility**
- **Backed by an extensive network of industry expertise**

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ASH PARK

Ash Park on crystal ball gazing

‘Fakery is everywhere’

Towards the end of last year this bold prediction – part of a full-page advertisement and not your typical sell-side year ahead fare – caught our eye over breakfast as we perused the *Weekend FT*:

“Today, as regulators dither on the sidelines, the wider financial sector is choc-a-block with greed-driven investors of all shapes and sizes. We are in an age of fantasy, where millions of people believe crypto “money” and stock market “value” can be created out of thin air, and somehow enjoy enduring worth. Others gorge on a seemingly limitless flow of central bank largesse. Fakery is now everywhere, regulation has failed and so Wirecard will not be the biggest collapse of this nutty era. Much more is to come.”[1]

Figure 1: The FT pulling few punches

Source: Financial Times

Gazing into our crystal ball

Inspired by the FT’s example, we thought we’d start the year with some predictions of our own. Our investment mindset is that it’s usually pretty futile – even dangerous – to try to be too certain what will happen in the next few months, so we’re not going to set an arbitrary deadline of 31st December 2022 for these things to come to pass: we’re much more comfortable thinking about what’s likely to happen over the mid to long term.

Our predictions are a mix of big picture and more detailed prognoses for categories of relevance to our strategy. Here goes:

- Expectations of what constitute normal investment returns will reset, and the ‘get rich quick’ mentality will fade;
- The global Consumer Staples sector is due a rebound after six consecutive calendar years of underperformance;
- Large-cap Staples aren’t dead;
- Staples’ earnings outperformance will resume, and the sector will prove its mettle as an inflation hedge;
- The disconnect between IPO / SPAC and public valuations will correct, and M&A in our sector will pick up;
- There is another important recovery leg to come in Beauty in Japan and travel retail over the next few years;
- Tequila sales will soon overtake American Whiskey for the first time ever in the US;
- The Tobacco self-help theme is just getting started.

Expectations of what constitute normal returns will reset, and the ‘get rich quick’ mentality will fade

The week before that FT ad appeared, an article in the same paper by columnist Lucy Kellaway had picked up on a related theme:

“It is registration time at a big comprehensive in Edgware, north London. Today, like every morning so far this term, the sixth form girls sit around chatting in twos and threes while most of the boys are in one large huddle. ‘I’m up over £100 in one day, bitches!’ a boy in the centre crows. Others proclaim their gains in a conversation peppered with the words shiba inu, dogecoin and Elon Musk. Their form tutor, a recent history graduate, looks on with a growing sense of unease. ‘Isn’t trading cryptocurrencies just like gambling?’ she asks them. More than half the boys in her class are Muslim and gambling is not something the Koran looks on kindly. The student in the middle gives her a scornful look. ‘Nah Miss,’ he says. ‘It’s investing’.”[2]

We feel fortunate that our own kids have so far been able to avoid the temptations of crypto trading or smartphone punting in meme stocks, although – and despite our efforts to sell them on the considerable merits of Nestlé shares – they have the curious view that buying *Pokemon* cards offers a route to financial security.

What’s more concerning is that the investing (speculative) environment of the last few years in tech or meme stocks, cryptocurrencies, and private equity and venture capital funds, seems to be distorting a generation’s idea of what constitutes normal financial returns. If something doesn’t have the potential to ‘10x’, who’s interested?

Recent returns from the broader stock market look rather pedestrian compared to the things that people get excited about, even though – at 16.1%, 13.5% and 11.5% annualised over one, three and five years, respectively – they have been well above the 50-year annual average of 10.0%[3]. And that 10%, if generated

[1] Fakery is now everywhere – *Financial Times*

[2] Crypto in the classroom: Lucy Kellaway on the kid’s new craze – *Financial Times*, 19th November 2022

[3] To be precise, for the 49 years to 31st December 2021. Figures for the Datastream World Index. Returns from the S&P500 have been a lot stronger, at 28.7%, 18.5% and 16.6% annualised over one, three and five years, respectively, compared to a 49-year average of 11.2%.

patiently over two or three decades, used to be enough for people to think they had invested very well[4].

Figure 2: Is this going to fund my care in old age?

Source: The Pokémon Company. By kind permission of Joseph Fell.

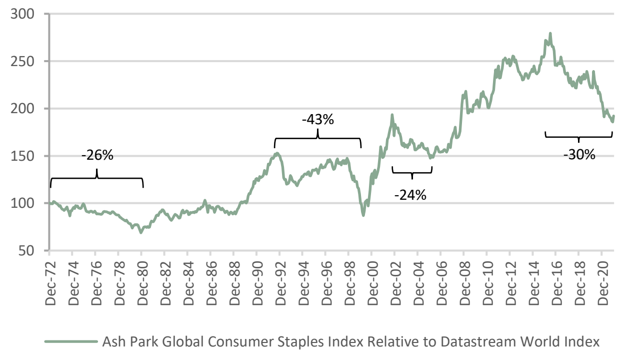
We've no wish to adopt a sour grapes or moralistic tone, nor to predict how or exactly when this is going to change, but we are convinced that it will. At some point in the next decade we are likely to look at the investing environment of the last few years and decide that it was very strange.

Consumer Staples is due a rebound after six consecutive years of underperformance

We focused our strategy on companies in the Consumer Staples sector because it's an unusually rich source of compounders. Long term returns from these companies – 11.5% annually since 1972, or 10.2% over the last 20 years – have been excellent. They sound dull compared to what people have recently come to expect, yet returns from Consumer Staples have outperformed the broader market by a significant margin over the last 50 years.

As Figure 3 shows, that outperformance has been both consistent and episodic. With hindsight, launching our strategy in October 2014, not long before the beginning of six straight calendar years of Consumer Staples underperformance (the worst run in 50 years)[5], was poor timing on our part. We still have very strong confidence in our tortoise and hare approach, but have been administered a firm reminder that the significant portion of the race where the hare disappears into the distance can feel quite painful.

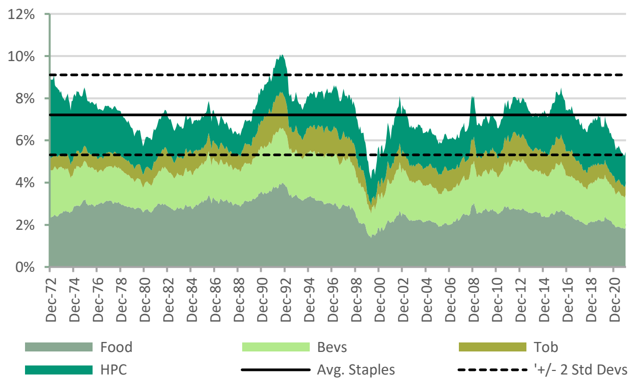
Figure 3: The long-run outperformance of global Staples



Total returns with gross dividends reinvested, USD, December 1972 = 100
Source: Ash Park, Refinitiv Datastream

The recent relative underperformance – 30% from the peak of September 2016 to the trough (so far) of November 2021 – is the second most severe of the last 50 years. One of the consequences is that by November the Staples sectors accounted for just 5.3% of global stock market capitalisation, two standard deviations below the long-run average and lower only during the peak of the dotcom bubble (Figure 4).

Figure 4: Staples % of market is 2 std deviations below average



Source: Ash Park, Refinitiv Datastream

Large-cap Staples aren't dead

We've written at length on disruption[6] and how we think the talk of big brands and big Staples companies being dead is overblown. Yet it's probably fair to say that the proliferation of smaller brand launches, itself partly the product of the last decade's investing climate, has made large companies have to work harder to generate sales growth[7].

That's one of the reasons why we decided a few years ago to increase the weighting of our strategy to slightly smaller, more

[4] At the risk of teaching granny to suck eggs: a 10% annual return generated for 25 years produces a sum nearly 11x the original investment. 'Ten bagging' isn't so unrealistic over that sort of time horizon.

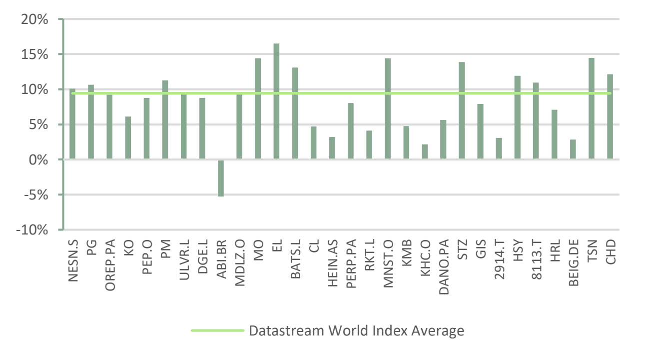
[5] The Ash Park Global Consumer Staples Index underperformed the Datastream World Index (and other commonly-used global equity indices) in each of the 2016, 2017, 2018, 2019, 2020 and 2021 calendar years. The previous worst runs were three consecutive years from 1978-80 and also 2003-5.

[6] *See Ash Park on Disruption* (Q3 2016), *Ash Park on Amazon* (Q4 2017), *Ash Park on Big Brands Being Dead* (Q3 2018), *Ash Park on Navigating Disruption* (Q1 2019)

[7] Not necessarily a bad thing for the long-term in that it's good discipline for companies to have to renew and reinvigorate themselves from time to time.

focused companies. We believe these focused companies have a longer growth runway – or larger opportunities to reinvest in their own businesses at attractive rates of return – compared to Staples mega-caps, but it would be wrong to dismiss all the larger companies as ex-growth.

Figure 5: Earnings + dividends, top 30 Staples 2015-21



Shows movement in 12-month forward consensus earnings in USD, plus the annual dividend rate, Dec 2015 to Dec 2021, for the 30 largest global Staples companies by Dec 2021 market cap (China excluded).
Source: Ash Park, Refinitiv Datastream

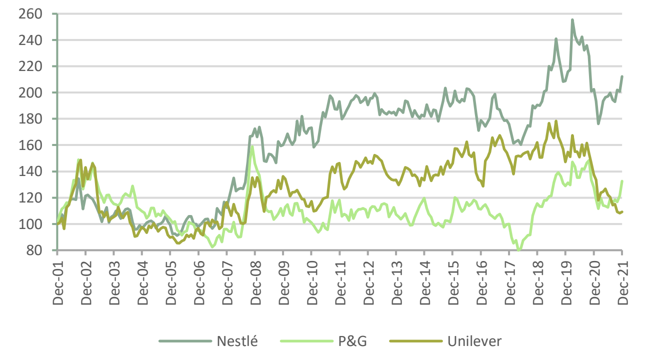
We thought we'd test the performance of the 30 largest Staples companies over the last six years by calculating their combined earnings growth and annual dividend rate: that ought to be a decent indicator of real underlying performance, since it excludes changes in stock valuations. Half of them produced a number better than the market average of 9.4% over the six years to the end of 2021 (Figure 5).

It's normal for these large companies to go through cycles and for the impact of management and portfolio change, or the influence of activist investors, to shift the course of the business from time to time. Each of the broadly-diversified giants Nestlé, P&G and Unilever has suffered at least a couple of prolonged periods of underperformance over the last 20 years. Nevertheless, over the whole period each of them has produced attractive total returns and also outperformed global equities (Figure 6)[8]. What creates the long-term outperformance is the inherent strength of the brands and market positions.

Unilever has recently attracted a lot of flak in the press and elsewhere for its approach for GSK's consumer healthcare business. We have found the tone of some of the criticism directed at management surprising in its apparent portrayal of the company as a serial underperformer: as is clear in Figure 6, the stock's underperformance has only been a recent phenomenon and has been driven at least in part by a spike in input costs which we expect to have an ephemeral impact on earnings.

That's not to say we don't have concerns, or that there aren't aspects of Unilever's strategy with which we disagree. It's our job to be worried, but we find we have more productive conversations with executives if they're comfortable that they're not going to find their remarks used later as the butt of a gag in our marketing material.

Figure 6: Mega-caps have been long-term outperformers

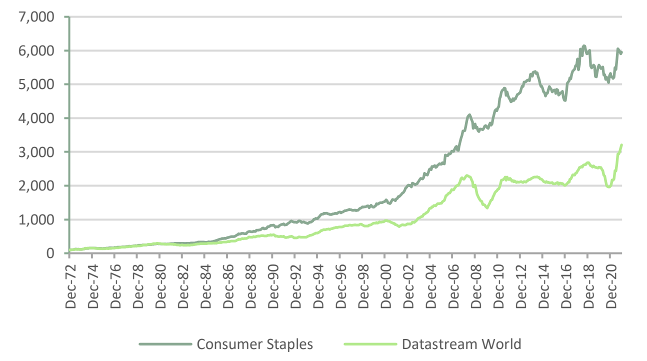


Total returns in USD, relative to Datastream World Index. Dec 2001 = 100
Source: Ash Park, Refinitiv Datastream

Staples' earnings outperformance will resume, and the sector will prove its mettle as an inflation hedge

The long-run outperformance of Consumer Staples has been driven by superior earnings growth. Staples' earnings have actually lagged the market over the last six years, but the whole of that gap emerged in the last nine months (Figure 8)[9]. Earnings for the broader market have benefited from a very strong rebound after the initial hit from Covid lockdowns, and you'd expect a defensive sector like Staples to lag during a period of strong growth; Staples generally gains most ground during recessions.

Figure 7: Earnings drives Staples' long-run outperformance



Trailing earnings indexed to December 1972
Source: Ash Park, Refinitiv Datastream

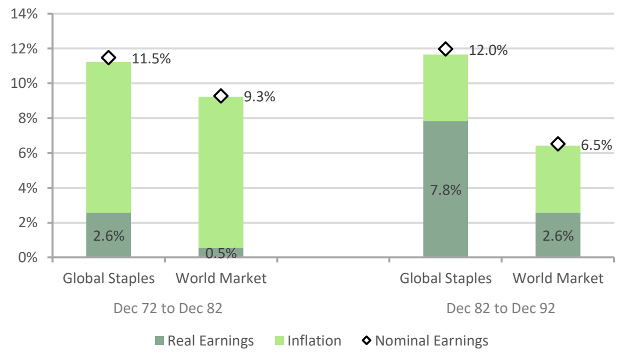
[8] Compound annual total returns in USD of 12.9% for Nestlé, 10.3% for P&G and 9.3% for Unilever, compared to 8.8% for global equities, Dec 2001-Dec 2021

[9] 12-month forward earnings forecasts for the market have grown at a 6.8% annual rate in nominal terms and for Staples grew 4.8%. Deflated by US CPI those equate to a market growth rate of 4.0% (compared to a 2.9% average over 1987-2021), while Staples earnings grew 2.0% a year in real terms (4.7% average 1987-2021. Figures in USD for Datastream World and Ash Park Global Consumer Staples Indices.

Figure 8: Staples earnings have lagged over the last six years

12-month forward earnings forecasts in USD. December 2015 = 100
Source: Ash Park, Refinitiv Datastream

Figure 9: Staples v market earnings in high-inflation decades



Shows real and nominal earnings CAGRs in USD. Uses trailing earnings data.
Source: Ash Park, Refinitiv Datastream

Another important factor temporarily holding back Staples earnings growth has been the much-reported big jump in input cost prices, exacerbated by global supply chain disruption. Situations like this cause a noticeable initial dip in operating margins, for two reasons:

1) If manufacturers put up prices in order to cover higher input costs, there is always a hit to percentage margins, even if absolute profit is unchanged: that's just the way the maths works[10].
2) It's normal for manufacturers to smooth the impact of commodity spikes for their customers and consumers. Branded consumer companies tend to make good margins, so they can afford to help their consumers out in tough times (and generic brands, operating on much slimmer margins, struggle in this scenario). They can take a medium-term view and reason that a combination of a number of smaller prices increases, plus the likely normalisation of input prices at some point, will help to restore operating margins to their previous level.

We have data for two 10-year periods when inflation was high or relatively high: the decades to December 1982 (when US CPI averaged 8.7%) and to December 1992 (CPI average 3.8%). Earnings from the Global Staples companies beat the market quite handily each time: annual growth in real terms of 2.6% in the first decade, compared to just 0.5% for the market, and 7.8% annually in real terms over the second decade, versus the market's 2.6%. If anything, the advantage of high-ROIC, low capital-intensity businesses should become even more important in inflationary periods.

The disconnect between IPO / SPAC and public valuations will correct, and M&A will pick up

We saw somebody argue the other day that 2022 would witness *"a never before seen dislocation between public and private markets. More and more capital will flood into private markets, increasing valuations and minting new unicorns and decacorns at a record pace. This generation of entrepreneurs will no longer seek to take their companies public, unless absolutely necessary, and rather demand that increasing pools of private capital come their way."*[11]

The *Financial Times* took up this topic a couple of weeks later, in an article about the rise of 'growth equity' funds, which plough money into later-stage, larger private businesses as an alternative to those businesses going public. The piece included these remarks from a managing director at Carlyle Group:

"It's a sign of froth, but we just have to accept that the market is attracting new sources of capital, and you can't complain too much about that, whether it's hedge funds or mutual funds… It's not going to go away unless we have a massive fallout from a bursting bubble."[12]

For now the music is still playing and people are still getting up to dance, but we admit to being puzzled as to how this is going to end, even if it seems inevitable that it will at some point. Has the VC / PE world invented a new class of company that will always grow more quickly than publicly-listed peers? Is there a point at which so much money is poured into VC or PE growth funds that these effectively become the new public markets?[13] Aren't investors in private and public markets ultimately the same? If there's a big gap between private and public valuations, why wouldn't that gap be closed by all the really cheap public markets businesses being taken private?

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[10] Take a business with sales of 100 and a 50% gross margin. If input costs rise 10% to 55, and the business is able to raise prices 5% without an elasticity effect – so that sales move to 105 – the gross margin drops a scary-sounding 240bp to 47.6%, even though absolute gross profit is unchanged at 50. We have found over the course of our careers that people can overlook the maths of this, so that a drop in margin is reported as 'manufacturers can't raise prices enough to protect margins'.

[11] Zavain Dar, Partner at Lux Capital in this recent substack post: The next big thing in 2022 is... 50 of technology's top thinkers weigh in on the year ahead Nikhil Basu Trivedi, *next big thing*, 22nd December 2021

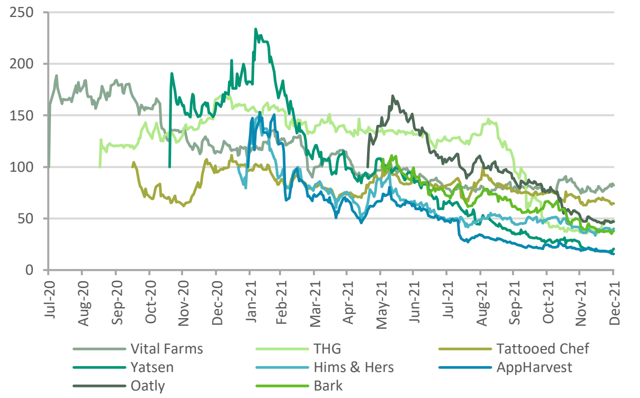
[12] Growth equity booms as investors embrace private markets – *Financial Times*, 7th January 2022

[13] It's strange to think that an ever-greater portion of the investment world's assets might be tied-up in illiquid investments; surely at some point somebody would think of developing a solution to that illiquidity?

Figure 10: Who's reality coming for next?

Source: @10_ch_10

Figure 11: Performance of some recent Staples IPOs & SPACs



IPOs measured from the IPO price, SPACs measured from the SPAC price the day before the de-SPAC transaction was consummated. USD.
Source: Ash Park, Refinitiv Datastream

As we have watched a parade of Consumer IPOs and SPACs come to market in the last couple of years we have been struck by how far their valuation has been removed from those of peer companies listed on public markets. As we discussed in last quarter's letter[14], that has recently played out in the valuations of the newly-public businesses – many of which are loss-making or marginally profitable – coming back down to earth as the market has refocused on earnings and free cash flow rather than EV/TAM[15] or adjusted EBITDA (Figures 10 and 11).

With captive capital, businesses seem to have been encouraged to focus on growing sales as quickly as possible, with rather less concern for the need to make profits. We'd guess that public market investors generally have an average investment horizon somewhere between three months and three years and can sell a stock whenever they want to; at that point, being profitable starts to matter a lot more. With the transition from private to public markets proving difficult for many of these companies it seems likely that there will be an impact on pre-IPO funding rounds too, and that investors will now be working backwards from a considerably lower potential valuation. Over time, this is likely to impact valuations and fund raising further down the capital-raising chain.

We think the very high valuation that has been put on new businesses is one of the factors which has caused M&A activity in the Consumer Staples sector over the last couple of years to run at the lowest level we can remember in a long while. The larger companies just don't seem to be finding many businesses that they can buy at a price they regard as attractive.

One of the reasons we like our smaller *Monsters* is that several of them (L'Occitane, Nomad and Campari spring to mind) have a record of finding things to buy at valuations which seem much more reasonable than those we see being applied to higher-profile VC exits. Smaller companies also tend to have more obvious avenues for internal investment, so that an absence of M&A targets isn't a big disadvantage for them.

For the larger Staples businesses, M&A has long been an important mechanism for them to evolve their portfolios and create additional value, especially through helping to increase the scale and reach of newer companies. A normalisation of the valuation environment, including an emphasis on more traditional fundamental valuation metrics, could help restart M&A activity and open up more growth avenues for the larger companies.

There's another important recovery leg to come in Beauty in Japan / travel retail over the next few years

Our Beauty exposure performed in line with our strategy during 2021 but, perhaps more importantly, as we head into 2022 we believe that our exposure carries very significant recovery potential as parts of Asia continue to unlock, in particular Japan, and in due course travel resumes in earnest – important because the travel retail channel happens to be where margins are highest.

According to L'Oréal's estimates the value of the global Beauty market fell by around 8% in 2020, although trends across the different regions, categories and channels diverged quite widely through the Covid mayhem (Figure 12). In turn that meant quite different outcomes for particular companies, depending on their exposures.

Figure 12: Global Beauty growth rates in 2020

Sector & Channel		Category		Region	
Professional	-16%	Skincare	-3%	North America	-6%
Pharmacies	2%	Haircare	-4%	W Europe	-15%
Mass Market	-5%	Make-Up	-23%	Asia Pacific	-7%
Luxury	-14%	Fragrances	-19%	China	4%
				Latin America	-8%
E-Commerce	40%			Africa & ME	-10%
Travel Retail	-26%				
		Global Beauty	**-8%**		

Source: L'Oréal FY 2020 Results Presentation

[14] *Ash Park on Dealing with Change* (Q3 2021)

[15] TAM = Total Addressable Market

As growth returned through 2021, the Beauty market has normalised and, overall, looks close to being back to its long-term trends. To highlight this point more clearly, focusing on the luxury end of the Beauty market, we estimate that for the first nine months of 2021 L'Oréal's luxury division, Estée Lauder, and Shiseido (ex-Japan – and more on that later) each had sales that were approximately 6%-10% higher than their 2019 peak sales levels.

That's a pretty impressive recovery, and it's fascinating how similar the outcomes are across companies, but the apparent simultaneous bounce-back beyond pre-crisis levels also masks some important regional shifts.

The previously-booming beauty spend in Asian travel retail channels has been onshored to China, via rapid growth in e-commerce and the travel destination of Hainan Island. Overall beauty consumption inside China is therefore significantly above 2019 levels and explains why many international and local companies are doing so well there. We estimate that our own Asian Beauty exposure will have increased onshore Chinese sales by at least 30% in 2021, significantly ahead of the overall Chinese beauty market.

But that Chinese boom has come at the expense of other markets, particularly Japan and Korea, which have lost large pools of revenues from travelling Chinese consumers (sometimes accounting for up to a third of domestic sales), while also facing weak domestic consumer spending on the back of regular localised lockdowns and states of emergency. Japan has been hit hardest: for instance the total Japanese sales of Shiseido, the market leader, were still 37% below their 2019 level during Q3 2021.

Figure 13: A Shiseido beauty consultant ready for reopening

Source: Shiseido

The current realities of Japan are in complete contrast to China, but also to other markets. Europe is nearly back to 2019 levels and the US, which was quickest to bounce back from Covid restrictions, is already past them. L'Occitane and Estée Lauder have managed well through this environment and have so far been clear winners on the way out of this crisis. On the other hand, it's been a big challenge for our large domestic Japan-exposed names, Pola Orbis and Kosé, although that has also allowed us to build our positions at what we think are very attractive prices for the long term, and they seem to be handling those challenges well.

For example, Pola Orbis still generates around 85% of its revenue in Japan, even though its Chinese sales grew 56% over the first nine months of 2021. Despite the pressures we've described it has managed to maintain its gross margin at record levels (it's the highest of any company in the Ash Park portfolio) and kept operating margins near 10%, most critically without sacrificing marketing spend.

Figure 14: Pola Orbis through the Covid crisis

	9M19	9M20	9M21
Sales Index (9m 2019 = 100)	100	76	79
Gross Margin	84.5%	83.7%	84.3%
A&P to Sales	15.4%	16.4%	16.8%
EBIT Margin	14.2%	7.8%	9.3%

Source: Pola Orbis Holdings, Ash Park

Pola Orbis has the additional benefit of having a large cash pile at its disposal, now close to 30% of its current market cap. Special dividends (which the company paid in 2014 and again in 2019) and buybacks are creeping up the agenda; given the choice we would strongly prefer buybacks at the current valuation, but in any event a further return of capital looks likely once the company feels that the Covid emergency is properly behind it.

Our portfolio approach to investing in Asian Beauty has helped us weather the near-term volatility in market dynamics. When Japan follows other regions out of lockdowns we remain significantly exposed to a rebound, over and above the long-term attractions of the Asian Beauty market landscape.

Although we are working to identify more Asian Beauty jewels, we are also pleased to have avoided taking direct investments in China so far. Some of the high-profile local Chinese consumer investments have performed very poorly, with Yatsen, a Chinese Beauty IPO darling of last year, now some 85% below its IPO price.

Tequila sales will soon overtake American Whiskey for the first time ever in the US

For as long as we can remember, the Spirits industry has been looking for ways to translate its popularity in the on-trade (bars, restaurants etc) to the wider at-home setting. From teaching consumers the 'perfect serve' and encouraging retailers to stock requisites such as ice, garnishes and mixers in the Spirits section, to the meteoric rise of Fever-Tree in the premium mixer category, progress has been steady but relatively modest.

Covid lockdowns, particularly in the US, appear to have been a catalyst for at-home cocktail-making taking a major step forward. Having had more time on their hands, more money in their pockets and probably the desire to treat themselves with something more special than a bottle of beer or glass of wine, consumers have "*established a culture of making cocktails at home*"[16] which we believe is here to stay.

[16] Campari CEO Bob Kunze-Concewitz to the *Financial Times*, 10th January 2022: Campari chief bets 'cocktails at home' will outlast pandemic

Figure 15: Ingredients for a Spicy Paloma

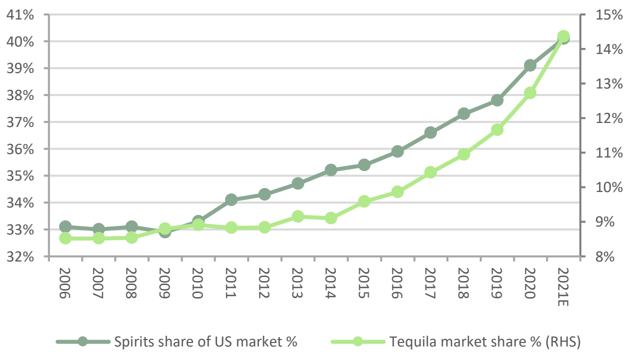
Source: Sipsy

This phenomenon is likely to continue to accelerate the existing trend of Spirits taking a greater share of the overall alcohol category (especially at the expense of beer); it now accounts for over 40% of US alcohol consumption (by value) on our estimates – up from 33% 15 years ago (Figure 16).

The standout winner of recent years within Spirits has been Tequila. Its resurgence can be traced back to the Patrón company which reinvented the liquor as an aspirational category, backed by authenticity, mixability and very premium pricing and helped by favourable US demographic trends and the rise of Mexican culture and food.

Tequila's share of the US spirits market will have recently breached 14% according to our calculations, from less than 10% five years ago. In the next couple of years it's likely to overtake American Whiskey (~15% share) as the second largest category in US Spirits; at the current rate of progress it could get very close to the largest category, Vodka, in the next 10 years.

Figure 16: Spirits and Tequila winning US 'share of throat'



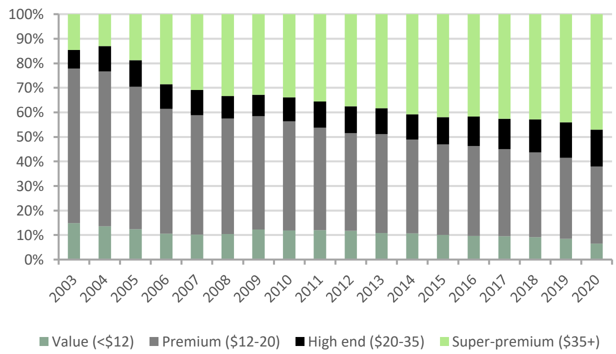
Source: DISCUS, Consejo Regulador del Tequila and Ash Park

Tequila is perhaps the closest thing to the perfect category in Spirits: it's governed by strict industry standards, is supported by multiple long-term tailwinds and has the ability to sustain very premium price points without onerous ageing requirements[17], thus avoiding the working capital drag associated with other attractive spirits categories like Whisk(e)y and Cognac.

Even with very little absolute recent pricing (which may well change given the wider inflation picture), industry price-mix has been growing at mid to high single digits as consumers trade up to higher-priced brands, especially the super and ultra-premium categories (Figure 17).

As the only listed Tequila 'pure play', Becle (owner of the *Cuervo*, *1800*, *Maestro Dobel* and *Reserva de la Familia* franchises) will be a major beneficiary of the rise of Tequila. For their exposure to the broader growth in the US spirits industry, we think Fever-Tree (in the premium mixers) and Gruppo Campari (the fastest-growing of the listed Spirits companies), are also both extremely well-placed.

Figure 17: US Tequila sales by price point, 2003-2020



Source: DISCUS

The Tobacco self-help theme is just getting started

If Consumer Staples overall are due a strong recovery after six years of underperformance, you can say that in spades for the Tobacco part of our portfolio. We were pleased to see that these stocks produced much better returns for us in 2021 compared to the preceding five years (Figure 18).

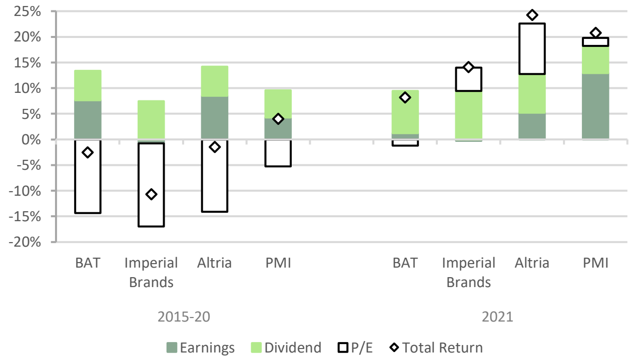
We'd be hard-pressed to pick any fundamental factors behind this improved performance, other than to highlight that valuations began 2020 at fairly extreme levels (Figure 19 – and they haven't improved a lot). The introduction of the EU Sustainable Finance Disclosure Regulation in March last year – which caused a massive fund rebranding / relaunch effort in Europe (Figure 20) – may also have slowed down the adverse impact of ESG-related flows for a while: if you were going to move your fund in that direction, you've probably already done so.

We think it's important that Tobacco's cash return, or 'self help' story began to gain some momentum. First Altria and then PMI announced share repurchases over the course of 2021, and BAT

[17] Añejo, typically the most premium and 'oldest' Tequila category, only requires ageing for a minimum of one year (the newer and modestly-sized category of Extra Añejo has a minimum ageing requirement of three years).

also seems to have made it as clear as it can – without formally announcing – that it will also begin share buybacks soon[18].

Figure 18: 2021 a much better year for our Tobacco holdings



Returns in USD, gross dividends reinvested. Earnings element represents movement in 12-month forward consensus estimates
Source: Ash Park, Refinitiv Datastream

Imperial might be another 12 months or so from following suit, but soon we expect that each of our Tobacco holdings will be returning to shareholders essentially all of the cash they generate, via a combination of dividends and share repurchases. That should create a lot of mid to long-term value given that the Tobacco element of our strategy generates a free cash flow yield of around 10%.

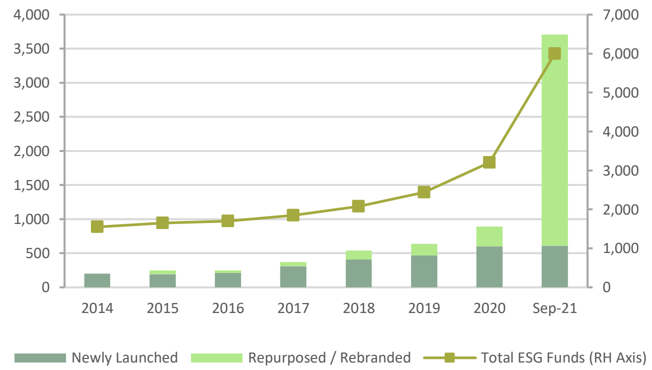
Figure 19: Tobacco valuations began 2020 at very low levels

12-month forward consensus P/E
Source: Ash Park, Refinitiv Datastream

We don't expect anything much to change as far as the underlying dynamics of the businesses is concerned: a managed decline of the combustible tobacco business, ameliorated by manufacturer price increases and a continued push into the various different reduced-harm products (principally tobacco heating, vaping and oral tobacco / nicotine pouches) is likely to be the picture for the foreseeable future.

'Newsflow' is likely to be bad, as it always is, and focused on regulatory developments. But since most of the stocks are already priced for fairly imminent extinction anyway, it's hard to say whether any of those regulatory issues will have a material impact on share prices. We have seen before with Tobacco that when the market gets in a mood to focus on cash flow and defensiveness it can turn a blind eye to stories that at another time might be used as the excuse for a much bigger short-term share price reaction. At some point the wall of money being returned to shareholders can't be ignored.

Figure 20: Sustainable fund launches and rebrands in Europe



Source: Morningstar[19]

Portfolio activity and business update

In September 2021 we launched *Monsters of Tomorrow*, to complement our existing *Global Consumer Franchise* strategy. *Monsters* is effectively a subset of our *Global Franchise* strategy, owning the smaller and mid-cap Consumer companies which tend to be more focused by brand and by category. We target higher returns for our *Monsters* investments but, given its size bias, we would expect those returns to be a little more volatile.

You can see the performance of the strategy in the table printed on page 11.

Over the course of the year we exited our small residual position in Brown-Forman and also sold out of Coca-Cola and Clorox. In Q1 we started new positions in Pola Orbis, the Japanese beauty company, and in Becle, owner of the *Cuervo* tequila brand. During Q4 we made an initial purchase of a new US company; we are still building our position and look forward to sharing more details at a later date.

In the summer we spun out of Kingsway Capital and the four of us now conduct our business through our own regulated partnership, Ash Park Capital. Following an evolution in our relationship with one of our original seed investors we are also pleased to have been able to negotiate an end to their revenue share in us - we thank them both for their support in helping to establish Ash Park. We

[18] BAT said in its 7th December trading update: *"We recognise the clear value of a share buyback at the current valuation. We also continue to be clear on the need to deliver on our 2021 commitment to reduce leverage to c.3x adjusted net debt2 / adjusted EBITDA and expect to reach this by the year end. This will provide greater capital allocation flexibility as we enter 2022."*

[19] Global Sustainable Fund Flows: Q3 2021 in Review – Morningstar, November 2021

begin 2022 delighted with our new independence and excited about the prospects for our strategy.

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All data sourced from Ash Park unless otherwise stated. Please refer to your individual statements or contact Ash Park for further information.

Note: Throughout this newsletter 'Consumer Staples' or 'Staples', where the term is capitalised, refers to the Ash Park definition or proprietary indices of the consumer staples sector, which include Food, Beverage, Tobacco and Household & Personal Care companies; other commonly-used indices for Staples – eg the S&P Global Consumer Staples index – also include the Food Retail sector.

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Ash Park Global Consumer Franchise Strategy Returns (EUR net of all fees and expenses)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2021	-2.1%	-1.9%	8.7%	2.1%	3.6%	2.2%	-2.3%	-1.1%	-1.3%	1.3%	0.5%	6.0%	16.2%
2020	0.1%	-9.2%	-6.2%	8.5%	0.9%	0.0%	-2.1%	1.2%	2.5%	-4.8%	6.0%	4.2%	-0.4%
2019	3.5%	5.5%	6.4%	-0.4%	-3.0%	0.7%	2.2%	0.9%	0.3%	-2.6%	4.6%	1.2%	20.6%
2018	-2.1%	-6.5%	0.6%	-1.0%	0.8%	2.5%	3.4%	-1.4%	-0.2%	-1.6%	-1.4%	-7.7%	-14.1%
2017	-0.2%	8.4%	1.8%	0.0%	4.4%	-3.6%	-3.5%	-1.2%	-0.2%	1.6%	0.0%	2.7%	10.1%
2016	-0.4%	-1.2%	1.4%	0.2%	2.6%	2.6%	-0.9%	-0.7%	-0.9%	-2.2%	-3.6%	2.3%	-1.2%
2015	9.7%	5.3%	-0.1%	-1.9%	3.1%	-4.3%	6.0%	-7.9%	2.0%	8.8%	3.0%	-3.3%	20.5%

				Cumulative			Annualised	
CY 2021	**CY 2020**	**CY 2019**	**CY 2018**	**12m to 31st Dec**	**3 yrs to 31st Dec**	**Since Inception**	**3 yrs to 31st Dec**	**Since Inception**
16.2%	-0.4%	20.6%	-14.1%	16.2%	39.6%	68.5%	11.8%	7.5%

The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not a guide to future performance.

Source: Ash Park. This table illustrates the returns of the Ash Park Global Consumer Franchise UCITS fund which launched on 14 October 2014. The Ash Park Fund returns illustrated above are the net asset value per share of GBP Class A shares of the Ash Park Global Consumer Franchise UCITS Fund translated into EUR at the relevant daily exchange rate (net of all fees and expenses, all dividends reinvested) up to 24th November 2015, and thereafter reflect the net asset value per share of EUR Class A shares. Past performance is not an indicator or guarantee of future results. The UCITS fund is not available to US investors.

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