

THE LONG VIEW

# When the going gets tough, the tough get going

30 September 2020



Skerryvore





As investors in emerging markets, we understand only too well the need to select businesses toughened by prior crises.

The proverb in the title of this article, popularised by Billy Ocean's hit 1980s song, highlights the ability of the resilient to respond positively in difficult situations. Environments like today's present opportunities for good managers and franchises to not only entrench market positions but find new ways to grow and

strengthen their reputations. More than six months from the onset of the Covid-19 pandemic, we can better understand how quality businesses are dealing with the fallout. We believe that part of being far-sighted investors is owning companies that can survive and adapt quickly in a crisis.







	Banner	Country	Established	# of Outlets	Population (min)
	Oxxo	Mexico	1978	19,089	127.6
	7-Eleven	Taiwan	1979	5,751	23.5
	7-Eleven	Philippines	1982	2,916	108.1
	Biedronka	Poland	1995	3,031	38.0
	Raia Drogasil	Brazil	1905	2,133	211.0
	Clicks	South Africa	1968	721	58.6

Figure 1 - Retailers held in the Strategy. Source: Skerryvore as at 30 Sep 2020.



One of the most-discussed topics of late is the acceleration of ecommerce. **L'Oréal**, the French beauty giant, claims e-commerce penetration grew in 10 weeks the equivalent of what took the prior 10 years in the US (L'Oreal, 2020). Similar changes can be seen throughout the world. Though many behaviours will probably reverse, some will not. Good companies have been preparing for this shift and have been able to use this time to accommodate such an acceleration. In India, the subsidiary of one of our largest holdings, **Unilever**, was able to connect over 200,000 outlets to a mobile app called 'Shikhar' since the onset of the pandemic (Hindustan Unilever, 2020). The app allows small retailers to order directly from Unilever's wide portfolio at a time when wholesalers may be struggling. Order values and the number of SKUs (stock-keeping units) have grown to more than twice those of pre-Covid (Hindustan Unilever, 2020). Another app developed by Unilever, 'MyKirana', lets consumers order directly from nearby shop owners. Applying technology to traditional trade channels has strengthened Unilever's franchise throughout emerging markets. These tools should help the millions of small business owners take part in the rapid growth of e-commerce, while working to level the playing field against disruptive tech giants, and will persist well beyond the end of these strange times.

## Adapting to demand and circumstances

Good companies have also been able to turn features of their business to their advantage. Proximity is a characteristic that has proved useful during this period of social distancing and isolation. Our strategy has significant exposure to businesses that have built deep networks within the communities where they operate after many years of investment. Pharmacies in Brazil and South Africa, grocers in Poland, convenience stores in Mexico and Taiwan... all have been ready to respond to changing consumer needs and operating conditions.

Our pharmacy holdings, **Raia Drogasil** in Brazil and **Clicks** in South Africa, continue to grow. However, more importantly, both have held prices in support of customers and accelerated their service capabilities such as flu shots, testing and consultations. In July alone, Raia Drogasil performed over 150,000 Covid tests across 800+ stores (Drogasil, 2020). Biedronka, the leading discount grocery chain in Poland was able to grow in a declining market while maintaining normal levels of profitability by adapting operating hours, assortment and promotional campaigns (Jeronimo

Martins, 2020). Their flexibility stems from an almost entirely local supply chain. Without these partnerships they could never deliver the high-quality private label products that dominate their store shelves (Jeronimo Martins, 2018). Biedronka is owned by **Jeronimo Martins**, a company controlled and managed by the fourth generation of the dos Santos family. Jeronimo's long-term investment philosophy created an operating model that could more easily adjust to this environment than competitors'.

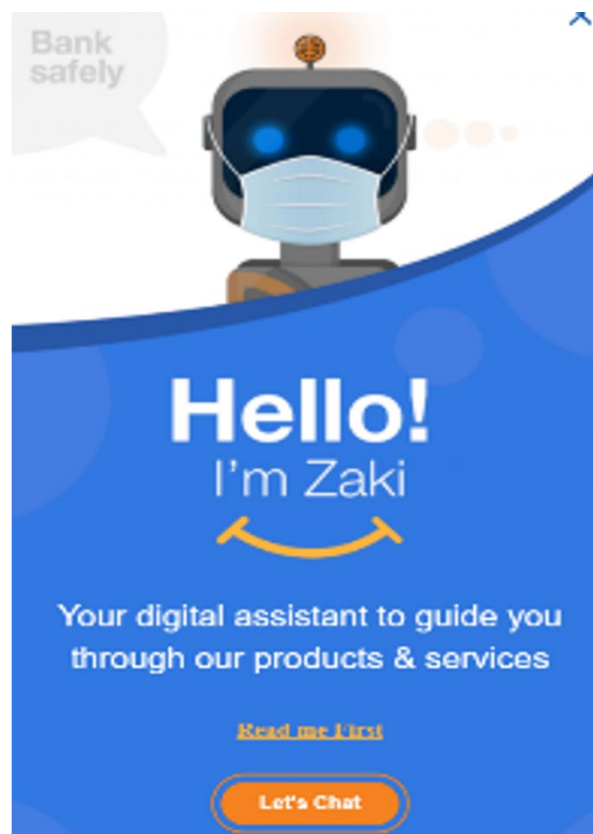


Figure 2 – CIB's digital assistant, Zaki

Unfortunately, not all our retailers were able to sustain growth. Oxxo, the leading convenience store chain in Mexico, suffered from strict lockdowns but also from a more discretionary assortment within their outlets (FEMSA, 2020). Key products such as beer were unavailable as a result of government restrictions, causing a significant drop in customer traffic. We expect sales to recover as lockdowns ease, though we continue to discuss with **FEMSA**, Oxxo's parent company, how they are improving the resilience of their assortment and expanding relevance for customers. Other convenience store chains such as **President Chain Store**, operator of the 7-Eleven franchise in Taiwan, have been successful in expanding their offering to include premium coffee and fresh meals, which combined now represent over 20% of sales and





growing (President Chain Store Corporation, 2019). This has benefited gross margins, but also customer loyalty. We believe there are opportunities for Oxxo to follow a similar path. Payments and logistics services, such as package pickup, are of growing importance for Oxxo's 19,000+ outlets in Mexico. It is important these businesses continue to strengthen their relationship with customers by fulfilling changing needs.

## Saving for a rainy day

We have discussed before the need to invest in only high-quality banks. Prior crises have helped us to recognise such institutions; the current situation is no different. Our largest banking exposure, **Commercial International Bank of Egypt (CIB)**, is no stranger to crises. Egypt has a large, young, unbanked population with a growing need for financial services. The country remains on a long journey since the Arab Spring in early 2011. Despite revolution, a coup, terrorist attacks and a large currency devaluation, CIB has still been able to grow its earnings per share by over 100% in US dollars since the end of 2010, almost 9% per year.

Covid-19 confronted Egypt with similar problems seen elsewhere. Policy response by governments has been significant. In Egypt, government-owned banks have been tapped to support the economy. CIB is a private sector bank, managed by one of the best teams we have come across. As such they have been provisioning more than normal for the past few years, saving for a rainy day. Today, CIB's capital adequacy and liquidity levels are amongst the best in our universe. From this position management are confident to invest in the long-term strength of their franchise. Given two-thirds of the bank's funding comes from lower-cost consumer deposits, it is critical they continuously improve service quality and trust. Nearly 700,000 of CIB's clients are active internet and mobile banking users compared with a base of approximately 1.5 million retail and SME customers (Commercial International Bank of Egypt, 2020). Besides digital investment, in late April, CIB acquired a majority stake in a small Kenyan bank. This will support export growth into the regional common market for CIB's corporate and SME customers. Covid, like crises before, helps illustrate that some companies are built to do more than just survive.

## Doing their bit

During times of crisis, maintaining your reputation is vital. It is far more than just what financial markets think. Reputation extends much further, to include how a company treats all stakeholders. In a crisis many businesses donate money and supplies, but good businesses find ways to build trust. **CIPLA**, a top holding in the strategy, has always had a holistic approach to dealing with stakeholders. This comes from its founding principle of care. During Covid, this was put on display, from online sessions about inhaler technique for health professionals to enhancing drug access via a 24/7 hotline and helping NGOs reach rural communities (CIPLA, 2020). A B2B business such as **Advantech**, which supplies a wide range of industries with automation solutions, has built its reputation on reliability.

From early in the outbreak, Advantech provided a detailed regional breakdown of its operating status (Advantech, 2020) as seen in figure 3. Such transparency is helpful to customers who rely on Advantech products and support to ensure they can continue to operate. Consumer-facing brands like Coca-Cola have used deep distribution strength to help with getting PPE into people's hands. Coca-Cola Hellenic even filled its vending machines with masks in the Czech Republic and Slovakia (Coca Cola Hellenic, 2020). The proceeds were given to charity. Others, such as Heineken, used by-products from the production process of non-alcoholic beer to manufacture hand sanitiser and disinfectant across nearly every market it operates in. These donations provide direct assistance to communities and governments struggling to meet public health needs. Besides direct donations, Heineken has committed to support its network of suppliers and pub owners (Heineken, 2020), a practice less likely to be seen at peers more focused on zero-based budgeting. The quantifiable impact of actions such as these is not clear. We believe, however, such a fair-minded approach to do one's part in a time of crisis should have a positive impact on reputation among a broad set of stakeholders.



### Regional Operation Status (各區產線狀況)

Region	Great China		Japan	US		Europe		
Assembly Line and Logistic Center Location (組裝線與發貨倉地點)	Kunshan (昆山)	Taipei (台北)	Fukuoka, Japan (福岡)	Milpitas, CA (加州)	Ottawa, IL (伊利諾州)	Eindhoven, NL (荷蘭)	Warsaw, PL (波蘭)	Munich, DE (德國)
Operation (營運狀態)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)
Available Capacity Output % (產能狀態)	100%	120%	100%	100%	95%	95 - 115%	95 - 110%	95 - 110%
Shipping Status (出貨狀態)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)	Normal (正常)

Figure 3 – Snapshot of Advantech's operational status report. Source: Advantech website

## Ready to face the future

Writing from Scotland, we appreciate those who plan for rainy days. When the going gets tough, quality companies tend to reaffirm to customers why they've earned their business. A fair-minded approach to addressing all stakeholders is critical for reputation. Far-sighted owners and managers understand this and invest against longer-term or less foreseeable risks. They maintain healthy financial positions because of an awareness of how invaluable that can be. Our aim remains to identify such businesses and encourage them over the long term. It makes buying much easier in times of difficulty knowing these companies are ready to adapt. We do not know how the pandemic or resulting economic impact will evolve from here, but we are confident our companies are up to the task.



Skerryvore Asset Management (Skerryvore) is a boutique asset management team which was established in partnership with BennBridge in 2019 to create a business with the independence to pursue its differentiated investment philosophy. Our goal is to generate absolute long-term returns by investing responsibly in emerging markets. We have an unwavering focus on the quality of the businesses in which we invest.

**For more information visit [skerryvoream.com](https://skerryvoream.com)**

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