

September 4, 2020

Dear Clients and Colleagues:

COVID-19 has resulted in a shift in consumer spending. Post-lockdown, there has been an uptick in home spending and increased demand for hygiene, health and well-being products, while demand for products associated with socializing or going to work has declined. Spending on technology hardware, such as PCs, laptops and cartridges has almost reached pre-COVID levels, while spending on gardening products has increased by a low single-digit year over year.

At this stage, we remain underweight within the consumer discretionary sector. We tend to favour consumer companies that can rely on several distribution channels and possess strong brands. In times of crisis, consumers tend to prefer to stick with brands they know and trust. Our investment philosophy also prioritizes companies that offer above average industry growth, better margins and stronger balance sheets.

Husqvarna, a company we included in our international portfolios during COVID-19, fits these characteristics. Husqvarna is a global leader in outdoor power products, including chainsaws, trimmers, lawn mowers, and garden tractors. It is also active in consumer watering products under the Gardena brand. Husqvarna's portfolio includes products for consumer and professional use. The company generates 36% of its sales in North America, 48% in Europe and 16% in other international markets. For its 2019 fiscal year, the company reported sales of US\$4,472 million and an EBITDA of US\$612 million.

Husqvarna remains the global leader in robotic lawn mowers and battery-powered products. In fact, the company invented robotic lawn mowers 20 years ago. There has been a recent increase in the market penetration and popularity of robotic mowers, stemming from several factors: a labour shortage in the service industry, the rising costs of contractors, lower productivity, and a lack of quality of the work done by contractors. Another reason for the increased use of robotic mowers comes from a sustainability standpoint. Robotic mowers are petrol free and generate only 60 decibels, a fraction of the noise made by conventional petrol-based mowers. Robotic mowers are also designed to service professional markets. Landscapers, property managers and other fleet owners are all adopters of the solution and this represents a very new and untapped market.

In an attempt to contain greenhouse gas emissions, citizens and consumers are expected to take on environmental initiatives. We anticipate increasing environmental consumer awareness to intensify

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within many product categories. We believe battery-powered products will continue to experience high consumer demand.

Market size

- The lawn and garden equipment market is expected to reach \$45 billion by 2025, growing at 3%-4% per annum.
- The U.S. market for power lawn and garden equipment is about \$12 billion. On average, approximately 6 million petrol-based lawn mowers are purchased every year.
- Electric-powered equipment should grow 8% per annum until 2025.
- The global construction equipment market was estimated at \$125 billion in 2019. Approximately 25% of that market is for concrete and road equipment. That segment is expected to grow 4% per annum.

Growth strategy

- Product development driving by innovation (e.g., batter-powered products)
- Bolt-on acquisitions in niche areas (e.g., in the construction segment that is very fragmented) to increase the product range.
- Growing the distribution network by signing new dealers, increasing the number of SKUs for the online channel, and signing new retail partners or increasing penetration with existing ones.

Strengths

- Husqvarna is the dominant player in mid- to high-end products for home gardening, landscaping and construction. Thanks to a strong brand, the company has a solid market share: number 1 in watering and construction in Europe, number 1 globally in robotic lawn mowers, and number 2 globally in chainsaws.
- Ability to innovate. The company spends more than peers on R&D.
- Widespread global coverage with a network of 25,000 dealers.
- Broad diversification of products, geographies and clients.
- Strong balance sheet.

Opportunities

- Housing activity and urbanisation overall.
- Smart gardening, green roof technology and staycation trends post-COVID.

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- Demand for battery-powered products driven by environmental considerations (noise pollution, vibration, protection).
- Professional markets opportunity with many areas underserved.
- Circular economy and growing emphasis on sharing products.
- Construction infrastructure spending.

Risks

- There is a high seasonality in the business skewed towards the first half of the year.
- Excluding the construction segment, recurring revenue is relatively small with 10% of total revenue.
- Excluding the construction segment, most of their products are discretionary and could be impacted by a retail shutdown and the levels of disposable income.

Have a great weekend.

The Global Alpha team

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