

Positive Change Q3 investment update

October 2024

Investment manager Abbie-Louise Gilbert and investment specialist Nduka Amadi give an update on the Positive Change Strategy covering Q3 2024.

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Nduka Amadi (NA): Welcome to the Positive Change quarterly update. We will talk you through performance for the quarter, the comings and goings from the portfolio, and end by sharing our outlook for performance going forward.

I'm joined today by Abbie-Louise Gilbert, who is an investment manager on the Positive Change strategy. Abbie, thank you for joining us today.

As a reminder to the audience, positive change is a strategy which has two equally important objectives. Impact is as important as financial returns. It would be nice to start by hearing about what aspects of impact investing inspire you and why.

Abbie-Louise Gilbert (ALG): I've always been passionate about healthcare, education, and equality, so the opportunity to combine those interests with my day job is incredible. Within these topics, areas of particular interest are those that are highly impactful but potentially overlooked or underappreciated.

And presently, two areas of real interest are financial inclusion and women's health. These are areas which I believe are currently not the hot topic, but are certainly areas of structural growth that are far from maturity.

But with changes like demographics or rising awareness of the benefits of contraceptive products or of opening a bank account increase, we should expect the companies within them to do very well. I'm fascinated by the opportunity to do the investigative research and find the names which meet both our objectives and are at the intersection of impact and financial return.

NA: That's great to hear, and I think mentioning financial returns moves us nicely on to talking about performance over the last quarter.

Now, we normally measure our performance over five-year periods. When we look at that performance period, we are ahead of target. More recently, it's fair to say that it's been more challenging. But we can see this quarter that we've had positive performance.

Now, one of the names that's been behind that positive performance is Duolingo. Would you like to talk through why it's done well recently?

ALG: Sure. So Duolingo is a language learning app, and it's had a very impressive quarter. We've seen the rapid onboarding of new users to a number that now stands at 100 million. That's more than double the number when we first invested.

What's particularly pleasing to see is the 50-plus per cent increase in paying users, which shows us that management are properly monetising their user base in a way which should translate to meaningful revenue and profit growth over the medium to long term.

On the back of these numbers, management updated and upgraded their four-year guidance, which is good news. But what really excites us as long-term investments is three themes that should continue to act as a tailwind for the next five years.

The first is the opportunity to grow market share. So I mentioned that Duolingo has 100 million users, but there are 2 billion language learners worldwide. We believe that as Duolingo's marketing increases and awareness of its user-friendly, highly engaging content rises, then it has huge scope to grow its market share.

The second reason is that there's an opportunity to grow the whole pie as well. So that 2 billion figure is not a static figure. We believe that through awareness of Duolingo's highly engaging, accessible, affordable content, there's an opportunity for people who weren't previously language learners, like myself, to become novices and join the language learning community.

And finally, we're really excited about where AI can take us. Already we're seeing it embedded into Duolingo's app to further differentiate the content. We're seeing the use of immersive language learning and conversational practice tools, which are really driving engagement rates.

But what we're also excited about is the opportunity for AI to help develop content a lot more quickly and effectively so that Duolingo can enter new adjacencies like mathematics or music, which are huge and under-penetrated areas of growth.

NA: That's great to hear. Duolingo is one of our more popular investments. It's not been in the portfolio as long as a lot of the holdings that we have, but it sounds like it's got a good runway up ahead of it.

Now, one of the other names that perhaps didn't have a really good quarter is Dexcom. Can you tell us a little bit about what happened?

ALG: Sure. So for those who don't know, Dexcom manufactures continuous glucose monitors, which helps patients of type 1 and type 2 diabetes to track their blood sugar content.

Dexcom had a pretty difficult quarter. We saw in the most recent numbers a significant miss of its revenue targets and a subsequent downgrade of its four-year guidance. Although profits held up OK, this shocked the market and shares fell significantly.

We've been reflecting on the update and we've also spent time with management and I think ultimately we feel encouraged. Management made clear that there's been no change in market demand. There's still huge scope for its CGMs to grow in penetration.

They admitted that the challenges had been purely operational. The first reason being that they had spent time realigning and redesigning the sales force. And we haven't yet seen those changes translate into revenue growth.

They also pointed out some quite specific one-off market challenges, like a change in rebate eligibility in the US. We'll be monitoring closely how management refocus its sales force, but also work more closely and effectively with channel partners. If Dexcom can do those things, then we believe that the opportunity to grow into the diabetes space and potentially the consumer health space over the long term remains very compelling.

NA: Okay, so it's good to hear that there is still an opportunity out there for Dexcom. Speaking about diabetes, it's a good way to pivot into transactions and one of our new buys is in this area, Insulet. Can you tell us more about Insulet?

ALG: Of course, Insulet is a fascinating company and it's highly innovative. What it does is it creates insulin pumps, which are placed on the arm of diabetes patients so that they can automatically and directly receive insulin when their blood sugar levels change. This saves them the need to inject themselves several times a day.

What's really unique about Insulet's product is that there's no tube attached to the pod, so it's incredibly easy for the patient to use. The friction to adoption is much lower, and therefore the retention and the health outcomes over the long term are much improved.

We also like that Insulet has great market access, so it sells direct to consumer and it's also available in retail pharmacies, which should, along with rising awareness and education of the benefits, cause a rise in adoption over the medium term. We believe that these changes will disproportionately benefit Insulet over the medium term and feel excited about its prospects.

NA: That's great. So what about things that have left the portfolio?

ALG: We have made a decision to sell Umicore recently. That's a company which has a catalysis business a metals recycling business and a rechargeable battery business. And although the first

two businesses have been performing well over our holding period the rechargeable battery business which is the most impactful has been quite disappointing.

The negative effects have been compounded by several changes to the management team, which have left us with a much lower conviction that profitable growth can play out here on. So subsequently, we decided to sell the holding and recycle the monies into higher conviction ideas.

NA: Okay, maybe let's move on to a more bigger picture kind of discussion. Can you talk to us about the outlook the team has? It's a much different investing environment. How does the team respond to that?

ALG: It definitely is. In the last two years, not only have we seen the steepest rise in interest rates we've seen in four decades, but we've seen global warfare, severe supply chain disruption, and an unprecedented increase in index concentration due to the rapid ascent of AI and processing power.

We're aware of these changes, and we're very mindful of how they affect our investing and operating environment. And we're incorporating those realities into our bottom-up stock research and our risk analysis. But against this changing backdrop, we remain steadfast in our objectives.

In fact, if anything, we believe the last few years have shown the severity of global problems and the need for long-term solutions to solve them. As impact investors, we are committed to finding companies which can meaningfully improve the status quo over the next five to 10 years, while also delivering outsized financial returns.

On this point, I would add that although we have had a strong quarter in absolute terms, we're slightly behind the benchmark in terms of share price performance. But we remain optimistic because in terms of earnings performance and revenue growth, we're actually far ahead.

So the average earnings growth of our names is 18 per cent versus the index, which is 9 per cent. And because we believe that fundamentals like earnings growth will translate into share price appreciation over the longer term, we feel incredibly optimistic about the future for the positive change strategy.

NA: Great, thank you, Abbie. So to summarise, performance has been good over the long term. It's come through a challenging period over the course of this year to deliver positive absolute performance.

The fundamentals of the portfolio remain really strong, better than the benchmark, and we think that over the long term this will lead to outperformance.

So, I'd like to finish by drawing your attention to our recently released Impact Report. So, this is the seventh edition of the Impact Report. We'd love you to take a read of it and share your feedback. Thank you very much.

Positive Change

Annual past performance to 30 September each year (net%)

	2020	2021	2022	2023	2024
Positive Change Composite	80.9	41.5	-42.7	15.7	18.7
MSCI ACWI Index	11.0	28.0	-20.3	21.4	32.3

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	Since inception*
Positive Change Composite	18.7	15.0	16.8
MSCI ACWI Index	32.3	12.7	11.8

*Inception date: 31 January 2017.

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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