Investment Insight

QUALITY MATTERS – GLOBAL LEADERS, TARIFFS AND RESILIENCE

The tariff policies announced and implemented by US president Donald Trump have forced companies to re-evaluate their manufacturing footprint. We want to share our thoughts on the impact of the tariffs on some of the companies we hold in our World Stars Global Equity strategy.

The announcement of a universal 10% tariff on all imports to the US, excluding the US, Mexico and Canada (USMCA) free trade agreement, did not catch market participants off guard. The scale of the reciprocal tariffs on a broad range of countries, however, did. Tariffs, by definition, increase the cost of goods sold, which leads to higher prices as companies pass on these higher costs in a bid to maintain profitability.

The most recent announcement of 50% tariffs that may or may not be imposed on European imports is an indication that some increased level of tariffs is inevitable but that tariff rates can and will change and that there will be exemptions for certain countries, industries and products and services. The 10% universal tariff, however, looks like it is here to stay. The first-order effect of the tariffs is the direct cost from tariffs on the cost of goods sold. Our financial analysis allows us to quantify it based on our assumptions. The second-order effect is the impact on the broader global economy. This could have a much bigger impact and depends on the real and perceived changes to corporate and consumer investment and spending.

Companies have now reported their first quarter results. Many reported after the US government's tariff announcement on 2nd April. Most of our companies reported good results and positive outlooks for the year despite the tariffs. 54% of our companies have reiterated their fiscal year 2025 guidance, 12% have raised their guidance, 8% have decreased it, while the remaining holdings did not provide such guidance.

The quality companies we invest in have strong and sustainable competitive positions, in robust and growing industries, with managements that have records of value creation and strong balance sheets that they can weather any kind of adversity. The impact of tariffs on our World Stars Global Equity strategy will depend on what tariffs are actually implemented and what our companies can do to mitigate their impact. The quality of our companies allows them to be resilient and we are confident in their ability to manage their exposure, adapt to whatever tariffs are imposed, seek out opportunities to improve their business and to come out stronger than before.

Below, we provide examples of companies from different sectors that we have invested in for more than three years, how we have analysed their exposure and why we think they will be resilient. Our analysis is based on the likely 10% universal tariff but the framework can be applied to different tariffs levels, including possibly higher European tariffs.

SIKA

Sika is a leading global manufacturer of speciality chemical products serving the construction and automotive sectors, listed in Switzerland. The company produces critical materials that support the structural integrity and safety of buildings, infrastructure and vehicles with core competencies in sealing, bonding, reinforcing and protection. Importantly, more than half

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(55%) of Sika's construction business is linked to refurbishment, which tends to be insulated from economic cycles. In fact, during the last twenty years, Sika has only twice failed to achieve positive organic sales growth; first during the global financial crisis in 2009 and second, at the height of the Covid pandemic in 2020.

The US tariff shock highlights the resilience of Sika's business model. With subsidiaries in over 100 countries and 440 plants across the world, the company benefits from an agile and resilient local manufacturing model. Despite 22% of group sales coming from the US, almost 100% of goods are sourced and produced locally, which provides Sika with an effective cushion against the current environment.

The company has reiterated its full year 2025 guidance for sales and margins while noting the elevated uncertainty in the overall macroeconomic environment. Importantly, it is still reaping the benefits of the recent acquisition of MBCC, the chemicals construction group, its largest to date. This acquisition has provided the company with significant scope to capture cross-selling/revenue synergy opportunities. Sika will be affected by macroeconomic weakness triggered by tariffs but we are confident that it can only serve as an opportunity to take market share and deploy capital, for example by acquiring smaller competitors, a key tenet of the Sika growth model.

L'ORÉAL

The world's largest beauty company operates through four business segments: Consumer Products 37% revenues, L'Oréal Luxe 36%, Active Cosmetics 16% and Professional Products 11%. The company's strength lies in its diversified portfolio by category and region. It has only failed to grow organic sales in two years since 2000, during the 2009 Global Financial Crisis and the pandemic in 2020. We have held L'Oréal in the World Stars Global Equity strategy for more than ten years and we remain confident that it can continue to outgrow the global beauty market, which historically has grown by 4-5% per year.

The US market accounts for 24% of group sales. Just under 50% is manufactured in the US, with 30% coming from Europe (luxury products) and the rest coming from Mexico, Canada (which is exempt because of the USMCA free trade agreement) and other parts of the world. The majority of the tariff impact will be from Europe. The company has already reduced the exposure of its NYX professional makeup brand sourced from China to around 20%. Therefore, without mitigation, we estimate the impact could be 1% of sales.

In the short-term L'Oréal has mitigated the impact of tariffs by increasing inventory in the US. In the medium to long-term, the company has two mitigation options at its disposal, price increases and relocation. L'Oreal is in a stronger position than competitors to increase margins through pricing due to sourcing a lower percentage of products from China. It can leverage its pipeline of new and innovative products to achieve increased pricing and maintain or grow its share. The company also has the option to relocate production to align with tariffs but is not forced to do so until there is greater clarity on tariffs going forward.

The beauty segment is not immune to consumer downturns but we are confident that L'Oréal's diversified portfolios and price ladders put it in a strong position to capture the consumer wallet at all price tiers, with operating margins almost equally attractive across its four divisions.

ABBOTT LABORATORIES

Abbott Laboratories discovers, develops, manufactures and sells a broad and diversified line of health care products. Medical devices generate 45% of revenues, diagnostic products 22%, nutritional products 20% and established pharma 13%. The company was a beneficiary of the Covid pandemic and built a multi-billion-dollar Covid-testing business in a matter of months. It demonstrated the ability of a large company to create and scale up a business when needed and subsequently to scale it down when Covid-testing demand declined from its peak in 2021 and 2022.

Abbott has 90 manufacturing sites across the world and decades of experience in managing its supply chain. That is a key reason why we expect the financial impact of tariffs to be limited. In its latest Q1 results, management said that the estimated tariff impact in 2025 would be several hundred million dollars, less than 0.5% of total sales. Encouragingly, they said that Abbott would not reduce its investment in research and development to mitigate the tariff impact. Instead they said that Abbott had other levers it can pull. In the short term, this includes building inventory. In the longer term, the company will work to optimise its supply chain in order to mitigate tariffs in a sustainable manner.

NVIDIA

Nvidia is a leading semiconductor company and is a pioneer in graphics processing units (GPUs), which are essential for accelerated computing. The company specialises in products and platforms across gaming, professional visualisation, data centres and automotive applications.

When we added Nvidia to the World Stars Global Equity strategy in the first quarter of 2022, it was shifting its focus to data centres from its historical reliance on gaming. Today, Nvidia's data centre products are powering the artificial intelligence (AI) revolution, and the company has established itself as the undisputed leader in the accelerated computing market. Revenue from the data centre division has grown at a compounded annual growth rate (CAGR) of 121% over the past three years, now accounting for 88% of total revenue, up from just 39% in 2022.

Recent commentary from hyperscalers like Amazon, Google and Microsoft, as well as major enterprises like Meta and Tesla, highlights robust capital expenditure plans. Additionally, government investment, like Saudi Arabia's new HUMAIN project to accelerate AI adoption, supports the long-term demand outlook. The rapidly increasing need for greater computing capacity and the significant capex plans give us confidence in the sustained strength and longevity of demand for Nvidia's technologies.

While the semiconductor industry was initially spared from tariffs, it is now the subject of a Section 232 national security investigation. Based on precedent from other Section 232 cases, like those involving steel and aluminium where tariffs reached 25%, we think that it is possible that semiconductors could face similar tariffs.

What remains unclear is how such tariffs would be calculated. Would tariffs apply to the value of the semiconductor itself, its components or the final product? Given the many complex stages of production, where does the product undergo 'substantial transformation,' the key criteria to determine its country of origin?

Semiconductor assembly and packaging are spread across multiple countries enabling companies to reconfigure their supply chains before the product reaches the US border. For Nvidia, with US sales reaching 47% of sales in the last fiscal year, the impact on Nvidia's gross margin, from a 25% tariff impact on cost of goods sold (COGS), could be around 300 basis points. However, the actual effect will depend on how the rule is implemented and the composition of the product mix.

Tariffs are not the only concern, however. Last month, Nvidia took a US$5.5 billion write-down related to inventory and purchase commitments after new licensing requirements restricted shipments of its H20 AI chip product to China. We think this could have an impact of more than US$10 billion on revenue, or 5-6% of its estimated total of c.US$200 billion for the year ended January 2026.

This write-down was linked to the AI diffusion rules introduced by the Biden administration, which imposed licensing requirements for advanced semiconductors and established a tiered system of country access and quantitative limits. Although President Trump's administration has since said that it will not implement these rules and will seek to simplify regulations, we expect that the new framework will be influenced by the ongoing Section 232 investigation.

For Nvidia and others in the semiconductor industry, it is a delicate balancing act, managing potential tariffs on US sales while also navigating export restrictions that impact international growth. We think that Jensen Huang, Nvidia's CEO, is right that the US government should remain committed to maintaining the US' and Nvidia's leadership in AI, and should avoid implementing policies that could compromise the company's competitive edge. AI represents the next paradigm in computing and the long-term growth opportunities are substantial.

We remain confident in the quality of our companies and their ability to weather the current macroeconomic and geopolitical issues. Warren Buffett's business partner Charlie Munger famously said that "Micro is what we do, macro is what we have to put up with." We are always looking for opportunities to strengthen the resilience of the portfolio. If the real and perceived impacts of tariffs lead to a significant dislocation in valuation as we saw during the pandemic, we will look to take advantage of opportunities again.

Investment Team
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