

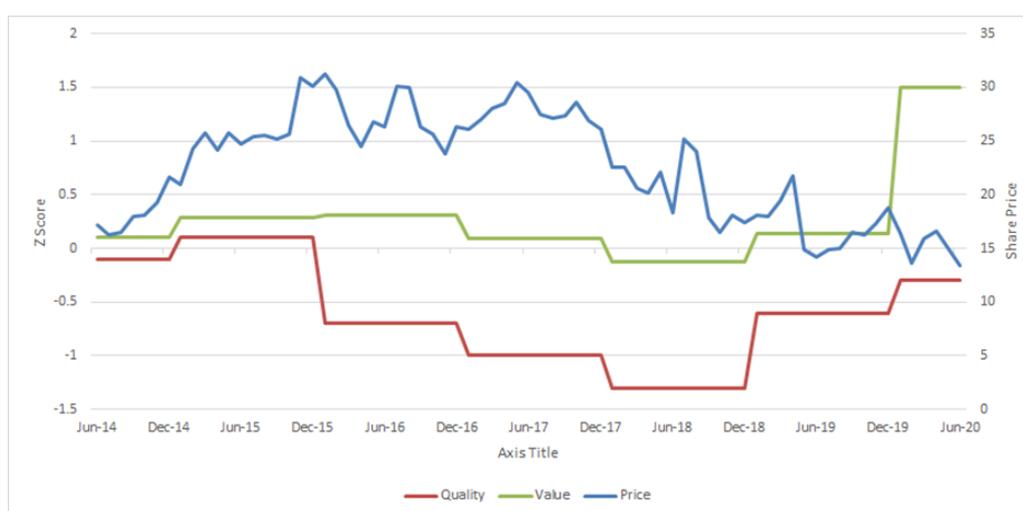


Friday Morning Coffee

Nr. 113 — More diapers

Following from our thoughts and discussion in our Friday Morning Coffee Nr 106, wherein we presented our Quality-Value framework and discussed one of our investments, the Belgian diaper producer Ontex; today we thought of revisiting our rationale and putting it into perspective after the company published its quarterly earnings results. We show here the same chart that we presented back then, and point to the change in the trend of the Quality score since the beginning of 2019, and that of the Value score since the beginning of 2020.

Ontex in the Quality / Value Framework



Source: ECP

The first thought that comes to mind is “Why did the price continue to trend downwards, even after the Quality score started to improve in the beginning of 2019?”. Well, we have to understand here the severity of the quality deterioration due to internal (bad execution of M&A, lack of cost control, etc.) and external factors (higher raw material prices) since 2014. With a quality score of 0 or market like profitability in 2014, the score of Ontex went down to negative 1.5, as seen over the course of four years, Ontex has fallen 500 ranks in our quality ranking in our universe of 1500 European companies to the bottom of the ranking. As the external headwinds started to abate with the fluff pulp prices increasing, we did see the Quality score improving since the beginning of 2019. However, the magnitude of damage was so severe that investors put Ontex in the Value trap bucket that can be seen from our value score, which stayed flat even after such dramatic derating in the stock price.

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Being an active investor, we were continuously and closely monitoring ongoing restructuring efforts at Ontex by not only following publicly available information, but also maintaining continuous contact with the company management. Hence through 2019 although the market ticked off Ontex as a fallen angel, which can be seen by the flat value score, we continued to believe in the Ontex investment case and measures taken by the company management.

Ontex published its quarterly results this morning which positively surprised market participants. In the testing times of Covid-19, we, as well as the market participants, not only expect them to post a benign 2% in like-for-like revenue in H1, but also positively surprised us with the execution of their cost savings measures and cash generation. There is another trigger to the investment case: the company announced today the departure of its CEO who was under severe criticism from activist shareholders due to the subdued profitability of the company. We view this departure as a move in the right direction, and a logical consequence of the arrival of a new Chairman one year ago. It is also not a surprise that the COO, viewed as the architect of the recent operational efficiency's gains, is promoted to interim CEO while a replacement is sought.. Ontex trades at a 42% discount towards peer hygiene Essity: this will change if quality at Ontex continues to improve. More diapers please.

We wish you a nice weekend,

Léon and Gajendra

Léon Kirch, CFA

Partner & Chief Investment Officer

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