HEPTAGON
Capital

Future Trends: Monthly Update

January 2021

The Heptagon Future Trends Fund has a very clear and distinct philosophy: we seek to identify and invest in a diverse range of businesses offering exposure to the key trends that we believe will help shape the future. The Fund has delivered consistent outperformance since its inception in January 2016. Over the past five years, it has gained 134.1% versus an 87.3% return for our MSCI World Index benchmark. Such outperformance has been achieved with only limited changes to the portfolio. January 2021 saw the Fund lose less money than its benchmark (-0.6% versus -1.0%). More importantly, when we look ahead, we believe that the prospects for our businesses remain as attractive as ever.

Don't believe the hype. Your Fund Manager learned this lesson when working on the sell-side covering telecoms network operators and nascent internet companies in the late 1990s at the start of his career. We all know how the TMT bubble burst. The advice remains compelling today. This is why the Future Trends Fund has *not* invested in themes as disparate as hydrogen or telemedicine. We have no doubt about the potential for such trends to grow in importance; it is simply a matter of current valuation levels. Take the median forecast EV/Sales multiple of a group of eight hydrogen businesses we follow: it's above 70 times, using Bloomberg consensus estimates. Not a single one of these businesses is forecast to be profitable at the EBITDA level in 2021, and only half of them are forecast to generate positive EBITDA by 2022. Mark Twain's famous notion of history rhyming (if not repeating) ought to be abundantly evident.

Within the Future Trends Fund we are able to identify not only trends which have long runways ahead of them, but also clear beneficiaries which trade on reasonable valuation levels. Take the former observation and review the table below. Many readers will undoubtedly be familiar with the case for why more shopping will occur online or more corporate workloads will move into the cloud going forward. However, consider global penetration or adoption levels. In both cases, at least 75% of the potential market remains untapped. This is a sizeable opportunity. It's an even larger one in areas such as renewable energy, non-meat-based protein consumption or genome sequencing.

Long runway ahead

Factor	Global Penetration
Smartphones	~50%
Digital payment volumes	~25%
Corporate workloads in the cloud	~20%
Retail purchases made online	~20%
Renewables share of energy industry	~10%
Electrical vehicles share of auto market	<10%
Education spend online	<5%
Non-meat-based global protein consumption	<5%
Human genomes sequenced	<1%

Source: Heptagon Capital. Evidence supporting all these trends can be found in publications on Heptagon Capital's website

The good news is that the Future Trends Fund offers exposure to all these themes and more. **Our philosophy has always been about pan-thematic diversification**. Even with this approach, our businesses share a set of common features: they are pure-plays, market leaders and proven out-innovators. Crucially, they also have attractive financial profiles and reasonable valuation levels (not to mention ESG-focused management teams). **All our businesses are profitable and are generating positive free cashflow**. Indeed, forecast-free cashflow generation for the businesses in the Future Trends Fund is 20.4% on a three-year compound annual growth basis, taking a weighted average for the Fund. This is more than double the level projected for the MSCI World, per Bloomberg consensus estimates. Further, our businesses have an average net debt/EBITDA level of 0.7x, well ahead of the global market's metric of 1.8x.

We believe that a weighted average forward P/E multiple of 28.9x for the Future Trends Fund is a reasonable price to pay for our businesses, given their superior growth and cashflow prospects combined with clear balance sheet strength. For the record, the current P/E premium relative to the MSCI World of 8.7 percentage points is *lower* than a month prior (10.2) and only slightly above the average premium of 8.2 points that the Fund has commanded since its inception. It is important also to remember that the Fund offers *balance*, with our businesses trading in a range of 11.3x to 55.0x forecast earnings, with IBM at one end of the spectrum and Chegg at the other.

It is this combination of discipline regarding the sort of businesses we want to own within the Future Trends that we believe has driven consistent outperformance across different market conditions. January 2021 proved no exception, with the Fund losing less money than its MSCI World Index benchmark (-0.6% vs -1.0%). This is despite the fact that the Fund gained almost 30% in 2020. In other words, there was limited mean reversion or profit-taking in our businesses during January.

There was, however, no shortage of volatility. Take First Solar. In 6 of the 20 trading days of January, the stock moved by more than 5% (4 times to the downside and twice to the upside). This is just short-term noise, however. First Solar ended the month up 0.2% and so comfortably ahead of the MSCI World. **Overall, we were pleased that 15 of our 23 businesses outperformed the MSCI World in January.** The past month was also relatively bereft of corporate newsflow, with just 5 of our investments reporting detailed results, although a further two provided brief trading updates. As ever, there was significant dispersion across the Fund, with the spread between our best- and worst-performing businesses equivalent to 25 percentage points.

TomTom was the Fund's leading outperformer, up 13.5% in January. There has been generally growing investor interest in the car of the future, a theme from which TomTom clearly benefits. We also note that the stock was a relative laggard in 2020 (down 10.4%) and so may be partially catching up from past underperformance. ASML and Thermo Fisher also both closed up more than 10% in January on strong results and a positive outlook presentation at a major healthcare conference respectively. At the opposite end of the spectrum, Mastercard and Avast traded more than 10% lower in the past month. In the case of Mastercard, this was despite better-than-expected financial results. Regardless, we consider prospects for these two businesses – and the remaining ones in our Fund – as attractive as ever. Thank you for your interest in and support for the Future Trends Fund.

Alex Gunz, Fund Manager

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For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

Risk Warnings

The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

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