HEPTAGON Capital

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Future Trends: Quarterly Update

Q1 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 which we believe will help shape the future. The strategy has delivered consistent outperformance since inception in January 2016, gaining 132.6% versus a 98.5% return for our MSCI World Index benchmark. Q1 2021 constituted the Fund's first period of quarterly underperformance since Q3 2019 and occurred *despite* the fact that both estimates for our businesses increased *and* their valuation improved. With our focus unchanged and the prospects for our businesses looking more attractive than ever, we believe the long-term opportunity to invest in the future is highly compelling.

A better future

Each quarter is unique. A year ago, the world had no playback for when the pandemic forced economies to shut abruptly. The rapid response of policymakers drove a corresponding recovery in equity markets. Successful vaccine trials and subsequent rollouts followed, a testament to coordinated scientific endeavour. Even if the world is far from back to normality, it is now substantially easier to see a path to future recovery than at any other stage in the past twelve months.

Throughout this quite unprecedented period, **it has been important to remain nimble, adapting to circumstances as they have changed**. The first quarter of 2021 saw one of the biggest moves in bond yields ever recorded in recent history. Using 10-year US Treasury debt as a reference point, the yield on 31 December 2020 stood at 0.91%; three months later, it was 1.74%. This is equivalent to an 82.7 basis point rise, or a 90.6% increase in the yield over a quarter. For context, in the fourth quarter of 2016 – when the election of Donald Trump to US President led to a swift upward move in yields – the corresponding figures were 84.9 basis points and 53.3% respectively. Turning to the 'taper tantrum' of 2013's second quarter, the 10-year yield moved 63.7 basis points, equivalent to a 34.5% increase. Bloomberg's data set stretches to 1991 and in *no other quarter* than those described did bond yields move close to what was witnessed at the start of this year.

How the Fund responded and how we reacted are two separate questions. In terms of the former, Future Trends lost 1.3% over the quarter, versus a 4.9% rise in the MSCI World. This constituted its first three-month period of underperformance since Q3 2019 and only the sixth since inception. The move in Q1, we believe, should also be seen in the context of 2020's 29.8% return, which placed the Fund 13.9 percentage points ahead of its benchmark. Importantly, **nothing changed in our approach to managing the Fund. Our philosophy and process has remained unaltered since inception. We used relative share price weakness in many of our businesses to increase our positions**.

When we consider the opportunity ahead, **we are more optimistic now on prospects for our businesses than at the start of the year**. Not only have growth prospects for our businesses improved, but they have also become cheaper – in both absolute and relative terms – since the start of 2021. Over the next three years, we forecast our businesses should enjoy compound annual revenue growth of 9.2%, earnings growth of 17.9% and free cashflow growth of 21.5%. These numbers

are derived from our own (conservative) modelling assumptions and constitute the weighted average for the portfolio. For context, at the end of last year, the comparable figures were 8.5%, 13.1% and 21.0%. It is also worth noting that our growth assumptions remain well ahead of those for the MSCI World, as derived from Bloomberg.

Future Trends: 3-Year Compound Growth Rates, monthly change

	Mar-21	Feb-21	Jan-21	Dec-20	MXWO Mar-21
Revenues	9.2%	9.2%	9.1%	8.5%	5.2%
Earnings	16.4%	15.6%	15.3%	13.1%	14.4%
Free cashflow	21.5%	22.0%	20.4%	21.0%	8.7%

Source: Heptagon Capital, Bloomberg

From a valuation perspective, **prospects for the Future Trends Fund also look more attractive than they did at the start of the year**. The Fund's weighted average forward P/E multiple is currently 27.8x, down from 30.0x as of 31 December 2020. As a result, the Fund currently trades at a 7.8 percentage-point premium relative to the MSCI World, substantially lower than the 10.2-point premium it commanded at the end of last year. We believe a certain premium is clearly merited owing to the superior revenue, earnings and cashflow prospects of our businesses as well as their balance sheet health (the portfolio's net debt/EBITDA ratio averages 1.1x versus 1.8x for the MSCI World). The Fund's current premium is also below its average 8.1-point premium recorded since the inception of the Fund. On other valuation metrics such as free cashflow yield and EV/EBITDA, the Fund's premium relative to its benchmark has also narrowed. Furthermore, when we review valuation on an absolute basis, our average business is 26.4% undervalued (on a weighted business across the portfolio) using long-term discounted free cashflow assumptions, which compares favourably against an 18.2% average undervaluation at the start of the year.

Future Trends: Valuation metrics, monthly change

	Mar-21	Feb-21	Jan-21	Dec-20
Forward P/E (x)	27.8	27.9	28.9	30.0
P/E Premium vs MSCI World (pp)	7.8	7.8	8.7	10.7
DCF upside potential (%)	26.4%	30.1%	20.1%	18.2%

Source: Heptagon Capital, Bloomberg

We added one new name to the portfolio (Aptiv) during the first quarter and exited from two (Microsoft and TomTom). Throughout, our approach has remained unchanged. **In other words, the Future Trends Fund emphasises pan-thematic diversification**, investing in everything from cloud to wind and fish to (semiconductor) chips. We invest only in pure-play, market-leading businesses – which derive at least 75% of their revenues from the theme to which they are exposed – who have a proven record of out-innovation and strong governance. **Our due diligence process is lengthy and thorough, beginning with our top-down thematic work and complemented by detailed bottom-up analysis and ongoing interaction**. To this end, during the first quarter of 2021, we conducted a total of 30 virtual meetings including with 15 of our current 22 investments in the Fund.

Throughout the more than five years we have been managing the Future Trends strategy, we have also been acutely conscious of just how important it has been to **avoid the hype**. We are patient and long-term investors and prepared to wait until the appropriate (valuation) opportunity arises in order to gain exposure to a trend which we believe will only grow in importance. Chegg, our preferred way of gaining exposure to the theme of edtech, constitutes a great case study in this respect. We first wrote on the topic in 2013 but did not invest until 2020. Since our initial investment, Chegg has gained

136.3%. We believe we may need to be patient too in respect of telemedicine, the topic of our most recent theme piece, discussed below. In the meantime, we retain conviction in the quality of the investments we currently own. As the late David Bowie said, "the future is coming to those who are willing to hear it." Further for those investors who "demand a better future" (a line that features in a 2004 song by the same artist), now is the time. As discussed, prospects for our businesses now look more attractive than they have done for some time.

Recent thematic work: Telemedicine – the virtual doctor calls

Proprietary thematic work represents one of the key differentiators in our investment process. We have published over 50 pieces of thematic work since 2011, all of which may be found on Heptagon's website. During Q1, we published our latest thematic piece, on the topic of telemedicine. Our key findings are reported below.

When was the last time you went to see a doctor? Think about what a strange process it is. Typically, a patient develops symptoms, next visits a surgery, potentially infecting others while waiting for their appointment. The doctor then diagnoses the problems, usually from outwards symptoms and subsequently sends the patient home, perhaps with a prescription but often with the recommendation of watch and wait. In most cases the patient recovers, although sometimes a trip to hospital becomes necessary. **This model is evidently ripe for disruption with virtual healthcare, or telehealth/medicine, providing the solution**. The COVID-19 pandemic has elevated a rethinking of healthcare from being not just about choice and convenience, to one of necessity to protect both doctors and patients.

Healthcare provision needs rethinking. How money is spent currently is highly inefficient, while populations are ageing, in the developed world particularly. Some studies suggest that **more than $1 in every $5 spent on US healthcare is either wasted or misallocated** (per the Journal of the American Medical Association). This matters when 28% of the US federal budget (or 17% of the country's GDP) is spent on healthcare annually. Consider that, even at a basic level, the average patient has to wait 24 days to schedule a doctor's appointment in the country's 15 biggest cities (per Doctors on Demand, a healthcare provider). The problems don't end there: if you do need treatment, medical error constitutes the third biggest killer in the US (data from the OCED). Perhaps this shouldn't be too surprising given that the World Health Organisation estimates that globally there will be a shortage of more than 7m healthcare workers; a figure that will rise to 13m by 2025. Overworked and under-resourced medical professionals are having to deal with increasingly elderly and more fragile populations too. Some 80% of people over the age of 65 have at least one chronic condition (per the New England Journal of Medicine), while 50% suffer from at least two.

The good news is that there are solutions at hand. New technologies will create better outcomes and free up resources to help manage demographic pressures. Consider it **the decentralisation of healthcare, enabled by broadband and smartphones**. Under this world view, patients become more empowered as consumers and (some) care is shifted from the surgery/hospital to the home. The recent pandemic has served to accelerate this trend. A McKinsey survey of May 2020 showed that 76% of consumers said they were interested in virtual care, a massive jump compared to the 11% in favour a year prior. In a separate study (by Teladoc, a leading provider), 67% of patients said they want a virtual care doctor to partner with their existing services. Additionally, 80% of large companies in the US state that implanting virtual healthcare solutions

is their number-one healthcare priority (per a survey conducted by the Business Group on Health). Viewed from the other perspective, 64% of healthcare providers now say that they are comfortable using telehealth services (again per McKinsey).

So what is telehealth? Put simply, it's a portmanteau combining telecoms/technology and healthcare. The term is used interchangeably with telemedicine too. Perhaps the best formal definition comes from the US Department of Health, which defines it as **the use of electronic information technologies to promote clinical healthcare and patient and professional health-related education**. Such services are typically provided using video communication technology but may also be provided using alternative audio and text-based media.

The main benefit of adopting telehealth services is that everyone wins: **customer demand is matched with physician supply**. Consumers typically lack access to high-quality, cost-effective healthcare at appropriate sites of care. Telemedicine effectively brings healthcare services direct to consumers, extending the geographic reach and expertise of both physicians and healthcare facilities. This results in **major cost efficiencies: better staffing, reduced travel times (on both sides) and fewer or shorter hospital stays**. The largest study to-date on the topic (conducted by Veracity Analytics in 2019 and covering 2m people) highlights that an average of $472 per patient was saved under a virtual health scenario relative to a real-world visit. The American Medical Association states that "studies have consistently shown that the quality of healthcare services delivered via telehealth is as good as those that are given in traditional in-person consultations." No wonder then that 84% of people who had a virtual medical consultation said they were able to completely resolve their concerns during the visit (per a JD Power 2019 consumer survey).

Against this background, **"telehealth is now being accepted as an essential service"**, per Amit Phadnis, the Chief Digital Officer at GE Healthcare. **Global virtual healthcare interactions probably exceeded 1bn in 2020** (per Forrester Research). The pandemic has had an inevitable effect in accelerating demand. McKinsey estimates that ~11% of US consumers used some form of telehealth service in 2019, a figure which had jumped to 46% during the peak of the pandemic (May 2020). Teladoc disclosed that on its busiest days during the past year, it was handling 15,000 video requests for telehealth services a day. Interestingly, demand cut across all age groups, cohorts and regions as well as medical reason. While some demand has inevitably dropped off as lockdowns started easing, **Teladoc's best estimate is that its virtual visit trend could stabilise at a level some 40%+ higher than pre-pandemic.**

Even if there is no consensus from analysts and consultants on exactly what falls under the broad umbrella of telehealth, the market has significant growth potential ahead. Most forecast **a 15%+ CAGR for the global market through to the middle of this decade** (based on studies from the likes of Grand View Research, Markets and Markets and Polaris). Thought of another way, Teladoc says that it has ~70m patient relationships today in the US, which compares to the country's population of 320m. If you were to add in the international population of other highly developed countries, this results in an addressable market of ~1.1bn people, of which **less than 1% are covered currently.** McKinsey's study suggests that in the US alone, 20% of all Medicare, Medicaid and commercial outpatient, office and home health spend could be virtualised, equivalent to a $250bn opportunity.

It's important to remember, however, that **there is a limit to what telemedicine can do.** It will never fully substitute for an in-person visit, lacking the ability to conduct a physical examination and a deeper inter-human connection based around non-verbal cues and the greater transmission of trust and empathy. Though telehealth is often pitched as a solution to improve access to healthcare for everyone, more than half (52%) of users say they encountered at least one barrier that made usage more difficult than anticipated. The most common hurdles were limited service, confusing technology requirements and lack of awareness about cost (per the JD Power consumer survey cited earlier). It is therefore crucial not only for regulators and insurers to create the appropriate framework for market development, but also better broadband access to be rolled out. Some 20m Americans – and often those most in need of healthcare – lack broadband access currently (per the FCC). Furthermore, in order to ensure greater adoption, matters such as the security and privacy of confidential data need to be considered as well as its sharing and the interoperability across different competing virtual solutions.

Teladoc is the largest player within the telehealth space. Listed in 2015 and capitalised at ~$28bn, it has an estimated global market share that is 4-5 times higher than its next closest rival. Services are delivered in more than 175 countries in over 40 different languages. Teladoc works with over 50,000 clinicians covering more than 450 sub-specialities. Over 14m virtual visits occurred across all Teladoc facilities in 2020, more than double the previous year's level. Teladoc shares have fallen ~40% from their 2021 high yet are still currently overvalued in our view. The business trades on 13.8x forward sales and is currently loss-making at an EBITDA level on a GAAP basis. Even taking non-GAAP EBITDA, Teladoc's multiple is over 100x for the year ahead. **We would prefer to remain patient**. At the same time, we are also continuing to explore lateral adjacencies for possible investment opportunities.

First quarter performance

Future Trends lost 1.3% during the first quarter of 2021. This compared to a 4.9% rise in the MSCI World. As the table below shows, this is only the sixth quarter of underperformance since the inception of Future Trends in 2016 and the first since Q3 2019. For reference, it is also worth noting that after the last time Future Trends underperformed by such a magnitude (in Q4 2016), the Fund had recovered all the period's absolute decline over the subsequent quarter and all its relative move in less than two quarters. Since inception, Future Trends has gained 132.6% versus a 98.5% return for the MSCI World. This is equivalent to 17.6% annualised returns for the Fund relative to 14.0% for the benchmark.

As ever, there was significant dispersion across the portfolio, with the gap between our leading and lagging businesses equivalent to more than 45 percentage points over the quarter. We were also pleased to see that the three main sources of alpha over the past three months hailed from exposure to different themes. **During Q1, ASML added 30.0%, Zebra Technologies 26.2% and MOWI 11.1%.** For those unfamiliar with these businesses, the former is the world's leading manufacturer of advanced lithography machines that make semiconductor chips – we regularly say the future can't happen without ASML. Zebra is the global number-one in the field of enterprise asset intelligence, or automatic identification and data capture; think the barcodes and QR codes, both hardware and software. Meanwhile, MOWI is the largest and most globally diversified producer of salmon, with a fully integrated value chain. The former two businesses benefited from strong earnings upgrades in the past quarter based on business momentum, while MOWI gained partly on optimism over re-opening (more venues serving salmon, cheaper freight transportation) as well as a positive investor briefing event.

Nonetheless, we were disappointed that only 7 of our 22 businesses outpaced the MSCI World during Q1. This was despite the majority of our businesses meeting and/or exceeding earnings expectations during the recent reporting season as well as generally providing better-than-expected forward commentary, whether qualitative or quantitative. Some of the relative underperformance can simply be attributed to profit-taking, exacerbated by market rotation. A great case in point is the Fund's two alternative energy names. **First Solar** ended Q1 down 11.7% and **Vestas** 9.6%. For context, the two businesses gained 76.8% and 113.8% during 2020. The past quarter saw an abrupt move *away from* renewable investments into conventional oil-based energy names, an area which the Fund would never consider investing in. In the first ten weeks of 2021, both First Solar and Vestas saw declines of ~30% in their share prices. We used this weakness to increase our positions in the two names and are pleased to have seen share price recovery from their nadirs since then.

Part of our conviction in First Solar was reinforced by a 1-1 call we had with the company's Chief Financial Officer in March. Similarly, we spent time with **Daifuku** – our other notable laggard since the start of the year – in order to gain further conviction in the business. Daifuku shares closed down 15.0% in Q1. Some of the move may again be a function of profit-taking, given the 91.6% gain the business enjoyed over 2020. There was also some relative disappointment in the investment community around the conservative financial targets provided by Daifuku when it announced its revised three-year business plan in February. Having discussed these objectives along with the prospects for the near-term operating environment with Daifuku's Investor Relations, we retain clear conviction in the business and remain opportunistic in terms of adding to our investment.

Period	Future Trends	MSCI World	Relative
Q1 16*	3.8%	6.1%	-2.3%
Q2 16	-2.4%	1.0%	-3.4%
Q3 16	10.4%	4.6%	+5.8%
Q4 16	-6.9%	1.9%	-8.7%
Q1 17	10.8%	6.4%	+4.5%
Q2 17	12.0%	4.0%	+7.9%
Q3 17	7.5%	4.8%	+2.7%
Q4 17	6.2%	5.5%	+0.7%
Q1 18	0.0%	-1.3%	+1.3%
Q2 18	2.7%	1.7%	+1.0%
Q3 18	5.4%	5.0%	+0.4%
Q4 18	-14.5%	-13.4%	-1.1%
Q1 19	16.1%	12.5%	+3.6%
Q2 19	5.8%	4.0%	+1.8%
Q3 19	-1.2%	0.5%	-1.7%
Q4 19	9.5%	8.6%	+1.0%
Q1 20	-16.6%	-21.1%	+4.5%
Q2 20	24.0%	19.4%	+4.6%
Q3 20	8.3%	7.9%	+0.4%
Q4 20	15.9%	14.0%	+1.9%
Q1 21	-1.3%	4.9%	-6.2%
From launch	**132.6%**	**98.5%**	**+34.1%**

**From Fund launch to end of quarter (12/1/16-31/3/16)*

Source: Heptagon Capital, Bloomberg. As of 31 March 2021. All figures shown are net of fees for the C USD share class.

Past performance is no guide to future performance, and the value of investments and income from them can fall as well as rise.

Portfolio changes

We made three name changes to the portfolio during Q1. In addition, **we continued to rotate *within* the Fund, adding to names that had underperformed on a relative basis**. Beyond adding to the alternative energy names discussed previously, we used early-January weakness in Alibaba – on concerns about increased regulation – to increase our weighting. Similarly, when Kerry Group sold off in February on the back of a spurious report from a hitherto unknown short seller questioning the acquisition strategy and accounting practices of the business, we took advantage of this share price weakness. Residual cash within the Fund (and inflows) allowed us to move quickly in each case. The Fund currently has 3.2% cash.

During January, **we exited from our position in Microsoft**. We had owned the business since the inception of the Fund in January 2016 and during the time we owned it, had enjoyed a **315.5% return,** well ahead of the MSCI World. Our rationale for exiting was premised not just on profit-taking, but on several other factors too: we had higher conviction in a new business for the Fund; we wanted to reduce our exposure to mega-cap tech businesses (on fear of potentially greater regulatory scrutiny); and our comfort in knowing that we retained exposure to many of Microsoft's thematic drivers via other businesses within the Fund (Alibaba and IBM).

The proceeds from Microsoft allowed us to **start a position in Aptiv**. For those unfamiliar, Aptiv is a $38bn US-listed business which we believe is exceptionally well-placed to benefit from the growth in both electric and smarter vehicles (as well as a near-term cyclical pick-up in the sector). We have been following the theme of the future car since April 2015. Aptiv is best thought of as a systems integrator, providing both the brains and the nervous system for future automobiles. We interacted regularly with management in December and January and were impressed with their vision as well as their commitment to ESG initiatives, where the company is a clear leader. Aptiv has gained 5.8% since the start of the year, ahead of the MSCI World.

The only other change we made to the Fund during the quarter was to **exit from TomTom**. This had been our smallest holding in the Fund and hence the business in which we had least conviction. We had been willing to give the company the benefit of the doubt and believed its strategy – as an independent provider of mapping data – would yield returns over time. February's results release and outlook statement did not reassure us. Further, TomTom appeared to be a laggard in the adoption of ESG best-practice and reporting; something which was of increasing concern to us. A call with TomTom's CFO shortly after results did not give us cause for immediate optimism, hence our decision to exit. Aptiv continues to provide exposure to the car of the future theme, while TomTom proceeds were redeployed across the Fund, providing cash also to add to performance laggards in which we retain strong conviction.

SRI considerations

A policy of responsible business investment is integral to the investment philosophy and process of the Future Trends Fund. Integrating ESG principles into our investment process enhances our ability to understand existing and potential risks and opportunities for potential portfolio companies. The businesses we invest in naturally align with the United Nations Sustainable Development Goals. Examples of trends to which the Fund is exposed include alternative energy, food innovation and healthcare solutions. At the same time, the Fund will not invest in areas such as fossil fuel extraction, tobacco, adult entertainment, gambling, civilian firearms, weapons and nuclear power. From a governance standpoint, the Fund also

avoids businesses with questionable accounting and/or governance practices, favouring transparent boards and non-dual share class structures. We published our latest ESG report in January 2021 and our next edition is due later this month. We were also pleased to see the **Future Trends Fund classified as an Article 8 Fund under the European Union's Sustainable Finance Directive** in March. For more information, see here.

Conclusion

The approach we continue to take in managing assets within the Future Trends Fund emphasises a focus on the long-term. This enables us to step-back from more immediate noise, whether it be moves in bond yields or the timing of when economies re-open. We derive reassurance from the fact that **our businesses have above-average growth prospects, markedly higher free cashflow-generating potential and more robust balance sheets relative to the overall market**. Overall, we remain pragmatic and opportunistic, constantly conducting research into new themes and businesses while continuing to assess current ones. Our aim – beyond delivering consistent returns – is to strike a strong balance in all respects of our portfolio through diversified thematic exposure to industry leaders benefiting from future trends.

Thank you for your interest in and support of the Heptagon Future Trends Equity Fund.

Alexander Gunz, Fund Manager

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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.

SFDR

This Fund has been classified as an Article 8 for the purposes of the EU's Sustainable Finance Disclosure Regulation ('SFDR'). The Fund promotes environmental and/or social characteristics but does not have sustainable investment as its primary objective. It might invest partially in assets that have a sustainable objective, for instance assets that are qualified as sustainable according to EU classifications but does not place significantly higher importance on the environmental objective of each underlying investment. Please see prospectus for further information on the Funds environmental and/or social characteristics and relevant sustainability risks and principal adverse impacts which may impact the Fund's performance.

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