HEPTAGON Capital

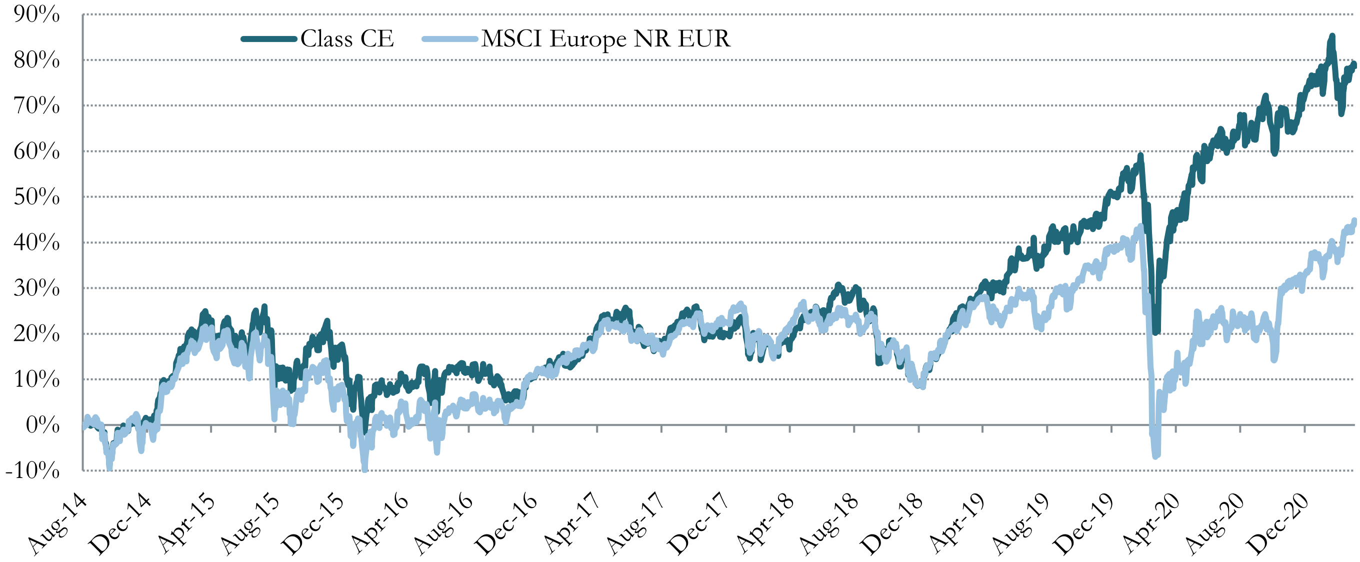
Heptagon European Focus Equity Fund

Market Commentary and Attribution Analysis for 1Q21

Performance and executive summary

During 1Q21, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value advanced by +3.02% to €178.6898 compared with the MSCI Europe NR (EUR) index, which appreciated by +8.35% in comparison.

The HEFEF's CE share class performance since inception on 26 August 2014



Source: Bloomberg

1Q21 was one of the best quarters for European equities in 10 years

Despite most of Europe being restricted by COVID-19 related lockdowns, generally slow inoculation programs and a tussle for vaccines, 1Q21 turned out to be a very good quarter for European equities. The strong return over the past quarter followed from 4Q20, which was a spectacular period for the region's stock markets as they yielded a return of +10.8%. It was striking to note that while January produced a negative return, February and March (in particular) were exceptional months. 1Q21 was different also in other ways. Although traditional cyclical recovery sectors, such as energy and financials, showed the strongest performance over 1Q21 (+14%), they were followed by shares in the later-cycle consumer discretionary segment (+11%). However, when analysing the stocks in the consumer discretionary sector, the main impetus to the strong performance derived from the German automotive shares following Volkswagen's remark (16th March) that it would challenge Tesla's dominance in the electric vehicle space. According to the STOXX Europe 600 index, which has a different sector-classification than the MSCI index, the automotive segment yielded a return of +26% in March and (as already mentioned) this was achieved primarily in the second half of the month.

The individual performance of the different sectors also shows that there was considerable rotation on a month-by-month basis. For example, technology, energy and material stocks were the best-performing sectors in January, while financials and consumer staples were amongst the weakest that month, but this was turned on its head in March when consumer staples performed strongly and energy and material stocks were amongst the weakest performers.

Why look at the market like this? We believe it is important to get an understanding of investors' sentiment since frequent rotation between sectors indicates that they don't have a clear idea of which way the markets may move; in this case whether to look beyond the likely cyclical re-opening boost, or to stick to a longer-term view and possibly benefit by holding '*structural pandemic winners*'. In this respect, we note that a number of observers have commented on a shift in the price dynamics in the stock markets over the past few months, where traditional '*value-driven*' shares in cyclical sectors on-and-off have been bolstered by rising inflation expectations. This has pushed bond yields higher with the effect that valuations of companies in growth industries, such as those in the technology sector, have fallen. Against this backdrop, we believe it is worthwhile to take a step back and consider what the implication of such a rotation means. We construe the following:

- ***First:*** if one believes that '*technology*' will have a smaller role to play after economies re-open in a post-pandemic environment, rotation to value-driven stocks makes sense (but we don't believe so).
- ***Secondly:*** other growth sectors, sometimes referred to as '*COVID-19 winners*', such as those in the TIC segment (testing/inspection/certification) and environmentally exposed stocks, have also been subject to profit-taking.

Possibly our biggest takeaway from the pandemic over the past year is that there have been structural shifts in consumer demand and consumer behaviour which will persist in a post-COVID-19 environment. For example, society will need increasingly more semi-conductors and chipsets as a higher proportion of the labour force will work from other locations than their normal offices (European Focus has direct and indirect exposures in this segment through: **ASML**, **Atlas Copco** and **Dassault Systèmes**). In a post-COVID-19 world, there will also be a structurally higher demand for '*testing*' (exposures: **Eurofins Scientific**, **Intertek** and **SGS**). Consumers are also likely to have become more wary when mingling with other people in confined spaces, such as shops. Hence, the already accelerating momentum in e-commerce prior to the pandemic has been given a further boost because of COVID-19 (exposure: **Zalando**). Increased concern about the environment and climate change is another demand factor (exposure: **Tomra**). Furthermore, the acceleration of governments' pursuit of carbon-neutrality, as per the Paris Climate Agreement, has also given environmentally exposed stocks a boost. Sadly, we also believe it is fair to argue that because of the many lockdowns, people's mobility has been impaired and, for many, food habits have likely been compromised by various shortcuts when working from home. Consequently, it is quite likely that more people will be affected by illnesses which could lead to diabetes (exposure: **Novo Nordisk**). Jointly, these 'structural pandemic winners' had a combined weighting of nearly 48% in the Fund at the end of 1Q21.

Higher discount rates affect the valuation of growth stocks but less so their businesses

Despite the aforementioned likely changes in consumer behaviour/demand, the attribution analysis below shows that several of last year's 'pandemic winners' (**Zalando**, **Tomra** and **Lonza**) were amongst the weakest performers in 1Q21. However, these companies invariably published excellent year-end results during 1Q21, which showed sequential acceleration in growth during 2H20 and their management teams did not lower their guidance for FY21 (rather the opposite). In our view, these stocks were subject to profit-taking primarily because of higher bond yields, which is a key component when valuing these types of growth companies on a discounted cash flow basis.

Against this backdrop, we believe it is worth taking another step back to ponder what the implications are of higher bond yields. *First*, companies in value-driven sectors are generally mature and therefore cyclical in nature as they tend to offer undifferentiated products with limited pricing power. *Secondly*, the most common way for mature companies to grow profits and increase profitability is by adding scale which means that they tend to be more acquisitive than growth companies. Acquisitions normally require additional capital – not only for the actual purchase of new businesses – but also for restructuring and integrating them into acquirers' existing networks. Consequently, mature businesses are often less well-capitalised compared with growth businesses – either because they operate extensive M&A activities in their role as '*consolidators*' and/or because their shareholders want them to return cash through higher dividend payouts.

It is worth looking at what happens to indebted companies' profits and balance sheets when interest rates move higher. While their capital structure remains unchanged, their interest expenses rise and this reduces their profitability, which implies that they may find it more difficult to: (*i*) raise new capital to pursue ongoing M&A, which penalises their growth rates (and eventually their stock market valuations), and; (*ii*) given lower profit growth, their ability to raise dividends becomes more constrained. Consequently, the revival in popularity of value-stocks is likely to be based on shorter term factors, such as mean-reversion after their long period of underperformance and higher inflation expectations in anticipation of the re-opening boost of economies. We construe that these factors may make them good 'trades', but we doubt they will be solid long-term investments as the current attributes are likely to be transitory.

Growth companies on the other hand are in a completely different situation. *First*, these companies are by definition not mature (i.e. cyclical) because there is an underlying demand for their products or services which implies that they enjoy pricing power. In our view, this attribute sets them apart from mature businesses since they, to a much higher extent, are masters of their own destiny as it is their prerogative to raise or lower their prices to the point where supply matches demand. This is a luxury which mature businesses (i.e. 'price-takers') don't have as they need to make capacity adjustments to meet demand. *Secondly*, growth companies are not expected to pursue acquisition-driven growth (unless it is for bolt-on purposes) because they already offer attractive growth rates by providing a desirable product/service offering. Moreover, growth companies are not necessarily expected to pay out high dividends since their shareholders regard it a better capital allocation to reinvest cash flows back into their businesses in order to generate higher profits.

In our view, growth companies, which have left their development stage (i.e. when they have moved from being loss-making to being profitable), have a trajectory of market share expansion, higher profit margins through additional scale and are at liberty to operate much more autonomously compared to mature businesses. Plus, their shareholders (such as ourselves) don't expect them to pay high dividends as long as their growth rates are intact. Heptagon European Focus invests in such companies and most of them have extremely strong and long track-records proving their success. In fact, our analysis shows that the average age of a Portfolio company in European Focus dates back to 1934 (oldest: Hermès/1837 – youngest: Zalando/2008).

Why European Focus should perform well in the quarters to come

European Focus grew its sales and profits in FY20 while the broader market contracted

The table below shows how Sales, EBITDA and EBIT developed for European Focus and Europe (MSCI index) in FY20. The table shows that European Focus grew its: Sales by +2.2% (MSCI: -17.2%) in FY20 while EBITDA increased by +9.8% (MSCI: -22.2%) and EBIT by +14.4% (MSCI: -34.3%).

Projection of sales and profit growth of European Focus and Europe (MSCI index)

HEFEF (%chg)	FY19	FY20	FY21e	FY22e
Sales		2.2%	9.5%	7.6%
EBITDA		9.8%	14.7%	10.0%
EBIT		14.4%	41.7%	12.1%

MSCI (% chg)	FY19	FY20	FY21e	FY22e
Sales		-17.2%	10.7%	4.3%
EBITDA		-22.2%	21.2%	8.0%
EBIT		-34.3%	32.0%	10.2%

HEFEF (units)	FY19	FY20	FY21e	FY22e
Sales	100	102.2	111.9	120.4
EBITDA	100	109.8	126.0	138.6
EBIT	100	114.4	162.1	181.7

MSCI (units)	FY19	FY20	FY21e	FY22e
Sales	100	82.8	91.7	95.6
EBITDA	100	77.8	94.3	101.8
EBIT	100	65.7	86.7	95.6

Source: Bloomberg

Some argue that '*sales is vanity while profit is sanity*'. We regard Sales as an under-rated attribute that is essential as this is the starting point from where businesses can grow their profits. Consequently, we believe the top-line needs to be analysed in the '*right*' way. Assuming that there is underlying demand for a company's products (i.e. it has pricing power), a natural constraint for Sales will be its capacity. Sales therefore needs to be broken down into 'organic growth' (price and volume) and 'other growth' (such as M&A and foreign exchange rate movements). Net-net, if a company continuously grows its Sales organically, this creates an ever-larger platform from where it can further expand its profits.

What happens when Sales decline, like they did for the European market in FY20 (see the right-hand side of the table)? In fact, Europe 'lost' -17.2% of its revenue base in FY20 and this means that the region needs to grow its revenues by +20.8% in FY21 to get back to square one. In similar fashion, Europe lost -22.2% of its EBITDA in FY20, which implies that it needs to grow by +28.5% in FY21 to get back to square one (the corresponding required growth from the -34.3% drop in EBIT to get back to square one is +52.2%). We ask ourselves if this is feasible? We have our doubts – especially this year since Europe has already been subject to one quarter in lockdown mode.

Of the four tables above, the two lower ones indicate how the revenue and profit-generating capacities of European Focus Fund and the European market will develop when re-basing the 2019 levels to 100 (i.e. before the COVID-19 crisis) and, factoring in Bloomberg's consensus expectations for the individual companies in the Portfolio as well as for the European market. Since European Focus grew its Sales, EBITDA and EBIT contrary to Europe in FY20, and according to Bloomberg's consensus estimates for FY21 and FY22, the Portfolio's higher expected revenue base implies that its capacity to expand its profits is considerably higher in comparison with that of the European market.

Our point is the following – given the drawdown in the revenue base of Europe vs. European Focus, it will take almost heroic efforts of the broader market to 'catch up' in terms of profit-generating capacity. Consequently, traditional 'value stocks', which are quite dominant in the European offering of equities, will therefore require a substantial re-rating to warrant valuations at or above their pre-COVID-19 sales and profit capacities. Over and above a '*mean-reversion trade*' – possibly triggered by optimism regarding a re-opening of economies - we find it quite unlikely that this segment of the market will continue to outperform in the medium-term as bond yields are expected to continue to increase.

Portfolio companies in European Focus are much better capitalised than the broader European market

As we have also alluded to earlier, rather than looking at higher bond yields only in the context of how they affect the valuation of growth stocks, we believe a more relevant question for the medium to long term is if higher bond yields will affect businesses' profitability (for example, if companies have sought government support during the pandemic or will require debt-relief).

On this note, we are pleased to report that the balance sheet strength of the average Portfolio company in European Focus is stronger now than it was a year ago. Following the FY20 reporting season and based on Bloomberg consensus EBITDA estimates for FY21, the Portfolio's net interest-bearing debt to EBITDA at the end of Dec-20 stood at 0.5x (Dec-19: 0.8x) excluding lease-debt obligations, while including lease-debt obligations the ratio was 0.8x (Dec-19: 1.3x). These strong Portfolio metrics compare favourably with the average net debt to EBITDA of the European market, which sits in the range of 3.0-3.5x.

The duration of debt of the average Portfolio company in European Focus has also improved in 2020. Our analysis shows that short-term debt (excluding lease-debt obligations) as a percentage of total interest-bearing debt stood at only 24% at the end of Dec-20 (Dec-19: 28%), while the corresponding short-term debt (including lease-debt obligations) stood at 21% (Dec-19: 23%). As and when investors start to consider what implications higher bond yields will have on companies' business performance – and not just in the context of the higher discount rates for valuing growth stocks – we are confident that this factor will be regarded as an impediment to many industries and it should play into further strength of Heptagon European Focus.

ESG considerations have been dramatically re-prioritised

Investors and companies dramatically re-prioritised ESG in 2020 and during the year-end reporting season over the past quarter, we noted that more and more companies had tied their managers remuneration to measurable ESG targets. All Portfolio companies in European Focus are on track to comply with the Paris Climate Agreement – and possibly earlier than 2050.

European Focus has an exclusion list which prevents it from investing in certain businesses, such as fossil fuel, nuclear, weapons, tobacco, gambling etc. and ESG as a concept has always been integrated into our strategy, given the mantra that it is essential for businesses that '***doing well and doing good is mutually dependent***'. In other words, it is not good business practice to cut corners in environmental, social or governance aspects given potential repercussions – be it financial risk, such as being liable to fines and/or damages, or reputational risk (which is ultimately likely to have financial implications).

Portfolio construction – the right balance between 're-opening boosters vs. long-term winners'

Earlier in the report, we highlighted areas which we believe will be structural winners in a post-COVID-19 world. However, we are not Pollyanna who focus only on the long-term; we also believe it is important to strike a balance and participate in the likely re-opening bounce. Against this backdrop, we look at stocks which performed well during the Nov-20 rally. Some of the best-performing stocks were **Diageo** (UK/spirits) and **EssilorLuxottica** (France-Italy/lenses-eyeglasses). Another stock in the Portfolio which we expect will perform well upon the re-opening phase is **L'Oréal** (France/make-up). Although L'Oréal published strong FY20 results (partly due to a very successful e-commerce strategy), the company's comparatively high exposure to make-up, which dropped by some -20% in volume terms in 2020, should have been a drag to its sales growth. Given the likely easing of COVID-19 related restriction, we suspect that this high-margin category will be a boon to the company. We believe that **Lindt & Sprüngli** (Switzerland/premium-chocolate) will perform well as lockdowns in North America and the APAC regions prevented the company from operating its 500+ store network. **Beiersdorf** (Germany/skincare) is another company which we believe will be a re-opening beneficiary. Although we feel that Beiersdorf could have done a better job in expanding its e-commerce business in FY20, management commented that its luxury brand (La Prairie) is more dependent on physical store sales, as this division's skincare consultants represent an important driver to its revenue stream. Jointly, these possible 're-opening beneficiaries' had a combined weighting of more than 23% in the Fund by the end of 1Q21.

Risks and uncertainties

- **USD weakness:** represents a risk for negative sales and profit revisions for European exporters. However, consensus sales and EBIT revisions for FY21 of the average Portfolio company in European Focus were unchanged between the end of Dec-20 and the end of 1Q21, while the corresponding upward revisions for FY22 were in the range of +1% to +2%.
- **High level of corporate indebtedness:** higher interest rates could continue to affect the valuation of equities and companies' profitability. As already outlined, the balance sheet strength of the average European Focus company is considerably better than the average for European equities (net debt to EBITDA including lease debt obligations of 0.8x vs. 3.0-3.5x for Europe).
- **COVID-19 jabs and vaccines:** a continued sluggish inoculation rollout and ongoing tussle for vaccines may affect Europe longer than expected. However, the US as well as China appear to be gaining economic momentum which should help to offset European-instigated weakness.
- **Another 'taper tantrum' as central banks reverse monetary stimuli and excessive level of debt:** While the ECB and BoE stand ready to support the markets while the pandemic is running, debt has maturity and cannot generally be rolled over into perpetuity without side-effects.
- **China:** the increasingly important Chinese economy in the context of global growth continues to operate in a debt-driven fashion. Any slowdown in international economic activity and/or defaults by major domestic SOEs or Chinese real-estate/construction companies may be a catalyst for tighter credit conditions in China.

HEFEF attribution analysis for 2021

During 1Q21, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value advanced by +3.02% to €178.6898 compared with the MSCI Europe NR (EUR) index, which appreciated by +8.35% in comparison.

There was considerable rotation in the top and the bottom performing positions during 1Q21 compared with 2020. Three of the top-five performing positions in 2020 were in the bottom-five in 1Q21 (**Tomra**, **Zalando** and **Lonza**) while two of the top-five performing stocks in 1Q21 were also in the top-five in 2020 (**ASML** and **Eurofins Scientific**). On a more positive note, one of the bottom-five performers in 2020 ended up as a top-five performer in 1Q21 (**Serco**).

Two other stocks pushed into the top-five performing positions in 1Q21 (**Atlas Copco** and **Dassault Systèmes**), while **Adidas** and **Lindt & Sprüngli** fell into the bottom-five category.

At the end of 1Q21, the top-five positions had a combined weighting of 24% in European Focus; the corresponding combined weighting for the bottom-five positions was 27%.

In the below attribution analysis, which covers the 1Q21 period, the performance of each stock has been converted to EUR from its local currency. Each stock's EUR denominated performance should be compared with the benchmark index, MSCI Europe NR (EUR), which advanced by +8.35% over the same period.

Contributors

ASML (ASML NA)

ASML (the Netherlands: +30.05%), the world's #1 manufacturer of semi-conductor equipment provider (and currently the largest position in Heptagon European Focus) was the best-performing stock in the Portfolio in 1Q21 (and the third-best performer in the Portfolio in 2020: +50.76%). Following the stock's coronavirus-infused low (18-Mar-20), its ascent has been more or less relentless as 'WFH' (working from home), 5G-rollouts and 'IOT' (internet of things) have been drivers for continued strong demand for smaller and faster chipsets. ASML's solid 4Q20 set of results (20-Jan) and management's encouraging guidance for FY21 have further boosted the investment story of the company. Given ASML's extremely strong position in its industry, where it dominates in several product categories, such as the high-end EUV-lithography (Extreme Ultra-Violet – extremely fine circuit patterns on micro-chips), we believe demand for semi-conductor manufacturing equipment will remain strong in the medium-term. Intel Corporation's announcement that it will invest in new semi-conductor capacity in Arizona has further bolstered the investment sentiment to the ASML share. In the face of USD weakness against the EUR year-over-year, ASML's sales and profit revisions for FY21 and FY22 have been very strong at +6-8%. The 1Q21 set of results is due on 21-Apr.

Atlas Copco (ATCOA SS)

ATCOA (Sweden: +23.85%), the leading provider of compressed air and other capital goods equipment, was the second-best performing in the Portfolio in 1Q21 (2020: +17.79%). Since the ATCOA share's coronavirus-driven low point (23-Mar-20), which was around the time when we re-invested in the company, the stock has shown a consistent upward traction with limited volatility. The 4Q20 set of results (29-Jan) was slightly ahead of highly set market expectations. Management commented that demand was strong from the semi-conductor industry (where ASML is likely to be a prominent customer) while the order intake also increased in other product categories, such as industrial compressors, medical equipment, equipment for automotive applications, particularly in the fields of electric vehicle and battery production. As with other USD-sensitive businesses, for ATCOA (we estimate that close to 60% of ATCOA's invoicing is in USD), consensus sales and profit revisions for FY21 and FY22 have been quite decent at +1-3%, reflecting expectations that the underlying business is continuing to perform well. Management guided for a sequentially unchanged organic growth rate in 1Q21 vs. the previous quarter. ATCOA's 1Q21 set of results is due on 27-Apr.

Serco (SRP LN)

SRP (UK: +21.11%), a leading British provider of outsourcing services, was the third-best performing stock in the Portfolio in 1Q21 (but the weakest performer in the Portfolio in 2020: -30.16%). SRP keeps exceeding management's sales and profit guidance and – under the current management team led by Rupert Soames – we are hopeful that the excellent operational execution has finally turned in SRP share's favour as a confluence of factors supports this view. *First*, (and outside of SRP's immediate control) investment sentiment to UK equities is poised to improve after the conclusion of around four years of cumbersome Brexit-negotiations and the UK government's highly successful COVID-19 inoculation program. *Secondly*, when SRP published its FY20 set of results (25-Feb), management (again) raised the underlying profit guidance to double-digit growth for FY21, confirming what we believe reflects the result of a much more profitable organisation after several years of cost-cutting efforts. *Thirdly*, following a few bolt-on acquisitions over the past two years as SRP's business has come out of restructuring mode, the management team has also proven that the company is ready to expand the portfolio of support-service contracts organically. The recent announcement of a contract-win with Canada's Defence Department (17-Mar) worth up to £870bn over an initial 10-year period (with a provision of two five-year extensions) for most of the non-military operation and maintenance functions at the Labrador Base was extremely well-received by the market. *Finally*, partly to re-confirm management's optimism about the business going forward, SRP re-instated a dividend for the first time since 2014. The company will release its 1H21 pre-close statement on 30-Jun and the complete 1H21 statement is due on 5-Aug.

Eurofins Scientific (ERF FP)

ERF (France: +18.77%), the leading testing-services group which offers bioanalytical services in the food, pharmaceutical and environmental markets, was the fourth-best performing stock in the Portfolio in 1Q21 (and the fifth-best performer in the Portfolio in 2020: +38.87%). Since 1Q20, ERF's share price performance has been quite strong and the stock has responded positively to every quarterly sales and profit announcement over the past year. The 1Q20 sales report (28-Ap-20) and the 1H20 set of results (6-Aug-20) acted as catalysts to send the ERF share sharply higher. Following the announcements that three of the most prominent COVID-19 vaccines were on the cusp of receiving approvals, the ERF share saw some profit-taking in Nov-20. Although management raised the FY20 guidance for sales, profits and cash flows (15-Dec-20), the stock responded in a surprisingly lacklustre fashion, possibly on the back of its already strong performance last year. ERF's FY20 results (1-Mar) again prompted the market to raise the expectations for FY21 and for the next few years as management upgraded the medium-term FY22 financial objectives. Not only should ERF be a '*fully digital*' company by that time, but given what we believe is a conservative annual 5% LfL sales growth assumption, the underlying EBITDA margin is set to expand to more than 23.5% (up from 20.4% in FY19 which is a more representative base compared with the bumper year FY20 when the EBITDA margin jumped to 26.0% because of COVID-19 testing). The consensus sales and profit estimates for ERF have been continuously raised at a very high rate of +5-20% for FY21 and FY22 since the FY20 report. The company will announce 1Q21 revenues on 28-Apr.

Dassault Systèmes (DSY FP)

DSY (France: +9.78%), the world's largest supplier of PLM (product life-cycle management) software and 3D solutions, was the fifth-best performing stock in the Portfolio in 1Q21 (2020: +13.37%). DSY's 4Q20 set of results (4-Feb) was ahead of market expectations. Management hosted an upbeat webcast where they outlined expected 14% LfL licence fee growth in FY21 and a quick uptake in cloud-based solutions, which today accounts for some 20% of its current revenue base. The market took the report extremely well; consensus expectations for FY21 and FY22 have been slightly raised at +1-2% despite the fact a considerable proportion of DSY's invoicing is in USD (we estimate 55-60%). Over the past 1-2 years, we have increasingly had the impression that the long-standing CEO, Bernard Charlès (who joined DSY in 1983), is preparing to take a step back as DSY's highly regarded CFO/COO, Pascal Daloz, has gradually become more prominent during the company's presentations. DSY will release the 1Q21 set of results on 28-Apr.

Detractors

Adidas (ADS GY)

ADS (Germany: -10.64%), the world's second-largest sports shoe manufacturer after Nike, was the weakest performing stock in the Portfolio in 1Q21 (2020: +2.80%). Although the 4Q20 set of results (10-Mar) was ahead of highly-set market expectations, the ADS share failed to break out of its €260-300 trading range in which it has traded since Aug-20. The stock performed strongly during the Nov-20 rally (when European shares posted their best-ever monthly advance: +14%) and it continues to stand to benefit from further easing of lockdown restrictions. ADS management hosted an excellent investor day in conjunction with the release of the 4Q20 report where they highlighted a major change to its strategy for 2021-25 with the aim of converting the business from being primarily wholesale-oriented to D2C (direct-to-consumer) driven. This will require some €8-9bn in additional investment-spending (circa 40% of FY20 revenues) but should transform the group into a digital company where sport will remain its core-competence. Not only should this lead to an acceleration in sales growth as an increasing proportion of the revenue stream moves online, but it should also bolster the group's profit margin. Together with some other international companies like Nike and H&M, ADS saw its share come under pressure following China's retaliation over the Xinjian cotton boycott (25-Mar). However, similar Chinese cases of 'bullying' foreign businesses in the past (such as Japanese, Korean and US companies) have tended to 'blow over'. Consequently, we took the opportunity to add shares to our existing ADS position (+0.6% to 4.8%). ADS will publish 1Q21 results on 7-May.

Tomra (TOM NO)

TOM (Norway: -8.19%), the world's leading supplier of recycling and sorting equipment, was the second-weakest performing stock in the Portfolio in 1Q21 (but the fourth-best performer in the Portfolio in 2020: +43.51%). Over the past year, all of TOM's quarterly results have been well ahead of market expectations and the 4Q20 statement (23-Feb) was no exception. Despite an extremely upbeat presentation by management and the market's positive view on the report, the stock soon deflated as bond yield concerns started to affect growth stocks. Nonetheless, at the results webcast, management (again) confidently reiterated that '*things are pretty much back to normal in both divisions*' and we believe market estimates have taken cue from this. While the FY21 and FY22 sales estimates have been left unchanged, EBIT estimates for both years have been raised by +2%. However, more important for the long-term investment story of TOM are the estimate upgrades for FY23 (sales +3% and EBIT +8%), which we believe will continue into FY24 and FY25, as the EU is planning to implement its restriction on single-use plastic containers. This regulatory change implies that by 2025, 77% of all single-use plastic containers need to contain recycled plastics (and this ratio will increase to 90% by 2029). As TOM is the leading company in this field (and with a core-competence in how to implement circular deposit systems in different jurisdictions), this should be a sea-change in the company's business evolution. TOM's 1Q21 set of results is due on 23-Apr.

Zalando (ZAL GY)

ZAL (Germany: -8.15%), Europe's largest fashion online retailer, was the third-weakest performing stock in the Portfolio in 1Q21 (but the best performer stock in the Portfolio in FY20: +101.55%). After several sales and profit upgrades by management in 2020 as lockdown restrictions fast-forwarded the shift to online retailing, ZAL had an absolute bumper period in 4Q20 reflecting +34% growth in active customers (i.e. consumers who use the ZAL platform at least once a year). Moreover, revenues grew by 30% and GMV (gross merchandise value) by +38%. The announcement of the 4Q20 statement (16-Mar) also incorporated an investor day where management stated its ambition to become Europe's largest fashion retailer (for example, ZAL is targeting a 10% market share from around 3% today) by 2025. Given ZAL's already extensive scale vs. the competition, we have few doubts that management's targets will be achieved. ZAL's 1Q21 set of results are due on 6-May. Given the ongoing lockdown restrictions in Europe so far in 2021, we have no doubt that this set of numbers will break new records.

Lonza (LONN SW)

LONN (Switzerland: -7.06%), the leading provider of fine chemicals, biocides, active ingredients and dosage-forms to the pharmaceuticals industry, was the fourth-weakest performing stock in the Portfolio in 1Q21 (but was the second-best performer in the Portfolio in 2020: +61.71%). We were fortunate to add LONN to the Fund one day after its lowest point last year (24-Mar-20) and from there on the stock had a very strong performance until mid-July following the announcement (1-May-20) that the company and the US biotechnology company, Moderna (MRNA US), had signed a ten-year agreement for the production of up to 1bn doses of the COVID-19 vaccine (code named: mRNA-1273). The terms of the deal are that MRNA will utilise LONN's factories in the US and in Switzerland for the production of the COVID-19 vaccine. The LONN share took another leap to its all-time high (CHF622) on the back of the appointment of a new CEO, Pierre-Alain Ruffieux (2-Nov-20), after which it has been oscillating in the CHF540-610 range. Despite solid FY20 results (27-Jan) which were ahead of market estimates, the LONN share has seen some profit-taking. The announcement of a deconsolidation of the Speciality Ingredients division (27% of sales and 15% of EBIT in FY20) has led to downward consensus revisions of -1% to -3% partly offset by the uplift in demand for more doses of the MRNA-1273 vaccine. However, the main reason for the profit-taking in our opinion is that LONN's management has been quite cagey about the financial benefits from the MRNA-agreement. Following some subscriptions to the Fund, the holding has been slightly diluted from around 5.0% at the end of Dec-20 to 4.7% at the end of Mar-21. LONN is due publish its 1H21 set of results on 23-Jul.

Lindt & Sprüngli (LISP SW)

LISP (Switzerland: -6.55%), the world's largest provider of premium chocolate, was the fifth-worst performing stock in the Portfolio in 1Q21 (2020: +15.19%). Although LISP's FY20 revenues (19-Jan) fell short of market expectations and we suspect the company's extremely conservative management took the opportunity to play down market expectations, the full FY20 set of results (2-Mar) was well ahead. At this time, LISP hosted a webcast where management could outline the main issues in FY20 which were two. *First*, LISP's retail network (circa 500 stores primarily located in the APAC and North American regions) did not perform well due to the lockdowns. *Secondly*, LISP is exposed to travel retail, which management claimed had been essentially non-existent since Mar-20. Against this backdrop, we still regard LISP to have performed well reflecting a sequential recovery in 2H20. Assuming easing up of lockdown restrictions in 2021, we believe there is little doubt that LISP will perform well this year. Management anticipates some catch-up demand in FY21 and is thus guiding for 6-8% LfL growth in FY21 and 20-40bps incremental improvement in the EBIT margin. For FY22, the long-term 5-7% LfL growth guidance will be re-applied with the traditional 20-40bps EBIT margin improvement. We slightly added to our LISP holding during the stock's weakness following the FY20 sales announcement in January. The stock performed well during Mar-21 and at the end of Mar-21, the position had a 4.3% weighting. LISP will announce 1H21 results on 27-Jul.

HEFEF Portfolio changes

The '5/10/40' UCITS rule states that positions over 5% cannot have an aggregate weighting which exceeds 40% and that an individual position cannot have a weighting which exceeds 10%. As trades of less than 1% are too small to have any meaningful impact on the Fund's performance, we only generally comment on trades exceeding this level. Over-and-above smaller changes to the Portfolio, which relate mostly to market opportunities and/or correction of passive UCITS breaches, we rebalanced the Portfolio by making nil changes during 1Q21 (1Q20: 4 changes).

Christian Diebitsch, Fund Manager, Heptagon Capital

Important Information

Past performance is not an indication or guarantee of future performance and no representation or warranty is made regarding future performance. This communication is for information purposes only. It is not an invitation or inducement to engage in investment activity.

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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.

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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