European Focus Fund: Quarterly Commentary

Q2 2021: Market Commentary and Attribution Analysis for 1H21

Fund Manager

Christian Diebitsch

Investment Objective

The Fund aims to deliver long-term capital appreciation by investing in European equities. The Fund employs a high conviction, bottom-up, low turnover, research driven strategy with a focus on companies that exhibit sustainable long- term growth.

Contact

Heptagon Capital
63 Brook Street, Mayfair,
London W1K 4HS

Tel: +44 20 7070 1800
Fax: +44 20 7070 1881
email london@heptagon-capital.com

Performance and executive summary

During 1H21, the Heptagon European Focus Equity Fund (European Focus) CE share class' net asset value advanced by +18.37% to €205.3176 compared with the MSCI Europe NR (EUR) index, which appreciated by +15.35% in comparison.

European equities close 1H21 on a near high

Most stock markets around the world have been on steroids so far in 2021. For European equities in particular, 1H21 was one of the strongest periods in more than 20 years. Despite Covid-19-related restrictions and a generally slow start to the vaccine rollouts in most of Europe, stock markets have homed in on the positive drivers. As lockdown restrictions were gradually eased, consumer and business confidence bounced back and there was a noticeable difference in optimism amongst the management teams of our Portfolio companies in 2Q21 compared with earlier this year. There were other drivers to equity markets as well - central banks provided support to the financial system through ongoing ultra-loose monetary policy, while at the same time, governments kept furlough schemes running; yet to come still are several fiscal stimuli programs, which should start to feed through during 2H21.

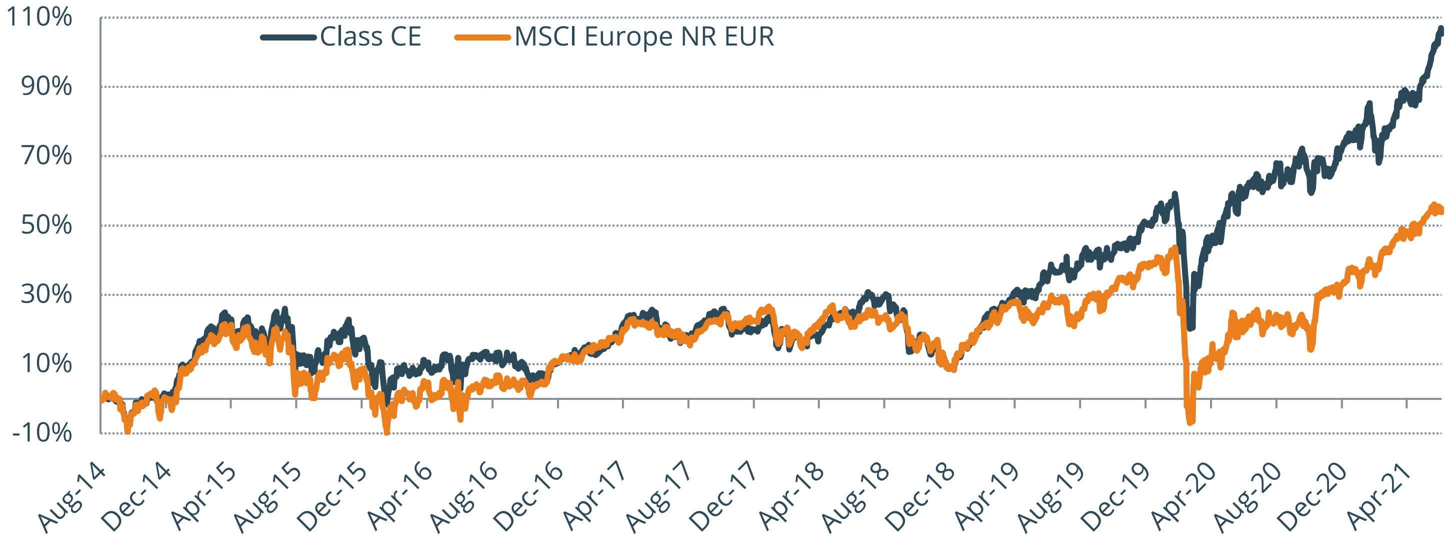
Equity market dynamics changed from 1Q21 to 2Q21

1Q21 was a strong quarter for European equities (MSCI Europe NR (EUR) index +8.35%), but what characterised the market dynamics at that time was how deep-value stocks continued to recover from 4Q20. However, 1Q21 in isolation was somewhat contrasting. While January delivered a negative return for European equities (-0.75%), February and March were both strong months (+2.54% and +6.47% respectively), prompting cyclical recovery sectors, such as energy and financials, to take the two top positions with advances of +13.66% and +13.65% respectively in that quarter.

Investors' sector preference changed dramatically in 2Q21 however, as the '*reflation-trade*', which pushed the aforementioned cyclical sectors higher earlier in 1Q21, began to unwind. While the MSCI Europe NR (EUR) index appreciated by +6.46% in 2Q21, healthcare stocks and information technology rose by +10.78% and +8.81% respectively. We believe a multitude of factors drove that change.

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

The European Focus CE share class performance since inception on 26 August 2014



Source: Bloomberg

April was dominated by companies' 1Q21 sales and profit statements

We were very pleased that every Portfolio company that announced 1Q21 figures showed like-for-like (LfL) revenue growth that was higher (and often considerably more so) compared with what the market was expecting. Moreover, the management teams of the companies that announced statements came across much more upbeat during April-May than over the year-end reporting season in January-March. From our analysis of the 1Q21 statements, we construe that: (*i*) our Portfolio companies had recovered what they lost during the first lockdown in 1Q20 and; (*ii*) most of them were back on their trendline growth, which indicate a '*V-shaped*' recovery. Thus, it goes to show that time and time again, the investment community tends to underestimate companies' flexibility to swiftly adjust to changes in underlying business conditions. This is particularly prevalent when the macro-economic environment is changing from recessionary to a booming one. In this case however, where Covid-19 related restrictions prevented businesses from engaging with customers face-to-face, the most successful companies were quick to embrace new digital formats and e-commerce. We consider some Portfolio holdings to have been particularly successful in this undertaking, such as **Eurofins Scientific**, **Hermès**, **L'Oréal** and to some extent **Nestlé**, as all of these businesses showed a very strong increase (and meaningful contribution to their businesses) deriving from digital selling.

May saw a swift recovery in consumer and business confidence due to the vaccine rollouts

Not only did economists and market strategists become more positive to European equities due to the strength of the economic bounce-back, but several began to caution that simultaneous bond buying by central banks; forthcoming fiscal stimuli by governments and generally strong pent-up consumer-demand in conjunction with high savings ratios would push growth, inflation and asset prices beyond what may be considered to be normal in a post-pandemic environment.

Although we were already positive on European equities leading into 2021, we concur with the general boost in investor sentiment in May, since equities typically record their strongest advances when the *'rate of change'* in fundamentals translates into accelerating growth. We believe such acceleration was (and still is) prevalent, which should place European equities in an extremely strong position compared with other parts of the world, where the vaccine rollouts have been regarded to be more efficiently handled and the fallout of Covid-19 perceived to have been less severe.

Hence, our thinking is that if there is indeed pent-up consumer-demand across the globe (which we expect), European companies are in a unique position to *'hit the ground running'*. Many of them never had to permanently lay off employees given generous furlough schemes and that is likely to set them apart from businesses in the US, which terminated staff early in the pandemic so will have to rehire new manpower (possibly at higher wages and salaries) and train them while facing rising demand. By experience, we are also aware that Europe, as a region to invest in, tends to be under-appreciated as it is generally regarded to be slow to react, to have inept and overly bureaucratic leadership alongside cumbersome labour laws.

What also differentiates Europe from the US is that Europe rarely gets *'US-style'* sensational headlines (e.g. *'Biden-headlines'*). Closer analysis shows that while President Biden's $1.9tn stimulus package in many ways stole the show in terms of size and scope, many appear to have forgotten that the €750bn European Recovery Fund in many ways is a game-changer for Europe. Not only is it the first time the EU will issue joint liability bonds, but the Recovery Fund will also be extended by a seven-year Multiannual Financial Framework (MFF) which is worth an additional €1.074bn. This brings the EU's total stimulus program(s) up to €1.82tn, which is more than President Biden's package.

In terms of structure, the MFF is seen to be longer term and more focused on a *'greener environment and infrastructure'*, while Biden's package is shorter term and more *'consumption-centric'*. Consequently, as economies are opening up it is likely that Europe will get a positive 'double-whammy' by benefitting from an initial cyclical boast, followed by a longer term structural impact that should translate to higher long-term growth rates as the impact of the MFF gains momentum until 2023-24e.

June reflects flagging belief in the *'reflation trade'*
At the FOMC meeting in June, the Federal Reserve (Fed) Chairman, Jerome Powell, reiterated the committee's view that a likely *'inflationary bump'* would only be transitory. Analysis of the movements of the US long bond yield during the days around the Fed meeting implies that investors were quick to catch on. While the US ten-year yield jumped from 1.49% to 1.57% on the day of Powell's remarks on 16th June, it fell back to 1.50% on 17th and down further to 1.44% on 18th. In short, it took the Fed 2-3 days to convince market participants of its *'transitionary inflation stance'* (at the time of writing, the US ten-year yield has fallen further to around 1.4%). Meanwhile, the USD strengthened by more than 2% against the EUR over the same period and at the rate of around 1.18 to the EUR. The USD will show year-over-year strength during 2H21, which is good news for European exporters.

2H21 and beyond

Looking back over the past three decades, which is even before George Soros busted the ERM (European Exchange Rate Mechanism, i.e. the precursor to the EUR), we cannot recall any other period when market conditions were so uniformly positive for European equities. Here are some of those drivers:

- Supportive monetary policies by the central banks
- Forthcoming and coordinated government fiscal stimuli
- Limited inflationary pressures (and possibly transitional)
- Pent-up consumer demand after some 1.5 years of lockdown restrictions

During European economic recovery periods over the past 30 years there were always inhibiting factors such as: the risk of escalating inflationary pressures; consumption sentiment bordering on frugality due to job insecurity (i.e. no furlough schemes) and several (national) central banks (before the launch of the EUR) having pursued much more hawkish policies and not being committed to underpin the region, only their respective country. Against this backdrop, this time around we would argue that the stars have really lined up for Europe to perform well during the likely forthcoming recovery.

Why European Focus should perform well in the quarters to come

The Fund grew its sales and profits in FY20 while the broader market contracted
We have updated the table on the following page from Apr-20. The table illustrates how sales, EBITDA and EBIT developed for European Focus and Europe (the MSCI index) in FY20 and what the current consensus expectations are for FY21e and FY22e. The table shows that European Focus grew its: sales by +2.0% (MSCI: -18.4%) in FY20 while EBITDA increased by +9.4% (MSCI: -21.1%) and EBIT by +13.4% (MSCI: -38.2%).

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

HEFEF	FY19a	FY20a	FY21e	FY22e	MSCI	FY19a	FY20a	FY21e	FY22e
Sales	—	2.0%	12.9%	8.1%	Sales	—	-18.4%	10.8%	4.3%
EBITDA	—	9.4%	20.9%	9.9%	EBITDA	—	-21.1%	26.7%	5.8%
EBIT	—	13.4%	57.5%	11.2%	EBIT	—	-38.2%	46.5%	6.0%

HEFEF	FY19a	FY20a	FY21e	FY22e	MSCI	FY19a	FY20a	FY21e	FY22e
Sales	100	102.0	115.2	124.5	Sales	100	81.6	90.4	94.3
EBITDA	100	109.4	132.3	145.4	EBITDA	100	78.9	100.0	105.8
EBIT	100	113.4	178.5	198.5	EBIT	100	61.8	90.5	96.0

Note: as at 12-Jul-21 and with Portfolio weightings on 30-Jun-21
Source: Bloomberg

Some argue that '*sales are vanity while profits are sanity*'. However, we regard sales as an underrated attribute that is essential for any business to grow its 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 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 compound its profits.

What happens when sales decline, like they did for the European market in FY20 (see the right-hand side of the table)? Europe 'lost' -18.4% of its revenue base and this means that the region needs to grow its revenues by +22.6% in FY21 to get back to square one, but the region is only expected to grow its revenues by +10.8%, according to consensus. In similar fashion, Europe lost -21.1% of its EBITDA in FY20, which implies that it needs to grow by +26.7% in FY21 (which in fact consensus expects). However, given the substantial EBIT drop of -38.2% for the region in FY20, Europe needs to grow by +61.8% in FY21 to get back to square one, however the region is only expected to grow EBIT by +46.5%, according to consensus. We have doubts whether the region can achieve such growth rates – especially this year since Europe has already been subjected to one quarter of lockdown mode.

Of the four tables above, the two lower ones indicate the revenue and profit generating capacities of European Focus and the European market when re-basing the 2019 levels to 100 (i.e. before the pandemic) 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 (upgraded) 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 considerable growth for the broader European market to '*catch up*' in terms of profit-generating capacity of European Focus. Hence, traditional 'value stocks', which are dominant in the overall European equity offering, will 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 (reflected in the strong market rally in Nov-20 as well as in 1Q21) – we find it unlikely that such deep-value sectors of the market will outperform other than in short spurts as profit-expectations will ultimately moderate.

Portfolio companies in European Focus are better capitalised than the broader European market
As we have also eluded to in previous quarterly reports, rather than looking only at the impact of higher bond yields in the context of how they affect the valuation of growth stocks, we believe a more relevant question is how higher bond yields affect businesses' profitability (for example if companies have sought government support during the pandemic and/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 a year ago. Following the FY20 reporting season and based on Bloomberg consensus estimates for FY21, the Portfolio's net interest-bearing debt to EBITDA at the end of Dec-20 –(and with updated EBITDA estimates) stood at less than 0.5x (Dec-19: 0.8x) excluding lease-debt obligations; whilst including lease-debt obligations the ratio was slightly less than 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 25% at the end of Dec-20 (Dec-19: 28%), while the corresponding short-term debt (including lease-debt obligations) stood at 22% (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 for the European Focus.

ESG considerations are continuously re-prioritised

Investors and companies are continuing to re-prioritise ESG as we note that more and more companies are tying 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. Two of our Portfolio companies (**SGS** and **Diageo**), hosted dedicated ESG webcasts during 1H21 where they either highlighted tangible ESG targets and/or updated existing targets. Four companies (**Adidas**/Portfolio holding; **Atlas Copco**/Portfolio holding; **Assa Abloy**/not a Portfolio holding and **Zalando**/Portfolio holding) have held their annual investor days and dedicated some two-thirds of the overall webcast time on ESG-related matters. In our view, they could have dedicated these events to specific ESG webcasts.

European Focus has an exclusion list which prevents it from investing in 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 are '***doing well and doing good are mutually dependent***'. In other words, it is not good business practice to cut corners in any of the ESG dimensions 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 tweaks and exposures

Against the aforementioned underlying macro-economic and stock market specifics, we have tweaked the exposures of European Focus slightly more towards consumer-facing businesses. The combined exposures in the Fund to such businesses - **Adidas**, **Beiersdorf**, **Diageo**, **EssilorLuxottica**, **Hermès**, **Lindt & Sprüngli**, **L'Oréal**, **Nestlé** and **Zalando** - had 39% weighting at the end 1Q21, but their aggregate exposure rose to more than 41% by the end of 1H21.

We have maintained other 'stalwart' companies which we consider to have strong pricing power such as: **ASML**, **Dassault Systèmes**, **Novo Nordisk** and **Coloplast** (22% aggregate weighting at the end of 1H21). Our high-conviction holdings (i.e. positions which have a higher weighting than 5%) at the end of 1H21 were the same as in 1Q21: **ASML**, **Eurofins Scientific**, **Novo Nordisk**, **Tomra** and **Zalando**, and their aggregate weighting was 32% at the end of 1H21.

Risks and uncertainties

Below are a few bullet points regarding risks and uncertainties which we currently consider in terms of relevance.

- **Delta variant of Covid-19 spiralling out of control vs. vaccine rollouts:** The Delta variant of Covid-19, which originated in India, is rapidly spreading across the world. We believe this negative trend needs to be balanced against the pace of vaccine rollouts and economies reopening.

- **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 an average European Focus company is considerably better than the average for European equities (net debt to EBITDA including lease debt obligations of less than 0.8x vs. 3.0-3.5x for Europe).
- **Another 'taper tantrum' when central banks reverse monetary stimuli:** 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 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.
- **USD-weakness:** Represents a risk for negative sales and profit revisions for European exporters. However, at a USD rate of 1.18 against the EUR, the USD should provide a slight exchange-rate tailwind for European exporters during 2H21.

Attribution analysis for 1H21

During 1H21, the Heptagon European Focus Equity Fund (European Focus) CE share class' net asset value advanced by +18.37% to €205.3176 compared with the MSCI Europe NR (EUR) index, which appreciated by +15.35% in comparison.

There was less rotation in the top and the bottom performing stocks during 1H21 compared with 1Q21 in isolation. Two of the top-five performing stocks in 1H21 (which were amongst the largest holdings in the Fund) were also in the group of top-five performing stocks in 2020 (**ASML** and **Eurofins Scientific**). Moreover, **Hermès** and **Diageo**, which were amongst the best-performing stocks in 1Q21, continued to show their strength in 1H21.

In terms of the five weakest-performing stocks in the Portfolio during 1H21, it is important to note that none of the stocks lost value over the period – they just did not appreciate as much as the benchmark index. The detractors in the Portfolio over 1H21 were more consistent in comparison with 1Q21, such as **Adidas** and **Lindt & Sprüngli**. **Intertek** was the weakest performer in 1H21 (as well as the fourth weakest performer in 2020); **Beiersdorf** was the fifth weakest-performing stock in 1H21 (and the third weakest-performer in 2020). However, as far as the detractors in 1H21 are concerned we see catalysts for each case which should prompt a re-rating over the next 2-4 quarters.

At the end of 1H21, the top-five positions had an aggregate weighting of 26% in European Focus; the corresponding aggregate weighting for the bottom-five positions was 19%.

In the below attribution analysis, which covers the 1H21 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 +15.35% over the same period.

Contributors

ASML (ASML NA)

ASML (the Netherlands: +45.74%), the world's #1 manufacturer of semi-conductor equipment (currently the largest position in European Focus), was the best-performing stock in the Portfolio in 1H21 (and in 1Q21 as well as in 2020: +50.8%). Following the ASML share's coronavirus-triggered low (18-Mar-20), its recovery was quick. The stock traded in a range-bound fashion during the months of July-October last year only to regain steam in November-December. 'WfH' (working-from-home), 5G-rollouts and 'IoT' (internet-of-things) have been ongoing drivers for strong demand for smaller and faster chipsets. The company's 4Q20 report (20-Jan) as well 1Q21 (29-Apr) and 2Q21 (21-Jul) sets of results were all excellent and have prompted ongoing sales and profit upgrades. Management's encouraging guidance for continued strong demand for FY21 and beyond have further boosted the investment story for ASML. Given the company'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 its equipment will remain strong for the foreseeable future. News flow from semi-conductor giants, such as Intel Corporation investing in new semi-conductor capacity in Arizona a few months ago, continues to bolster investment sentiment for ASML. The recent recovery of the USD against the EUR should help to bolster consensus sales and profit estimates for ASML. The company's 3Q21 set of results is due on 20-Oct.

Eurofins Scientific (ERF FP)

ERF (France: +40.46%), the leading testing services group which provides bioanalytical services in the food, pharmaceutical and environmental markets, was the second best-performing stock in the Portfolio in 1Q21 (and the third best performer in 1Q21). Since the outbreak of Covid-19, the ERF share has been underpinned by continuously strong demand for testing and the stock has invariably responded positively to every quarterly sales/profit announcement and several upgrades to the guidance management have provided over the past one and a half years. ERF's FY20 set of results (1-Mar) prompted the market to raise the expectations for FY21 as management (again) 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 rate assumption by management, 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). In the recent and outstanding 1Q21 sales report (28-Apr), management commented on further exceptionally strong demand reflecting new business dynamics on the back of Covid-19 testing. LfL growth in 1Q21 reached 44.3% (4Q20: +42.4% and 1Q20: +4.1%) primarily due to the pandemic, but ERF's core business still delivered '*underlying*' LfL growth of close to 10%. ERF also commented that Covid-19 testing-related activities had changed from '*standard*' testing to testing of '*variants*', which of course increases the sophistication of tests (and we suspect the pricing). ERF is due to publish its 2Q21 revenue and 1H21 set of results on 5-Aug.

Hermès (RMS FP)

RMS (France: +39.67%), the highly focused and leading French luxury company, was the third best-performing stock in the Portfolio in 1H21. So far this year, RMS has delivered excellent sales and results statements; the 4Q20 report (19-Feb) showed like-for-like (LfL) sales growth of +15.6% (sequentially up from +6.9% in 3Q20). Given the low base numbers for comparison in the period a year ago, LfL revenue growth reached +43.7% (1Q20: -7.7%) in 1Q21 (22-Apr). Graphically, it is now amply evident that the company has regained its poise and is back on trend-growth after the pandemic-infused slowdown. Due to the 'easy' base numbers for comparison (2Q20: LfL sales were -42.1%), we have no doubt that RMS's business will thrive in 2Q21 and thus in 1H21. The company's next interim set of results is due on 30-Jul.

Diageo (DGE LN)

DGE (UK: +25.44%), the world's largest distiller (and the owner of world-renowned brand names like Johnnie Walker, Gordon's, Tanqueray, Smirnoff and Captain Morgan, among others), was the fourth best-performing stock in the Portfolio in 1H21 (and the sixth best-performer in the Portfolio in 1Q21). Last year, global lockdowns caused a significant slowdown in DGE's on-channel business to pubs, bars and restaurants over-and-above virtually non-existent duty-free shopping that was caused by air-traffic and cruise restrictions. However, we assumed that consumers' spending habits on alcoholic beverages would eventually shift to more domestic consumption, thus prompting an uplift to the off-channel business (i.e. retailers and supermarkets etc). The DGE share's very strong performance during the market rally in November last year (+15.3% vs 14.0% of the benchmark) clearly positioned the stock as an '*opening-up winner*'. Against this backdrop, management issued an ad hoc trading update (12-May) where they highlighted: (*i*) very strong trading in 1H20/21 (Jul-Dec) which should lead to LfL growth of '*at least 14% (LfL) growth in FY20/21*' and; (*ii*) a resumption of a share buy-back program of up to £4.5bn (which was discontinued in Apr-20). The market took this statement particularly well and prompted a break-out of its £28-32 trading range. The DGE share appears to be on track to exceed its previous all-time high (£36.25 on 3-Sep-19), given solid consensus upgrades to the sales and profit estimates. DGE is due to publish its FY20/21 results on 29-Jul.

Atlas Copco (ATCOA)

ATCOA (Sweden: +23.26%), the leading provider of compressed air and other capital goods equipment, was the fifth -best performer in the Portfolio in 1H21 (and the second best-performer in 1Q21). Since the ATCOA share's coronavirus-infused 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) as well as the 1Q21 (27-Apr) and indeed the 2Q21 reports (16-Jul) were all ahead of highly set market expectations. Management has continuously commented that demand is strong from the semi-conductor industry (where ASML is likely to be a meaningful customer) while the order intake also increased in other product categories, such as industrial compressors, medical equipment and equipment for automotive applications – particularly in the fields of electric vehicle and battery production. As a USD-sensitive business (we estimate that close to 60% of ATCOA's invoicing is done in USD), consensus sales and profit revisions for FY21 and FY22 have been decent at +1-3%, reflecting expectations that the company's underlying business is continuing to perform well. Management guided for a sequentially unchanged organic growth rate in 2Q21 vs. the previous quarter, albeit at a continuously high level. ATCOA's 3Q21 set of results is due on 21-Oct.

Detractors

Intertek (ITRK LN)

ITRK (UK: +2.13%), the world's second-largest TIC (Testing/Inspection/Certification) company, was the weakest performing stock in the Portfolio in 1H21 (as well as the fourth weakest performer in 2020). The ITRK share has shown higher-than-normal volatility during 1H21; having nearly bounced back to its all-time high (£64.40 on 2-Oct-20) in late April, the stock had a dismal May (-11.6% vs. +3.1% of the benchmark). What prompted this downturn was the 4M21 trading statement (26-May) when the company reported LfL revenue growth of only +2.7% (2H20: -5.6%). While ITRK's management is commendably keen to inform analysts and investors on an ongoing basis, the webcasts sadly continue to be dominated by the CEO André Lacroix and to a lesser extent the (newly) appointed CFO, Jonathan Timmis. Unfortunately, ITRK's scripted communication tends to be identical from one presentation to the next with little new information over-and-above the changes in the divisional LfL sales and EBITA growth rates. Moreover, management gives evasive answers during the Q&A sessions (which are dominated by the CEO) and they frequently lack granularity. Consequently, the market took the 4M21 report badly. On a more positive note, consensus sales and profit revisions for ITRK have been surprisingly strong; while the projections for FY21 have been marginally downgraded (probably due to the strength of the GBP) consensus forecasts for FY22 and FY23 have been raised. ITRK is due to publish its 1H21 set of results on 30-Jul.

Lindt & Sprüngli (LISP SW)

LISP (Switzerland: +5.25%), the world's largest provider of premium chocolate, was the second worst-performing stock in the Portfolio in 1H21 (and the fifth worst performer in 1Q21: -6.55%). Although LISP's FY20 revenues (19-Jan) fell short of expectations, and we suspect the company's extremely conservative management took the opportunity to play down the market's expectations, the full FY20 result statement (2-Mar) was well ahead. At this time, LISP hosted a webcast where management took the opportunity to outline the two main issues in FY20 statement. *First*, LISP's retail network (circa 500 stores that are 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 LfL sales growth in 2H20. Assuming a gradual easing up of lockdown restrictions during 2021, we believe there is little doubt that LISP will perform well this year (the LISP share reached an all-time high of CHF9375 on 28-Jun). Management anticipates some catch-up demand in FY21 and is thus guiding for 6-8% LfL sales 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 incremental improvement of the EBIT margin. We slightly added to our LISP holding during the stock's weakness following the FY20 sales announcement in January. The stock has performed particularly well since mid-May on the back of a more promising outlook due to the further easing of lockdown restrictions. LISP will announce its 1H21 results on 27-Jul.

Adidas (ADS GY)

ADS (Germany: +5.37%), the world's runner-up sports shoe manufacturer after Nike, was the third weakest performing stock in the Portfolio in 1Q20 (and the weakest performer in the Portfolio in 1Q21: -10.64%). The company's 4Q20 results (10-Mar) were well ahead of highly set market expectations and so were the 1Q21 results (7-May), but the ADS share (along with some other Western retail-peers, such as Nike) traded in a sluggish fashion during much of 2Q21 amid concerns about China's retaliation over the Xinjian cotton boycott. Prior to this episode however, ADS hosted an excellent investor day in conjunction with the release of the 4Q20 report where management highlighted a sea change to its strategy for 2021-25 with the objective of moving the business from a primarily wholesale-oriented model to a 'D2C' (direct-to-consumer) operation. This will require some €8-9bn in additional investment-spending (circa 40% of FY20 revenues) but should transform the group to a digital company with '*sports-and-athletics*' still remaining as 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. Consensus revisions for ADS have been solid so far in 2021. Moreover, Nike recently published an outstanding 4Q20/21 set of results (25-Jun) which prompted the sharpest one-day spike for the stock since 1987 (+15.5%). We have no doubt that ADS will achieve similar glories; its recent quarterly growth rates have been similar compared with Nike but due to its smaller-sized business, it is easier for ADS to compound at a faster rate. ADS is due publish its 2Q21 results on 5-Aug.

SGS (SGSN SW)

SGSN (Switzerland: +5.48%), the world's largest TIC (Testing/Inspection/Certification) company, was the fourth weakest performing stock in the Portfolio in 1H21. Unlike its smaller British rival ITRK, SGSN only publishes full and half-year results, but the correlation between the two stocks is nonetheless quite similar. SGSN's FY20 results (28-Jan) fell slightly short of market expectations. The 1H21 report (19-Jul) slightly exceeded market expectations but management came across as overly guarded in terms of the outlook, in our opinion. We note that SGSN's CFO, Dominik de Daniel, is increasingly putting his footprint on the business as he is implementing the 'EVA-concept' (Economic Value Added) across the organisation (in a similar fashion to what he successfully did when he was CFO at Adecco). The consensus estimates for SGSN's sales and profits over FY21 through to FY24 have been positive since the 1H21 report (particularly for the later years).

Beiersdorf (BEI GY)

Beiersdorf (Germany: +7.74%), the owner of the world's largest skincare brand, Nivea, was the fifth worst performing stock in the Portfolio in 1H21 (and the fifth worst performer in 2020: -11.45%). BEI's FY20 statement (17-Feb) met market expectations in terms of financial performance as the sequential growth rates improved across the group including its *Eurcerin* (dermatology) and *La Prairie* (very high-end skincare) brands, which are more reliant on travel-retail which had slightly recovered. Nonetheless, the market took the report badly as management allocated another €300m '*re-set*' provision to kick-start e-commerce. Since BEI made a similar allocation in early 2019 when Stefan De Loecker took over as CEO, analysts and investors were perplexed what BEI's management had been up to over the past two years. Moreover, it had also been communicated that the highly regarded CFO, Dessi Temperley, would step back and that a new CFO (Astrid Herman) had been appointed. At the FY20 webcast, management were on the *backfoot* by providing an extremely conservative outlook and not raising the dividend despite the group's excessively strong balance sheet. BEI's 1Q21 revenue statement was pre-announced (7-Apr) but more importantly when the scheduled 1Q21 revenue release was ultimately published (28-Apr), there was the news that Stefan De Loecker would be replaced as CEO by Vincent Warnery as of 1-May. Warnery is an internal BEI candidate who was previously in charge of the Pharmacy & Selective divisions (*Eucerin*, *La Prairie* and *Hansaplast*) as well as the North American activities. In terms of revenue growth over 1Q21, BEI reported 6.3% on a LfL basis, of which the Consumer division (81% of FY20 sales) grew by 2.7% and the Tesa division (19% of FY20 sales) grew by 23.6%. There was an improvement in the sequential growth rates for all the divisions except for the Nivea brand; Eucerin, Aquaphor and La Prarie, which are more dependent on brick-and-mortar sales. However, we expect all three to benefit from the easing up of lockdown restrictions. Given the recent management reshuffling, we believe the BEI share has turned the corner. The company will publish its 1H21 results on 5-Aug.

European Focus Portfolio changes

The '5/10/40' UCITS rule states that positions over 5% cannot have an aggregate weighting which exceeds 40% and any 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 generally only comment on trades exceeding this level. Over-and-above smaller changes to the Portfolio, which relate mostly to market opportunities and/or the correction of passive UCITS breaches, we rebalanced the Portfolio by making 2 changes and 1 additional top-up during 1H21 (1H20: 9 changes).

- We added to **L'Oréal** 16 April
- We added to **EssilorLuxottica** 21 May
- We added to **EssilorLuxottica** 22 June

L'Oréal (OR FP) from 3.7% to 4.7% (16 April)

We added 1.0 percentage point in OR on 16-Apr following the 1Q21 sales report which fell short of market expectations. While the e-commerce business continued to thrive with LfL revenue growth of more than 47% (29% of group sales) in 1Q21, Western Europe and the Consumer Products division (39% and 26% of group sales respectively) were sluggish on the back of poor make-up sales given the lockdown restrictions. However, as OR's management commented during the FY20 presentation: '*Makeup will come back as soon as facemasks disappear*' and we agree with this view. Since OR's 1Q21 sales report, consensus sales estimates have been raised (and more so the profit estimates) for FY21 and onwards. We were fortunate with the timing of the purchase, since our top-up in OR the stock has appreciated by +11.4% vs. +3.3% of the benchmark up to the end of 1H21.

EssilorLuxottica (EL FP) from 2.6% to 4.0% (20 May)

We added 1.4 percentage points in EL on 21-May following weakness in the stock following the 1Q21 sales report (6-May). Although the LfL revenue numbers for 1Q21 broadly met market expectations, there was a sense of relief by the investment community following a series of 'mishaps' over several prior quarters. What prompted us to increase the weighting in EL was the cross-read from a Swiss hearing aid manufacturer, Sonova's (SOON SW) FY20/21 results (18-May), where management pointed to a very sharp recovery since late April and early May 2021. Hence, if customers are willing to visit audiologists, we would argue why would they not go to other equivalent retail outlets such as EL's Sunglass Hut chain of stores? Since EL's 1Q21 sales report, consensus sales and profit estimates have been raised by a wide margin for FY21 and for future years. We were also fortunate with the timing of the purchase, since our initial top-up of EL shares the stock has appreciated by +5.0% vs. +2.8% of the benchmark up to the end of 1H21.

EssilorLuxottica (EL FP) from 4.0% to 4.5% (22 June)

We added another 0.5 percentage points in EL on 22-Jun following an announcement that EL had won an arbitration case against GrandVision (GVNV NA), a Dutch optical retailer which EL launched a bid for in June 2019. This acquisition had already been somewhat contentious in that the EU antitrust authority had voiced some market share objections. While those hurdles were ultimately cleared, the arbitration outcome proved that GVNV's management had been 'dragging their feet' giving EL the option to walk away from the acquisition and/or renegotiate the price. Against this backdrop, there was a sharp drop in the GVNV share price on 22-Jun as well as in the EL stock price (while the European market was trading broadly flat). We thought it unlikely that EL would walk away from the deal but with the option for a lower target price of GVNV, the EL stock price should trade higher. Consequently, we added to the EL position.

Christian Diebitsch, Fund Manager, Heptagon Capital

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