HEPTAGON Capital

Future Trends: Monthly Update

September 2021

Fund Manager

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Investment Objective

The Fund aims to deliver consistent and sustainable long-term returns by investing in a concentrated portfolio of global equities.

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The Heptagon Future Trends Fund has a very clear and distinct philosophy: we seek to identify and invest in a diverse range of businesses offering exposure to the key trends that we believe will help shape the future. The Fund has gained over 150% since its inception in January 2016 and over 6% year-to-date. Despite having recorded an all-time high NAV on 6 September, the Fund is lagging its MSCI World Index benchmark in 2021, although the inception-to-date returns enjoyed by Future Trends remain well ahead of the Index. Most importantly, when we look forward, the conviction in both the businesses in which we are invested and the future trends to which they are exposed remains as strong as ever. We are investing in high conviction ideas for the long-term.

September was a tumultuous month for equities, with the MSCI World recording its first down month since January 2021 and its 4.2% decline marking the most disappointing month in performance terms since March 2020. Context, of course, always matters. First, equities globally have risen 92.1% since the market's nadir last year (and the Future Trends Fund by a similar amount). Next, nothing – as we know – is ever linear. **Setbacks create opportunities**. After a 5.1% drawdown in the past month, our businesses are cheaper than they were previously, while the fundamental outlook remains unchanged.

What is most remarkable about September's market developments is how the month can be divided into *two distinct* segments. As of 23 September, the Fund was up in absolute terms (by ~30 basis points) while its MSCI World benchmark was down -1%. In the final trading week of the month, the market dropped by a further 3.2%, but the Future Trends Fund succumbed to a 5.5% decline. Sure, there was a rapid and well-documented rotation from perceived 'growth' to perceived 'value' (sectors such as banks and traditional energy – where the Fund has never had any exposure – did particularly well), but this downward performance was compounded by a 14.4% decline in the Fund's largest holding.

We have discussed in many previous commentaries **the investment case for ASML**. Put simply, **the future can't happen without ASML**. The business – the world's largest producer of machines that make semiconductor chips – has been a Future Trends holding since 2017 and has been the biggest position in the Fund since April 2021. Even with an 8.3% decline in September (and more in the last week of the month), ASML shares remain the best-performer in the Fund on a year-to-date basis, up 62.5%. The adverse price action occurred *despite* the fact that ASML hosted its first Capital Markets event for investors since 2018 on 29th September.

The business provided explicit financial guidance through to 2025 and also suggested that it would be able to grow revenues by over 10% annually through to 2030. As the company's Chief Executive noted, **we all continue to "structurally under-estimate semiconductor growth."** We have high confidence that even this bullish guidance provided by ASML will likely prove conservative.

We believe it is a strong endorsement of the future trends in which we invest for *any* of our businesses to have sufficient confidence amidst so much macro uncertainty to provide modelling assumptions and a clear line of sight for financial performance for the next five years. Not only did ASML do this in the past month, but so did **Thermo Fisher, our joint current largest holding** (both ended the month with identical weights of 5.93%). As a reminder, Thermo could be considered to the life sciences industry what Amazon is to the online retail sector. In other words, **Thermo has the largest supply globally of medical equipment diagnostics and services**. Inevitably, the business has been a beneficiary of the pandemic, but the most important take-away we drew from its September investor event was that Thermo is now calling for 7-9% organic growth over the next five years, a 200 basis point upgrade relative to its previous guidance, equivalent to market outgrowth (on its assumptions) of up to 500 basis points annually.

Owning both ASML and Thermo speaks clearly to **the pan-thematic approach that the Future Trends Fund has always pursued**. Having exposure to multiple themes also means that when some businesses (such as ASML) underperform in a certain month, others will outperform, providing balance to our Fund. Thermo rose 3.0% in September. Our best performer deserves particular mention, however, since it is the newest addition to the Fund. **In August, we initiated a 2.0% position in Airbnb.** Since the time of our investment, Airbnb shares have gained 12.2%, which compares to a 2.7% decline in the MSCI World. September saw Airbnb shares gain 8.2%. The business is **currently a 3.2% weight in the Fund**.

Most readers of this piece will be familiar with what Airbnb does. Your Fund Manager had been a regular user of its services long prior to our investment and we first made the case for the business in our thematic work on the sharing economy issued in 2016. Our investment approach always emphasises patience. We followed Airbnb from the time when it was private, first built a financial model in late 2019 prior to its IPO, and initiated dialogue with management in early 2021.

What has impressed us most about the business is that it has emerged from the pandemic stronger than it had been previously. In other words, last year's crisis forced Airbnb to cut costs and refine its search engine in order to be more flexible and adapt better to the revised operating environment. It's quite notable how consensus estimates have correspondingly had to react. The street began 2021 assuming that Airbnb would generate $37.7m of EBITDA this year. The current estimate (per Bloomberg) is for $1.16bn. Airbnb is set to turn free cashflow positive soon and subsequent rapid free cashflow generation – with the potential to reinvest some of this back into the business and further strengthen its competitive moat – should provide additional ballast for the investment case.

The question we are asked with most regularity about Airbnb is how we justify its valuation. On a 10-year discounted free cashflow model, we see the shares comfortably above $200 (they are currently trading at ~$167). However, the more important point is that we believe investors are wholly justified in paying 6.1x sales and 28.2x EBITDA (using our own 2022 estimates) given the growth prospects we expect the business to enjoy. We are forecasting compound annual revenue growth of 35.9% for the next three years during which time Airbnb's EBITDA margin should improve by over 30 percentage points. **Growth at the *right* price** is the key mantra which underpins the philosophy of the Future Trends Fund. Taking the full portfolio, **our businesses are forecast to enjoy 11.7% compound revenue growth and 22.4% compound free cashflow growth over the next three years**. For this clear outgrowth relative to the broader market, investors are paying 28.2x forward earnings. This compares to 29.8x multiple a month prior and a metric of 30.0x at the start of the year. 4% cash in the Fund also provides us with added near-term flexibility.

Thank you for your ongoing interest in and support for the Future Trends Fund.

Alex Gunz, Fund Manager

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