HEPTAGON Capital

Future Trends: Monthly Update

October 2021

Fund Manager

Alex Gunz

Investment Objective

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

Contact

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

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

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. October saw the strongest monthly return for Future Trends (up 5.4%) recorded so far in 2021, which helped drive year-to-date returns to 11.8%. Although the Fund remains behind its MSCI World benchmark over this period, returns of over 163% since inception (equivalent to 18.2% annualised) place Future Trends well ahead. 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.

How can we best understand the future? There's no single answer to this question; rather think of the response as being to look at it through multiple lenses. Our process involves marrying top-down thematic work with bottom-up company analysis. A case study perhaps provides the best explanation. **Kerry Group** is one of three businesses that has been in the Fund since its inception (the other two are Mastercard and Novo Nordisk). In October we published a detailed thematic piece on the future of food. Separately, Kerry hosted its first investor day (albeit virtually) since 2017. Both reinforced our conviction in the business.

Begin with the big picture. **Future Trends is premised on the notion of owning businesses across a range of sectors that are able to provide solutions to the problem of how to allocate scarce resource efficiently in the context of a growing global population**. Few problems come bigger than how to feed the world, particularly when available arable land is shrinking, and climate change is making food production more challenging. Our contention in our thematic work was that the world needs to diversify away from conventional proteins and embrace a range of more novel solutions including plant-based, insect and cultured meat options. Kerry, as the largest provider of outsourced research and development solutions for the food and beverage industries, stands highly well-placed to benefit in our view.

At its October Capital Markets Day, Kerry provided financial guidance for 4-6% volume growth over the period 2022-2026, an acceleration relative to its previous guide (of 3-5% over the 2018 to 2022 period) and ~2 percentage points ahead of the broader industry.

Such outgrowth should be possible given its focus on the most value-added segments of the food and beverage market. Another under-appreciated aspect of Kerry's strategy is to develop solutions to improve food preservation and minimise food waste, a topic explored in one of our recent Blog posts. Such an approach – beyond being strategically logical – also helps improves Kerry's green credentials.

Investors are paying 27.8x 2022E earnings for Kerry at present, which places the business at a discount both to its five-year and ten-year historic average levels (31.0x and 34.2x respectively) as well as at a 30%+ discount to our fair value of ~€155/share, derived using discounted free cashflow analysis. Despite all the above, Kerry shares were flat over the month of October. From our perspective, this constituted a clear buying opportunity, and **we took advantage of Fund inflows during the period to add to our weighting in the business**. Kerry currently sits at a ~4% position in the Fund, just outside our top-ten. We are investing for the long-term.

A similar argument can be made for **IBM**, which also lagged the broader equity market during October. The shares traded 10% lower as quarterly results disappointed relative to consensus expectations. However, this move ignores the fact that IBM hosted an investor event where it profiled the form its business would take once its managed services unit (named Kyndryl) will be demerged, at the start of November. 'New IBM' will be a much more focused business with improved growth prospects, which the investment community is not fully discounting in consensus expectations. IBM trades on 11.9x 2022E earnings and could be worth well over $200/share (versus a closing price of $125.10 at the end of October), on our estimates. We also added to our weight in IBM during October.

Beyond the raised weightings in Kerry and IBM, we were proactive across much of the rest of the portfolio, using price action as an opportunity to take profits and/or increase weightings. Most significantly, **we reduced our weight in ASML and increased our position in Prologis**. As of the end of October, ASML had been the stand-out best performer in the Fund year-to-date, trading over 76% above its 1 January share price. Although we have huge conviction in the business – as we have said in the past, **the future can't happen without ASML** – we felt it was judicious to lock in some gains. ASML had been the largest weighting in the Fund from April through to September and remains in our top-five most significant holdings.

We used our ASML proceeds to take up our weighting in Prologis, which we have owned since December 2018 and has been in our top-five since July this year. As a reminder, Prologis is the largest owner of industrial real estate globally. It is benefiting from multiple secular trends including the shift to e-commerce and the increased need for greater supply chain resiliency. The business beat results in October for the seventh consecutive quarter and raised financial guidance for the third quarter in a row. A subsequent press release later in the month highlighted that warehouse space at Prologis was "sold out", with demand at an all-time high. **Prologis is currently the second-largest holding in the Fund**, just behind Thermo Fisher (which we discussed in more detail in our previous monthly commentary). Following the various trades we executed, cash within the Fund was 3.3% at the end of October, down from 4.1% a month prior.

We were pleased to see that 14 of our 23 holdings outperformed during the past month. Prologis was one of the Fund's most significant gainers, up 15.6%, although this performance was surpassed by both First Solar and Aptiv (up 25.3% and 16.1% respectively). Strong gains in these businesses were helped by solid quarterly results from peer businesses. Both companies will release their own results in the first week of November. During this period, Chegg – the Fund's laggard in October, down 12.6% – will also issue its results. We retain conviction in the business (which provides online educational learning tools) and used price weakness to add to our weighting. The same can be said of PayPal – down 10.6% in October – where we also added. We were pleased to see management of the business decide to walk away from the rumoured acquisition of Pinterest. Maintaining focus on what PayPal is good at matters.

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

Alex Gunz, Fund Manager

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