HEPTAGON Capital

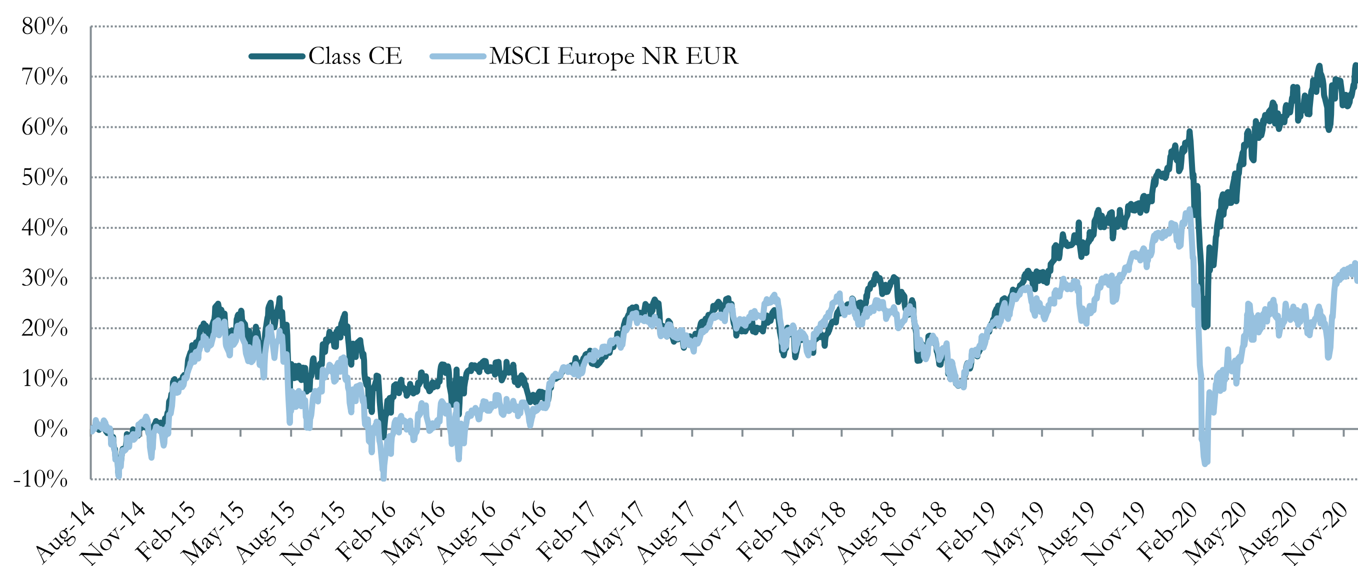
Heptagon European Focus Equity Fund

Market Commentary and Attribution Analysis for 2020

Performance and executive summary

During 2020, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value increased by +15.43% to €173.45 – rising considerably more than the MSCI Europe NR (EUR) index, which fell by -3.32% in comparison.

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



Source: Bloomberg

2020 – a year of extremes

2020 was an exceptional year in many ways. Most market participants will remember it as going from one extreme to another. For example, most investors would have felt despair in March when the European equity markets slid by more than -14% and suddenly turned to exuberance in November, when stocks advanced by around +14%. In fact, March was the second-worst month for European equities on record (after October 1987), while November was the region's best-ever month (data going back to 1986). Given these sharp gyrations, we consider it to be fair to assume that nobody had any clear idea of how severely COVID-19 would hit the equity markets and how quickly they would recover.

This raises the question of where we are in the cycle. Typically, '*normal*' recessions last for 1-2 years, prompting stock market sell-offs in the -35% to -40% range. Come February, it will be one year since COVID-19 had a material impact on European equities, which saw a -35% drop from their peak on 19 February to their nadir in March. Against this backdrop, we believe it is important to ask ourselves if the COVID-19 impact on the markets should be regarded as part of a '*natural*' recession or if the recession was '*forced*' upon us.

Although the current bull-market has been in motion since March 2009 and, theoretically, we are long overdue a recessionary drawdown when compared with history, we still regard the sell-off in February 2020 as forced upon us. This is probably

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

why equities were so quick to bounce back from their trough on 18 March. While the magnitude of the sell-off in quantitative terms suggests that a recession was in fact inflicted, it still begs the question whether the world economy needs to go through a 'natural' economic cycle, or whether the next upswing will be driven by, for example, confidence that vaccines have put the world economy on a more sustainable path of recovery and for equities to continue their upward trajectory.

We don't believe anyone can confidently say what type of recovery the world economy is facing next. When looking at the underlying economic forces and how different institutions in society have dealt with them, we construe that central banks and governments have done most of what is possible to keep the global ship on an even keel by providing unprecedented monetary support and fiscal stimuli through furlough schemes during what we would characterise as '*the lockdown phase*'. While this support is poised to continue in 2021 as the new variants of COVID-19 are causing a sharp escalation in new coronavirus cases, we believe monetary stimuli and furlough subsidies will be gradually phased out once confidence grows that the vaccines are working. At the same time, it is fair to assume that governments will step up other forms of fiscal stimuli, like infrastructure spending, as the discontinuation of furlough schemes is bound to lead to higher unemployment. Unfortunately, the backside of this scenario is a massive aggregation of debt – sovereign as well as corporate – and at some point in time this is likely to be reflected in higher default rates, which could also be associated with rising unemployment.

The Heptagon European Focus Equity Fund had an exceptional year in 2020

For the Heptagon European Focus Equity Fund, 2020 was also an exceptional year. The strategy attained two milestones. *First*, the Fund recorded its best-ever relative year – comfortably appreciating by an average of more than one percentage point per month (which is one of our unofficial objectives), while the broader market posted overall losses for the year, thus showing a relative outperformance of +1875bps. *Secondly*, 2020 was the first year when the five largest positions in the Portfolio, representing close to 32% exposure, took the top-five positions in terms of best-performing stocks. Moreover, it was gratifying to note that the underlying businesses of these stocks originated from different walks of society as well as from different countries. The scope of their diversity ranged from online retailing (**Zalando/Germany**); support for the coronavirus vaccine (**Lonza/Switzerland**); equipment for semiconductor manufacturing (**ASML/Netherlands**); environmental and recycling concerns (**Tomra/Norway**); to clinical-testing (**Eurofins Scientific/France**).

When looking at the performance of the Portfolio in its entirety from January through to the end of October, as well as in the month of December in isolation, there was a similar performance profile of most stocks as to whether they beat or fell behind the benchmark (which follows our belief that stocks that perform well tend to perform well for longer and vice versa). However, this reversed in November (Europe's strongest ever equity month), when deep-value stocks, like energy and financial, advanced by some +30%. European Focus only saw three Portfolio stocks outperforming the benchmark in November. Of these three stocks, we consider one to have been an anomaly (**ASML**) that should not have done so well given its overall strong performance throughout the year, while the other two stocks (**Diageo** and **EssilorLuxottica**) must be deemed as post-COVID-19 recovery plays. We suspect that **ASML** beat the benchmark in November due to mean-reversion after a weak performance in October (-11%) when most of the world's technology shares suffered due to speculation that US Congress had started to look into breaking up mega-tech gatekeepers like Facebook, Google, Amazon etc. The outperformance of the other two Portfolio stocks in November is easier to explain. **Diageo** (distilling and beverages/UK) had continuously suffered from lockdown restrictions and social distancing forcing pubs/bars and restaurants to stay closed for much of last year. **EssilorLuxottica** (lens-eyeglasses/France/Italy) suffered from the fact that

people were forced to spend considerable time at home for extended periods last year. Looking ahead, **Diageo** (as well as the hospitality sector) should benefit from the easing of lockdown restrictions and **EssilorLuxottica** from more people spending time outside and visiting brick-and-mortar shops, like the group's fully-owned retail chain, Sunglass Hut.

ESG considerations were boosted in 2020

We also note that investors and companies alike dramatically re-prioritised ESG as a necessity in 2020. We have never seen so many articles being written in one year about how greenhouse gases affect climate change and we believe this partly prompted our Portfolio companies to explicitly set timelines for when they will reach carbon neutrality.

European Focus has never invested 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 '***doing well and doing good is mutually dependent***'. In other words, it is not good business practice to cut corners (be it environmental, social or governance) given potential repercussions – be it financial risk, such as incurring fines and/or damages, or reputational risk, which is ultimately likely to have financial implications.

Portfolio holdings are on balance well-capitalised

We regularly check how well-capitalised our Portfolio companies are in terms of the composition and the duration of their debt vs. their EBITDAs, cash flows etc. Our analysis shows that from the beginning of FY19 to the last point when companies published their balance sheets in 2020 (either in the 1H20 reporting season during the summer or in the 3Q20 period during October-November), the average balance sheet of a Portfolio company improved (see table below). Furthermore, five Portfolio holdings were net cash positive including lease obligations and pension debt (**Beiersdorf**, **Hermès**, **L'Oréal Novo Nordisk** and **Zalando**) and they had a combined weighting of 24% at the end of 2020.

The table below shows the balance sheet strength of European Focus after the FY19 results had been released in February-March last year and how it progressed throughout 2020. We have calculated the unweighted and the weighted average based on the various exposures at the end of 2020 and we note that the weighted average come out more favourably than the unweighted (although both must be deemed as solid). In order to avoid using our own (and perhaps biased) EBITDA projections, we have used Bloomberg's consensus estimates for FY20 and FY21. The calculations clearly show that the average Portfolio company's financial shape improved over the course of 2020.

Progress of balance sheet strength of Portfolio holdings in European Focus during 2020

	After FY19				After 1H20/3Q20			
	Weight 2020e	Weight 2021e	Unweight 2020e	Unweight 2021e	Weight 2020e	Weight 2021e	Unweight 2020e	Unweight 2021e
Net debt / EBITDA (excl. leases)	**0.77**	**0.75**	0.79	0.75	**0.64**	**0.57**	0.81	0.72
Net debt / EBITDA (incl. leases)	**1.33**	**1.25**	1.33	1.24	**0.98**	**0.84**	1.20	1.03
S-T debt (excl. leases) / total debt (excl. leases)	28%				26%			
S-T debt (incl. leases) / total debt (incl. leases)	23%				23%			

Sources: company accounts and Bloomberg consensus

Portfolio holdings forecast to continuously grow throughout 2020-2022

Our latest analysis of the consensus estimates for sales and profit growth of European Focus show that the Portfolio should generate continuous sales, EBITDA and EBIT growth over the period 2020-2022. We ventured to compare the Portfolio with the broader European market (as per the STOXX Europe 600 Price Index) but due to considerable drops in sales and profits of many of Europe's cyclical sectors (such as energy, mining, financials and automotive sectors to mention a few) in 2020, which combined carry a considerable weighting, we consider such an exercise to be meaningless as there are too many businesses which are swinging from profits to losses and vice versa. Moreover, there are a substantial number of exceptional items and book-keeping technicalities, such as loan-loss provisions in the case of the banks, which supports our view that a comparison with Europe in its entirety is irrelevant. Against this backdrop, more stable sales and profit streams, like those in European Focus, should be more 'fit-and-proper' for different types of equity market environments (which we expect in 2021) and this was clearly reflected in the Fund's strong relative performance last year. The table below sets out consensus sales and profit expectations of European Focus on a weighted basis.

Sales and profit growth of European Focus

	Sales	EBITDA	EBIT
2020e	1.4%	8.0%	17.7%
2021e	8.8%	15.9%	25.3%
2022e	7.1%	10.6%	13.0%

Note: as per Portfolio weightings on 31-Dec-20

Source: Bloomberg

Quality never goes out of style

Given the high volatility we saw in 2020, which was reflected by the extreme movements ranging from despair to greed, we believe successful investment strategies need to have attributes that enable them to straddle different types of stock market environments. Hence, '*quality-growth*' as an investment philosophy - characterised by pricing power; high barriers to entry; companies having stood the test of time and being well-capitalised - should continue to perform well over time. We would summarise this in a few words: '*quality never goes out of style*'.

Where to go from here

We believe equities as an asset class remain advantageous. Leading central banks should continue to support the financial markets by providing essentially unlimited liquidity (to paraphrase the former Chairman of the ECB, Mario Draghi: '*to do what it takes*') and this will be complemented by fiscal stimuli in the form of furlough schemes and later on through new infrastructure projects. Assuming that national governments will be successful in inoculating people with coronavirus vaccines during 1H21, we anticipate a pickup in economic activity – as well as in corporate sales and profit growth – during 2H21. We also expect long-term bond yields to move higher as inflation should start to rise (while central banks also taper their yield-curve control). This should coincide with investors placing more emphasis on companies' financial strength as furlough schemes come to an end and unemployment rising (see table above on European Focus' balance sheet strength).

In the short-term – say over the 2020 year-end financial reporting season during January-March – we believe analysts will prune the headline FY21 sales and profit estimates for many of Europe's exporters since: (*i*) the USD is showing year-over-year weakness against the EUR and; (*ii*) tighter lockdown restrictions across much of Europe in early 2021 are likely to keep a lid on economic activity, at least during the early part of the year.

It is anybody's guess how this will play out in the equity markets, but we find it slightly discomforting to note that there is currently an ingrained '*optimistic narrative*', which is never a good sign. For example, the European stock markets advanced by more than 10% in 4Q20 while GDP forecasts for 2021 were slightly moderated as most of Europe's leading economies reinstated tighter lockdown restrictions. Although essentially all of the equity market's recovery in 4Q20 was generated during the November rally (and was probably part of a mean-reversion from the sell-off earlier in the year), we note that there was still a dichotomy between the optimistic bottom-up views of investors vs. the more conservative top-down assessment by economists and investment strategists.

Risks and uncertainties

As we have highlighted before, we consider the two biggest risks for European equities in 2021 to be the: (*i*) **USD-weakness** and; (*ii*) **high level of corporate indebtedness**. Given Europe's export-dependency, the USD-weakness vs. EUR-strength will affect the sales and profit outlook for the entire region's equity markets and we suspect this will be visible when analysts are making their adjustments following companies' year-end results. According to our calculations, at its current level the EUR is around 11% stronger against the USD in 1H21. Assuming that USD-invoicing represents around 50% for an average European exporter, that weakness should knock 5-6% off the absolute sales growth in 1H21. Although this negative effect will partly be offset by companies' FX hedging policies further down the P&L account, we will still carefully monitor this development. However, European Focus should be reasonably well protected against such downgrades given the high quality and price inelasticity of the products sold by the Portfolio companies. In other words, the opportunity cost for a buyer of such products is higher as it tends to be more costly to have a machine idle than to pay up for quality and a swift delivery.

Other risks we have considered over the past few quarters, such as the **COVID-19** pandemic and a **hard Brexit**, have been de-emphasised. Obviously, we continue to monitor the progress of the coronavirus vaccination and how the pandemic is developing, but we believe most of the actual COVID-19 crisis is now discounted into stock prices. In regard to Brexit, given Boris Johnson's announcement that the UK and the EU had reached a trade deal shortly before Christmas, we believe this uncertainty to some extent can be finally put to rest.

We still consider **negative bond yields** and **excessive levels of sovereign debt** - which more or less every European government is running in an unperturbed fashion - to constitute a risk. Although the ECB stands ready to support the markets while the pandemic is running, let us not forget that debt has maturity and cannot be rolled over into perpetuity. This raises the question of where all the necessary funds for repayment will come from. We believe the answer is through higher taxes and higher interest rates.

Finally, on **China**, we note that there is an increasing number of defaults by Chinese SOEs and that there appears to be considerably less willingness by the central government to bail out either local governments or the SOEs themselves. While China continues to reap the benefits of its status as the world's 'manufacturing hub', it is also one of the most highly indebted countries in the world. Whilst it seems unlikely that China will run into any debt-related problems during a forthcoming global recovery, since demand will underpin economic momentum, default rates in the domestic economy are nonetheless rising. Furthermore, from a geopolitical perspective, the trade-war between China and the US is still raging, and China's ambitions to expand its territory into the South China Sea, along with its not-so-subtle escalation of pressures towards

Taiwan (particularly in light of China's recent treatment of Hong Kong) as well as on countries supporting Taiwan's independence, are all factors worth noting.

HEFEF attribution analysis for 2020

During 2020, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value increased by +15.43% to €173.45 – rising considerably more than the MSCI Europe NR (EUR) index, which fell by -3.32% in comparison.

There were only minor changes in the top-five performing stocks in the Portfolio in 2H20 compared with 1H20, which supports our hypothesis that stocks which perform well tend to perform well for longer. In terms of the top-five rankings last year, the best performing stocks were: **Zalando** (online retailing/Germany); **Lonza** (active pharmaceutical ingredients/Switzerland); **ASML** (semi-conductor equipment/Netherlands); **Tomra** (recycling and sorting installations/Norway); **Eurofins Scientific** (food and clinical testing/France). **Givaudan** (manufacturer of natural/synthetic flavours and fragrances/Switzerland), which was one of the top-five stocks in 1H20 and 9M20 lost its position to Eurofins Scientific. The five best-performing stocks had a combined weighting of 32% in the Portfolio at the end of 2020 (32% as at the end of 9M20 vs. 27% as at the end of 1H20).

None of the top-five performers can be considered '*cheap*' in terms of valuation in a traditional sense – not against the broader European equity market, nor against their own history. We consider this to be partly a testament that quality is a key attribute which must be highly regarded in a currently complex economic environment. With the exception of Tomra, which we suspect has been pushed higher by extremely strong ESG credentials, the other stocks have the common denominator that they are expected to show solid underlying organic growth in FY20 as well as in FY21.

The worst-performing stocks in the Portfolio in 2020 were also quite consistent throughout the year. Five stocks in the Portfolio underperformed the benchmark last year (vs. only three stocks that underperformed the benchmark index in 9M20). Over 2020, the weakest performers were: **Serco** (outsourcing/UK); **Diageo** (distilling and beverages/UK); **Beiersdorf** (skincare and adhesive products/Germany); **Intertek** (testing-inspection-certification/UK) and **EssilorLuxottica** (eyeglass lenses and sunglasses/France-Italy). The five weakest performers in 2020 had a combined weighting of only 16% in the Portfolio at the end of 2020 (vs. 13% of the three stocks which fell short of the benchmark in 9M20 and 15% of the four underperforming stocks in 1H20).

In the below attribution analysis, which covers the 2020 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 fell by -3.32% over the same period.

Contributors

Zalando (ZAL GY)

ZAL (Germany: +101.55%), Europe's largest online fashion retailer, was the best-performing stock in the Portfolio in FY20. The stock had a positive start in 2020, but as a highly rated share, it dipped in March only to bounce back later the same month and to embark on a further significant recovery phase in April. What prompted the strong stock price recovery in

2Q20 was a pre-announcement for the 1Q20 period (16 April) when management anticipated a faster-than-expected recovery from the pandemic in online fashion. When the 1Q20 results were released (7 May), ZAL reported record-breaking growth in new customers for April. The stock continued to advance until its largest owner, the Swedish holding company, Kinnevik (KINVB SS), announced that it had divested 4.4% of the equity stock corresponding (15 June). Although KINVB remains ZAL's largest shareholder with a stake of 21.3%, the stock fell on the announcement. Two days later (17 June), ZAL again pre-announced that 2Q20 sales and profits would be '*significantly above market expectations*' and the ZAL share took another leap ahead. The 2Q20 set of results (11 August) were outstanding. Management again raised the profit forecast for 3Q20 following yet another pre-announcement of better-than-expected results (8 October) and when the numbers were published (4 November), the stock advanced yet again. Late November, management commented that ZAL had registered a record number of new customers during Cyberweek. Given the tightened lockdown restrictions in several European countries in December, we have no doubt that ZAL's e-commerce trading platform will have continued to prosper during the Festive Season. ZAL's 4Q20 results are due on 3 March.

Lonza (LONN SW)

LONN (Switzerland: +61.71%), the leading provider of fine chemicals, biocides, active ingredients and dosage forms to the pharmaceuticals industry, was the second best-performing stock in the Portfolio in 2020. Although we only added LONN to the Portfolio on 24 March (see below), the stock returned 14.8% over the last four trading sessions in 1Q20, which was higher than what it generated during the entire 1Q20 period (+14.0%). Since its trough in March, the LONN share had a very strong performance in 2Q20 (it appreciated by +24.6% vs. +12.6% of the benchmark). The catalyst followed from a press release that LONN and the US biotechnology company, Moderna (MRNA US), had signed a ten-year agreement (1 May) for the production of up to 1bn doses of what then looked like a promising COVID-19 vaccine (code named: mRNA-1273), where MRNA would utilise LONN's factories in the US and in Switzerland for the production of the vaccine. The LONN share took a leap forward in the run-up to the 1H20 results (24 July) only to flatline until the investor day (15 October). The share again advanced on the back of the appointment of a new CEO, Pierre-Alain Ruffieux (2 November). Despite the strength of the CHF vs. the USD and the EUR, consensus sales and profit estimates for LONN have been gradually raised during 4Q20 as the new mRNA-1273 vaccine has been hailed as possibly the most effective of three coronavirus vaccines. LONN will publish FY20 results on 27 January. At that point, we anticipate management to be more explicit about the timing and likely financial benefits of the mRNA-1273 vaccine.

ASML (ASML NA)

ASML (the Netherlands: +50.76%), the world's #1 manufacturer of semi-conductor equipment, was the third best-performing stock in the Portfolio in 2020 (and the fourth best-performing stock in the Portfolio in 1H20). Given that none of the company's quarterly results statements in 2020 were particularly well-received on the actual days of their announcement (4Q19/22 January; 1Q20/15 April; 2Q20/15 July and 3Q20/14 October), we find it interesting to note that the ASML share still performed so strongly (and consistently) throughout the year. Against this backdrop, we construe that two forces were at play. *First*, we believe investors have been affected by '*FOMO*' (fear of missing out) as the world will require considerably higher volumes and faster chipsets to meet demand for the steady transformation to a digital world. *Secondly*, we believe there is an element of '*scarcity value*' of well-managed European technology businesses. Irrespective of the market's initial lacklustre reaction to the ASML share at the time of the quarterly results announcements, consensus has continuously raised the FY20 and FY21 estimates, which indicates that ASML's underlying business is performing well. Given the company's extremely strong position in its industry, where it dominates the market for EUV-lithography

(Extreme Ultra Violet – extremely fine circuit patterns on micro-chips) as well as in other less sophisticated technologies, we believe demand for its equipment will remain strong both in volumes and value as 5G roll-outs are likely to gain momentum in 2021. ASML published strong 4Q20 results (20 January) and management hosted an upbeat presentation which highlighted strong order intake in the period and the prospect of yet another year of double-digit revenue growth in FY21. The company's 1Q21 results are due on 21 April.

Tomra (TOM NO)

TOM (Norway: +43.62%), the world's leading supplier of recycling and sorting equipment, was the fourth best-performing stock in the Portfolio in 2020 (as well as in 9M20). Since the low point of the TOM share in March, the stock staged a strong recovery. All the company's quarterly set of results (4Q19/20 February; 1Q20/5 May; 2Q20/17 July and 3Q20/22 October) were all ahead of market expectations. Against this backdrop, momentum in the TOM share was strong and the stock reached an all-time high (NOK423.5 – 31 August), but it came off after a few articles detailing what appears to be an extravagant, albeit not fully clarified compensation programme for its management. Furthermore, in October the long-standing CEO, Stefan Ranstrand (since March 2009), announced his wish to retire in 2021. Whilst Ranstrand is in no rush to leave TOM, the company is currently searching for a new leader, expected to arrive sometime this year. We believe accelerating environmental concerns and the EU's '*single-use plastics directive*' from March 2019, which states that 77% of all single-use plastic bottles should be recycled by 2025 and 90% by 2030, will continue to drive TOM's long-term fundamentals. The company will announce 4Q20 results on 23 February.

Eurofins Scientific (ERF FP)

ERF (France: +38.87%), the leading testing-services group, which offers bioanalytical services in the food, pharmaceutical and environmental markets, was the fifth best-performing stock in the Portfolio in 2020 (the third best-performing stock in 9M20 and the seventh best-performing stock in 1H20). ERF's share price performance was quite consistent on a quarterly basis in 1H20, but the 1Q20 sales report (28 April) and the 1H20 set of results (6 August) acted as catalysts to send the ERF share sharply higher. Following the announcements that three COVID-19 vaccines were on the cusp of receiving approvals, the ERF share saw some profit-taking. Management raised the FY20 guidance for sales, profits and cash flows (15 December) but the stock responded in a surprisingly lacklustre fashion. Looking ahead into 2021 and beyond, we note that: (*i*) the demand for laboratory services should continue to be greater than in the pre-COVID-19 world due to higher clinical testing requirements; and (*ii*) ERF operates one of the largest networks of laboratories (+800) across the globe. The company's FY20 results are due on 1 March.

Detractors

Serco (SRP LN)

SRP (UK: -30.16%), the leading provider of outsourcing services, was the weakest performer in the Portfolio in 2020 (as well as in 9M20) despite what we consider to be excellent execution by management. SRP normally publishes 'pre-close statements' before its half-year and full-year results. In 2020, SRP released its pre-close statement (18 June) about a week earlier than normal since management was in a position to reinstate the FY20 guidance. LfL growth for 1H20 would be some 14% higher (compared with consensus growth estimate of around 10%) and LfL growth for FY20 would be some 9% higher (before management pulled the guidance, consensus expected around 4% growth). In addition, EBIT for 1H20

was expected to jump by some 50% and for FY20, the EBIT range was raised to £135-150m (previously £145m). SRP's 1H20 set of results (6 August) was ahead of market expectations. However, management cautioned that LfL growth for 1H21 would '*normalise*' (we estimate to around 4-7%). The market took this remark badly, notwithstanding the fact that the UK's stranded Brexit-negotiations had already dented poor investor sentiment for high-profile UK companies that often figure in British media (SRP is in charge of the government's track-and-trace system for COVID-19). Contrary to the market's treatment of the SRP share, since the announcement of the 1H20 report, consensus estimates for SRP have been raised for FY20 as well as for FY21. The company published an unexpected 3Q20 trading update (16 October), when it disclosed that the LfL revenue growth guidance for FY20 was raised to around 15% and 30% in underlying EBIT, and this prompted a 10% spike in the stock price on the day. SRP released its traditional pre-close statement for FY20 (17 December) when it yet again raised the LfL revenue guidance to 16% and 35% in underlying EBIT. SRP's full FY20 results are due on 25 February.

Diageo (DGE LN)

DGE (UK: -14.92%), the world's largest distiller, was the second weakest-performing stock in the Portfolio in 2020 (and the second-weakest performer in the Portfolio in 9M20 and indeed in 1H20). Despite DGE's poor performance in 2020, we have held on to the position as more normal circumstances (i.e. a non-COVID-19 environment) should offer highly defensive qualities. We have assumed that spending habits on alcoholic beverages would shift to domestic consumption as pubs/bars and restaurants have been either fully or partly locked down during extended periods in 2020. However, other factors have also been behind the DGE share's weak performance, such as a renewed threat of higher US import duties and virtually non-existent duty-free shopping given air-traffic and cruise restrictions. More recently, we suspect stigma towards UK equities due to the threat of a hard Brexit. DGE's FY19/20 results (4 August) were slightly ahead of market expectations but the statement included exceptionals and impairment charges relating to India as well as some other isolated businesses. The market took the numbers badly as any meaningful recovery in sales and profit growth from the on-trade segment was likely to be deferred until 2H20/21 (i.e. January-June 2021). Nonetheless, on most metrics DGE is attractively valued and, given a number of world-renowned brand names in its portfolio (Johnnie Walker, Gordon's, Tanqueray, Smirnoff, Captain Morgan, to mention a few), we believe there is considerable hidden value should inflation eventually pick up. Since the publication of the FY19/20 results, consensus estimates have been raised for the next two years. In connection with the AGM (28 September), management issued a trading update which reflected a recovery across all regions prompting a positive reaction in the stock. DGE will announce 1H20/21 results on 28 January.

Beiersdorf (BEI GY)

BEI (Germany: -11.45%), the parent company of the world's largest skincare brand '*Nivea*', was the third weakest-performing stock in the Portfolio in 2020 (but it was ahead of the benchmark in each of the prior quarterly periods in 2020). What caused the poor performance of the share in the final quarter of 2020 was the 3Q20 sales statement (28 October). Although the revenue numbers were in line with consensus expectations, reflecting a sequential improvement in nearly all the regions in the Consumer division (80% of group sales). However, the *Eucerin* business (dermatology), which is more reliant on physical store sales, performed poorly. The market took the report badly and we construe it was also partly due to poor communication by management, which came across as too much '*on the backfoot*' in terms of the outlook. The BEI share closed -6.5% lower (benchmark -2.9%) on the day of the announcement. Consensus left the FY20 and FY21 sales forecasts unchanged while EBITDA and EBIT for FY20 was cut by around -2%. BEI's FY20 results are due on 17 February.

Intertek (ITRK LN)

ITRK (UK: -8.68%), the world's #2 TIC (testing/inspection/certification) group, was the fourth weakest-performing stock in the Portfolio in 2020 (it was ahead of the benchmark in 9M20 but fell short of the benchmark in 1H20). We believe there were two reasons for the poor performance in 4Q20. *First*, 10M20 statement (24 November) fell short of market expectations. The webcast, which was dominated by CEO (André Lacroix) and to a lesser extent CFO (Ross McCluskey), conveyed a very similar message as in the previous two webcasts with no meaningful new information over-and-above small changes in the LfL growth rates. We also consider management to have come across as evasive and their answers lacked sufficient granularity during the Q&A session. *Secondly*, given stranded Brexit negotiations during much of 2H20, British stocks were even more out-of-favour. While ITRK's last trading statement left more to be desired – both in terms of financial performance and management's presentation skills – there was still an improvement in the sequential growth rates between the 1H20 and 10M20 for the large Products division (60% of group sales). Moreover, consensus sales and profit revisions for the FY20 and FY21 were left broadly unchanged. The company will publish its FY20 results on 2 March.

EssilorLuxottica (EL FP)

EL (France/Italy: -6.08%), the world's largest eye-lens and frames manufacturer, was the fifth weakest-performing stock in the Portfolio in 2020 (vs. the third-weakest performer in 9M20 and 1H20 and the second weakest-performing share in 1Q20). EL made several blunders in 1H20 and management was visibly more careful regarding its commentaries during 2H20, but not enough to offset the poor performance from earlier in the year. For example, shortly following the release of the FY19 results (6 March), EL launched a share buyback programme (17 March) of up to €300m (circa 1% of EL's market capitalisation) only to cancel it shortly afterwards (27 March). At this time, the company withdrew the FY20 guidance which had been presented when the FY19 results were published. Furthermore, EL issued a press statement that the long-serving and highly regarded COO, Laurent Vacherot, would retire and that the expected dividend for FY19 (€2.23 per share) would be decided at a '*later date*'. At the same time the AGM was postponed (from 15 May to 25 June) due to the serious COVID-19 situation. The blunders went on; in another announcement (20 April), EL decided to suspend the dividend for FY19 in order to 'preserve cash' and, to add insult to injury, the European Commission cautioned EL about anti-competitive issues (4 June) regarding the acquisition of the Dutch optical retailer, Grandvision. EL's 1Q20 sales announcement (5 May) was lacklustre, but the market took the statement as a relief, as sentiment to the stock was already at rock-bottom. The 1H20 results (31 July) were slightly ahead of market expectations and the stock moved higher on the day. The 3Q20 sales report (3 November) was broadly in line with market expectations and after a few quarters of confusion (and lowly-set market expectations), the market awarded the stock with a relief-rally. The EL share closed 3.5% higher (benchmark +2.3%) on the day of the announcement. Renewed lockdown restrictions again affected investor sentiment and against that backdrop, consensus estimates have been slightly reduced since the release of the last trading statement. The stock still looks attractively valued by most valuation criteria and this value could easily be unleashed upon an announcement of a group CEO, which is expected in 2021. EL will publish its FY20 results on 12 March.

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 10 changes to HEFEF during 2020 (2019: 18 changes).

- We divested the exposure to **Chr Hansen** 13-14 February (from 1.7% to 0.0%)
- We initiated an exposure to **Tomra** 26-27 February and 1-19 March (from 0.0% to 3.6% and from 3.8% to 4.2%)
- We initiated an exposure to **Lonza** 24 March (from 0.0% to 3.8%)
- We initiated an exposure to **Atlas Copco** 25 March (from 0.0% to 3.8%)
- We initiated an exposure to **Assa Abloy** 17 April (from 0.0% to 3.2%)
- We added to **Eurofins Scientific** 19 May (from 5.0% to 6.1%)
- We added to **Assa Abloy** 25 May (from 3.0% to 4.1%)
- We reduced **Assa Abloy** 16-29 June (from 4.1% to 2.0%)
- We divested **Assa Abloy** on 1 July (from 2.0% to 0.0%)
- We initiated an exposure to **Hermès** on 9-13 November and 2 December (from 0.0% to 3.8% and from 3.8% to 4.5%)

Chr Hansen (CHR DC) from 1.7% to 0.0% 13-14 February

Following a pre-announcement of CHR's 3Q18/19 results in (26 June 2019), which highlighted a *'temporary'* loss of sales momentum in the APAC region, the Middle East and parts of LATAM, we initiated a 4.1% position (28 June 2019) on the back of a drawdown in the stock. Since these issues did not relate to CHR's important core markets in Europe and North America, it seemed conceivable that management would get on top of these matters in the short-term. However, when the 4Q18/19 results were announced (10 October 2019), management warned that the difficulties, which had come to be a drag on the company, would continue into 1Q19/20 and possibly later. Against this backdrop, we divested nearly half of the position (from 3.7% to 2.1% – 10 October 2019) and decided to re-evaluate whether to remain invested in CHR or not. When CHR announced 1Q19/20 results (15 January), management made a new and alarming remark that the end market of its largest division, Food Cultures & Enzymes (circa 60% of group revenues) was likely to see lower growth in dietary supplements. This prompted management to lower the company's long-term guidance from 'high-single' to 'mid-to-high-single' digit growth until 2024/25. Following this piece of news, we actively started to look for an exit point from CHR and thus we divested the remaining 1.7% holding during 13-14 February.

Tomra (TOM NO) from 0.0% to 3.6% 26-27 February

Having kept TOM on our watch-screen for several years, we formally added this interesting Norwegian recycling and sorting equipment company to our investment universe in the summer of 2019. What prompted us to make this move is TOM's likely huge opportunity to what we believe almost single-handedly addresses the EU's proposed draft regulation to tackle plastic litter. This includes a requirement to recycle at least 77% of all single-use plastic bottles by 2025 and 90% by 2029.

TOM's 4Q19 results (20 February) led to a spike in the stock price as the less highly regarded Sorting division (circa 50% of group revenues) had a much better-than-expected performance. Like all desirable stocks, either the price action or the valuation nearly always seems to be too far to bridge, but after a price-drop of TOM in February along with the general market drawdown, we decided to make an initial 3.6% investment during 26-27 February with the intention to add to the position should the market come off further (see below).

Tomra (TOM NO) from 3.8% to 4.2% 11-19 March

As the broader European (and international) equity markets was experiencing considerable profit-taking on the back of the escalating coronavirus news, we added to the TOM position on a pragmatic basis. Needless to say, it is nearly impossible to '*catch a falling knife*' by trying to invest in highly desirable stocks when markets are free-falling. However, on this occasion we managed to enter a full TOM position at what appears to have been a '*good*' level. Based on the average purchase price since we started to invest in TOM, we lost approximately -1.5% compared to where the stock closed on 31 March. However, that compared favourably with the benchmark MSCI Europe NR (EUR) index which fell by -20.3% over the same period. The TOM position has since appreciated considerably (see the Attribution Analysis).

Lonza (LONN SW) from 0.0% to 3.8% 24 March

LONN, the leading Swiss provider of fine chemicals, biocides and active ingredients to the pharmaceuticals industry, is a more recent addition to our investment universe as it only goes back to late 2019. From a timing point of view this has so far been a particularly successful investment. We acquired an initial 3.8% position in LONN on 24 March, i.e. only five trading sessions before the end of 1Q20 during which the LONN share had fallen by some -30% from its peak in February. Since this purchase, we generated an investment return of +14.8% (i.e. more than the stock's price return for the entire 1Q20 – see the Attribution Analysis), compared to the benchmark MSCI Europe NR (EUR) index, which strengthened by +5.3% over the same five last trading days of 1Q20.

Atlas Copco (ATCOA SS) from 0.0% to 3.8% 25 March

We invested 3.8% in the Swedish capital goods company, ATCOA. This stock had also come off by around -25% in the general market drawdown since its peak. ATCOA added more USD-sensitivity to the Portfolio in the civil engineering space as, we believe, fiscal spending was poised to get a boost by government announcements around the world. ATCOA also indirectly increases our exposure to the semi-conductor industry as the company is one of the leading suppliers of vacuum-pumps to businesses like ASML (one of our Dutch Portfolio holdings). We believe this is particularly relevant now when the world is likely to see an increase in demand for micro-chips, as people are encouraged or forced to work from home and 5G deployments get underway.

Assa Abloy (ASSAB SS) from 0.0% to 3.2% 17 April

We invested 3.2% in the Swedish capital goods company, ASSAB. This stock had lagged the market as well as ATCOA, which we believe the ASSAB share is commonly used to make peer trades with. Over several years, ASSAB has relocated a considerable part of its manufacturing facilities to China. As the Chinese economy was starting to open up after its COVID-19 lockdown, the ASSAB share started to respond well. As ASSAB had pre-announced its 1Q20 set of results (7 April), which indicated a weak set of numbers, we assumed that most 'skeletons would be out of the closet' at that point.

Eurofins Scientific (ERF FP) from 5.0% to 6.1% 19 May

ERF issued a press statement after market closure (18 May) that the company had raised 1m new shares through accelerated book-building (total €535m or circa 5% dilution to the equity stock) for COVID-19 testing capabilities and strengthening of its capital structure. The following day the stock fell by some -5%. We saw this as a win-win situation for ERF since the new testing facilities would add to the company's revenue and profit streams, while at the same time, the new capital would improve its balance sheet (which some observers consider somewhat weak). The capital-injection should have improved ERF's net debt to EBITDA to around 2x before hybrid debt (and including hybrid debt to around 3x) – all pre-IFRS16.

Assa Abloy (ASSAB SS) from 3.0% to 4.1% 25 May

We added to our recently acquired ASSAB position. The stock was on an upward trajectory but temporarily slipped to the lower end of its price range of SEK180-200.

Assa Abloy (ASSAB SS) from 4.1% to 2.0% 16-29 June

We reduced our acquired ASSAB position (see above) as the stock was trading at the SEK200 during mid-June but started to weaken towards the end of the month. Due to lack of positive corporate news and slightly negative revisions to consensus sales and profit forecasts, we presumed the stock would lose some of its earlier momentum.

Assa Abloy (ASSAB SS) from 2.0% to 0.0% 1 July

We sold our remaining position in ASSAB on the back of the aforementioned arguments.

Hermès (RMS FP) from 0.0% to 3.8% 9-13 November

Having looked for an entry point to Europe's most focused luxury goods company, Hermès, for some time, we initiated a position in this fine business during 9-13 November. Although the RMS share had outperformed the benchmark index as well as the other European luxury goods companies during 2020, the stock showed relative weakness to the other less-concentrated European luxury goods group (Richemont (CFR SW), LVMH (MC FP) and Kering (KER FP)), following the announcement that CFR and Chinese Alibaba (BABA US) had formed a strategic partnership with the British-Portuguese online luxury fashion-retail platform Farfetch (FTCH US) to accelerate digitalisation of the luxury goods industry and enhance access to the Chinese market. We believe Hermès already holds a very strong position in China – and indeed most of Asia – and we suspect its customers are less inclined (compared with other, more aspirational luxury goods brands) to purchase high-end products from generic e-commerce platforms, such as the one which FTCH provides.

Hermès (RMS FP) from 3.8% to 4.5% 2 December

We added to our recently acquired Hermès position as renewed lockdown restrictions across Europe pushed the RMS shares lower, while at the same time consensus sales and profit estimates for FY20 and FY21 were slightly raised despite the weakness of the USD.

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.

The document is provided for information purposes only and does not constitute investment advice or any recommendation to buy, or sell or otherwise transact in any investments.

The contents of this document are based upon sources of information which Heptagon Capital believes to be reliable. However, except to the extent required by applicable law or regulations, no guarantee, warranty or representation (express or implied) is given as to the accuracy or completeness of this document or its contents and, Heptagon Capital, its affiliate companies and its members, officers, employees, agents and advisors do not accept any liability or responsibility in respect of the information or any views expressed herein. Opinions expressed whether in general or in both on the performance of individual investments and in a wider economic context represent the views of the contributor at the time of preparation. Where this document provides forward-looking statements which are based on relevant reports, current opinions, expectations and projections, actual results could differ materially from those anticipated in such statements. All opinions and estimates included in the document are subject to change without notice and Heptagon Capital is under no obligation to update or revise information contained in the document. Furthermore, Heptagon Capital disclaims any liability for any loss, damage, costs or expenses (including direct, indirect, special and consequential) howsoever arising which any person may suffer or incur as a result of viewing or utilising any information included in this document.

The document is protected by copyright. The use of any trademarks and logos displayed in the document without Heptagon Capital's prior written consent is strictly prohibited. Information in the document must not be published or redistributed without Heptagon Capital's prior written consent.

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.

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

tel +44 20 7070 1800

fax +44 20 7070 1881

email london@heptagon-capital.com

Partnership No: OC307355 Registered in England and Wales

Authorised & Regulated by the Financial Conduct Authority(FRN:403304)