HEPTAGON
Capital

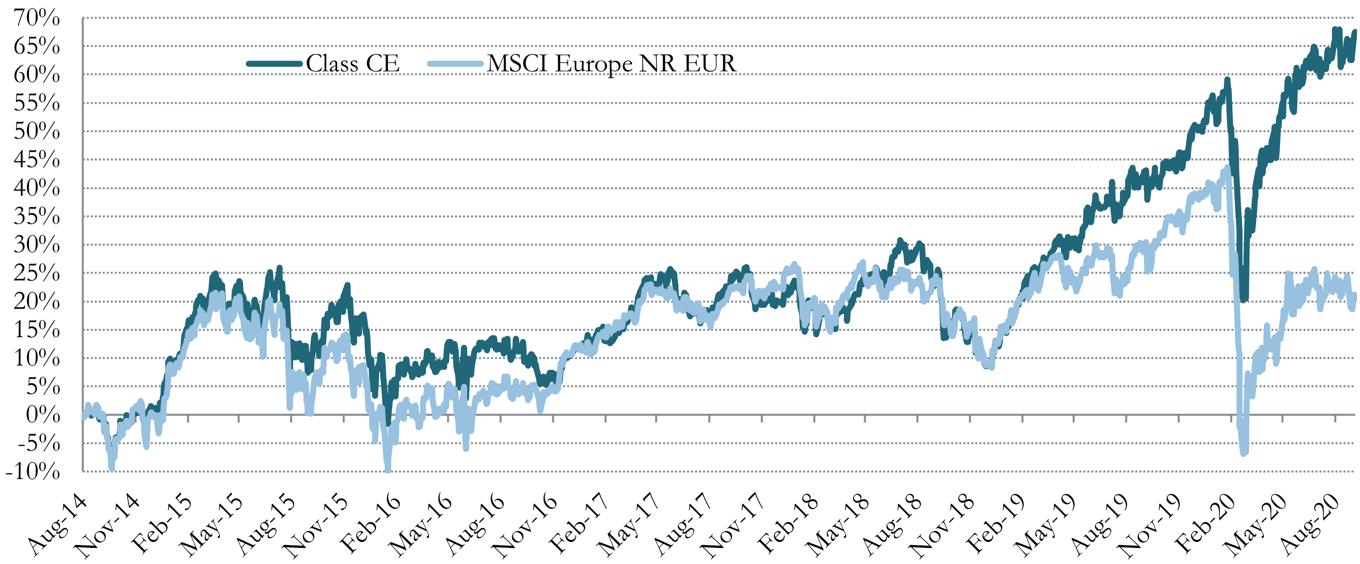
Heptagon European Focus Equity Fund

Market Commentary and Attribution Analysis for 9M20

Performance and executive summary

During 9M20, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value increased by +11.50% to €167.54 – rising considerably more than the MSCI Europe NR (EUR) index, which fell by -12.75% in comparison.

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



Source: Bloomberg

Contrasting performance of leading markets in 3Q20

Having seen similar performance profiles throughout 1H20, 3Q20 reflected a distinct difference in returns between the leading stock markets. US and Chinese indices showed positive returns over the 9M20 period, while other regions like Japan, India, Germany, France and the UK, saw their equity markets register negative returns. Major pan-European indices, such as the Eurostoxx 50 and Eurofirst 300, flatlined in 3Q20 but were still lower over the 9M20 period. Despite the negative investor-sentiment caused by Covid-19, we construe that Continental European stocks finally gave back some gains due to the extended Brexit –negotiations; something that, until recently, appears to have primarily affected British stocks. Somewhat surprisingly, while the FTSE 100 index fell by -4.9% in 3Q20 and -22.2% in the year to the end of September, the more domestically exposed FTSE 250 index appreciated by +1.1% in 3Q20 but fell by -20.9% in the year to the end of September. Against that backdrop, it seems that investors (at least for now) have ceased to discount more bad news to the domestic UK economy.

Investors are de-emphasising monetary policy and stand ready to evaluate forthcoming fiscal stimuli

We sense from the reaction of stock prices following commentaries from the leading central banks that monetary policies have done what they can in terms of stimuli. We believe this helps to explain investors' generally blasé reaction as far as the central banks' recent announcements go. We also sense that governments have woken up to the fact that fiscal policy is essential to reinvigorate economic momentum given that once furlough schemes come to an end – irrespective of whether they are temporarily extended – unemployment is poised to rise and a partly slack labour-force needs to be put to work.

HEFEF has gone from strength to strength so far in 2020

In the year to the end of September, HEFEF has performed very well. The strategy has shown its mettle by offering solid downside capture during periods of tough market conditions (1Q20) while appreciating in a paced fashion during periods of price appreciation. So far, the Fund has outperformed its benchmark index in each quarter this year (see table below).

Quarterly performance of HEFEF in 9M20

	1Q20	2Q20	1H20	3Q20	9M20
HEFEF	-9.70%	17.07%	5.71%	5.47%	11.50%
MSCI Europe NR	-22.59%	12.60%	-12.82%	0.10%	-12.75%
Difference in bps	**+1289**	**+447**	**+1853**	**+537**	**+2425**

Source: Bloomberg

The month of March remains the Fund's best-ever individual month demonstrating its solid downside capture. While the benchmark index fell by -14.3% in March, HEFEF's drawdown was restricted to -4.8%, thus reflecting an outperformance of +958bps.

In terms of the Fund's monthly performance to the end of September 2020, the Portfolio outperformed in seven out of nine months. It underperformed by -113bps in June (+1.94% vs. +3.07% of the benchmark) and by -5bps in August (+3.54% vs. +3.59% of the benchmark). It is worth noting that 31st August – a day that saw the Portfolio perform very well - was a Bank Holiday in the UK so there was no official NAV. Our internal calculations, however, show that the Portfolio advanced by +0.22% on 31st against the benchmark which fell by -0.63%, indicating an outperformance of +85bps for that day. Consequently, if the Fund had attained a NAV for the last day of August, HEFEF would have outperformed the benchmark that month too thus limiting the underperformance to only one month so far in 2020.

Where to go from here?

As we have discussed in past quarterly reports, we believe central banks and governments across the world have already gone to great lengths to accommodate society in different ways. Yet, we see it as beyond doubt that there will be a slowdown in economic activity. A number of market commentators and industry-leaders have been arguing that it may be 2022 (or even later) until some industries are back to pre-Covid-19 volumes. Key questions are: (*i*) how severe will any new Covid-19 waves be and; (*ii*) when will vaccines be available in sufficiently large volumes? These considerations raise some questions in their own right. Is the world economy at the beginning of a longer downturn, or should the current recession be regarded as a macro-economic consolidation period with prospects of greener pastures ahead? As we believe the world is nearer the end of the pandemic than the beginning, our hypothesis supports the chance of a more synchronised global recovery over the next 1-2 years.

HEFEF's Portfolio companies are poised to show growth throughout FY20 to FY22

From mid-October to mid-November, the majority of our Portfolio companies will publish quarterly statements. While there are still several hurdles to clear before the year is over, 2021 is less than three months away and as a prudent investor, we believe it is essential to start looking at expectations for FY21 and to some extent FY22 in more detail. We note that some of the input factors the analyst community uses have changed due to the adjustment of sales and earnings forecasts over the summer period. For example, the average EUR/USD rate in July-August was in the range of 1.16-1.17. Whilst this shows that the USD has depreciated from earlier in the year, the average USD rate at its current level is some -6% weaker than the EUR in 2H20 vs. the same period a year ago. Consequently, the logical 'knee-jerk reaction' for the analysts has been to reduce their projections.

Against this backdrop, we have analysed how consensus sales and profit projections for the Portfolio are expected to change from FY20 to FY22. The first table below shows what the changes are to sales and profits for the Portfolio in 2020 from 2019 and for each of the following two years. In order to reflect the various exposures in the Portfolio, we have made the calculations in unweighted and weighted terms.

HEFEF's aggregate year-on-year growth in sales and profits during 2020e to 2022e

	Unweighted				
	Sales	**EBITDA**	**EBIT**	**PBT**	**Net profit/EPS**
2020e	0.2%	1.5%	9.1%	7.9%	13.9%
2021e	8.1%	17.2%	28.4%	36.5%	33.9%
2022e	7.1%	10.1%	13.0%	13.8%	13.8%
	Weighted				
	Sales	**EBITDA**	**EBIT**	**PBT**	**Net profit/EPS**
2020e	2.1%	5.4%	13.4%	11.9%	17.8%
2021e	8.9%	17.2%	27.3%	35.1%	32.2%
2022e	7.6%	10.9%	14.2%	15.0%	15.0%

Note: data collected during 1-5 October, 2020

Source: Bloomberg

The above table shows that the Portfolio should generate growth in each of the three years regardless of whether Portfolio holdings are calculated as unweighted or weighted. In fact, when considering the actual weighted Portfolio exposures by the end of 3Q20, growth rates for the three years are generally higher than when considering an unweighted average. This is largely because of the biggest Portfolio holding, Zalando, which is expected to show significantly higher growth than the other stocks.

Analysts tend to make the biggest adjustments to their sales and profit forecasts at times when companies publish their financial results since each reporting date represents a '*check-point*' for organic sales growth, profit margins etc. However, exchange rate movements are normally continuously factored into the estimates – at least on a monthly basis. The table below shows how the consensus estimates for HEFEF have changed since the Portfolio holdings' last reporting date in the summer and looking at this, the Portfolio appears to be in solid shape. A few companies, which are either directly or indirectly related to some of our Portfolio holdings (for example, European retailers like H&M, Inditex and Next Plc. in the case of Zalando, Sonova in the case of Essilor(Luxottica) and Nike in the case of Adidas) published statements during September which were stronger than market expectations. Given that the USD is currently registering weakness of around

-6% in 2H20 year-on-year, estimated changes to the Portfolio have been limited to around -1% to -1.5% for FY20, indicating that the underlying businesses of the Portfolio companies are faring comparatively well.

Consensus changes to HEFEF's sales and profit estimates since last reporting date during summer

Average changes	Sales	EBITDA	EBIT	PBT	NP	EPS
2020e	-0.7%	0.6%	-1.5%	-0.2%	-0.7%	-1.3%
2021e	-1.0%	-0.2%	-0.3%	-1.1%	-0.7%	-0.6%
2022e	-0.8%	-0.2%	-0.7%	-1.3%	-0.5%	-0.3%

Note: data collected during 1-5 October, 2020

Source: Bloomberg consensus

Consensus revisions for FY21 and FY22 are more homogenous, i.e. there are consistent downgrades across the board. Our key conclusion from this is that consensus does not expect any material deterioration in terms of the performance of underlying businesses in FY21 since the downgrades are lower than the USD depreciation. With regard to expectations for FY22, the analyst community appears to have simply transposed the assumed growth rates for FY21 but 'tweaked' them slightly lower for that year. We, however, believe the downgrades for both years should be considered against the currently limited visibility since it is more or less impossible to take a firm view of how economies will perform in the coming 1-2 years at this juncture. For example, will national governments manage to curtail a possible second wave and/or will there be Covid-19 vaccines readily available early/late in the year and in sufficient volumes?

The negative revisions also raise some of their own questions. As we discussed earlier, are we at the beginning of a longer downturn, or should the current recession be regarded as a macro-economic consolidation period with prospects of greener pastures ahead? We believe the world economy is nearer the end of the pandemic than the beginning, which supports the chance of a more synchronised global recovery over the next 1-2 years. Consequently, we think that analysts' revision changes for FY21 and FY22 appear overly conservative – particularly when considering the readiness of leading central banks to support macro-economic momentum, alongside the likely larger impact of fiscal policy on economic activity going forward.

Why HEFEF should continue to outperform in 2020

In terms of successful stock-picking, we still view the two below criteria as the key ingredients for a strong investment performance in the months and quarters ahead. If the answer to the two questions is 'yes', we believe the underlying stock will perform well.

- Will the company grow in a world economy operating at sub-normal activity?
- Is the company's balance sheet strong enough to sustain a protracted period of sub-normal activity?

HEFEF's investment philosophy is based on the tenet that earnings drive stock prices and companies with consistent earnings power tend to generate superior stock market returns over time. The objective of the strategy is to construct an ever-rising earnings stream along the mantra: '**Where earnings lead stocks follow'.** As a rule –of thumb, equities as an asset class perform the best when their rate of change is accelerating and economic activity is expanding. Later in the stock market cycle, however, those shares where the '*relative rate of change in term of growth*' is better than the broader market (such as those for HEFEF) tend to outperform; something clearly reflected by the Portfolio's strong performance in 9M20. Over and above these remarks, the investment idea of HEFEF centres on the following:

- **Sustaining society:** Portfolio companies help to sustain and bring society forward – this should be particularly important now as the planet aims to get back to some form of '*new normality*'. In this context, HEFEF is more about evolution than revolution. In Portfolio construction terms, this implies that we are building a like for like (LfL) revenue stream which compounds at 6-8% per year (or 2-3x 'normal' global GDP growth), translating to 12-15% net profit and/or EPS growth over time.

- **Lack of cyclicality:** HEFEF's combination of high quality businesses, currently defensive characteristics and strong, sustainable growth has already shown its mettle; in 1Q20, when the market was falling and the Portfolio's downside capture led to a strong outperformance; in 2Q20, when stock markets recovered; and in 3Q20, when markets were more or less flatlining. Only three stocks in the Portfolio have betas higher than 1: **Adidas**, **ASML** and **Zalando**. However, as we have outlined earlier in this report, the Portfolio is expected to continue to generate positive sales and profit growth for FY20e through to FY22e, according to consensus.

- **Withstood the test of time:** Portfolio companies have withstood the test of time with their average foundation dating back to early 1940s. All companies are focused on the execution of their core competencies which, in turn, has led to high barriers to entry and solid pricing power. The Fund does not invest in mature industries, such as pure financials (banks/insurance companies) or price-takers (energy/commodity companies), which we believe are at risk in this stage of the economic cycle.

- **Asset-light and highly cash-flow positive:** Portfolio companies are asset-light and generate high ROI, which is compatible with low inflation. All companies generate solid cash-flows, which are primarily redeployed back into the business to support growth rather than be paid out as dividends or used for share buybacks.

- **Proven superior downside-capture: Despite its limited number of holdings, HEFEF has a proven solid downside-capture due to the very high quality of the Portfolio companies. This was clearly evidenced by the strong relative performance during the sharp market drawdown in March.**

- **Top-ranked on ESG: HEFEF has always applied ESG considerations as an integral part in its due diligence process when finding new companies in which to invest. The Fund has an ESG-exclusion list and uses an inhouse ESG checklist in the due diligence for identifying new stocks, which makes it possible to compare a business to other companies in the investment universe. Consequently, the Fund has always enjoyed very high ESG scores with leading institutions like MSCI and Morningstar. (A separate SRI report on HEFEF's holdings was published in July 2020.)**

Risks and uncertainties

We differentiate between *risk* and *uncertainty*. In the case of risk, we are able to predict, measure and quantify the possibility of future outcomes; not so in the case of uncertainty. In terms of both risks and uncertainties, we regard the following issues as meaningful potential difficulties in navigating the markets and our stock-picking.

- **The Covid-19 pandemic:** (*i*) will there be a second and/or a third wave and; (*ii*) what are the likely medium to long-term implications in respect of unemployment and corporate default rates?
- **Negative bond yields and excessive levels of debt:** virtually every government is now issuing debt in a seemingly unperturbed fashion (for example, some two-thirds of all European sovereign debt traded with negative yields even before the coronavirus outbreak). However, debt has a maturity and cannot be rolled over into perpetuity and thus ultimately needs to be repaid. This raises the question of where the necessary funds for repayment will come from? We believe the answer is through higher taxes and/or higher interest rates - but how will this affect the equity markets?
- **China:** the country runs debt-driven growth but its aggregate indebtedness has arguably reached a very high level. Furthermore, what are China's geopolitical ambitions? Such as its gradual expansion into the South China Sea and it's not-so-subtle escalation of pressure on Taiwan (particularly in light of China's recent treatment of Hong Kong).
- **The UK vs. the EU:** the ongoing tension between the UK and the EU and the uncertainty in terms of agreeing on a trade deal.

HEFEF attribution analysis for 9M20

During 9M20, the Heptagon European Focus Equity Fund (HEFEF) CE share class' net asset value increased by +11.50% to €167.54 – rising considerably more than the MSCI Europe NR (EUR) index, which fell by -12.75% in comparison.

There have only been minor movements in the top-five performing stocks in the Portfolio in 9M20 compared with 1H20, which supports our hypothesis that stocks that perform well tend to perform well for longer. In terms of the top-five rankings over 9M20, the best-performing stocks were: **Zalando** (Germany/online retailing which was #2 in 1H20); **Lonza** (Switzerland/active pharmaceutical ingredients which was #1 in 1H20); **Tomra** (Norway/recycling and sorting installations which was #6 in 1H20); **Eurofins Scientific** (France/food and clinical testing solutions which was #7 in 1H20); and **Givaudan** (Switzerland/manufacturer of flavours and fragrances which was #5 in 1H20). The five best-performing stocks had a combined weighting of 32% at the end of 9M20 (vs. 27% at the end of 1H20).

As we highlighted last quarter, none of the top-five performers can be considered '*cheap*' in valuation terms in a traditional sense – neither against the broader European equity markets, nor against their own history. However, with the exception of Tomra, which has been pushed higher by extremely strong ESG credentials, the other stocks have the common denominator that they will show underlying organic growth in FY20 as well as in FY21.

The worst-performing stocks in the Portfolio in 9M20 (only three stocks underperformed the benchmark index in 9M20) showed less similarity than in 1H20. These three were: **Serco** (UK/outsourcing which slightly beat the benchmark in 1H20); **Diageo** (UK/distilling and beverages which was the weakest stock in the Portfolio 1H20) and **EssilorLuxottica** (France-Italy/eyeglass lenses and sunglasses which was the #3 weakest stock in the Portfolio in 1H20). They had a combined weighting of 13% of the Portfolio at the end of 9M20 (vs. the four underperforming stocks which had a combined weighting of 15% at the end of 1H20).

In the below attribution analysis, which covers the 9M20 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 -12.75% over the same period.

Contributors

Zalando (ZAL GY)

ZAL (Germany: +76.85%), Europe's largest online fashion retailer, was the best-performing stock in the Portfolio in 9M20. 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 then embark on a significant recovery phase in April. What prompted the strong price momentum in 2Q20 was a pre-announcement for the 1Q20 period (16th April) when management commented that it anticipated a faster-than-expected recovery in online fashion. When the full set of 1Q20 results was released (7th May), ZAL commented that it had seen record-breaking growth in new customers (40% during April). The stock continued to move along a positive trendline until it's largest owner, the Swedish holding company Kinnevik (KINVB SS), announced that it had divested 11.25m shares (4.4% of the company) through an accelerated book-build (15th June). Although KINVB remains ZAL's largest shareholder still with a stake of 21.3% (54.0m shares), the stock dipped close to -5% on the announcement. Two days later (17th June), ZAL's management again pre-announced that it expects 2Q20 sales and profits to be '*significantly above market expectations*'. The ZAL share once again took a leap forward and is currently trading around its all-time high. The 2Q20 set of results (11th August) were outstanding. The company is increasingly benefitting from its 'partner-programme', where it helps 3rd party brand names get better penetration to the online market. ZAL's 3Q20 set of results is due 4 November.

Lonza (LONN SW)

LONN (Switzerland: +61.58%), the leading provider of fine chemicals, biocides, active ingredients and innovative dosage forms to the pharmaceutical industry, was the second best-performing stock in the Portfolio. Although we only added LONN to the Portfolio on 24th March (see below), the stock generated a return of +14.8% over the last four trading sessions in 1Q20, better than the entire 1Q20 period (+14.0%). Since its trough in March, the LONN share had an exceptionally strong 2Q20 (the stock appreciated by +24.6% vs. +12.6% of the benchmark). The main catalyst was the press release that LONN and the US biotechnology company, Moderna (MRNA US), have signed a ten-year agreement (1st May) for the production of up to 1bn doses of a promising Covid-19 vaccine (codenamed: mRNA-1273), whereby MRNA will utilise LONN's factories in the US and in Switzerland. Against this backdrop, the LONN share is currently trading at the upper-end of its long-term valuation range, but its sales and profit revisions have been positive. LONN's 1H20 set of results (24th July) were slightly ahead of consensus expectations but, was muted as management tempered expectations for any revenue/profit-contributions from the MRNA agreement until FY21. LONN hosted an investor day on 15th October where management guided for double-digit revenue growth until 2023 and an EBITDA margin in the range of 33-35%. The market took this new information very positively. The company has not yet set a date for the release of the FY20 results, but they are normally published in late January.

Eurofins Scientific (ERF FP)

ERF (France: +36.67%), the leading testing services group, which offers bioanalytical services in the food, pharmaceutical and environmental markets, was the third best-performing stock in the Portfolio in 9M20. ERF's performance has so far been very solid in 2020 but the 1Q20 sales report (28th April) and the 1H20 set of results (6th August) acted as catalysts to send the ERF share sharply higher. The main messages from management were that: (*i*) in order to analyse Covid-19 tests you need laboratories and; (*ii*) ERF operates one of the world's largest networks of laboratories (+800) across the globe. While ERF was in the process of ramping up its analytical Covid-19 capacity earlier in 2020, management came across as positive in terms of new business opportunities and thus reconfirmed the FY20 guidance, which should generate 5% organic sales growth (to circa €5bn); EBITDA of some €1.1bn and FCF of €500m. Since the release of the 1H20 set of results, the consensus estimates for ERF have been upgraded for FY20 as well as FY21. The company's 3Q20 sales report is due on 22nd October.

Tomra (TOM NO)

TOM (Norway: +34.69%), the leading supplier of recycling and sorting equipment, was the fourth –best-performing stock in the Portfolio in 9M20. Since the low point of the TOM share in March, the stock has staged a strong recovery. The 1Q20 set of results (5th May) as well as the 2Q20 set of results (17th July) were ahead of market expectations. Having reached an all-time high (NOK423.5) on 31st August, the stock came off following some media articles regarding what appears to be an extravagant, albeit not fully clarified, compensation programme for the company's management. We have no doubt that management will be forced to clarify how its compensation programme is structured in more detail when the 3Q20 set of results will be published on 22nd October. Nonetheless, given 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, TOM's long-term fundamentals appear excellent.

Givaudan (GIVN SW)

GIVN (Switzerland: +31.63%), the world's leading supplier of natural and synthetic flavour and fragrances, was the fifth best-performing stock in the Portfolio in 9M20. 3Q20 was the third consecutive quarter when GIVN figured as a top-five performing stock in the Portfolio (we initially purchased the shares on 12 October 2018). A key feature with GIVN is that it more often than not outperforms the benchmark albeit in an undramatic fashion. To some extent, this characteristic is comparable with that of Nestlé (Nestlé was the 12th best-performing stock in the Fund in 9M20 +4.9%). In other words, GIVN's strong long-term performance is difficult to detect on a monthly and to some extent also on a quarterly basis, but the stock holds defensive qualities due to its sound downside-capture. GIVN's 1Q20 revenues (8th April) showed a sequential deceleration in LfL growth +5.4% (4Q19: +4.2%) and further deceleration to +2.6% for 2Q20 in isolation. Although GIVN's 1H20 results were comfortably ahead of market expectations, the market's reaction was rather muted given the stock's solid performance in the run-up to the press release. Since then, consensus estimates for the company's sales outlook have been broadly unchanged but, profits for FY20 and FY21 have been sharply upgraded. GIVN's 3Q20 sales report was published on 8th October. The organic growth rate for 3Q20 in isolation accelerated, but the stock saw modest profit-taking and slight downgrades to the FY20 and FY21 estimates on the back of the USD weakness.

Detractors

Serco (SRP LN)

SRP (UK: -26.73%), the leading provider of outsourcing services, was the weakest performer in the Portfolio in 9M20, despite what we consider to be excellent execution by its management. SRP normally releases 'pre-close statements' before its half and full-year results. This year, management pre-announced the pre-close statement (18th June), which was about one week before normal, as the company reinstated its FY20 guidance. LfL growth for 1H20 would be some 14% higher (compared with the consensus growth estimate of around 10%) and LfL growth for FY20 would be some 9% (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 (6th August) were ahead of market expectations but, management advised caution that LfL growth for 1H21 would come down to a more 'normal' level (we estimate 4-6%). The market took this remark badly, notwithstanding the fact that the UK's stranded Brexit negotiations with the EU have led to poor sentiment for high-profile companies that often figure in British media (SRP is in charge of the government's track-and-trace system for Covid-19). However, since the publication 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, where the organic revenue growth guidance for FY20 is expected to be around 15% associated with a 30% increase in underlying EBIT, which prompted a spike of more than 10% in the stock on the day. SRP will release the next FY20 pre-close statement on 17th December and the FY20 set of results is due on 25th February.

Diageo (DGE LN)

DGE (UK: -22.79%), the world's largest distiller, was the second weakest-performing stock in the Portfolio in 9M20 (as well as the weakest performer in the Portfolio in 1H20 and the fifth weakest performer in the Portfolio 1Q20). Despite DGE's poor performance in the YTD, we have held on to the position given what under normal circumstances (i.e. non-Covid-19-related) would be highly defensive qualities. We have assumed that spending habits on alcoholic beverages would shift to domestic consumption as pubs/bars and restaurants have been in full or partial lockdown mode across the globe. 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 due to restrictions in air traffic and cruises. DGE's FY19/20 results (4th August) were slightly ahead of market expectations but the numbers contained exceptionals and impairment charges relating to India as well as some other isolated businesses. The market took the numbers badly as any likely 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 the large number of world-renowned brand names in the portfolio (like Johnnie Walker, Gordon's, Tanqueray, Smirnoff, Captain Morgan to mention a few) we believe there is considerable hidden value should inflation eventually pick up. Furthermore, since the publication of the FY19/20 results, consensus estimates have been raised for the next two fiscal years. In connection with the AGM (28th September), management issued a trading update which reflected a recovery across all regions. This announcement prompted a strong and positive reaction to the stock. DGE has not yet confirmed the date for the release of the 1H20/21 statement but it is normally in late January.

EssilorLuxottica (EL FP)

EL (France/Italy: -14.47%), the world's largest eye-lens and frames manufacturer, was the third weakest-performing stock in the Portfolio in 9M20 (as well as in 1H20 and the second-weakest-performing share in the Portfolio in 1Q20). While EL made several blunders in 1H20, management was more careful in 3Q20 but not enough to remedy the poor performance of the stock earlier in the year. Shortly after the release of the FY19 results (6th March), EL launched a share buyback programme (17th March) of up to €300m (circa 1% of EL's market capitalisation) only to cancel it shortly afterwards (27th March). At this time, the company withdrew the FY20 guidance which had been presented when the FY19 results were published. Finally, EL issued a press statement that its long-serving manager, Laurent Vacherot (group COO), would retire and that the expected dividend for FY19 (€2.23 per share) would be decided at a '*later date*' as the AGM was postponed (from 15th May to 25th June) because of the Covid-19 situation. The blunders went on - in another announcement (20th 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 (4th June) in respect of its acquisition of the Dutch optical retailer, Grandvision. EL's 1Q20 sales announcement (5th May) was lacklustre, but the market took the statement as a relief. The 1H20 results (31st July) were slightly ahead of market expectations and the stock moved higher on the day. However, the threat of additional lockdown restrictions has again affected investor sentiment and against that backdrop, consensus estimates have been cut since the release of the last set of results. Nonetheless, the stock still looks attractively valued on most valuation criteria. EL will publish 3Q20 sales on 3rd November.

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 9M20 (9M19: 11 changes).

- We divested the exposure to **Chr Hansen** 13-14th February (from 1.7% to 0.0%)
- We initiated an exposure to **Tomra** 26-27th February (from 0.0% to 3.6%)
- We added to **Tomra** 11-19th March (from 3.8% to 4.2%)
- We initiated an exposure to **Lonza** 24th March (from 0.0% to 3.8%)
- We initiated an exposure to **Atlas Copco** 25th March (from 0.0% to 3.8%)
- We initiated an exposure to **Assa Abloy** 17th April 19th May (from 0.0% to 3.2%)
- We added to **Eurofins Scientific** 19th May (from 5.0% to 6.1%)
- We added to **Assa Abloy** 25th May (from 3.0% to 4.1%)
- We reduced **Assa Abloy** 16-29th June (from 4.1% to 2.0%)
- We divested **Assa Abloy** on 1st July (from 2.0% to 0.0%)

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

Following a pre-announcement of CHR's 3Q18/19 results in (26th 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 (28th 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 (10th 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% – 10th October 2019) and decided to re-evaluate whether to remain invested in CHR or not. When CHR announced their 1Q19/20 results (15th 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 of CHR and thus we divested the remaining 1.7% holding during 13-14th February.

Tomra (TOM NO) from 0.0% to 3.6% 26-27th 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 almost single-handedly address 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 (20th 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. However, like all desirable stocks, either the price action or the valuation nearly always seems to be too far to bridge. After a price-drop of TOM in February along with the general market drawdown, we decided to make an initial 3.6% investment during 26-27th 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% 11-19th March

As the broader European (and international) equity markets were 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*' when trying to invest in highly desirable stocks while 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 31st March. However, that compared very 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% 24th March

LONN, the leading Swiss provider of fine chemicals, biocides and active ingredients to the pharmaceutical 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 24th 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% 25th 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 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% 17th 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 (7th April), which indicated a weak set of numbers, we assumed that most 'skeletons would be out of the closet' by this point.

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

ERF issued a press statement after market closure (18th May) that the company had raised 1m new shares through an accelerated book-build (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% 25th 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% 16-29th June

We reduced our recently 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% 1st July

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

Christian Diebitsch, Fund Manager, Heptagon Capital

Glossary

Asset Class	A group of securities with similar characteristics that tend to behave similarly in the marketspace, such as equities, bonds and cash equivalents.
Asset light strategy	A company that has relatively few capital assets compared to its operations.
Balance sheet	A document that provides information on the financial position of a company at a particular point in time. It includes what it owns (assets), what it owes (liabilities) and the value of business to equity holders (shareholders' equity).
Barriers to Entry	Refers to obstacles that potential entrants in a market might experience, such as strong customer loyalty or patents.
Basis Point (bps)	A common unit of measure in finance. One basis point is equal to one hundredth of 1%, e.g. 0.01%.
Benchmark	A point of reference against which investment performances can be measured.
Beta	A measure of a security's or portfolio's sensitivity to movements in the market as a whole. Bull Beta is a measure of the volatility to positive changes in the market. Bear Beta is a measure of the volatility to negative changes in the market.
Bloomberg	A company that provides business and market news, data and analysis.
Bond	A security issued by a corporation or public body that pays the holder a fixed (or variable) rate of interest and matures at a set date.
Cash Flow	The money generated by a business before it needs to repay debt and/or other obligations.
Consensus earnings	A figure based on the combined estimate of analysts who are covering a particular public company.
Compound Returns	Rate of return, expressed as a percentage, that represents the cumulative effect that a series of gains or losses has on an original amount of capital over a period of time.
Cyclical Stock	Stock whose price is affected by macroeconomic and systematic changes in the economy.
Divestment	The process of selling an asset.
Dividend	A share of a company's profit paid to its shareholders.
Downgrade	When the rating of a security deteriorates due to analysts' opinions on it.
Downside Capture	A measure of a portfolio's correlation to a benchmark when the market is in decline. A ratio of less than 100 indicates that the portfolio has less negative returns than the benchmark during a specific period.
Drawdown	The amount an investment or fund declines from peak-to-trough during a period of time, usually shown as a percentage.
Earnings before interest and tax (EBIT)	An indicator of a company's earnings and shows how much profit a company generates from operations before paying interest rate charges and tax.
EBITDA	An accounting measurement used to indicate the profitability of a business, calculated by analysing earnings before taxes, interest, depreciation and amortization are subtracted.
Earnings per share (EPS)	An indicator of a company's profitability and shows the portion of profit allocated to each share of common stock outstanding.
Equity Security	A security that represents ownership in an entity and that may pay income as dividends.
Euro Stoxx 50 Index	An index that captures Europe's leading blue-chip companies. It covers 50 of the largest and most liquid stocks.

EuroFirst 300	An Index that comprises the 300 largest companies ranked by market capitalisation in the FTSE Developed Europe Index.
ESG	Environmental, Social, Governance.
European Central Bank (ECB)	The central bank of the Eurozone, responsible for administering the European Union's monetary policy.
Exit	The process of realizing a return on an investment, typically through a trade sale, an Initial Public Offering or a secondary sale.
FED	The Federal Reserve System is the Central Bank of the United States.
Fiscal Policy	A government policy that makes use of government spending and taxation to influence an economy.
FTSE 100 Index	An index representing the 100 highest market capitalisation companies traded on the London Stock Exchange.
FTSE 250 Index	An index representing the 250 highest market capitalisation companies traded on the London Stock Exchange.
Fund	A structure where money is pooled from various investors to collectively invest while each investor keeps ownership of his or her capital.
Gross Domestic Product (GDP)	The value of all goods and services produced in a given country during a specific time period.
Inflation	The rate in which the cost of goods and services is rising
Investor Sentiment	Refers to the overall attitude of investors towards a particular market or asset.
Like for like growth (Lfl)	A measurement of growth, adapted for a divested business, often use as an indicator for performance
Macro Analysis	The analysis of economy wide factors, such as employment, inflation or monetary and fiscal policies.
Market Cap	The market value of the outstanding shares of a publicly traded company.
Momentum	When rising asset prices continue to rise and falling asset price continue to fall.
Monetary Policy	A policy set by a Central Bank or a regulatory committee that alters an economy's money supply in an attempt to affect, for example, inflation and liquidity.
MSCI Europe Index	A market cap weighted benchmark index that represents the performance of large and midcap equities across 15 developed countries (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK).

Net Asset Value (NAV)	The value per share at any one moment in time for a fund.
Net Profit Margin(NP)	The net profit margin is equal to how much net income or profit is generated as a percentage of revenue. Net profit margin is the ratio of net profits to revenues for a company or business segment.
Organic Revenue Growth	Growth derived within the company itself, including areas such as: marketing, operations and innovation
Portfolio Weight	The percentage amount of a holding in a portfolio.
Profit Margin	A profitability ratio calculated as net income divided by revenue.
Profit Before Tax (PBT)	Profit before tax is a measure that looks at a company's profits before the company has to pay corporate income tax. It essentially is all of a company's profits without the consideration of any taxes.
Return on Investment (ROI)	A profitability measure that evaluates the performance of a business by dividing net profit by net worth.
Revenue	Income that a business generates from its business activities.
Share	A unit of ownership that gives the holder the right to a proportion of the capital of the company.
Share Buyback	When a company purchases its outstanding shares back from investors.
Sovereign Debt	Debt issued by a central government, typically as bonds, to finance its domestic initiatives.
UCITS	Undertakings for Collective Investment in Transferable Securities. It is a regulatory framework in the European Union.
Valuation	The process of determining how much a company or an asset is currently worth at a particular point in time.
Yield	The income that is generated from an investment.

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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.

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