

The value emerging across our watch list

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After one of the most tumultuous starts to the year since the 1970s, we are starting to see opportunities appear across our watch list of innovative companies.

Our philosophy is simple – we believe innovative companies can achieve superior returns. Why? Because innovative companies can achieve faster growth, build stronger barriers to entry and are more resilient and adaptable.

The Global Innovation investment process identifies companies that are creating genuine value for customers by driving down prices – like Amazon has done – or greatly improving the quality of a product or service. We see innovation as the ultimate marker of quality in a business and the best driver of growth. But not every innovation is a great investment so companies must also have strong barriers and management teams that can execute.

As markets have sold off indiscriminately, value has emerged for us across two types of companies. First, high quality, defensive companies with exceptional barriers to competition, such as Universal Music Group (UMG), which is down around 30% this year, opening up a rare window to buy. Second, high growth companies such as Twilio – down as much as 70% year-to-date – are representing attractive long-term investment opportunities.

UMG, home to many of the top recording artists globally, from Taylor Swift to Ariana Grande and The Beatles, has innovated over the past 25 years of turbulent change in the music industry as it shifted from CDs to streaming. UMG provides unparalleled value for its artists, deploying its unrivalled network and resources to support them through each stage of their development.

As the largest recorded music company in the world (with around a 31% market share), UMG's scale provides significant fixed cost leverage and bargaining power over distribution platforms. Combined with industry-leading IP ownership of content (over 3 million recordings which can be monetized across multiple revenue fronts and for many years), this creates a flywheel of value creation, as evidenced by around a 20% return on capital. At the same time, its bargaining power with artists is assured by no individual artist making up more than 1% of its revenues in any given year. This means the company is well-positioned to benefit from the strong growth in the music industry driven by companies from Spotify and Apple to Tencent Music.

Twilio (a technology company that makes communication software) has been hard at work since its founding in 2008, solving the toughest challenges of business to consumer communication via SMS, video, email and so on.

Twilio boasts over 268,000 active accounts and is helping companies as diverse as Lyft (to communicate directly with drivers and riders) and the American Red Cross (to communicate directly with volunteers to solve critical problems). In fact, Twilio is now so deeply integrated into the digital

economy that it has over 9 million developers on its platform – far more than its closest competitor Vonage with 1.2 million.

When do we interact with Twilio in our daily lives? All the time: when you order your dinner from Deliveroo, receive an SMS from PayPal and American Express requesting a confirmation of identity, or when you buy groceries on Amazon Fresh. The company is reducing communication costs for its clients by 90%, which is a huge saving and will be very important for businesses trying to navigate the current high-inflation environment.

Twilio is a great example of a company that has invested heavily for growth over the past decade, building robust barriers in the process and is now pivoting its focus towards profitability. We believe it can become a hugely profitable company, generating lots of cash for investors.

While we expect markets to remain volatile in the short term as central banks move to keep long-term inflation expectations anchored, value is emerging across our watch list and we are putting capital to work in these two types of companies.

For a comprehensive list of common financial words and terms, see our glossary at:

<https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms>

Key Risks

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Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.

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