LIONTRUST

THE SUSTAINABLE FUTURE PROCESS

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Liontrust SF European Growth Fund: Q1 2022 review

Fund managers: Martyn Jones and Peter Michaelis

The Fund returned -13.9% over the quarter, underperforming -7.4% from the MSCI Europe ex-UK Index and the -7.7% IA Europe ex-UK sector average (both of which are comparator benchmarks)*†.

We have written at length about the current headwinds for our quality growth investment style, with longer-duration companies hit harder by fears of inflation and interest rate hikes intended to control it. Equities, broadly speaking, had a stronger March but we reiterate those comments, especially if this year remains volatile. In short, over the 21 years we have managed the Sustainable Future funds, we have seen many periods of inflation and interest rate shifts. During these, we have remained resolutely focused on the long-term prospects of our high-quality companies that can grow profitably year after year by making the world a better place. Our experience is that the long-term success of our investments will be determined by the compounding of growth, not the discount rate shifting up a few per cent.

Of course, this situation has been exacerbated by the conflict in Ukraine but while we are following events closely, we do not attempt to forecast macroeconomic or geopolitical factors. We continue to focus on our core competence: identifying businesses exposed to strong sustainability trends that will endure and grow their value per share regardless of economic backdrop. At times of indiscriminate sell-offs, the market presents us with opportunities to add to our highest-conviction companies at more attractive valuations, as well as starting positions in names we have long admired but, prior to now, were fairly valued by the market, and we introduced one new investment over the quarter, Netcompany.

This is an IT services company with a consulting business model, held under our *Improving the resource efficiency of industrial and agricultural processes* theme. The company's thousands of IT engineers help businesses across sectors to modernise and digitise their operations, improving efficiency, customer experience, resilience and digital security. Netcompany works on a fixed cost basis and this is key to winning projects (particularly in the public sector), assuring clients it will deliver the project both on time and on budget.

We see a major trend towards digitalisation in Europe, with the EU launching a huge stimulus package called The Recovery and Resilience Facility in response to Covid. The fund amounts to over €800 billion to be spent over the next five years, with the goal to stimulate and modernise the European economy, increase growth and transition to a lower-carbon digital future.

We like the culture of the business in that it remains IT people leading IT people, with the founders engineers by training and looking to keep the same technical leadership. The company recently made a large acquisition in the shape of Intrasoft and is taking a slow and steady approach to integration, keeping this as a separate entity and shifting it to the Netcompany model. Finally, the current 25x PE valuation is close to cashflows given the capital-light nature and for the returns and growth profile, we believe this is an undemanding multiple.

Over a volatile period marked by indiscriminate selling, our positive names were either financials amid the value rotation, including DNB Bank and Axa, or benefited from strong results such as French payment company Edenred. The latter is a good fit for our *Improving the resource efficiency of industrial and agricultural processes* theme, with its payment solutions bringing efficiency and value for money for customers. Edenred announced record earnings and growth for 2021 over the quarter, with this cash generation allowing the business to strengthen its financial profile and propose a higher dividend than before the pandemic, while also maintaining an ambitious M&A strategy.

Befesa reported record earnings levels for both Q4 and FY 2021 in March, delivering strong double-digit growth year-on-year and results well above pre-pandemic levels. Held under our *Delivering a circular materials economy* theme, these positive earnings developments were primarily driven by strong base metal prices and good volume performance, including the acquisition of US firm AZR in the middle of August.

Among weaker performers are generally our fastest-growing companies that are not yet profitable from a P&L perspective. These continue to reinvest and grow in their nascent markets, developing their products and services, growing their headcount and building strong competitive advantages.

Trustpilot, for example, is becoming the world's leading review platform, allowing an independent and objective space for customers and merchants to interact online. As the economy continues to digitise, we believe Trustpilot's dominant position in this fast-growing market will result in strong cashflow generation over the long term with millions of reviewers and merchants on this two-sided platform. The shares have dropped precipitously since IPO in March 2021, yet the results continue to positively surprise us. We have added to the position on weakness and remain confident in our thesis.

A poster child for indiscriminate selling is Unifiedpost, which has seen its shares falling despite posting a 147% increase in group revenue over 2021 driven by organic growth and a string of acquistions. This is another holding exposed to our *Improving the resource efficiency of industrial and agricultural processes* theme, focusing on digitising business administration and payments. Around 95% of documentation between European businesses is still paper based, which is slow, subject to error and has a significant environmental footprint, and this company's software allows companies to cut down paper, time, money and fraud.

Elsewhere, Zur Rose is another strong example of a company driving digitisation. Operating under the Doc Morris brand, it is Europe's leading digital pharmacy, providing over-the-counter products to over 12 million users. The German market presents a huge opportunity, valued at over €60 billion per annum, and is poised for disruption, with a recent change in legislation mandating the use of digital prescriptions. This shift has been delayed due to the recent Omicron variants hampering the technology roll-out, however, sending Zur Rose's share price down over 50%. After review, we do not believe this delay will change the long-term direction of this market and added to this position on weakness.

Spotify's shares have also been weak following its 2021 fourth-quarter results released at the start of February. The results for the quarter itself were solid and generally in line with analyst expectations but the company's guidance on Q1 2022 was slightly below what the market had been expecting in terms of new monthly subscribers, which Spotify put down to an increasingly seasonal approach to marketing and acquiring new customers. The company also announced it would be no longer providing annual guidance, just focusing on the next quarter. Any company that gives less information to the market is generally looked on with great suspicion. Spotify, however, is led by the founder Daniel Ek, who comes across as extremely thoughtful and very focused on the long term and, as such, this is not something that concerns us.

Finally, despite generating positive cash flows, Spotify posted another year of accounting losses and in this market, companies not seen as generating profits today seem to be punished more than most. Although predicting the future margin profile of this business is difficult, we believe expansion is likely to follow as it continues to grow in scale, as well as grow high-margin lines such as podcasts or the marketplace business. Spotify shares are now trading at 1.7x 2022 sales – this is the lowest multiple on which the business has traded since listing in 2018 and 25% below the 2.2x it fell to during Covid. As such, we believe our internal rate of return is likely to be driven by revenue growth from here, with potential for re-rating if sentiment in the market turns.

Meanwhile, Avanza Bank, the largest savings and investment platform in Sweden, has seen its price fall over 40% from the peak seen in November 2021. Avanza's earnings are correlated to several factors, all of which are impossible to predict, including broader market levels, interest rates, and volatility of markets. 2021 was a fantastic year for the business, where earnings reached all-time highs because of a larger-than-ever customer base, high levels of trading activity, and high absolute market levels. It is therefore likely Avanza will earn less in 2022 than in 2021, while the company continues to reinvest in people and products to maintain its competitive advantage – it is around four times larger than the nearest competitor in Sweden.

As long-term investors, however, we care about what the company is likely to earn five years from now, and its relentless focus on customer satisfaction, alongside an efficient platform, means we are confident the earnings power of the business will be significantly larger in the future. After weakness in the shares, the company trades on around 20x next year's earnings – a similar multiple to the trough reached during the Covid selloff in 2020.

Discrete years' performance*, to previous quarter-end:
Past performance does not predict future returns

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Liontrust Sustainable Future European Growth 2 Acc	-1.5%	38.6%	3.8%	-2.7%	4.5%
MSCI Europe ex UK	5.5%	33.5%	-8.3%	2.2%	3.0%
IA Europe Excluding UK	4.2%	39.6%	-9.4%	-1.2%	5.6%
Quartile	4	2	1	3	3

***** Source: FE Analytics, as at 31.03.22, primary share class, total return, net of fees and income reinvested

For a comprehensive list of common financial words and terms, see our glossary at:
liontrust.co.uk/benefits-of-investing/guide-financial-words-terms