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Liontrust GF SF Pan-European Growth Fund: Q1 2022 review

Fund managers: Martyn Jones and Peter Michaelis

The Fund returned -13.8% over the quarter in euro terms, underperforming the MSCI Europe Index's -5.3% (which is the comparator benchmark)*†.

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 two new investments over the quarter.

Our first addition was Oxford BioMedica, a long-term holding in our UK portfolios, under the *Enabling innovation in healthcare* theme. Shares have been falling since November, which we find hard to understand as, operationally, the business has never looked stronger. It may see less demand for AstraZeneca vaccine manufacturing as the pandemic appears to be receding but this is being replaced by higher value contracts with partners developing ground-breaking gene therapies.

Oxford BioMedica is a leader in lentiviral vector innovation and manufacture, one of the core delivery mechanisms within gene and cell therapies. We believe such treatments are set to revolutionise the healthcare landscape, as they have the potential to provide a one-off cure to underlying diseases versus the current chronic therapy paradigm, where patients are expected to take medication or treatment for the rest of their lives. As with many healthcare companies, there is a risk some pipeline therapies are unsuccessful but one of the core reasons we like Oxford BioMedica is that it has broad exposure to innovation as a whole and to other organisations working in gene and cell therapy.

Netcompany was a second purchase over the quarter, 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.

In terms of other trades over the quarter, we sold IP Group under the *Enabling innovation in healthcare* theme on risk management and liquidity grounds, having added Oxford Nanopore – IP's largest investment, which listed with an IPO in September – in Q4.

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.

Global catering business Compass Group, held under our *Leading ESG management* theme, also had a solid Q1, with the company reporting a solid first quarter of its financial year (to end December), during which it spent a further £87 million on bolt-on acquisitions in the US. Despite some concerns about impact from the Omicron variant in Q2, its guidance for FY22 remains unchanged.

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.

Meanwhile, London Stock Exchange shares rallied as the group announced plans to sell a group of assets known as BETA+ for US$1.1 billion to private equity firm Motive Partners and investment firm Clearlake Capital Group. The BETA+ platforms deal with securities processing, custody, clearing, and asset servicing, as well as cost and tax basis reporting software and front-end client solutions. LSEG said its data and analytics business will target mid-single digit annual revenue growth in the medium term following the divestment of BETA+.

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.

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.

Finally, Hargreaves Lansdown's shares fell on the back of interim results and its Capital Markets Day in February. Net new business and earnings per share were weaker than consensus expectations and the company also announced a suspension of special dividends and a higher cost trajectory for the next couple of years as it plans to reinvest in the business. We think these investments are the right thing to do for the long term, helping HL maintain its market-leading position, but they have taken too long to make and are not without execution risk.

We continue to believe this is one of the better businesses in the UK but have concerns over management quality. Due to the de-rating of the shares and the exposure to our *Saving for the future* theme, we maintain a position but prefer other names in this space such as St James's Place.

Key Features of the Liontrust GF SF Pan-European Growth Fund

INVESTMENT OBJECTIVE & POLICY[1]:	The Fund aims to achieve capital growth over the long term (five years or more) through investment in sustainable securities, mainly consisting of European equities. The Fund is biased towards companies that provide or produce more sustainable products and services as well as having a more progressive approach to the management of environmental, social and governance issues. The Fund will seek to achieve its objective through exposure mainly to equities of companies incorporated in any European Economic Area Member State, the UK and Switzerland, although it can invest globally. In normal conditions the Fund invests at least 75% of its Net Asset Value in European equities. In addition, the Fund may invest in debt securities for liquidity and cash management purposes. Any investment in bonds will be in corporate and government fixed or floating rate instruments which may be rated or unrated up to 25% of the net assets of the Fund. The Fund may also invest in exchange traded funds and other open-ended collective investment schemes. The Fund is not expected to have any exposure to derivatives (contracts whose value is linked to the expected future price movements of an underlying asset) in normal circumstances but may on occasion use them for investment, efficient portfolio management and for hedging purposes. The use of derivatives should not lead to a significant change in the risk profile of the Fund.
RECOMMENDED INVESTMENT HORIZON:	5 years or more
SRRI[2]:	6
ACTIVE / PASSIVE INVESTMENT STYLE:	Active
BENCHMARK:	The Fund is considered to be actively managed in reference to the MSCI Europe Index (the "Benchmark") by virtue of the fact that it uses the benchmark(s) for performance comparison purposes. The benchmark(s) are not used to define the portfolio composition of the Fund and the Fund may be wholly invested in securities which are not constituents of the benchmark.
SUSTAINABILITY PROFILE	The Fund is a financial product subject to Article 9 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: [1]As specified in the KIID of the fund; [2]SRRI = Synthetic Risk and Reward Indicator. Please refer to the KIID for further detail on how this is calculated.

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 GF SF Pan-European Growth Fund A1 Acc	-1.8%	42.2%	-1.3%	-1.5%	0.6%
MSCI Europe	9.3%	35.3%	-13.5%	5.5%	-0.4%

	Mar-17	Mar-16	Mar-15	Mar-14	Mar-13
Liontrust GF SF Pan-European Growth Fund A1 Acc	12.0%	-8.4%	23.8%	16.9%	14.7%
MSCI Europe	16.9%	-13.7%	22.0%	16.0%	14.7%

*Source: FE Analytics, as at 31.03.22, primary share class, in euro terms, 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