



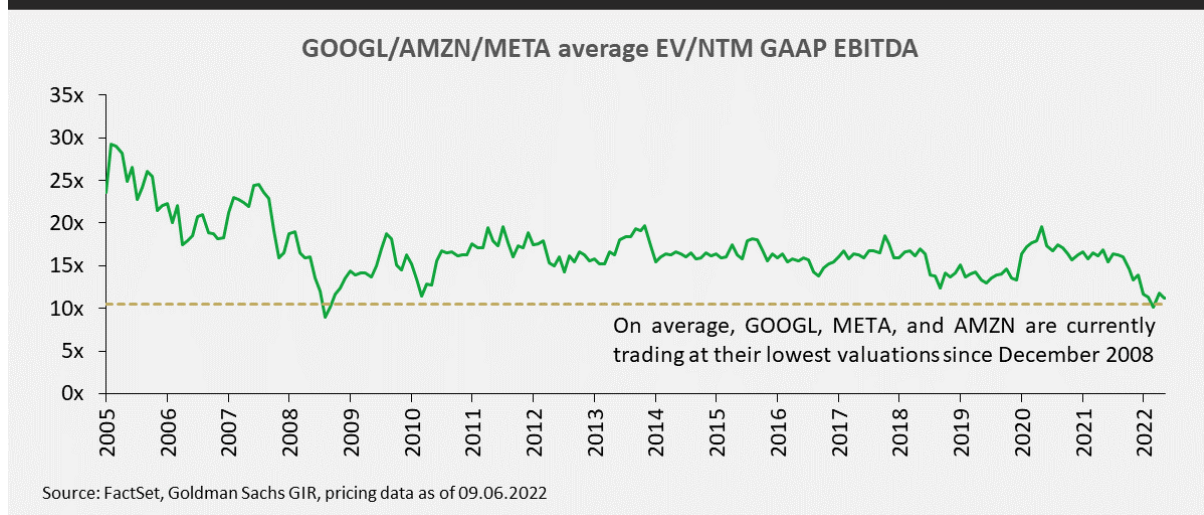
Liontrust Global Innovation Fund: August 2022 review

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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 Alphabet, are 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 opportunity. Focusing on the first type – high quality companies – these include companies such as Alphabet (GOOGL), Amazon, and Meta, which are exposed to broad secular growth themes spanning e-commerce, advertising, cloud computing, media consumption, and consumer subscription adoption.

These companies have scale, product/platform diversification, stable/rising operating profits, low levels of stock-based compensation awarded, and are returning significant capital to shareholders (buybacks and/or dividends). Across our out watchlist of the 200 most innovative companies, we are seeing the most compelling buying opportunities in these large cap companies who have greater ability to weather any potential global economic downturn. But should these companies on average be trading on their lowest valuations since 2008?

Tech valuations have sharply declined



Stock prices have clearly fallen, but what is the underlying operating performance of these companies telling us? Starting with Alphabet, the core Google search engine has remained resilient because it offers advertisers direct access to industry leading returns on digital advertising spend – this “bottom of funnel” marketing is therefore very resilient even in periods of economic weakness. We find it impossible to believe that this innovating leader warrants a cheaper valuation than British American Tobacco (BATS), and yet the company is currently cheaper on every valuation metric apart from price

to earnings (which does not take into account leverage). Over the past five years, Alphabet has compounded earnings at 30% a year, a magnitude four times greater than BATS. Rarely is Alphabet's dominant business model on sale like it is today.

Amazon, on the other hand, is exiting a heavy investment period necessitated to meet the surge in demand over the last two years and is now focused on driving operating efficiencies (achieving the same output for lower costs). We expect profitability to inflect as the business becomes more efficient. And lastly, Meta is making a successful transition to "Reels" that is showing up in the companies reported advertising load data and creating a new monetisation channel. As pricing starts to catch up with the volume of impression growth, the company will be able to generate significantly more cash off the same level of costs. The key takeaway for Amazon and Meta is that free cash flow generation is poised for an acceleration, which, as we all know, is typically followed by an inflection in the share price.

With these companies and many others executing across our watchlist – from an operational perspective and taking advantage of a weaker economic climate to focus on efficiencies – should the baby really be thrown out with the bath water? We'll leave you to decide, but we don't think so.

Company news

FARFETCH We recently purchased **Farfetch**, an ecommerce company focused on luxury fashion. We believe the company is an attractive investment for three main reasons. First, through exceptional execution over the past fifteen years, Farfetch has built the leading global consumer platform and distribution network for luxury brands. It has so far only penetrated a small fraction of the large and fast-growing online luxury total addressable market so there remains a long growth runway ahead.

Second, luxury has always had special economics and in the online world they favour a specialised platform like Farfetch over a general one like Amazon, which cannot offer luxury brands the required consumer environment. Moreover, whether physical or online, 80% of luxury sales take place in a multi-brand environment where consumers can compare and contrast offerings. As such, most luxury brands can benefit by using Farfetch's global marketplace of 30 million annual visitors and 3.5 million active consumers as a well-curated alternative sales channel alongside their own websites, just as they have traditionally used department stores like Selfridges and Harrods in physical sales. With average order values of around \$600, Farfetch can command a 30% take-rate whilst providing brands with better economics than traditional wholesale: a win-win ecosystem that drives a sustainable competitive advantage.

Third, the stock has de-rated around 80% since in the past 18 months, whilst the underlying business has progressed significantly, providing us with an exceptional buying opportunity.

During August, Farfetch announced a long-anticipated deal to acquire its main competitor YNAP – which owns the Net-a-Porter platform, among others – from luxury goods company Richemont, having out-manoeuvred it over the past few years. This deal will give Farfetch a big boost in GMV scale, put more brands on the platform and was done on attractive financial terms for Farfetch at an implied EV/GMV of around 0.5x vs. past industry transaction multiples of around 2x.



As a leading enterprise software company, **Salesforce** is undeniably subject to the challenging macroeconomic environment as companies cut back on IT spend. Indeed, in August the company significantly cut its FY23 revenue targets. Nevertheless, the stock's de-rating this year from a 5-year historical average of 55x forward P/E to currently 29x more than adequately prices in this bump in the road. Structurally, Salesforce is extremely well positioned to enable the ongoing digital transformation of businesses across the economy, through its core offering of customer relationship management software and its cross-selling opportunities to power productivity growth more broadly across its clients' businesses – including marketing and analytics – and enable them to achieve deeper and more valuable customer relationships.

But productivity begins at home and Salesforce is also driving its own efficiency efforts, which we believe will drive margins higher over the next couple of years. Its recent guidance on capital allocation is also encouraging – re-focusing its M&A approach to deals with strong strategic fit and low margin and shareholder dilution and announcing a new \$10bn stock buyback program. This is a high-quality structural winner trading at a discount.



Nvidia's results were undeniably weak, as expected, following management's negative pre-announcement that a downturn in videogaming demand would significantly impact the third of Nvidia's business that sells high-performance graphic processors (gaming chips). Gaming revenue duly was down sequentially 44% yoy, even sharper than expected, and the outlook for pressures to continue in the current quarter hardly lifted spirits. However, we still found reasons to be optimistic: datacenter revenues held up well, and as gaming demand normalises post a pandemic-induced boom, this should illustrate how far the company has evolved from being a gaming chip supplier to becoming the platform powering AI across multiple industries.

The cyclical nature of the semiconductor industry provides some historical lessons here. The reversal in fortunes of Nvidia's gaming business appears markedly similar to the last time the company experienced a gaming flush in 2019. It took 18 months to recover this revenue, but this time around new product launches are around the corner (in both gaming at datacenter) which should support the company's next leg of growth. Indeed, the company's current strategy is to under-ship its current generation chips in order to correct channel inventory and prepare for its next-generation products. This may make for not pretty numbers today, but sets the company up well to benefit from strong secular tailwinds (the sell through for the company's flagship gaming platform GeForce, is still up over 70% since before the pandemic.)

But the real story with Nvidia, albeit less headline grabbing than gaming, lies in the company's data centre and AI capabilities. Targeting the niche of graphics computing for gaming in 1993 (overlooked by the likes of Intel) provided the opportunity for Nvidia to break into the processor market in classic Clayton Christenson fashion. With this foothold secured, it has been able to move upmarket and conquer the data computation and processing market. Its graphic processors quite simply provide far greater value to customers than the legacy alternatives offered by peers, with the ability to perform far greater computationally intensive things, leveraging machine learning. Combining this hardware with software (making its processors easier to use for customers) was the gold dust Nvidia found to

cement its moat as the go-to platform in accelerated computing, creating barriers through scale and network effects.

Today, data centre revenues comprise around two thirds revenues, up from just 6% five years ago, and 72% of systems on latest top 500 list of world’s fastest supercomputers are powered by Nvidia. As hyperscalers (think the Meta’s of this world) continue to invest in their data processing and machine learnings capabilities, the computing behind enabling them to power these AI models at scale is provided by Nvidia. Recent results showed continuing strength of demand with North American hyperscaler revenues doubling yoy.

We think the 50% drawdown in the stock YTD has priced in the business environment risk faced by the company. Whilst geo-political tensions between the US and China will be an overhang, long-term drivers remain intact. In short, being the enabler of AI across computing, networking, gaming, auto and enterprise produces enormous productivity benefits and cost savings for clients. In the words of Paul Krugman, ‘productivity isn’t everything, but in the long-run its almost everything.’

Discrete years' performance (%), to previous quarter-end:**

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust Global Innovation C Acc GBP	-25.1%	24.2%	23.0%	2.0%	19.4%
MSCI AC World	-4.2%	24.6%	5.2%	9.7%	8.9%
IA Global	-8.8%	25.9%	5.4%	7.5%	9.1%
Quartile	4	3	1	4	1

****Source: FE Analytics as at 30.06.22. Quartile generated on 06.07.22**

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

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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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