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## Liontrust GF SF Pan-European Growth Fund: Q3 2022

Fund managers: Martyn Jones and Peter Michaelis

**The Fund delivered a return of -9.5% over the period in euro terms, underperforming the MSCI Europe Index's -4.1% (which is the comparator benchmark)\*.**

After a strong rally in equity and bond markets in July, both sold off aggressively again in August and September.

The market's strong performance in July was aided by the anticipation of the Fed's rate rises peaking in 2023, raising hopes of a soft landing for the economy. However, in August, the Federal Reserve and other central banks repeated that their main concern remains the fight against inflation instead of supporting growth. This, along with hotter-than-expected US inflation reading in mid-September and subsequent 75 basis point interest rate hike by the Fed, were the key drivers of the sharp rise in bond yields and sell-off in stocks in the second half of the quarter.

We do not attempt to forecast or anticipate these moves in macroeconomics. Our focus is resolutely on our 20 sustainability themes that over the long-term should provide strong and stable growth, regardless of the business cycle, and on finding the rare companies that can harness this positive growth and can generate persistently high returns on capital.

Shares in Trainline, held under our *Making transport more efficient* theme, surged at the very start of the quarter and maintained this to notch a positive gain. The company announced an upgrade to its 2023 full year guidance, while also reporting that net ticket sales for the first four months of FY2023 were up 16% versus the same period in FY2020 (pre-Covid). The company fell on hard times through then Covid crisis, but we back the management team and recognised the long-term mispricing of the companies value – adding to our position. We are doing the same in 2022 with the struggling parts of the portfolio.

Also among the top performers was Unilever following the announcement of robust interim results. Unilever has sought to become a leader in managing its many ESG impacts; it is not perfect, but has taken leadership positions in palm oil, plastics and emissions. Equally, Unilever has focused on its product portfolio by improving the nutritional profile of its portfolio, divesting some areas and improving others under the Sustainable Living strategy.

Swiss healthcare company Roche was among the positive contributors following a read-across from a rival drugmakers' promising results in the challenging field of Alzheimer's disease. Eisai Co. and partner Biogen Inc. said an experimental medicine they are developing significantly slowed Alzheimer's disease. Roche will present key results on its own drug in November.

Held under our *Enabling innovation in healthcare* theme, Roche creates truly innovative therapies that help change the course of disease. In the short to medium term, this benefits western economies which pay for it while on patent; in the medium to long term, these benefits accrue to developing economies as patents roll off or are not enforced.

Among the weaker performers was GN Store Nord, a global leader in the hearing aid and unified communication markets (professional headset and connectivity), operating under the ReSound, Beltone and Jabra brands.

Shares in GN Store have underperformed over the year after a profit warning relating mainly to the professional headset part of the business. The company manufactures the majority of its products in China which have been unable to ship due to recent Covid-19 lockdowns. The company has stated that demand and the order backlog remains strong but unfortunately it has not been able to satisfy this with supply. The lack of profits has had a

deleterious impact on leverage ratio but the company has recently restructured its balance sheet, raising over €500m, with debt and profitability normalising post the China lockdowns.

We recently spoke to the Head of Investor Relations who reiterated the improving supply chain situation and pointed to the previous resilience of the hearing aid market in an economic downturn. Despite the very poor performance, we continue to believe that this is a high-quality business in two attractive markets (high margins, high returns and reliable long-term growth) and is attractively valued for the longer-term prospects.

Netcompany posted a poor set of Q2 results, growing 7% organically despite the guidance of 13-18% for the full year. This poor performance was primarily due to illness amongst its Danish engineering team, cutting utilisation rates of its billable capacity dramatically. In addition, there were a few projects in the Norwegian and Belgian operations which did not go to plan, partly due to those contracts being signed in 2020 and the scope of the projects changing.

We spoke with the company recently on these issues and are satisfied that the illness issue is not systemic in nature, and that it is strengthening the audit process to ensure that project scope changes are accompanied with a revised costing to the client. Despite the poor performance in the first half, the company has retained its full year guidance based on a strong pipeline of projects and stronger than expected performance from the new Intrasoft acquisition. Overall, we retain confidence in our thesis and maintain the position.

Also among the weaker performers in the quarter was Grifols, which is held under our *Providing affordable healthcare* theme. Grifols is a blood plasma manufacturer, and one of a handful of companies trusted to take donations from patients and convert it in a long and complex process into critical life-saving medicines. Given the size and complexity of this process, we see significant barriers to entry in providing such life-saving products to patients.

The first, and ultimately key driver of the company's poor performance, is the nature of the Covid-19 pandemic's impact on the blood plasma industry. The barrier around the long timelines required to collect, process and manufacture high quality healthcare products – from human donations – has become a near-term weakness in a world where everyone was forced to stay at home. This dynamic was further compounded when the incentive of paid blood donation was significantly weakened by US stimulus cheques paid to the broad population. The company has now moved through this dynamic, but the length of the manufacture process (again normally a strength) does mean it cannot achieve the full bounce back in revenues seen in almost any other more 'normal' company through this situation.

The second market worry is around debt. The organisation has taken an excellent (and unmissable) opportunity to acquire another business called Biotest. This makes rational business sense, but the timing of it – during a period of very low revenues / profits – has led to high leverage ratio. We believe this factor, in the context of rising interest rates, is another reason investors have been apprehensive. We have checked the covenants attached to the debt and do not believe there is a significant dilutive equity event coming, with leverage normalising in the next 12-24 months.

As a family run business, this organisation has significantly longer-term time horizons than most of the market. Its market communication is not the clearest but in our view it does make sensible long-term decisions – as evidenced by the strong long-term free-cash flow growth and total shareholder return generated prior to Covid. The combination of the points discussed above, however, provides the market with multiple reasons to be worried in the short term and no perceived reward in the shorter term either. However, we think the long-term upside for patients and shareholders is significant.

In terms of portfolio changes for the quarter, we added Admiral under *Insuring a sustainable economy*. This is a motor and household insurer in the UK which is consistently rated highly by customers. We have long admired its very strong employee culture with a focus on promotion and share ownership from within that makes it stand out from other organisations. Its low-cost operating model means it can be the most competitive on insurance rates without detracting from the quality of its cover. We have followed it for many years and used the sell off as an opportunity to start a position.

Following the split from GlaxoSmithKline, we have a new holding in Haleon which we retain in the portfolio. Haleon is a consumer healthcare business formed by the combination of GlaxoSmithKline and Pfizer's consumer healthcare units. We believe the company demonstrates strong sustainability credentials, aiming to help individuals take responsibility for their health before reaching the healthcare system, with over-the-counter products such as vitamins, toothpaste and painkillers. We also feel the entity has a robust credit profile given its large scale and strong diversification by geography and product line, with a dominant position across several markets. It is highly cash generative, with resilient cash flows, which should be supportive of its deleveraging ambitions over the coming years.

We also initiated a position in Scandinavian insurance company Tryg, which provides property & casualty (P&C), or non-life insurance to businesses and individuals. Held under our *Insuring a sustainable economy* theme, the vast majority of Tryg's insurance portfolios is providing accident cover. It also has elements of health insurance within its portfolio in child and adult insurance, as well as workers' compensation products.

Vestas Wind Systems was another new addition over the quarter. This Danish firm, one of the three main players outside of China, is the quality leader in the supply of wind turbines globally, which are key to the transition away from Russian gas and fossil fuel dependency. Vestas' strategy to shift away from *just* turbine manufacturing towards turbine design, optimising connection to grid to yield highest cashflow and profitable service revenue look set to help it grow profitability for the next decade and beyond.

In terms of sells, we exited Zur Rose, the Swiss-listed online pharmacy which operates across Europe via its DocMorris brand, with the German market – valued at over €60 billion per annum – appearing to present a huge opportunity following a change in legislation which mandated the use of digital prescriptions. However, Zur Rose's share price has suffered in 2022 due to a delay to the rollout of the new digital system, as well as the general trend of technology-focused businesses suffering from higher discount rates amid the market rotation towards value stocks. The position was placed under review earlier this year as the regulatory backdrop shifted, before it was exited in Q3.

We also sold our long-term holding in Axa, the large European insurance company. Axa was one of the Fund's strongest performers in 2022 and a position which we had increased in 2020 due to attractive valuations. We sold the position to fund our new position in Nordic insurer Tryg which has a higher return on equity and a stronger growth rate.

We exited another long-term holding in Assa Abloy. This has been successful holding for us, with an excellent management team consolidating the lock and digital entrance market. However, we believe that the valuation does not reflect the reduced opportunity for market consolidation and potential for a slowdown in the residential construction market. We used the proceeds to fund our new position in Vestas.

We also exited Hargreaves Lansdown on the back of weaker business fundamentals and concerns over management quality. Net new business and earnings per share have been weaker than expectations and the company also announced a higher cost trajectory for the next couple of years as it plans to reinvest in the business. While these investments are the right thing to do for the long term, they have taken too long and are not without execution risk.

Last, we sold our position in Cellnex to fund new positions Haleon and Admiral. All three businesses have resilient and defensive business model characteristics with high levels of recurring revenue. However, with the recent pullback in the valuations of Haleon and Admiral, we took the opportunity to upgrade the risk-reward dynamic of the portfolio.

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

<b>INVESTMENT OBJECTIVE &amp; POLICY<sup>1</sup>:</b>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>
<b>RECOMMENDED INVESTMENT HORIZON:</b>	5 years or more
<b>SRRI<sup>2</sup>:</b>	6
<b>ACTIVE / PASSIVE INVESTMENT STYLE:</b>	Active
<b>BENCHMARK:</b>	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.
<b>SUSTAINABILITY PROFILE</b>	The Fund is a financial product subject to Article 9 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: <sup>1</sup>As specified in the KIID of the fund; <sup>2</sup>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**

	Sep-22	Sep-21	Sep-20	Sep-19	Sep-18
Liontrust GF SF Pan-European Growth Fund A1 Acc	-32.9%	30.5%	10.1%	4.7%	-4.3%
MSCI Europe	-11.0%	28.8%	-7.8%	5.7%	1.5%

	Sep-17	Sep-16	Sep-15	Sep-14	Sep-13
Liontrust GF SF Pan-European Growth Fund A1 Acc	15.8%	0.7%	15.6%	6.7%	19.7%
MSCI Europe	16.3%	1.8%	2.6%	13.4%	18.1%

\*Source: FE Analytics, as at 30.06.22, primary share class, in euro terms, total return, net of fees and income reinvested.

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**Key Risks and disclaimer**

**†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. Non-UK individuals: This document is issued by Liontrust International (Luxembourg) S.A., a Luxembourg public limited company (société anonyme) incorporated on 14 October 2019 and authorised by and regulated as an investment firm in Luxembourg by the Commission de Surveillance du Secteur Financier ("CSSF") having its registered office at 18, Val Sainte Croix, L-1370 Luxembourg, Grand Duchy of Luxembourg and registered with the Luxembourg trade and companies register under number B.238295. UK individuals: This document is issued by Liontrust Fund Partners LLP (2 Savoy Court, London WC2R 0EZ), authorised and regulated in the UK by the Financial Conduct Authority (FRN 518165) to undertake regulated investment business. **This is a marketing communication.** This document should not be construed as advice for investment in any product or security mentioned, an offer to buy or sell units/shares of Funds mentioned, or a solicitation to purchase securities in any company or investment product. Examples of stocks are provided for general information only to demonstrate our investment philosophy. It contains information and analysis that is believed to be accurate at the time of publication, but is subject to change without notice. While care has been taken in compiling the content of this document, no representation or warranty, express or implied, is made by Liontrust as to its accuracy or completeness, including for external sources (which may have been used) which have not been verified. It should not be copied, forwarded, reproduced, divulged or otherwise distributed in any form whether by way of fax, email, oral or otherwise, in whole or in part without the express and prior written consent of Liontrust. Always research your own investments and if you are not a professional investor, please consult a regulated financial adviser regarding the suitability of such an investment for you and your personal circumstances.

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