HEPTAGON Capital

# Future Trends Equity Fund

## Q1 2025 Commentary

## Fund Manager

**Alex Gunz**

## Investment Objective

The Fund aims to deliver consistent and sustainable long-term returns by investing in a concentrated portfolio of global equities.

## Contact

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*Opinions expressed whether in general or in both on the performance of individual investments and in a wider economic context represent the views of the contributor at the time of preparation.*

**The Heptagon Future Trends Fund ended Q1 down 6.4% in Dollar terms, 460 basis points behind its MSCI World Index benchmark. A strong January was offset by weaker performance in February and March. Although clearly frustrating, we understand the reasons behind the underperformance. Market dynamics, especially the shift from growth to value, explain more of the move than any change in company fundamentals, in our view. When we step back from the noise, we remain confident in both the top-down and bottom-up positioning of our businesses. Over time, a multi-thematic approach to investing in the future has the clear potential to generate meaningful returns.**

### Stay focused

It would be an understatement to call the first quarter dull. America's volatile and unpredictable President succeeded in upending almost all prior assumptions, whether about diplomacy, economic growth or asset allocation. For more on these topics, we recommend investors read our monthly macro commentary. As a result of these dynamics, however, equity investors have been whipsawed and fundamentals challenged, while there has been a notable change in stock market leadership. Tariff chaos and uncertainty are rampant at the time of writing. Throughout this period of profound dislocation, it is important not to lose focus. **There has been no change in our investment philosophy or approach to stock selection**.

From a high-level, the first quarter of 2025 can be divided into two parts. The market gains of January morphed into declines in the MSCI World Index in both February and March. March's monthly Index drawdown of -4.5% since September 2022 (-9.3%). As a result, the MSCI World fell 1.8% during Q1. Investors would need to go back to the third quarter of 2023 to find the last similar drawdown of this magnitude.

These headlines, of course, do not explain the considerable dispersion that occurred *within* the market. We would call out three dynamics. First, **value has massively outperformed growth year-to-date**. During Q1, the MSCI World Value Net Total Return Index has *gained* 4.8% versus the MSCI World Growth Net

Total Return Index *falling* 7.8%, the biggest spread between these two indices in favour of value since the start of 2023. Next, **almost every developed world region has outperformed the US so far in 2025**. In particular, the MSCI Europe Index added 5.5% in Q1 versus a 4.6% decline in the S&P 500 Index. Finally, last year's winners have proven to be this year's losers. Put another way, **the Bloomberg Magnificent 7 Total Return Index dropped 16.0% in Q1**, its worst quarterly performance since mid-2022.

For an investor in Future Trends, these dynamics have inevitably created certain challenges. Similar to the path of the MSCI World, the Fund recorded a strong gain of 6.2% and marked relative outperformance of 270 basis points versus its benchmark in January only for these returns to be eroded by underperformance in February and March. While we have been long time sceptics of the Magnificent 7 (their over-valuation and excessive investor concentration), the clear growth bias of the Future Trends Fund has constrained its returns in an environment where value has been in the ascendent. Likewise, in Europe, the two best performing sectors in Q1 were banks and insurance (up 22.8% and 16.6% respectively). The Fund, unsurprisingly, plays in neither area.

None of the above is to make excuses, rather to highlight the factors that have had the biggest impact in driving *market* returns so far in 2025. We have spent the first three months of the year focused on fundamentals. As we detail further below, **we have added three new businesses to the Fund** (American Express, Coherent and Door Dash), which **complement exposure to existing themes** – cashless society, the data deluge and the online platform economy respectively. This is consistent with the approach we detailed in our prior quarterly report where we have sought to **concentrate on the themes in which we have highest conviction**, correspondingly exiting from areas in which we see a less attractive outlook (such as renewable wind energy or online education, both of which we sold out of in 2024).

At the same time as making these new additions to the Fund, **we have continued to increase our knowledge of our existing holdings**. We remained London-based over the quarter but undertook 15 meetings (albeit some virtual) with management teams, including with 9 of our current portfolio holdings. Interactions included **meeting with C-suite executives from Coherent, First Solar, MOWI, Republic Services and SIG Combibloc**. As evidence of our ongoing thematic discipline, readers may wish to review the 11 Blog posts issued year-to-date as well as a thematic white paper on humanoid robots.

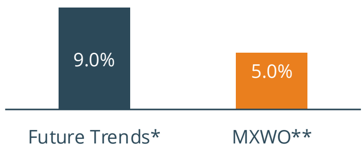
It is not only our top-down work but also the bottom-up analysis we conduct that supports the conviction we have in the businesses (as well as the themes) in which we are invested. **Over the past quarter, consensus estimates, on average, for our businesses have improved, while multiples have become more compelling**. How estimates will evolve during the upcoming reporting season remains to be seen, given the current unknowns around tariffs.

The weighted average 12-month forward P/E multiple for the Future Trends Fund today is 27.3x, down from 33.0x at its recent peak (in February) and versus 30.2x at the end of last year. Clearly the MSCI World's forward multiple has compressed over the course of 2025 (from 20.7x to 19.9x) as the market outlook has deteriorated, but the premium commanded by the Fund over the MSCI World has *narrowed* in our favour. The current premium of 7.4 percentage points compares to a 9.5pp premium on 31 December 2024.

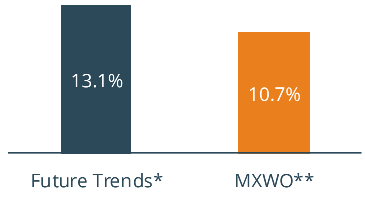
We believe this premium can be justified owing to the superior financial outlook our businesses are set to enjoy. Taking the weighted average of the estimates embedded in our financial models, the Fund should see growth of ~9% in revenues, ~13% in earnings and ~17% in free cashflow on a compound annual basis over the next three years. These metrics compare favourably to those of the MSCI World, of ~5%, ~11% and ~12%, using Bloomberg consensus data.

Other valuation support comes in the form of the **average 42% upside potential for our businesses** derived from the discounted free cashflow outputs of our company financial models. This discount is close to the peak discount of ~45% witnessed during the life of the Fund and compares to an average discount of ~30%. Further, our businesses currently offer an average 4.1% forward free cashflow yield.

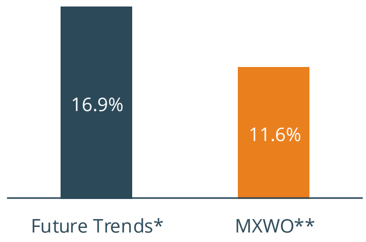
### Revenue Growth (3Y CAGR) 2025-2028E



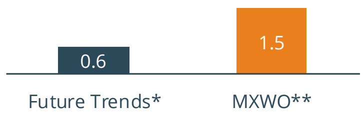

### Earnings Growth (3Y CAGR) 2025-2028E




### FCF Growth (3Y CAGR) 2025-2028E

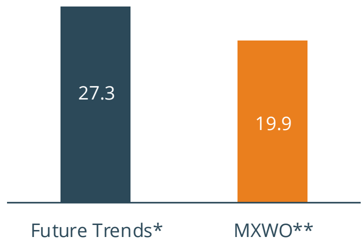



### Net debt/EBITDA (x) 2024A




### 1Y forward FCF yield (%) 2025E


### 1Y forward P/E (x) 2025E




*Sources: MSCI, Bloomberg, Heptagon Capital. *Weighted average for the Fund. **MSCI World NR USD.*

## How we are positioned

As should hopefully be evident to readers of this report, **there has been no style drift or change in focus within the Future Trends Fund**. Since inception in 2016, the Fund has followed a philosophy of low turnover. Three of the Fund's current top five positions – Cheniere Energy, Mastercard and Intuitive Surgical – have been investments since 2016. The former has been the Fund's second biggest contributor to performance year-to-date, while Mastercard (in the Fund since day one) has seen an absolute increase in its share price of almost 500%. For reference, a detailed analysis of Q1's performance appears in the Appendix to this report.

Below follows a short summary of each of our current top five holdings:

CHENIERE

**Cheniere Energy (6.2% weight):** Cheniere is a full-service liquefied natural gas (LNG) provider offering gas procurement, transportation, liquefaction and shipping. It is the largest producer of LNG in the US and the second largest globally (based on total production capacity of over 55mpta as of end 2024, equivalent to greater than 10% of global liquefaction capacity). Customers are integrated energy companies, utilities and energy trading companies. 95%+ of its revenues are contracted through to the mid-2030s, based on commercial agreements. Agreements are typically on long-term 20-year take-or-pay contracts. Revenues have grown at a 10%+ CAGR over the last five years during which time Cheniere has grown its margin to ~40%. Consensus assumes above-GDP forward revenue growth while the sunk cost of infrastructure implies significant operating leverage and cashflow generation over time.

mastercard

**Mastercard (6.0% weight):** Mastercard is the world's second-largest global payment network with c30% market share (ex-China), switching over $10tr of payments. Unchanged since 2009, Mastercard lists its priorities being to (1) grow the core business (consumer credit, debit, commercial, pre-paid, physical-digital convergence (2) diversify customers and geographies (merchants, businesses, governments, financial inclusion, new markets) (3) build new businesses (advisers, safety & security, loyalty & rewards, processing, fast automated clearing). Over time, Mastercard is evolving beyond a core payments network to being both a data network and a digital identity network, or a global, open loop solution.

***Past performance is no guide to future performance, and the value of investments and income from them can fall as well as rise***

**Palo Alto Networks (5.6% weight):** Palo Alto Networks is the leading next-generation global cybersecurity provider. It is the only cybersecurity business currently to provide a fully integrated set of solutions (all of which are cloud native and were built bottom-up) for customers. Palo Alto sees itself more as a cybersecurity partner to its customers than a vendor per se. A typical industry approach requires 12-15 principal products and up to 75 security products to monitor and manage assets versus the single integrated solution suite offered by Palo Alto. The business estimates that it is growing at around two times the rate of the broader market. This performance has translated into ~44% annualised shareholder returns in the last five years.

**Intuitive Surgical (5.2% weight):** Intuitive is the industry leader in robotic assisted, minimally invasive surgery. Last year, a surgeon somewhere in the world started a new procedure using an Intuitive system once every 20 seconds. There is very limited competition given complexities of the technology and high regulatory approvals. Guidance is for mid-teens procedure growth over the medium-term. Future growth will be driven by performing more procedures (growing penetration) and addressing new market segments (as technology provides more flexibility). Over time, Intuitive sees further opportunities from building an ecosystem from leveraging data collected to result in better surgical outcomes.

**Republic Services (5.1% weight):** Republic is the second-largest listed business in the waste industry as measured by revenues. The business has a customer base of 13m+ and conducts 5m average daily pick-ups. Republic sits at the intersection of two key future trends: decarbonisation (via renewable energy) and circularity. Waste is generated and needs to be disposed of safely no matter the economic environment. Collection and disposal services are governed by long-term contracts (typically 3 years for commercial and industrial collection services, and up to 15 years for residential collection services granted by municipalities). ~80% of Republic's revenues have annuity-like characteristics, and ~45% of contracts benefit from automatic annual pricing indexation to CPI (or higher), providing above-average revenue visibility.

## New portfolio additions

As noted previously, the Fund added **DoorDash** to its portfolio at the end of the fourth quarter of 2024 and both **American Express** and **Coherent** during Q1. In March, we added a further name to the Fund within the European technology sector, which we will disclose in due course.

The DoorDash purchase was funded through our decision to exit from Vestas in December 2024 (discussed in last quarter's report), while subsequent new investments have been funded through cash and by reducing weightings in other fund holdings. **Total portfolio holdings currently stand at 25, a number that we do not envisage increasing meaningfully from here**.

Below follows a profile of each of our recent additions.

**DoorDash:** Founded in 2013, DoorDash has become the US market leader in food delivery, with over two times more share than the next nearest player. It is also present in 30 other countries, including Israel, where it operates under both the DoorDash and Wolt brands.

The business has significant runway ahead over a multi-year period as online food delivery, grocery and convenience remain under-penetrated in both the US and internationally. We have made the case in our future trends work for the growth in online and sharing economy themes for many years. DoorDash benefits from a clear flywheel effect in its business, attracting new customers, merchants and Dashers (independent contractors responsible for delivery services).

Over 50% of its regular customers now have DashPass or Wolt+ subscriptions, which drive recurring revenues. Established user cohorts spend increasing amounts of Dollars and time on the app. Attractive unit economics drive scope for margin improvement at the same time that DoorDash continues to invest in technology infrastructure and superior logistics capabilities to further build its differentiation.

DoorDash has been GAAP earnings profitable since Q3 2024. The recent move to profitability resulted in DoorDash being included in the S&P 500 Index for the first time, effective March 2025. Although the business trades on ~48x earnings for 2025E, this figure needs to be seen in the context of 18% consensus compound annual earnings growth over the next three years (and a low starting point figure for of absolute reported EPS). We see DoorDash as being almost 40% undervalued using discounted free cashflow analysis.

**American Express:** The card issuer and payment processor has a unique business model and provides a strong complement to our long-standing holding in Mastercard. Both businesses offer exposure to the theme of cashless society and the digitalisation of payments.

Amex benefits from its global scale and increasing acceptance (83m cards in issue, accepted at 90m+ locations, up four times versus levels of ten years ago). The business is differentiated versus Mastercard and Visa since it has direct relationships with both customers and businesses (as opposed to issuer banks).

In pursuing a membership/subscription model, Amex is winning share in the premium segment. Its customer base is high-value and loyal, with around three times higher US card spend versus other networks, two times higher customer income and a 150-basis point lower annual delinquency rate. Conservative growth guidance is not fully discounted in consensus estimates, while margin upside may come from operating cost discipline and a growing mix shift to international markets.

The company has consistently returned cash to shareholders via both buybacks and dividends (the latter increased by 17% for 2025). Amex trades at a marked discount to Visa and Mastercard, with considerable fundamental valuation upside potential on a long-term fundamental free cashflow basis. When we last travelled to New York in December 2024, we visited American Express at their corporate headquarters, increasing our conviction prior to investing.

**Coherent:** While neither as well-known or as long-established as American Express, the products manufactured by Coherent (founded in 1971) play a critical role in many industrial and technological end-markets. Coherent is a material science company with a heavy focus on optical networking technologies. The business is the market leader in optoelectronics, engineered materials and laser sources globally.

As a result of its positioning Coherent is exposed to multiple future trends including the growth in AI and data, healthcare and electric vehicles. Coherent sizes its addressable market as worth over $60bn and growing at a 14% CAGR over the five-year period to 2028. We believe that Coherent has a deep competitive moat based around its proprietary IP, core production competencies, product breadth and vertically integrated approach to manufacturing at scale.

New management (well-regarded and formerly with Lattice Semiconductor) were appointed last year have the potential to expand Coherent's franchise and accelerate growth. Coherent's strategy is premised around growing share across key verticals and deepening spend with existing customers. The new Coherent team is likely to focus more on portfolio optimisation (i.e. potential disposals) and allocation of resources to areas where there is most scope to grow returns. Debt paydown from a peak level of over 4x EBITDA and a May 2025 Capital Markets Day event are additional catalysts. We hope to attend the latter and have already engaged extensively with management on its strategic intentions and sustainability strategy.

Our conviction in Coherent is strengthened by the valuation analysis we have done on the business. Coherent trades on ~17x consensus earnings for 2025E, with a free cashflow yield of ~6%. Using a long-term discounted free cashflow analysis, we see Coherent shares as being ~60% undervalued.

## Conclusion

**Investing in the future means thinking responsibly about the future**. What this means practically is that the process of interacting with our businesses remains an ongoing one, centred on encouraging them to take greater account of their environmental and social responsibilities within a framework of good governance. We will continue to look for alignment with Sustainable Development Goals and increased transparency. While we are encouraged by the generally good levels of progress made by the businesses within our Fund, we also recognise that there is much work still to be done. We will continue to look to hold all our businesses accountable. As new data and analytical methodologies become available, we will also look to incorporate these into our investment process and analysis.

We welcome any feedback or questions you may have. Thank you for your interest in and support for the Future Trends Fund.

***Alex Gunz, Fund Manager***
***April 2025***

## Addendum, 22nd April 2025 –

Since this report was originally prepared at the start of April, investors in all assets classes have been subjected to extreme volatility owing to the many, and often contradictory statements that have emerged from the Trump administration concerning its approach to tariffs. We will not comment in detail on this topic since the situation clearly remains very fluid. However, it is fair to note that amidst more heightened uncertainty, the risks for businesses, particularly in terms of their forward financial planning (and formal guidance) are higher than at the start of the quarter.

With over 25 years of investment experience, past periods such as the Dotcom boom and bust, the Great Financial Crisis and the COVID-19 pandemic have taught us not to panic. The *worst possible* thing to do in the face of uncertainty is to shift strategy abruptly. We have consistently asserted that the themes in which we continue to invest should grow in importance *broadly regardless* of the macro backdrop and the actions of governments and regulators. We believe this continues to hold true at present. We have, quarter-to-date, made no significant changes to the portfolio and note that its performance has been steady, at least relative to its MSCI World benchmark. We will remain attentive to newsflow and judiciously opportunistic, particularly with the upcoming Q1 reporting season likely to serve as an important yardstick.

## Appendix: Q1 leaders and laggards –

**The Future Trends Fund saw a 6.4% drawdown in Q1, which compares to a 1.8% decline in the MSCI World**. A very strong January (up 6.2% in absolute terms, and 270 basis points ahead of the benchmark) was followed by underperformance in February and March (by 350 basis points in each month).

Financial results and forward guidance released by our businesses was generally stronger in January than it was in February. The Fund remained ahead of its benchmark through until 24 February. However, as the likely adverse impact of President Trump's policies became more evident as the quarter progressed, underperformance intensified. Value as a style outperformed growth, helping sectors such as financials and utilities, where the Fund has little exposure.

Just 6 of the 22 businesses owned by the Fund for the entirety of the quarter outperformed the MSCI World Index. We were particularly pleased to see that **Republic Services** and **Door Dash** (added in November and December 2024) were our two best performers in absolute terms during Q1. Republic gained 20.4% and Door Dash added 9.0%.

From a contribution perspective, Republic also claimed the top spot, contributing 67 basis points over the period. Door Dash ranked fourth on this scale, with 11 basis points. In between featured **Cheniere Energy** and **Mastercard** (49bp and 17bp respectively). What all these businesses share are relatively defensive profiles, less exposed to the potential downside impact of tariffs and a weaker economy. Both Door Dash and Republic also issued financial guidance that was ahead of prior consensus expectations.

At the opposite end of the spectrum, eight businesses within the Fund that were owned throughout the quarter saw absolute drawdowns of at least 10% in price terms, with two (**Novo Nordisk** and **First Solar**) witnessing declines of more than 20%. From a contribution perspective, the downside in Novo and First Solar was somewhat mitigated by position sizing. The former averaged a 3.0% weight over the quarter and the latter 2.1%. The two businesses closed March at 2.4% and 2.0% weights respectively.

Novo Nordisk reported strong results for its quarter ending 31 December in February and issued guidance that was ahead of consensus expectations. However, these positive developments were offset by a combination of factors including disappointing new drug trial data (for CagriSema), increasing competitive pressures and a risk of pricing reviews for certain products in the US. Although we see a long runway ahead for the obesity theme, Novo's positioning within it is now better understood than when we first invested almost a decade ago. The weighting of the stock reflects our current conviction towards the opportunity.

The single largest negative contributor to Fund was **Quanta Services**, which cost Future Trends 92 basis points during Q1. The 19.6% decline year-to-date in Quanta needs to be seen in the context of a 46.5% return in 2024, during which time it was the Fund's second largest positive contributor (after Cheniere). Quanta delivered strong results in February and boasts a $34bn+ order backlog. Although some investors have expressed concerns about the exposure of the business to the (diminishing near-term) theme of AI, we met with management in March and remain highly confident in the group's positioning. Electrification remains a secular trend in which we continue to invest for the long-term.

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The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

## SFDR

This Fund has been classified as an Article 8 for the purposes of the EU's Sustainable Finance Disclosure Regulation ('SFDR'). The Fund promotes environmental and/or social characteristics but does not have sustainable investment as its primary objective. It might invest partially in assets that have a sustainable objective, for instance assets that are qualified as sustainable according to EU classifications but does not place significantly higher importance on the environmental objective of each underlying investment. Please see Prospectus for further information on the Funds environmental and/or social characteristics and relevant sustainability risks and principal adverse impacts which may impact the Fund's performance.

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For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

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