

Evenlode Global Investment View

February 2021 – European Innovation



As eyes turn to the post-pandemic world, investors' imaginations have been captured by tech giants across America and Asia, whilst in stark contrast, Europe's corporate elite in more traditional industries have faced difficult questions over their ability to keep pace. This is highlighted by Boston Consulting Group's recent list of the 50 most innovative companiesⁱ. Europe contributed only 15 companies and did not have a single entry in the top 20 (Asia had 6). With the development of cloud computing, AI, and the internet of things, does Europe face being left behind in what Microsoftⁱⁱ are hailing as the "*dawn of a second wave of digital transformation*"ⁱⁱⁱ?

Mr. Market would appear to think so, as this concern has been reflected in recent share price movements. In 2020, the MSCI World Index return was dominated by contributions from US tech firms such as Tesla, Amazon, Apple, and Microsoft.^{iv} Over the past 12 months, this geographical performance split has also been apparent in the returns of the Evenlode Global Income fund. American firms have accounted for 79% of total returns, while averaging less than 40% of the total portfolio weight. European firms have only contributed 11% in the same period, despite being c.55% of the portfolio.^v This divergence is particularly interesting given the narrative that equity performance is being driven by very low discount rates. European benchmark long bond yields are even lower than those in the US, yet European companies are broadly cheaper than those in the US.

The relative valuations of US and European markets is repeated within our investment universe. Our proprietary forward cash return model suggests that European companies provide 22 of the 30 cheapest opportunities (within our investable universe).^{vi} Many of these companies operate in industries traditionally seen as defensive, such as consumer goods and healthcare, but even in these industries we believe it is possible to spot the seeds of technological innovation through careful qualitative analysis. To aid us in this endeavour, we utilise a framework with four specific innovation-related risk factors; the long-term industry outlook, the competitive edge of the company, their ability to sustain investment, and their culture.

Below, we consider the innovation prospects for three leading European companies operating in three different industries, all currently held by the Evenlode Global Income fund.

Roche - Innovation in Pharmaceuticals

The Swiss pharmaceutical giant, Roche, is a leading innovator in the field of personalised medicine. This new paradigm of medical treatment shifts away from the previous approach of generalised pharmaceuticals to tailored therapies for individuals. The market for personalised medicine is estimated to grow at over 10%^{vii} per annum for the next five years, far ahead of the overall pharmaceutical market at 4% per annum^{viii}. The anticipated growth is expected to be driven by improved genetic technology, including next generation sequencing, improved patient data resources, and the creation of companion diagnostic tests.

Roche's culture and recent investment will allow the company to over-participate in this growing market. While other pharma companies lent towards buying late-stage pipeline drugs, Roche has championed a culture of internal innovation. This has been supported by investment, with Roche averaging an R&D to Sales ratio of 22% over the past five years. This has contributed to the internal

Evenlode Global Investment View

February 2021 – European Innovation



development of new blockbuster drugs, such as Ocrevus, Tecentriq and Hemlibra. Where Roche has made acquisitions, it has sought to add differentiated competitive resources. For example, the acquisitions of Flatiron Health (\$1.9 billion) and Foundation Medicine (\$2.4 billion) have given Roche access to a large pool of genomic data for oncology patients. The company is now using AI algorithms to leverage this data, both to target clinical research and create companion tests in the diagnostics division.

Bureau Veritas - Innovation in Industrials

While the crisis has led to a cyclical reduction in industrial activity, it has also provided many businesses with the time and space to research and trial productivity improvements. Improvements within physical industries are often designed to reduce costs and this has led to increased software adoption, use of networking tools, and remote working, to give just a few examples. For industrials with capital equipment that requires frequent certification and inspection there has been an increased adoption of technology such as drones and augmented reality. The inspection company, DNG VL, estimates that this will reduce inspection costs for offshore assets by 35%.

Improvements within physical industries are often designed to reduce costs and Bureau Veritas, as the leading company in physical inspection of capital equipment, is well positioned to help customers realise value and benefit from the drive for productivity gains. Even prior to the pandemic, the company had invested substantially in the use of remote monitoring equipment, signing partnership agreements with Sky-Futures and Puffin Technology for drone piloting. This head start has enabled Bureau Veritas to conduct entirely remote inspection of ships and offshore platforms in 2020. The company highlights a 900% increase in demand for remote inspection of offshore assets, and global energy infrastructure spend (particularly for wind and solar farms) is expected to increase. The shift from human to machine inspection should also imply attractive margin accretion opportunities for companies like BVI.

Nestlé - Innovation in Consumer Goods

The market for plant-based nutrition is growing rapidly and Nestlé, the Swiss consumer goods giant, is well positioned to benefit. Concerns over the rate of global population growth, climate change, and income inequality have all increased the need for innovation in affordable nutrition. Plant-based alternatives may provide an answer, with reduced costs of farming (no livestock) and a lower carbon footprint. As a result, the plant-based food market is expected to grow at 12% per annum over the next seven years.^{ix}

Nestlé has been ahead of the curve in investing in plant-based food, with the acquisition of Sweet Foods in 2017 and continued investment in R&D. At present, 10% of the company's scientists, engineers and product developers are working on designing new plant-based foods. The company is also investing in manufacturing, with a \$100 million investment in a Chinese plant-based meat-substitute manufacturing plant already announced this year. Alongside a strong cultural commitment to improving product nutrition and lowering emissions, this investment is yielding results. For

Evenlode Global Investment View

February 2021 – European Innovation



example, the launch of the Garden Gourmet Sensational Burger, which has a Nutri-Score A rating, helped the company to recent double-digit growth in its vegetarian and plant-based sales.

These three examples demonstrate the value that can be created by taking new technologies and applying them to the traditional industries that dominate Europe. To give the full Microsoft quote - *“What we are witnessing is the dawn of a second wave of digital transformation sweeping every company and every industry. Digital capability is key to both resilience and growth.”*

While European giants are unlikely (and would be unwise) to attempt to replicate much of the American tech giants’ advancements, they can still leverage these new technologies to create exciting and profitable products and services. Many of these will also require further developments within traditional sciences, such as biology and chemistry. If the last decade has been dominated by information technology firms, the next may require the wider index to exploit new technologies and deliver real value to their consumers. We believe that this will ultimately drive growing shareholder returns for companies that rise to the innovation challenge, and we will continue to endeavour to identify these companies on behalf of our investors.

Ben Peters, Chris Elliott and the Evenlode Team

16th February 2021

Please note, these views represent the opinions of the Evenlode Team as of 16th February 2021 and do not constitute investment advice.

Past performance is not a reliable indicator of future results. The value of investments can go down as well as up, and investors may not get back the money they invested.

ⁱ BCG Most Innovative Companies 2020, Boston Consulting Group

ⁱⁱ Microsoft is held in Evenlode Global Income

ⁱⁱⁱ Microsoft Q2 Results, 26/02/2021

^{iv} Factset 31/01/2020-2021

^v FactSet, 31/01/2020-31/01/2021. All figures in GBP terms. The remainder (c.9%) was from Australian firm Sonic Healthcare.

^{vi} Evenlode FER data, 09/02/2021

^{vii} Personalized Medicine Market Report 2019-25, Grandview Research

^{viii} Growth perspectives for the pharma market, IQVIA 2019-2023

^{ix} Plant Based Food Market - Global Opportunity Analysis and Industry Forecast (2020-2027), Meticulous Research