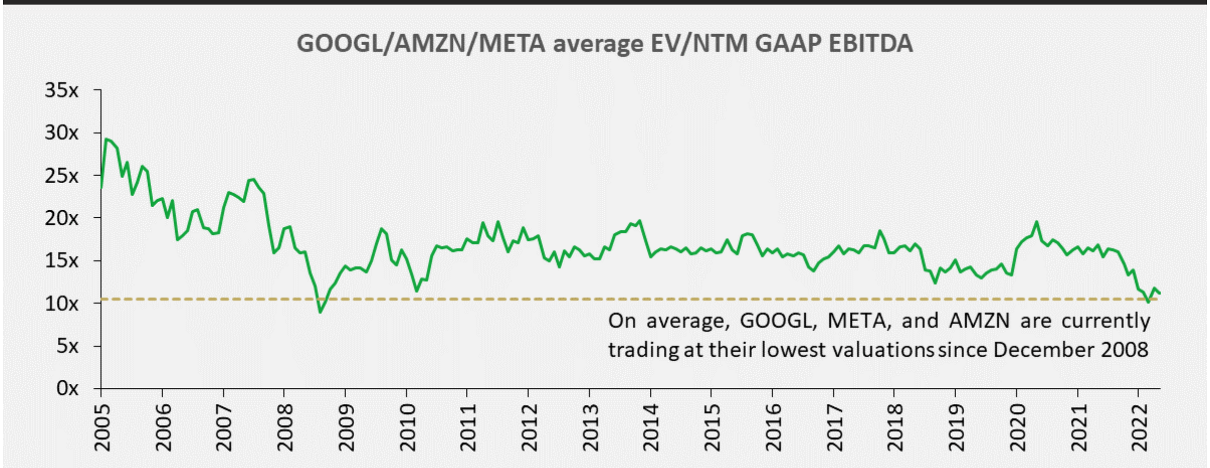
Liontrust Global Dividend Fund: August 2022 review

Fund Managers: James Dowey, Storm Uru & Clare Pleydell-Bouverie

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



Source: FactSet, Goldman Sachs GIR, pricing data as of 09.06.2022

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

Roper Technologies, held in the Fund since 2018, announced the acquisition of another high-quality vertical software business, Frontline Education, at the price of $3.4bn and a 2023 EBITDA multiple of 19x. We like the acquisition virtually on all fronts as the business carriers a high single digit growth rate (versus Roper at 7%), is 90% recurring (~50% for Roper), has negative working capital, and produces unlevered FCF at 100% of free cash flow. All in, the deal fits the bill, and we believe will fuel one of the best cash compounding machines around.

As a reminder, Roper operates in niche markets that are generally neglected by technology and insulated from broad competitive threats. Roper generates value for its customers by providing critical vertical software services to a collection of end markets and generates value for shareholders by perpetually deploying capital into asset-light businesses that continually enhance the firms return on investment. This makes Frontline Education an excellent new acquisition for Roper feeding the virtuous cycle of compounding free cash flow.

Two new holdings to the Fund in the first half of 2022 after significant stock price weakness – **Intuit** and **Nvidia** are both down 50% year to date – we think this provides excellent buying opportunities. This is why we believe so.

Intuit's results showed the company is firing on all cylinders, beating on both the top and bottom line. Small business online ecosystem growth of 31% growth (and raised long-term guidance) was particularly impressive in the face of investor (and Microsoft's) warnings of slowing small business software spend, highlighting the resilience of customer demand and Intuit's position as the platform of choice. As the company grows more as a consolidated platform over time, this is driving efficiencies and encouraging operating margin expansion, supporting long-term earnings growth.

Very few companies in history have disrupted multiple times. Intuit is the poster-child, disrupting the personal financial software market in the 1980s with its 'Quicken' product, followed by the small business accounting software industry with the advent of 'QuickBooks', and then personal tax assistance with is TurboTax platform. Today it is disrupting the consumer credit and planning market through its Credit Karma platform, whilst simultaneously layering sustaining innovations atop its core products to remain competitive.

How has it achieved this extraordinary feat? By listening to its customers needs, and therefore producing enormous customer value. Indeed, founder Scott Cook sent Intuit's marketeers into customer's homes to observe them loading and using Quicken and QuickBooks software. These observations would become the foundations of Intuit's next innovations, and this attention to the customer would bolster client retention. Today, 80% of Intuit's revenue stream is subscription based and highly predictable, underscoring the mission-critical nature its platform for its customer base of 102 million. Bookkeeping, submitting tax returns and accessing lines of credit are but some of the most burdensome tasks that Intuit relieves small businesses, consumers and accountants of.

Each disruptive wave engineered by Intuit has been modelled on its offering being easy and convenient for its customers, enabled by incumbents having overshot the functionality required by their markets. The simple adequacy – as opposed to technological superiority – of QuickBooks was precisely what captured Intuit 70% of the market in two years. Disruption from the low-end is the cornerstone of innovation that we look for in our companies, but equally important are the sustaining innovations that keep these blockbuster products resonant. 'QuickBooks Advanced' and 'QuickBooks Live' are prime examples of such value-add features, which as recent earnings evidenced, are profit accretive.

With this innovation playbook finely tuned, we are excited to see the customer value proposition build in Credit Karma – which deploys machine learning to connect borrowers with financial institutions and deliver personalised insights based on credit scores. Currently no one can replicate this given the treasure trove of data points Intuit has to play with. Which comes back, again, to the power of Intuit's platform and network effects this generates.

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 Dividend C Acc GBP	-7.3%	26.5%	9.9%	17.2%	8.8%
MSCI World	-2.6%	24.4%	5.9%	10.3%	9.3%
IA Global Equity Income	1.0%	21.2%	-2.6%	8.4%	3.6%
Quartile	4	1	1	1	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. Do remember that the value of an investment and the income generated from them can fall as well as rise and is not guaranteed, therefore, you may not get back the amount originally invested and potentially risk total loss of capital. The MSCI World Index and IA Global Equity Income sector are comparator benchmarks.

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.

Disclaimer: