HCP Focus Second Quarter 2020 Investor Letter

14 August 2020

Dear investors,

this is the second in a new series of quarterly letters to HCP Focus investors. The letter has arisen out of your requests for greater disclosure, and its purpose is to update you on the fund's performance and disclose details about specific investment decisions. We will also be discussing key developments of the companies we invest in.

The profit for the quarter is +47.9%, thus reversing the loss for the first quarter of the year, while the benchmark index MSCI ACWI IMI Total Return returned +17.8%. The year-to-date profit as of 30 June 2020 is +33.2%, having exceeded the benchmark index's return of –7.0%.

	Q2 2020*	**YTD***	**Annualized return***
HCP Focus	+47.9%	+33.2%	+21.1%
MSCI ACWI IMI Total Return	+17.8%	–7.0%	+10.9%

*Q2 2020, YTD, and Annualized return are calculated since inception of the HCP Focus fund on 30 November 2012 as of 30 June 2020. Returns are indicated after fees. Please note that past performance is not indicative of future performance.

General Updates

Although the aim of this investor letter is to concentrate on the fund specifically, I will briefly discuss changes in HCP Focus operations, as the second quarter of 2020 has been the first full quarter under the new HCP Focus management team. Most importantly, HCP Focus has undergone personnel changes in the spring – after Ernst Grönblom's departure as portfolio manager, Pasi Havia has been appointed the new portfolio manager of HCP Focus. I, Anthony Simola, have been appointed as the fund's analyst, and Elias Koski continues in his role as junior portfolio manager. During the lockdown in Helsinki, our entire operating and investment team worked remotely without disruption to our business, and we are certain we will be able to continue operations in the event of another lockdown.

Investor relations specialist Jo Iwasaki has departed Helsinki Capital Partners after working in her position for almost two years. We thank Jo for her service and wish her all the best. Additionally, the company's ownership structure has changed – three former partners Ernst Grönblom, Thomas Hoyer, and Toni Schlobohm are no longer shareholders of the firm, while the company has taken on five new partners – Vesa Kemppainen, Elli Leino, Panu Satama, myself, and Tuomas Ranta.

The aforementioned significant changes have coincided with the Covid-19 pandemic and the subsequent global lockdown, which have had an enormous impact on businesses and markets around the world. This has been partly a tailwind and partly a headwind for the company and the fund, but net-net, the fund has exceeded its historical return year-to-date, and we have an optimistic outlook for the future.

Our results have been recognized by Investment Research Finland, which has ranked HCP Focus as the best global equity mutual fund in Finland by 5-, 3-, and 1-year returns in its latest Mutual Fund Report.[1] Additionally, BarclayHedge has ranked HCP Focus number 9 in long-only equity funds globally.[2]

As we have informed you earlier, the HCP Focus fund strategy remains the same, the proprietary valuation methodologies are well known within the fund's management team, and we do not intend to make drastic changes to the portfolio in the short term. However, we have spent the spring and summer studying new investment opportunities, and will inform you in due course if and when we make changes to the fund's holdings.

Although the aim of the fund is to identify, buy, and hold dominant companies over the long term of 10-25 years, the Covid-19 pandemic and the ensuing global lockdown have over a few months given the HCP Focus portfolio companies a once-in-a-lifetime external push for demand. We have witnessed significant volatility over the year in the fund as well as global markets in general, and part of our buy-and-hold strategy is paying attention to the news cycle while firmly holding on to our positions. Much more interesting than the daily news are the global trends, such as the popularization of remote work, ecommerce, cloud computing, and the growth of online lending and banking, among others, which we seek to identify and exploit through specific investments over the long term.

As to the changes done thus far, we have rebalanced the portfolio to reflect a more equal weighting across our positions at the turn of the year as well as in late spring, exited our position in FeverTree Drinks at the beginning of the year, initiated a position in Intuitive Surgical, and elected to accept shares in the proposed transaction to separate Match Group from its parent InterActiveCorp.

1 Investment Research Finland's *Mutual Fund Report*, 30 June 2020, https://www.sijoitustutkimus.fi/wp-content/uploads/2020/07/Fundreport_202006.pdf.

2 *BarclayHedge Managed Funds Report*, https://portal.barclayhedge.com/research/bmfr-rankings/pdf/BarclayHedge_1st_Q_2020_BMFR.pdf?.

Intuitive Surgical

Intuitive Surgical Inc., the robotic surgery device manufacturer based in Sunnyvale, CA, is our newest holding. In terms of competitive advantage, Intuitive is the clearly preferred surgical system by patients, surgeons, and hospitals thanks to its extensive market penetration, friendly user interface, and limited invasiveness when compared to conventional surgery. Surgeons have reported that using the da Vinci surgical system allows them to perform certain procedures in cardiothoracic, gynecologic, urologic, and general surgery with more limited invasiveness than in conventional surgery, helps them overcome line-of-sight limitations, and reduces certain complications arising out of conventional surgery.

Intuitive's revenues have nearly doubled to $4.5bn over the past four years, producing a net income of $1.4bn for 2019, and its installed base of devices (primarily the flagship da Vinci System and related add-ons and accessories) stood at approximately 5,600 at the end of 2019, which Intuitive continues to service and derive recurring revenue from. At $3.2bn, 72% of Intuitive's overall revenue is recurring (consisting of instrument, accessory, service, and operating lease revenue), and this component grows largely in line with its installed base of systems. Currently 70% of revenue is derived from the United States, and Intuitive's management and direct sales organizations are making a concerted effort to diversify the company's revenue geographically, however facing some reported challenges from the steep price of the da Vinci Surgical System.[3]

Besides internationalization, a potentially significant future driver of Intuitive Surgical's sales is healthcare organizations' shift from owning surgical robots to leasing them under constrained budgets, which makes financing easier in the short term. Intuitive Surgical currently holds approximately 25% market share in the United States, even with its well-known high price tag, but also enjoys the highest popularity among surgeons in terms of usability. Surgeons have repeatedly asked for more tactile feedback, smaller instrumentation, and lower prices, but these are features that Intuitive Surgical is expected to implement in their next iteration of the da Vinci Surgical System.[4]

The company's revenues are expected to dip this year but resume to a level higher than 2019 in 2021. It remains to be seen if healthcare spending will take off significantly post-Covid-19 but if it does, Intuitive Surgical will stand to benefit.

3 *Intuitive Surgical, Inc. Form 10-K for the Fiscal Year Ended December 31, 2019,* https://www.sec.gov/ix?doc=/Archives/edgar/data/1035267/000103526720000032/isrg-20191231.htm

4 Third Bridge Forum interview with John Meehan, co-director of robotic surgery at Seattle Children's Hospital – *General Surgical Robotics – Market Update & Coronavirus Impacts,* 21 May 2020, https://forum-portal.thirdbridge.com/transcripts/conference-calls/.

Match Group Transaction

We elected to accept shares in the transaction to separate Match Group from its parent InterActiveCorp (IAC), a transaction which concluded at the close of business on 30 June 2020. The proposal offered one share of common stock in the new entity that owns Match Group for each share held in pre-transaction Match and either cash or shares in Match Group. The transaction was planned to simplify Match's and IAC's respective corporate structures, with the possible benefits for Match shareholders including the potential elimination of a trading discount (due to pre-transaction Match's status as a controlled company) and the possibility of new Match being included in major stock indices, such as the S&P 500, as a result of its new single class structure (one share, one vote). Prior to the transaction, IAC controlled 80.7% of Match Group's shares and 97.5% of its voting rights.[5] With last available fiscal-year revenues standing at $2.1bn and 9.3 million average subscribers across its platforms in 2019,[6] we expect Match Group shares to gain from the company's newfound independence and its shares' possible inclusion in stock indices.

On the operating side, Match Group specifically benefits from the shift to paid subscriptions in software and content, especially among young people who have matured as computer users in an age where memory is rented online rather than bought as physical storage devices, and software is subscribed to rather than paid up. Additionally, the stigma of online dating has vanished in a few short years, which has been achieved through extensive marketing and popularization of these services.

In terms of numbers, Match Group's revenue growth over the past five years has averaged approximately 20% per annum, and about half of 2019 revenues come from Tinder, while the rest is split between its other applications and websites (Match, PlentyOfFish, OkCupid, Hinge). Geographically, the revenue is split almost evenly between North America and the rest of the world. Though the US online dating market is maturing, there is plenty of growth opportunities internationally, particularly in Asia, with Japan and India in particular.

We expect Tinder's management to be successful in gamifying their platform, steering user behavior through machine learning, and converting those users to paid subscriptions. Former Tinder executives have indicated that a segment of users is very adamant about not paying for subscriptions, and Tinder has therefore experimented with advertising within its app as well,

5 *IAC/InterActiveCorp and IAC Holdings, Inc. Form S-4* as filed with the Securities and Exchange Commission on February 13, 2020, https://www.sec.gov/Archives/edgar/data/891103/000104746920000859/a2240670zs-4.htm.

6 *IAC/InterActiveCorp Form 10-K for the Fiscal Year Ended December 31, 2019*, https://www.sec.gov/ix?doc=/Archives/edgar/data/891103/000089110320000004/iac-20191231x10k.htm.

meaning that advertising revenue could grow in the coming years, as it currently stands at only 5% of total revenue.[7]

Amazon, Alibaba, and Shopify

Of the current portfolio companies, Amazon is the one we have been holding the longest, within the HCP Focus fund since its inception in November 2012 and already before that on a managed-account basis since 2009. We believe that the growth in online retail has received an abnormal boost from Covid-19 but will continue robustly in the coming years. Similarly, the shift to remote work will further benefit Amazon's cloud computing business, Amazon Web Services.

Alibaba similarly mirrors Amazon in its ability to benefit from growing demand for cloud computing through its cloud computing business, Aliyun (Alibaba Cloud). Ant Group, the company formerly known as Ant Financial and operating Alipay, has announced its intention to go public in 2020 in a Shanghai-Hong Kong dual listing in what is predicted to be one of the largest IPOs in history, and we expect Alibaba shares to benefit from its stake in Ant Group becoming listed.[8]

When it comes to online shopping, Shopify has begun competing more directly with Amazon by launching its consumer-facing shopping app Shop, which aggregates individual Shopify storefronts into a consumer-facing online store that is in more direct competition with Amazon and has similar functionality – delivering consumers access to individual merchants and a concentrated system through which to place and track orders.[9]

The company's revenue breakdown has shifted somewhat from charging its 1 million businesses fixed fees for online storefronts to charging merchant fees tied to on transaction volumes, making the company's revenue more directly exposed to fluctuations in consumer spending. Even though traditionally consumer spending has largely been a function of economic growth, online shopping is still such a small fraction of all retail spending that transaction volumes of merchants and thus Shopify's overall revenue can grow at a steady clip even if overall consumer spending remains flat or falls.[10]

Clearly, the societal migration to online retail is not only an acute but structural change in consumption, and we expect our holdings to benefit from ecommerce growth directly through our

7 Third Bridge Forum interview with Karine Dussert-Sarthe, former COO of Match Group Inc.'s Europe division, *Match Group – Global Growth Drivers & New Management,* 26 February 2020, https://forum-portal.thirdbridge.com/transcripts/conference-calls/.

8 China Banking News, *Ant Group Plans Dual Listing on Shanghai STAR Market Board and Hong Kong Stock Exchange,* 21 July 2020, http://www.chinabankingnews.com/2020/07/21/ant-group-plans-dual-listing-on-shanghai-star-market-board-and-hong-kong-stock-exchange/.

9 *Shopify Unveils Its Consumer App: Shop,* https://news.shopify.com/shopify-unveils-its-consumer-app-shop#.

10 *Shopify Inc. Form 40-F for the fiscal year ended December 31, 2019,* https://www.sec.gov/ix?doc=/Archives/edgar/data/1594805/000159480520000010/form40-f2019.htm.

holdings in Amazon, Alibaba, and Shopify but also Etsy, Facebook (through Facebook Marketplace), MercadoLibre, and indirectly by merchant fees and payment processing through our position in PayPal.

Investing in the HCP Focus Fund

We would like to remind you that the next subscription deadline will be 30 September 2020. You can subscribe to the HCP Focus fund by filling out the form at https://www.hcp.fi/en/make-a-subscription/ according to the instructions on the website.

Please contact us at ir@hcp.fi or +358 9 6898 8474 for feedback or questions.

Best regards,

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