Investec Europe Research Bulletin

August 2020

Out of the Ordinary®

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Executive Summary

In August's Research Bulletin we look at some of the latest domestic economic indicators and round-up international trends as virus responses continue to dominate.

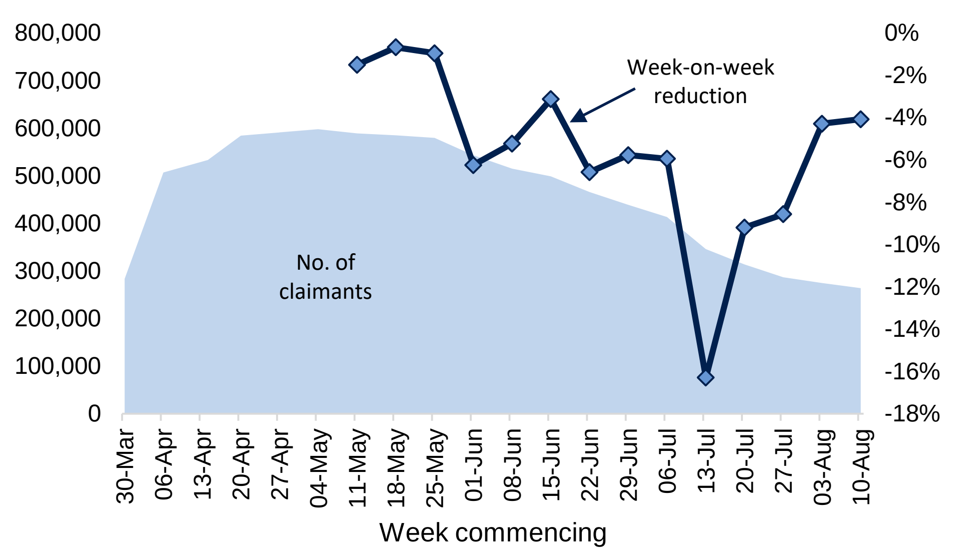
Investec Treasury summarises a tsunami of central bank actions in recent months and assess the ongoing rally in oil markets. We also have contributions from Investec Ventures, who outline how well its investee companies have adapted to unforeseen challenges, and Investec Private Finance Ireland Limited, who look at the new ways of doing business in the home-buying market.

Stay safe and healthy and don't hesitate to contact us if we can be of assistance.

Economic Update: Ireland

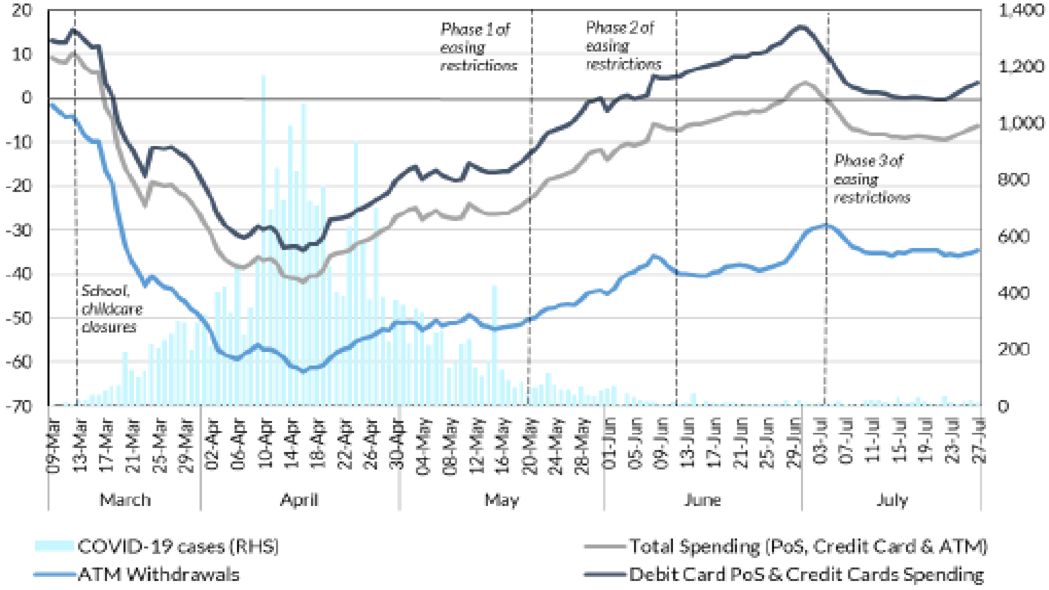
Unemployment decline slows but resilient taxes give government added flexibility

Pandemic Unemployment Payment – no. of recipients



Source: DEASP

Spending vs. same month of last year



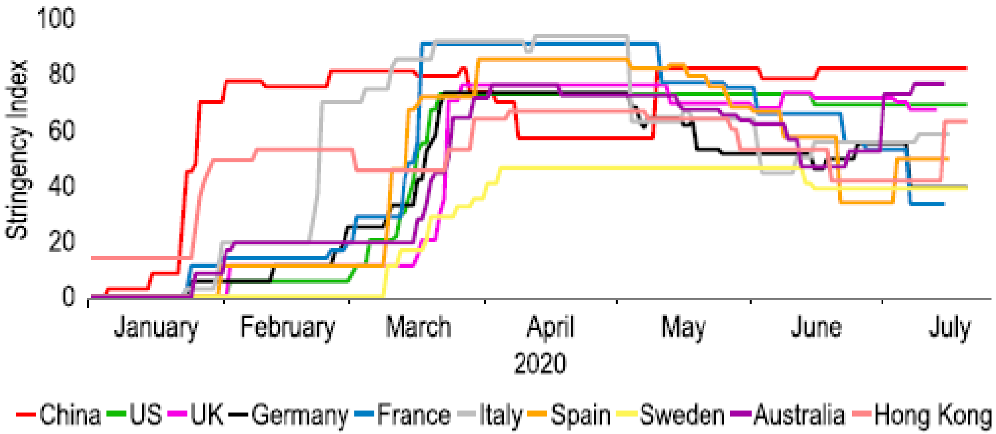
Source: CBI

- Data in the past two weeks show that the pace of decline in the number of Pandemic Unemployment Payment (PUP) recipients has slowed markedly. The reduction in June/July averaged more than 30,000 per week, but this dropped to 12,300 in the first week of August and is set to drop further in the second week.
- It was always going to be the case that the pace at which people could return to work would slow at some point, and it now appears that further gains will be harder to come by. Unemployment currently stands at 16% - the same rate as at the peak of the last economic crisis.
- However, the resilience of the country's tax base has given the government sufficient confidence to extend its primary income supports (the PUP and Employee Wage Subsidy Scheme) to April of next year. Tax revenues to end-July are just 2.5% lower than last year and more than €5bn higher than the Department of Finance's April 2020 projections.
- Consumer spending rebounded back to normal levels in June with retail sales volumes +3.5% year-on-year. However the nature of these purchases indicated a degree of pent-up demand that may not be sustainable in future months and card payment statistics indicate that consumer spending retreated in July – total card spending in late July was 6% below year-earlier levels.

Economic Update: International

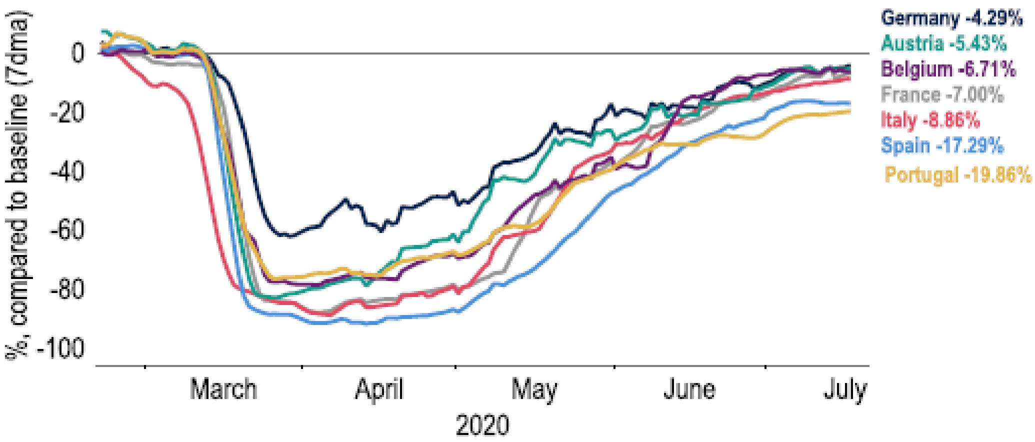
Activity rebounds, but virus remains the ever-present danger

Some countries have had to tighten social restrictions



The index is a composite measure based on nine indicators including school closures and travel bans. Source: Macrobond, University of Oxford

Google mobility reports show a tapering in activity



Source: Macrobond, Google

- **Eurozone**: Official Euro-area statistics have so far pointed to a rebound in activity as lockdown measures have been eased, but the path of recovery to regain pre-crisis levels will likely be drawn out. A resurgence of virus cases in some areas has caused alarm and is the ever-present danger – Google data show mobility has been curtailed where local lockdowns have been reintroduced, notably in Spain and Portugal. Into the medium-term, the EU's agreement on a €750bn Recovery Fund represents a significant milestone and should begin to provide additional stimulus just as some government support measures lapse. Furthermore, ECB policy is set to remain exceptionally accommodative and its €1.35trn PEPP programme has seen sovereign yields return to pre-COVID levels.

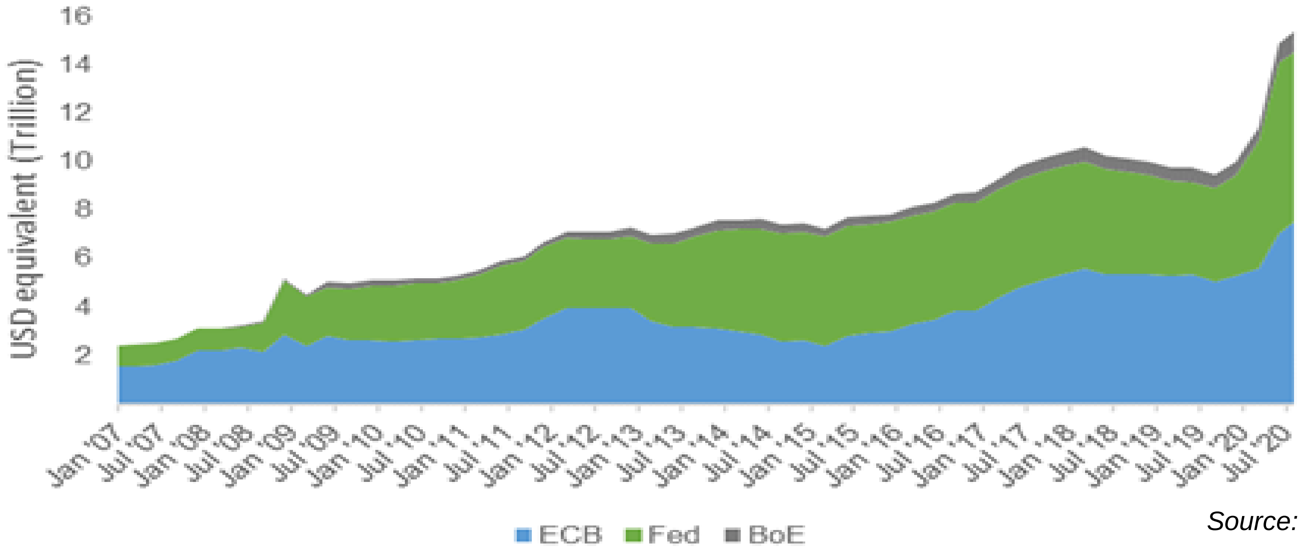
- **UK**: Although the number of daily COVID cases seems to have begun to rise again recently, this may well be due to 'clustering' in specific areas rather than a generalised outbreak, which would be more worrisome. While May's rebound in GDP was relatively subdued, both June and July should see a more robust rise in activity on the back of a more significant lifting of restrictions. Further ahead the key will be the extent of second round effects, but the Chancellor's latest measures should help prevent a double dip recession.

- **US**: The US has continued to struggle to control coronavirus case numbers, leading to a tightening in restrictions and this shift has led to a levelling-off in economic activity data. Worryingly, the largest state, California (14.6% of US GDP), has the most punitive restrictions. With an eye on the impending Presidential election, we expect that further fiscal support will be agreed, but, at the time of writing, a comprehensive new programme had yet to be agreed. Investors will soon begin to appraise the likely consequences of the election result, and how any fiscal repair work will be tackled from 2021. Here Joe Biden is calling for a 28% corporate tax rate but he's also likely to be less hawkish in trade disputes, with US-China tensions continuing to rise.

Investec Treasury: Currencies

Central Banks hit the pause button after tsunami of stimulus

Central Bank Balance Sheets



Source: Bloomberg

- The US Federal Reserve was the first of the big Western Central Banks (CB's) out of the trenches, leading the charge with an unscheduled 0.5% rate cut on 4 March, and the speed and scope of the global monetary policy response that has followed has been nothing short of eye watering.

- After some justified criticism that some of the other larger systemically important CB's were slow to react, and with the trauma of the global financial crisis still firmly at front of mind, they quickly followed suit. The war chests were flung open and no instrument of defence was regarded as even remotely taboo this time.

- Very quickly, CB balance sheets ballooned as mammoth asset purchase (QE) programmes were reactivated in tandem with rapid zero-bound rate cuts, coordinated swap lines and incentivised lending provision (to bolster liquidity). While the sharp 'V shaped' recovery that this avalanche of monetary and fiscal stimulus was hoping to achieve seems now to be a bit of wishful thinking, the flood of stimulus helped push yields on medium- and long-term sovereign debt to all-time lows. Equity, commodity and currency markets also appear to have pulled back substantially and, in some cases (S&P 500), are within kissing distance of their February all-time highs. Central bankers the world over have, without doubt, earned themselves some well-deserved breathing space.

- As we move into what would typically be an August lull, we will continue to watch the virus situation nervously and consume as much real time activity data as we can. If the recovery continues to flatten out and even swing into reverse, the major CB's are likely to feel greater urgency to jump back in. As such, they may well opt to reinforce their policy stance through explicit forward guidance and, if necessary, further credit and liquidity facilities. Beyond the short term, central bankers and economists will have their work cut out attempting to ascertain what the pandemic means for the path of monetary policy over the longer term.

Oil rally continues with supportive risk environment

Brent Crude Front Contract

Source: Bloomberg

- Brent set its highest level since the beginning of the coronavirus outbreak with oil trading at $46.20/barrel this month. The market has gradually set higher highs starting with 43.41 $/b in early June, 44.89 $/b in mid-July and 46.20 $/b at the start of August. The 200-day moving average lies at 47.10 $/b, while the 50-day average, which supported Brent in its sell-off last week, is close to 42.30 $/b.

- In terms of what is behind this move, the American Petroleum Institute estimated at the start of August that US crude inventories fell by 8.5m barrels. This was also confirmed by the official numbers from the US Department of Energy inventory report showing stocks falling by 7.3m barrels, broadly in line with estimates. In addition, there has been a supportive risk environment as the market reacted positively to progress on the renewal of a COVID-19 support package in the US, even if a comprehensive package has yet to be agreed.

Investec Ventures

What has been the experience of our venture backed SMEs during Covid-19?

Introduction

- The Harcourt Venture Fund has backed many high growth, privately owned Irish SMEs. What characterises the majority of these investees is that they are typically focused on technology but, more specifically, enabling software, and they target an international client base and are therefore export orientated. In general, our investees either have a limited addressable Irish market, or none at all, and are targeting North America and EMEA.
- It's pleasing to say that I have been pleasantly surprised at how well our investees have managed themselves and reacted to the challenges faced as a result of COVID-19. By mid-March, the venture capital eco-system made up of investees, their investor bases and government agencies were attempting to forecast and assess the outlook and impact of COVID-19 on future trading, cash reserves and collection, the ability to meet liabilities, etc.
- Anyone who knows private equity and venture capital knows that, at the best of times, venture backed SMEs typically have limited cash available at any time and face significant challenges as they scale internationally, so when a once in a lifetime pandemic comes along, the future certainly looked bleak.

So What's Happened?

- What's happened is that the entrepreneurs who run these companies adapt, improvise and overcome. These entrepreneurs work twice as hard and twice as long. They react differently to most, keep cool and remind us, their backers, why we invested in the business in the first place.
- Remote working, be it an airport lounge or working staggered hours from home to service customers in multiple time zones is second nature to staff in hi-tech start-ups. Don't get me wrong, the first few weeks of lockdown were 'seat of the pants' stuff, offices emptying, wifi challenges, child care issues, sales staff scrambling to get home, office chairs in the back of cars, and, to make matters worse, when our investees were settled into their bunkers there was incredible silence from international clients as they too scrambled to isolate, given that there was no coordinated geographical lockdown.
- Once the client base got back up and running remotely, it was clear they too were then assessing purchasing decisions, project implementations and their own cash resources. Decision making was put on hold, as too were projects and deployments. It was a waiting game and it certainly looked gloomy.
- As we got to late April and into May, we began to see signs of hope, not recovery. This was a function of clever "sales personship"; rapid prototyping; innovation; client demand for hosted solutions; demand for mobile solutions; access issues to onsite servers; issues with office access; the need to support staff; etc. While every crises is an opportunity in its own way, no one has made hay, and these very welcome sales opportunities (along with savings in travel and marketing) have helped stem the flow of falling revenues, falling cash balances and uncertainty.

The Importance of Cloud Software and Software as a Service ("SaaS")[1]

- The pandemic has shown that Cloud Software is critical to modern business. We have all witnessed Zoom and other SaaS communication and collaboration platforms experiencing a material uptick in demand. Structurally, workforces have changed due to the sheer number of people working from home. Software applications that can be deployed remotely and rapidly are fundamentally enabling tools facilitating continuity of productivity and service; workforce and workflow efficiencies; better outcomes; lowering costs; empowering workers; improving customer experiences; etc.
- Businesses that have continually kicked-the-can on upgrading from on-premise to cloud software have found their employees locked out of mission critical applications and productivity plummeting, if occurring at all. For SaaS companies with such a solid customer base, there is likely no better time to help legacy customers migrate to the cloud.

[1] [2] Source: Kris Beible, Software Equity Group

Investec Ventures

What has been the experience of our venture backed SMEs during Covid-19?

What Sectors have held up for us?

- AdTech - StitcherAds' dynamic ad solutions and shopping experiences drive incremental sales online and in-store across social platforms. While some retail clients have reduced branding and prospecting budgets, StitcherAds has seen significantly increased online marketing budgets as consumers spend more time on websites and apps.
- e-Commerce - With the closure of motor factors during lockdown, Micks Garage enjoyed strong domestic demand for parts as well as demand from DIY car enthusiasts. With 'staycations' becoming the holiday of necessity this summer, MG is well positioned to take advantage of consumer spending in the domestic travel and leisure markets.
- EdTech - Terminalfour develops digital engagement and web content management platforms for third-level colleges and universities. Developed during 'lockdown', it is currently rolling out BetterExaminations Online with a large Canadian university to manage remote exams and all of the governance and invigilation around that.
- Internet of Things - CREW, a remote early warning system for the detection of Covid-19 uses Davra's IOT platform to monitor incoming data and generate automatic alarms if temperature thresholds are breached.
- Health and Human Services - Diona's mobile solutions enable government agencies to rapidly deploy social care, social protection, welfare payments and 'food stamps'. COVID-19 saw increased adoption and deployment of IT solutions in large population centres in the US affected by the virus.
- Online Health - SilverCloud Health provides accessible, scalable, digital behavioural healthcare. Its solutions are deployed by health systems to client populations and more recently front-line staff, with increased adoption and usage.

We're not out of the woods yet - there are continuing challenges

- Maintaining workforce productivity, staff communication and collaboration are key priorities for our executive management teams. Getting sales teams and account managers onsite will be tricky with international travel restrictions and health concerns a challenge in the medium term. New hires will be tricky as good talent stays put.
- While new customer growth Annual Recurring Revenue ("ARR") is important, the importance of net retention cannot be underestimated. Net retention is a function of lost, contraction, and expansion ARR and is critical to success for our SAAS investees. Maintaining and upselling to the existing base is critical as new business target customers are expected to continue to make slow purchasing decisions.[2]
- The trick is to find a way to survive, avail of the supports domestically and internationally, retain key staff, innovate and undertake "white space analysis" (the process of digging through existing customer sales data to hunt for new white space opportunities to cross-sell and up-sell).
- Selling internationally to new customers is always a challenge but, at times like this, the answers can be closer to home, be it domestic funding or upselling to existing customers.

Portfolio Companies

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Leo Hamill is Joint Managing Partner of The Harcourt Venture Fund, a €75m venture fund managed by Investec Ventures

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Home viewings – the new way of doing business

- After an uncertain Q2 2020, the sectoral restrictions for property viewings were lifted in early June.

- Viewing numbers are reported to be strong in the new homes and mid-market sectors in particular.

- Like most sectors of the economy, the residential sector has adapted new protocols to ensure a safe return to business;
    - Focus on maintaining social distance, limiting interaction between viewing parties and agents, and minimising touch points within the property.
    - Viewings are strictly by appointment, online virtual tours are available for most properties and a maximum of two individuals per viewing party is permitted.
    - The allotted time slot is generally 15 minutes per viewing allowing plenty of time to view every corner of the property without bumping off other parties, as has been the case in the past.
    - This more targeted and focused approach results in well-informed potential buyers arriving to view with specific requirements in terms of reliable broadband, storage space and transport links.

- Across all segments of the market, the COVID-19 experience has re-focused house buyers on the importance of having the option of a dedicated work from home space, proximity to leisure amenities and an outdoor amenity.

- Home buyers are approaching their house purchase with a shopping list of fine-tuned requirements to suit their expected needs over the medium term.

- The new way of doing business in this sector could well have the effect of filtering out anyone not committed to a purchase resulting in a more efficient sales process for all sides.

Investec Private Finance Ireland Limited

Our view on recent residential housing sector data

- The COVID-19 impact on residential property prices has yet to become apparent but, from our interactions with agents and buyers in the market, price adjustments may not be as dramatic as initially feared.

- Official price data from the CSO (through its RPPI series) showed an immaterial impact in May (prices were 0.3% higher y/y), but these transactions largely reflected deals that were struck before the scale of the current problems became apparent.

- Other indicators, such as asking price data from listings websites, suggest that the pandemic's effect on prices to date has been negative, but only modestly so.

- According to the June 2020 Daft.ie residential sector report, listed asking prices in June 2020 were an average of 3.3% lower than 12 months previously.

    - In Dublin this reduction was on average 3.8%.
    - However there were 5,200 homes advertised for sale in Dublin in June 2020, 15% fewer than during June 2019.
    - Nationally, the total number of homes available for sale on 1 July 2020 was 19,510, down 25% year-on-year and the lowest July total since 2006.

Dublin asking prices down 3.8% year on year

Supply of properties advertised for sale is down 25% year on year in July

- It is too early to pass judgement on those that have predicted double-digit declines in property prices as the evidence is unclear.

- Supply figures demonstrate that, in the short-term at least, supply will continue to be a key factor in the ongoing performance of this sector for the rest of 2020 and into 2021.

- At Investec Private Client Lending we believe downward pressure on house prices is likely to be mitigated to some extent by the decline in new housing output and the effect that this will have on the structural undersupply of housing in the country. We continue to actively support a sub-set of the market with Specialised Lending solutions and understand that finance is generally available in the market but through even more rigorous underwriting.

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