

Evenlode Investment View

March 2019 – The Long-Term Voyage



“The best response when seas are choppy is to focus on completing the long-term voyage and not think about whether the next wave is going to push the nose of the boat up or down”

Howard Marks

Global stock markets have continued to edge higher in March, albeit with an element of nervousness and volatility. Economic indicators remain subdued and continue to suggest a slowdown in global growth. More positive for investor sentiment, however, has been the marked shift to a more accommodative stance from the US Federal Reserve since January, which has led to a rapid fall in interest rate expectations. Optimism surrounding a possible tariff resolution between the US and China has also helped. At home, Brexit rumbles on interminably. Despite a continuing lack of political clarity, the pound has remained reasonably steady over the last month, with the risk of a hard Brexit scenario still deemed fairly low.

Since the start of the year, the Evenlode Income fund has risen by +9.0%, compared to a rise of +8.7% for the FTSE All-Share.*

British Business - Getting On With It

“What really counts is a management having both a determination to attain further important growth and an ability to bring its plans to completion”.

Philip Fisher, *Common Stocks For Uncommon Profits*

Company results have come thick and fast over the last few weeks for Evenlode holdings, and we have had some interesting conversations with management teams. Recent operating performance remains reassuringly robust, with cash generation and dividends making good progress. It is also heartening to observe how most companies are just quietly getting on with their long-term strategic plans, despite operating in a world with no shortage of complexity and vicissitudes. In fact, I’ve been thinking how similar the mindset used by long-term orientated business management is to our approach as long-term orientated investors. Like us, they do not try to predict the short-term ‘chop’ of economic and political events - interest rates, inflation, politics, elections etc. Instead they aim to look past this noise and develop investment plans that should help to insulate a company from a wide range of environments. It’s about getting the basics right: improving customer service, deepening customer relationships, investing in innovation, expanding geographically, and always looking to tilt activities to business areas where competitive advantage is strongest, and where economics and long-term growth prospects are most compelling.

This month I would like to discuss a few examples of companies whose prospects over coming years seem interesting to us, and that are in our view making sensible investments today to take advantage of the opportunities of tomorrow.

Healthier and Cleaner: Reckitt Benckiser

Reckitt hasn’t been the most fashionable company over the last couple of years. It has had some operational issues and announced the retirement of its long-standing chief executive earlier this

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year. However, we think the company has compelling long-term growth prospects and have rebuilt Evenlode Income's holding over the last 18 months as the valuation has improved. Reckitt has evolved over the last decade into a pure 'health and hygiene' business and has recently separated into two operating companies: one focused on 'Consumer Health' (Durex, Dettol, Nurofen, Strepsils, Gaviscon, Enfamil etc.) and one focused on 'Hygiene Home' (Vanish, Finish, Harpic etc.). These are both structurally growing markets, thanks to both global demographics and emerging market dynamics, with penetration in many of the categories that Reckitt operate in remaining low. I have discussed Reckitt's 'toilet opportunity' in previous investment views, but it is worth revisiting. At recent results, Reckitt highlighted that one in three people in the world don't have access to a proper toilet today. More and more toilets are being built to address this issue (roughly 20 million a year in India, for instance) and they then need to be kept clean. Reckitt, with well established brands in India such as Harpic and Dettol, are well placed to help keep these new facilities clean. Similarly, only 0.2% of Indian households have dishwashers, but the penetration rate is growing steadily, providing the Finish brand with interesting long-term growth potential. More generally, 40% of Reckitt's sales are generated from emerging markets, a figure that is likely to tick up steadily over time.

Whilst things won't unfurl quarter-to-quarter without a hitch (as the last two years have demonstrated) Reckitt are committed to investing meaningfully behind these long-term opportunities. The company has a long track record of successful innovation and will be opening a £100m innovation hub in the UK this year. Reckitt also has local innovation centres in the US, India, China and Mexico. Meanwhile, the company is investing heavily in its digital capabilities as consumers increasingly interact with and purchase products through digital channels. Reckitt has trebled the level of investment in e-commerce and digital over the last two years and the company's e-commerce sales are growing at +40%.

The Strong Grow Stronger: Howden Joinery

Toilets and dishwashers in India: these are the sort of things that get us excited at Evenlode! On a similarly prosaic theme, but closer to home, we like Howden Joinery's approach to selling kitchens and other joinery products in the UK. Howden's close relationships with builders, local depot network, decentralised management culture and vertically integrated supply chain have helped it establish a market leading position (now significantly more than twice as big as its next biggest competitor). Management also take a very conservative approach to the company's financials. In the knowledge that short-term demand can sometimes be volatile, the company always run with at least £100m of net cash on the balance sheet (currently £231m). This approach, along with Howden's scale, enables the company to invest consistently even when times are tougher. In 2018, despite a difficult UK economic backdrop, Howden continued to grow its sales and profit and take market share. It's a good example of the strong growing quietly stronger in a tough environment, even though this progress is masked somewhat within current financial results due to economic headwinds. Howden continues to invest heavily in future growth plans: opening new stores, introducing a new store format, investing in technology, increasing production capacity and expanding its French business, all of which could provide interesting avenues of growth over coming years.

Evenlode Investment View

March 2019 – The Long-Term Voyage



Innovating For Long-Term Growth: Smiths Group, Rotork, Spectris

Smiths Group, Rotork and Spectris are speciality engineering firms, and their short-term performance is to some degree dictated by the ups and downs of the end markets they operate in. However, these companies are market leaders in their niches and sell mission-critical products that enjoy good economics. Their markets also have interesting structural growth drivers, both in terms of increasing demand for efficiency, safety, security, innovation and data analytics, and thanks to population growth and increasing urbanisation over time. We think these businesses are being run with a sensible eye on the long-term. Under new management, Smiths Group have increased research and development expenditure by more than +25% over the last three years. The pipeline of new products has, as a result, increased rapidly (in its medical business, for instance, the company have launched 29 new products in the last 18 months and are set to launch another 10 in the next 6 months, compared to only a handful a year in preceding years). Rotork and Spectris are taking a similarly proactive approach to innovation under new management teams. All three companies are also simplifying their businesses and tilting their portfolios towards those products and services that have the most interesting market positions, long-term growth drivers and attractive economics. The management teams of these companies have no better idea than you or I as to what will happen to the global economy over the next week or month, and don't pretend to. But they are busy getting on with the job at hand, and see significant potential for sales growth, margin expansion and cash generation as they steadily take advantage of the opportunities they see in their markets.

Time and Patience

My basic message this month is, I admit, boringly repetitive for regular readers: share prices wobble around in the short-term but the part-ownership of good businesses (that are prepared to invest and evolve) is generally an enjoyable experience for the long-term saver. I think it's a message that bears repeating in an investment landscape that is constantly evolving, and at times feels like it is tempting investors into decision-making over shorter and shorter timeframes. With the above considerations in mind, we will aim to keep our eye on the horizon and focus on the long-term voyage.

Hugh and the Evenlode Team

28th March 2019

Please note, these views represent the opinions of Hugh Yarrow as at 28th March 2019 and do not constitute investment advice.

*Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2018 to 28/03/2019.