

# Evenlode Investment View

November 2021 – Hidden Champions

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Up until the last week of November, Mr Market's mood was quite positive thanks to the continuing global economic recovery. However, sentiment in global stock markets took a turn for the worse at the end of November, as the new Omicron Covid variant emerged in South Africa.

As I write, the FTSE All-Share has returned +12.9% so far in 2021 and the Evenlode Income fund has returned +13.8%<sup>i</sup>.

## Healthy fundamentals

The third quarter earnings season has now come and gone, and the vast majority of Evenlode Income holdings have updated the market since early October. Operational progress has been reassuring, with the recovery from the pandemic progressing ahead of expectations this year. We have been particularly impressed with the adaptability that portfolio holdings are demonstrating in terms of dealing with recent issues relating to supply chains and input cost inflation. Few companies are immune from these pandemic-related distortions but the pricing power, global scale and operational flexibility that portfolio holdings enjoy are all helpful when trading through such a volatile period.

The dividend recovery has also proceeded well, and we now expect full year growth for the fund's dividend distribution of more than +15% (versus our previous expectation of around +15% growth)<sup>ii</sup>.

## Hidden champions

Last month I discussed the Evenlode Income's consumer branded goods holdings, which constitute approximately 28% of the portfolio, and represent a significant portion of the consumer-facing companies held in Evenlode Income. Most of the rest of the fund is composed of a wide variety of business-to-business franchises. These 'hidden champions' may not always be well known to the general public, but they tend to enjoy market-leading positions in niche (often global) sectors, embedded relationships with their corporate clients, and interesting long-term growth potential. Below are three examples of these 'quiet' market-leaders, which help to highlight both some important structural growth opportunities within the fund, and some interesting themes across the wider post-pandemic corporate world.

### RELX

At the turn of the millennium, RELX (previously known as Reed Elsevier) was predominately a print publisher, with about 20% of revenues coming from digital formats. Thanks to consistent investment in product development over the last two decades, the company now generates 87% of revenues from digital and data analytics services. RELX provides these decision tools to a wide range of professional and business customers (academic researchers, doctors, nurses, lawyers, corporates etc.). These digital services tend to be subscription-based, form an integral part of a company's day-to-day workflow, and represent a low-cost relative to overall expenditure. At the RELX investor day this month, management explained how they go about developing these services for lawyers: *We use advanced technologies such as machine learning, natural language processing and AI on our vast quantity of data and content to extract data points, recognise patterns and drive insights. We then embed these data-driven insights at key decision points in attorneys' workflow and provide them with actionable*

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*decision-support tools. This work would be incredibly time consuming or nearly impossible for lawyers to do manually. We ingest a vast amount of data from more than 69,000 data sources in varying formats, managing about 128 billion documents and records in our LexisNexis legal and news database.*

Professional and corporate clients have increasingly prioritised digital investment over the last decade given the benefits it brings, and this trend has accelerated through the pandemic. RELX reported revenue growth of +6% for the first nine months of the year and management expect full year growth in both revenue and earnings to be above historical trends.

## **Compass**

Compass is the global market leader in the provision of outsourced food services to a wide variety of clients and locations (offices, hospitals, schools, universities, sports stadiums etc.).

Social distancing measures mean Compass has been one of the most pandemic-impacted Evenlode Income holdings. The trading recovery is well underway though, with revenue over the last quarter at 88% of the level it was for the same quarter in 2019. Free cash flow generation has also recovered strongly, and the company resumed dividend payments this month. Taking a longer-term view, Compass represents a good example of ‘the strong growing stronger’ in adversity and is emerging with great potential for long-term cash compounding growth. The company’s reputation, scale and ability to manage complexity have meant that Compass has seen a ‘flight to trust’ from competitors less well placed to deal with recent challenges (hygiene requirements, food sourcing, volume variability, changing consumer preferences, staff sourcing, input cost inflation, digital capabilities etc.). At this month’s full year results, Compass noted that both client retention rates and new business have hit an all-time high, with new business wins +15% higher relative to 2019 (the previous record year). Half of these new business wins came from first-time outsourcing, compared to a more normal historical level of 30%. Management think this trend is likely to continue as customers continue to look to remove hassle and inefficiencies from their ancillary operations in order to remain flexible and adaptable in a fast-changing, complex world.

This is how management summed up the opportunity at recent results: *We’re confident that we will emerge as an even stronger business, further extending our market leading position with growth potentially beyond our historical range... there’s a huge runway for growth in all regions and in all sectors.*

## **Intertek**

Intertek is a global market-leader in the assurance, testing, inspection and certification (ATIC) sector. ATIC companies provide important third-party audit and verification services for their business customers. Sounds dull and boring perhaps! But as with both Compass and RELX, Intertek tends to have long-term, embedded relationships with customers: many of Intertek’s services form a mission-critical part of safe, compliant, sustainable and resilient day-to-day operations. The sector also enjoys several structural growth drivers, such as increasingly stringent regulatory standards, and the need and desire for supply chain and sustainability audits.

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Intertek was impacted by the pandemic, but recent discussions with the company (and other sector peers such as Evenlode Income holding SGS) suggest that the sector's growth outlook has accelerated over the last two years. This is how Intertek management put it at this month's trading update: *Our clients are seeing a strong yet uneven global recovery with two major challenges. First, they need to resolve, immediately, the disruptions in the global supply chain to meet the needs of their clients. And second, they need to invest in safer and more resilient supply chains, innovations to make their products and services better and, of course, more sustainable. These additional investments from our clients will provide Intertek with additional growth opportunities.*

These three examples of 'hidden champions' highlight some important themes that we see across many holdings in the Evenlode Income portfolio. They were all impacted, to varying degrees, by the recent Covid downturn. But they have coped well and subsequently emerged in healthy shape, with attractive growth potential over the coming years as their corporate clients prioritise investments in areas such as digitalisation, flexibility, sustainability and quality assurance.

## **Hugh and the Evenlode team** **26 November 2021**

*Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 26 November 2021 and do not constitute investment advice.*

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*Source: Evenlode Investment Management Limited. Evenlode Investment Management Limited is authorised and regulated by the Financial Conduct Authority, No. 767844.*

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<sup>i</sup> Source: Evenlode Investment, Financial Express, total return, bid-to-bid, 31 December 2020 to 26 November 2021 (TB Evenlode Income B Inc.).

<sup>ii</sup> Source: Evenlode Investment, forecast for year-on-year growth for the fund's full year distribution to February 2022 (TB Evenlode Income B Inc.).