

Evenlode Income

Investment View



July 2022 – New holdings

Following a difficult first six months of the year, July saw a strong recovery in global stock markets. Leading indicators continue to suggest a global economic slowdown is underway, but these concerns were mitigated by the continuation of reasonably steady operating results from the corporate sector. Signs of lessening input cost inflation also reduced expectations for interest rate rises over coming months.

During July, Evenlode Income rose +8.8% compared to a rise of +4.4% for the FTSE All-Share and +5.7% for the IA UK All Companies sector. Since the start of the year Evenlode Income has now fallen -1.6%, compared to a fall of -0.4% for the FTSE All-Share and -7.8% for the IA UK All Companies sector.ⁱ

Healthy results

It has been a busy month for second quarter/first half results, with more than 75% of the portfolio releasing a trading update. We have been analysing these results and talking to company management teams. In the context of a very challenging operating backdrop (Chinese Covid lockdowns, input cost inflation, the war in Ukraine, the cost-of-living-crisis etc.) the overall picture has been reassuring and healthy, with average year-on-year revenue growth for the April-June quarter running at +16% for those reporting.

What is driving this growth? First, structural growth opportunities (and the investments companies are making behind these opportunities) continue to be supportive. Digitalisation trends remain strong for instance, with Microsoft's +16% and RELX's +13% revenue growth examples of this opportunity. Second, a handful of companies are still recovering from the impact of Covid lockdowns in the first half of 2021, which is driving strong year-on-year growth. Informa and Compass, both benefiting from the lifting of social distancing and travel restrictions, saw revenue rise 40% and 43% respectively in the most recent period. Third, companies are raising prices to help offset input cost inflation. More than half of the Evenlode Income portfolio has released interim results, which disclose profit growth in addition to revenue growth for the January-June period. To help give a flavour of current profitability dynamics, this subset of holdings posted revenue growth averaging +16% for the six-month period, with average profit growth lagging slightly behind at the (albeit still healthy) level of +14%. In recent investment views, we have discussed some 'Evenlode' characteristics that are helpful in an inflationary environment (including high gross margins, loyal customers, low product cost relative to customer expenditure, and asset-light economics). Though there is no perfect hedge against inflation, it has been reassuring to see this 'theory' translate into real-world operating performance over recent months.

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Investing through the cycle

Looking ahead, the global economy is experiencing a slowdown and, though most companies are continuing to trade well, company management teams are understandably cautious on the operating outlook. For the more economically sensitive businesses held in the portfolio, the key is being well equipped to weather any downturn and emerge in good shape. Several of these holdings (Howden, Page Group, Hays, Spectris, Rotork etc.) have seen share price weakness in 2022 as investors price in a global recession. We think this is providing interesting forward return potential for the long-term investor. More defensive, repeat-purchase holdings (which form the bulk of the portfolio) aren't completely immune from the vagaries of the economic cycle. They are, however, well placed to trade relatively resiliently through a slowdown, and for several of these companies (particularly in the consumer branded goods sector) there is also a silver lining to recent economic weakness, as commodity prices have begun to ease. Several management teams have noted this dynamic at recent results, with Unilever and Reckitt for instance noting that cost inflation is likely to peak before the end of the year.

New holdings

As discussed last month, we have seen a significant broadening out of the opportunity set, with some of the constituents of the Evenlode Income investable universe (great businesses not held in the portfolio for valuation reasons) experiencing a sharp valuation de-rating over recent months. Reflective of this trend, we have added five new companies to the portfolio in recent weeks. To finish this view, below is a brief synopsis of the four new holdings we added in June, which gives a sense of the high-quality and varied opportunities we are seeing.

Experian

Experian is one of the leading credit bureaus in North America and the UK, with a growing presence in emerging markets, particularly Brazil. Experian's data assets are incredibly difficult to replicate with credit histories and repayment data on 1.2 billion people and 145 million businesses. The core business serving banks with credit data and scores is highly cash generative, and it has significant growth potential as it expands the use cases for its data assets into new areas, such as employment verification for landlords and governments, and fraud detection for retailers. Experian is a resilient business which continued to grow through the 2008-2009 downturn, and has also performed very well over recent months despite a considerable slowdown in the US mortgage market, posting +8% organic revenue growth over the most recent quarter.

Diploma

Peter Lynch once noted that investing in ostensibly dull and mundane companies with forgettable names can be surprisingly enjoyable: Diploma is a good example of this point. Previously a strong performer in the Evenlode Income portfolio, we have reinitiated a position this year as its share price correction brought the forward return potential and dividend yield back to a more interesting level. Diploma is a niche, value-adding distributor of industrial products, with a portfolio ranging from electrical connectors to medical equipment to industrial valves. The company has market-leading positions selling these mission-critical products to its loyal business customers, whose spend with

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Diploma is a small percentage of their overall project spend. This creates attractive economics, including high gross margins and pricing power. Diploma has a strong track record of generating growth through both consistent organic investment and sensible bolt-on acquisitions. We think the long-term growth runway for Diploma remains very interesting.

LVMH

LVMH is the global leader in luxury, with a diversified portfolio of products (leather goods, jewellery, cosmetics, spirits) and brands (Louis Vuitton, Christian Dior, Bulgari, Hennessy). The business model is resilient, with product primarily manufactured in-house and distributed through its own physical and online retail outlets, while its brands are iconic, with most more than 100 years old. LVMH is growing strongly, with revenue increasing +21% in the first half of the year. The long-term outlook is promising with global wealth building and a growing number of newly affluent consumers in Asia and across emerging markets. The company posted healthy revenue and profit growth at recent interim results.

Games Workshop

Games Workshop provides fantasy miniature models and associated materials and content to its loyal and growing hobbyist customer base. The company was founded in the UK more than forty years ago, and through a relentless focus on organic growth, has grown to be the international leader in its niche market, with more than 70% of sales generated from outside the UK. The company has very interesting long-term growth potential, both from international expansion (particularly in Asia and the US) and by leveraging its unique intellectual property via partnerships with video game, TV and film production companies. We would recommend reading the company's annual report, one of the most enjoyable within the UK market. It gives a down-to-earth and honest account of developments at the company, as well as a very clear exposition of the long-term, consistent strategy. As management put it, *"...our ambitions remain clear - to make the best fantasy miniatures in the world, to engage and inspire our customers, and to sell our products globally at a profit. We intend to do this forever. Our decisions are focused on long-term success, not short-term gains."*

Diversified quality

The above four companies may seem like an eclectic group of business models, but they all share several attractive characteristics from an investment perspective: market-leading positions in their respective sectors, good growth potential over coming years, and cash generative economics. They also bring interesting diversification to the portfolio's cash flow stream.

Looking ahead, share price volatility remains high and we continue to monitor a broad variety of opportunities both within the existing portfolio and on the portfolio's watchlist. As always, we remain open to evolving the Evenlode Income portfolio gradually over time and look forward to updating you on any further portfolio developments over the coming weeks and months.

Hugh, Ben P, Chris M, and the Evenlode Team
31 July 2022

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Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 31 July 2022 and do not constitute investment advice.

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For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (<https://evenlodeinvestment.com>). Recent performance information is also shown on factsheets, also available on the website.

Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown in Pound Sterling, inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors.

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

ⁱ TB Evenlode Income B Inc class. Source: Evenlode, Financial Express, total return, bid-to-bid, GBP terms. Year to date figures are for the period 31 December 2021 to 31 July 2022.