

Evenlode Income Investment View

July 2023 – The well invested grow stronger

July was a positive month for global stock markets. Though concerns over persistent inflation and higher interest rates linger, recent disinflationary trends have helped the mood, as have reasonably reassuring corporate results and economic data.

So far this year, Evenlode Income has returned +6.7% compared to +4.5% for the IA UK All Companies sector and +5.3% for the FTSE All-Share Indexⁱ.

Results season

The second quarter results season is in full swing, with more than three quarters of Evenlode Income holdings updating the market since the start of July. These fresh updates, and subsequent conversations with management, provide an interesting bottom-up view across the global economy.

The backdrop is tough, but results have been reassuring. For Evenlode Income holdings releasing interim results thus far, organic revenue growth has averaged +9.3%, and operating profit growth has averaged +10.0%ⁱⁱ.

Some companies have seen a slowdown in demand (Hays, Page, Howden etc.) but the portfolio's bedrock of repeat-purchase holdings remains a source of resilient growth. Portfolio holdings also continue to cope well with input cost increases which are still, with a lag, working their way through the system. Most management teams are now seeing a vastly improved supply chain picture, with many of the Covid-related bottlenecks returning to a more normal situation. Input cost inflation is therefore beginning to moderate - a welcome trend, expected to continue into the second half of the year.

Short-term, long-term

Quarter-by-quarter results provide an interesting window on recent progress and resilience but, for the long-term investor, questions of longer-term health and sustainability are even more important.

There are many questions worth exploring from this longer-term perspective. How well-invested is the company? Are management continuing to invest steadily for the long-term? Are employees happy and motivated? Is the competitive position strengthening? Are relationships with customers improving and becoming more embedded? Do long-term growth prospects look healthy, even if short-term conditions are tough? And the list goes on.

Howden Joinery

These short-term versus long-term considerations are well illustrated by Howden Joinery Plc - we spoke with management following interim results in July.

Howden is quite unusual within the Evenlode Income portfolio as it is a predominately domestic-focused company (it has expanded into Ireland and France over the last few years, but the bulk of revenue and profit is still generated from the UK economy). Howden is the market-leader in the provision of kitchen and joinery products to trade-builders and has grown to more than 25% of the overall UK kitchen market.



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Well-invested

This dominant position has been driven by a culture of customer-focus and consistent investment, leading to steady, incremental market share gains over many years. Trade builders value the convenience of Howden's local depot networks and strong service levels very highly. Both builders and the end-consumer also value the company's wide range of quality, low-cost products.

Despite a tough backdrop, Howden has shown a continued commitment to invest over recent years, with a steady programme of depot refurbishments and openings, new state-of-the-art manufacturing and warehousing facilities, and consistent investment in digital capabilities. The company also has a cash generative business model and a strong net cash balance sheet. This financial health means significant investments can be made whilst the company also pays a healthy, sustainable dividend - shares currently offer a dividend yield of 2.8%, well supported by free cash flow. When balance sheet cash exceeds £250m after all investment and dividend needs (which it quite regularly has), the company also returns this excess to shareholders.

Howden has risks too, like any business. It is a relatively focused company (by geography and by category), economically sensitive, and the shares are less liquid than most held in the Evenlode Income portfolio. We reflect all this in a relatively low maximum position size (Howden currently represents about 2% of the portfolio).

Through the downturn

Like the UK economy, Howden has been facing challenges over the last eighteen months - market conditions have been tough as consumer incomes have been squeezed, and Howden has seen its performance slow. For the first six months of 2023, the company's sales grew at +1.5% and profit was impacted by a particularly high level of investment in the first half.

Markets may remain uncertain for some time. Thanks to its well-invested offering, though, the company has continued to strengthen its competitive position. As the saying goes, *the strong grow stronger* in a downturn. In 2022, UK kitchen market volumes fell approximately -8%, whereas Howden's volumes were flat. In the first half of 2023, market volumes were estimated to fall another -10% to -15%, but Howden's were down only -5%. These statistics are just a numeric way of noting that, on a relative basis, customers are voting with their feet and choosing Howden's offering over others.

Growth and investment

Looking ahead over the coming years, a combination of market recovery and growth, continuing share gains, and expansion into adjacent product lines and geographies provide opportunities for growth. The company's strategy is to harness these opportunities through continued investment. As management put it at recent results:

Our model is hard to replicate and difficult to compete with, and we have initiatives in place to make it more so in markets with significant longer-term growth opportunities for us. We continue to prioritise investments in the business on this basis.



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More generally, the Evenlode Income portfolio contains an interestingly diverse range of well-invested, market-leading companies. We think they offer an attractive combination of cash-backed dividends today and good potential for compounding free cash flow and dividend growth over time.

Hugh, Chris M., Ben P. and the Evenlode team

1 August 2023

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iTB Evenlode Income B Acc (GBP). 31 December 2022 to 31 July 2023. Source: Evenlode, Financial Express, total return, bid-to-bid, GBP terms.

iiSource: Evenlode, company results. Q2 2023 figures compared to Q2 2022 figures.

