

After a positive start to the year, markets gave back some of their gains in March. The rapidity of interest rate rises over recent months have steadily unveiled lurking fragilities in certain corners of global financial markets. The latest manifestation is a banking crisis. Originating in the US with a run on Silicon Valley Bank, worries spread as investors turned their eye to other weak banks, both in the US and further afield, culminating in an emergency weekend-takeover of Credit Suisse by UBS. Though the overall banking sector looks in considerably better health than it did during the 2008-9 crisis, worries remain that other weaker banks could potentially fail over coming weeks or months. Investors are also now concerned that the aftershocks from these events may have broader consequences for the real economy, as banks rein in their horns. On the flipside, these developments may, at the margin, ease global inflationary pressures - which provided a silver-lining for investors to consider.

From a performance perspective, risk management moved back into investor focus, with the share prices of financial companies (and more generally companies with high financial and economic leverage) leading global stock markets lower. During March, Evenlode Income rose +1.5% compared to a fall of -2.8% for the FTSE All-Share and -3.4% for the IA UK All Companies sector<sup>i</sup>. The market leadership, healthy bedrock of repeat-purchase cash generation, strong balance sheets and lack of exposure to banks within the Evenlode Income portfolio all helped relative performance.

So far this year, Evenlode Income has now risen +4.6%, compared to a rise of +3.1% for the FTSE All-Share and +2.6% for the IA UK All Companies sector<sup>ii</sup>.

### Company Results

Meanwhile, in the corporate world, full year results season is complete. For holdings reporting full year results to December 2022, organic revenue growth averaged +11% and earnings growth averaged +10% for the 12-month period<sup>iii</sup>. We think this represents a solid performance given the significant challenges that all companies faced during the year. In particular, Evenlode Income holdings have done a good job of coping with the extreme inflationary pressures of 2022: loyal customers, high gross margins, asset-light business models and strong balance sheets have all been helpful characteristics.

We will use the rest of this investment view to give some more detail and colour from companies within several of the portfolio's key sectors.

### Global Consumer Branded Goods (c27% of Portfolio: Unilever, Diageo, Reckitt, P&G, PepsiCo)

Of all the business models held within the portfolio, it was the consumer branded goods companies that faced the most significant input cost inflation in 2022, with cost-of-goods typically increasing by +15-20%. This was driven by the sharp rises in key commodities such as oil, resin and agricultural-based inputs, and represented a highly unusual situation - to find anything resembling an historical analogy in recent history you would need to travel back to the 1970s. These businesses have coped and adapted well. Customer loyalty has helped, with demand for essentials and little luxuries remaining robust in the face of higher prices. To give a flavour of this dynamic, the fund's five key consumer branded goods holdings reported average revenue growth of +9% at recent results. Prices rose +11% on average, and volumes fell -2%<sup>iv</sup>. Some companies expect pressure on volumes to increase



a little more in the first half of 2023 given cost-of-living pressures. As pricing continues to work through these business models over the next year or two and (all things being equal) input cost inflation moderates from recent extremes, margins are expected to recover.

### **Software and Data Analytics (c22% of Portfolio: RELX, Sage, Experian, LSE, Microsoft, Wolters Kluwer)**

Technology shares have, on the whole, been out of fashion over the last 18 months. Some companies, such as Microsoft, have seen growth slow (to +7% in the latest quarter) due both to tough year-on-year comparatives and customer caution on the economic outlook. Discussions with digital-orientated holdings though continue to highlight compelling opportunities, and growth rates for the most recent reported periods have by no means been shabby (RELX +9% underlying revenue growth, Sage +9%, Experian +6%, LSE +6%, Wolters Kluwer +7%). Erik Engstrom, RELX's chief executive, summed up the growth runway they are seeing at recent results: *'Across all market segments, the improving long-term growth trajectory is being driven by the ongoing shift in our business mix towards higher growth analytics and decision tools'*. And more specifically, when asked about the growth opportunities in the company's Science, Technical and Medical division: *'I don't see any end point or limit at which we would hit an end to this growth in the world of science'*.

In terms of cost inflation pressures, these digital companies have all coped well. Gross margins are helpfully high, and the main cost input for these asset-light businesses is people costs, which have been growing at a lower rate than raw material inflation (typically at a mid-single digit rate for most multinational companies). The embedded critical nature of the software these companies provide also leads to significant pricing power. At Sage's most recent market update, for instance, management highlighted price increases of +4-5% in 2023, similar to last year and helping to drive the expectation of strong overall revenue and profit growth for 2023.

### **Support Services (c17% of portfolio: Bunzl, Compass, SGS, Intertek, Hays, Page Group, Diploma)**

Business-to-business outsourcing is, like digitalisation, another entrenched growth theme. An increasing number of companies want to focus on their core operations and outsource ancillary services to specialists. This tends to lead to more agility, improved service levels and lower costs. Compass is a good example, with its new business pipeline for first-time food catering outsourcing running at an all-time high. Net new business growth is currently adding +5.5% to annual revenue growth, significantly above the historical rate of approximately +3%. This is how Compass management summed up the opportunity at recent results: *'We remain excited about the significant structural growth opportunities globally and the continued strong levels of outsourcing. The combination of an increasingly complex operating environment and trends that includes sustainability and digitalization, as well as our market-leading offer, mean we're best placed to capture these opportunities'*.

Specialist recruitment holdings PageGroup and Hays are also benefiting as contract and temporary placements increase in popularity for both businesses and employees, whilst an increasing number of jobs across the world get placed through specialist recruiters rather than in-house HR departments. Hays, for instance, are seeing a very significant opportunity in Germany as the contractor model



grows in popularity (both for employees and employers) in areas such as engineering and software development. As Hays management put it at recent interim results, ‘...*there are simply decades of structural opportunities ahead and as the far and away leader in Germany, we have so many options to grow*’.

For most support services companies, higher inflation has been a net benefit to both revenue and profits for these businesses. Bunzl, for instance (a specialist distributor of not-for-resale goods) benefits from an ad valorem business model in which any increase in each van’s drop-value leads to higher revenue. Bunzl’s underlying revenue grew +10% in 2022, operating profit grew at a higher rate, and the dividend was increased for a 30<sup>th</sup> consecutive year.

### **Engineering (c8% of Portfolio: Smiths Group, Spectris, Halma, Rotork)**

The engineering holdings in the fund sell mission-critical components with significant pricing power. The bigger challenge last year was a shortage in key components, especially electronic components. This resulted in unfulfilled demand, and order books grew faster than revenue. As supply chain issues have started to ease, order book growth is now translating to revenue growth. Smiths Group, for instance, released interim results last week with organic revenue growth of +14% and profit growth of +27%.

Though the economic outlook casts some short-term uncertainty on the engineering sector, the structural growth potential is striking. The global industrial system needs re-equipping over the next decade or two, in order to address both energy security and decarbonisation: projects such as LNG infrastructure, green hydrogen, green steel, nuclear, carbon capture and methane emissions reduction are all being prioritised, and legislation such as the Inflation Reduction Act in the US is accelerating demand. Companies with market-leading products that sell into these end markets look well placed to benefit. As Smiths Group noted in conversation with us this week, orders from a green steel project in Northern Sweden will alone add 1.5% to annual group revenue (steel is currently responsible for about 8% of carbon emissions globally). Rotork and Spectris are also well placed to benefit. Spectris enjoys a market-leading positions in battery and electric motor testing, and Rotork’s mission-critical actuators and controls address end markets such as carbon capture, methane emissions reduction, hydrogen and nuclear.

### **Resilience and Growth**

In summary, the outlook is no less uncertain than normal. But we remain encouraged by the resilience and growth opportunities that we see across the portfolio, as highlighted by the examples above. Valuations also remain modest, with the fund’s 2.7% dividend yield well covered by a free cash flow yield of more than 5%<sup>vi</sup>.

Hugh, Ben, Chris M, Rob and the Evenlode team

31 March 2023



# Evenlode Income Investment View

## March 2023 – Results round-up

Please note, these views represent the opinions of the Evenlode Team as of 31 March 2023 and do not constitute investment advice. Where opinions are expressed, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice. This document is not intended as a recommendation to invest in any particular asset class, security or strategy. The information provided is for illustrative purposes only and should not be relied upon as a recommendation to buy or sell securities. 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 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. Current forecasts provided for transparency purposes, are subject to change and are not guaranteed. Source: Evenlode Investment Management Limited, authorised and regulated by the Financial Conduct Authority, No. 767844.

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<sup>i</sup>TB Evenlode Income B (Acc). 28 February 2023 to 31 March 2023. Source: Evenlode, Financial Express, total return, bid-to-bid, GBP terms.

<sup>ii</sup>TB Evenlode Income B (Acc). 31 December 2022 to 31 March 2023. Source: Evenlode, Financial Express, total return, bid-to-bid, GBP terms.

<sup>iii</sup>Source, Evenlode, company results. Unweighted average using constant currency organic revenue and EBIT growth.

<sup>iv</sup>Source, Evenlode, company results. Unweighted average using constant currency organic revenue and EBIT growth.

<sup>v</sup>Source: RELX 2022 Results. Also interesting to note are RELX's comments on ChatGPT: 'RELX is a big user of AI technology and has been for many years. Generative AI and the technologies behind ChatGPT are the next step on this journey. And it's steps like this that have enabled us to grow and develop in the way that we have developed. But it's only one step of many. There'll be many more to come. And we're very excited about it'. 'AI' is an imprecise term that tends to get used to describe whatever the most cutting-edge algorithm is at any point in time – chess computers were described as artificial intelligence back in the 1960s, for instance. But for data analytics companies such as RELX, what matters is having excellent proprietary data and then combining this data with analytics services that add an increasingly high level of value to their loyal, embedded userbase.

<sup>vi</sup>Source: Evenlode. Free Cash Flow Yield based on FactSet estimates for current financial year. Dividend yield is historic yield as at 31 March 2023 (B Inc), based on distributions in previous 12 months.

