

# Evenlode Investment View

October 2021 – Consumer Brands

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The UK stock market has been range-bound in October, eking out a small gain thus far. As I write, the Evenlode Income fund has risen +10.8% since the start of the year compared to a rise of +15.0% for the FTSE All-Share.<sup>i</sup>

Though Covid cases have been rising again in the UK, the situation continues to improve in most parts of the world. Meanwhile, huge levels of pandemic-related monetary and fiscal stimulus have been helping the global economic recovery. Several economic concerns have, however, emerged. Energy prices have risen sharply, which will act as a tax on the global economy over coming months. More generally, the rapidity of the rebound in demand from the Covid downturn has caught global supply chains on-the-hop, leading to bottlenecks and input cost pressures across a range of goods. Meanwhile, pandemic-related fiscal stimulus programmes are beginning to wind down as furlough arrangements come to an end, and monetary conditions are also beginning to tighten.

## Results Season

The third quarter results season is in full swing, with more than two thirds of the Evenlode Income portfolio having released updates so far this month. Operational progress has been reassuring, with the recovery from the pandemic continuing to progress well. We have been particularly impressed with the adaptability that our portfolio holdings are demonstrating in dealing with the recent issues with 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 the portfolio's underlying companies enjoy are all helpful when trading through such a volatile period.

## Consumer Brands

Next month I will give a more detailed round-up on the wider portfolio's progress, but this month I would like to briefly discuss Evenlode Income's consumer branded goods holdings. These companies have seen their share prices lag the broader market in 2021: partly because they have been deemed too boring for Mr Market so far this year, with investors more interested in other sectors with a higher gearing to both the recent economic recovery and rising commodity prices. The share prices of these companies have also lagged because investors have worried about the impact of rising input costs on near-term profitability.

Evenlode Income's main holdings in the sector are Diageo, Pepsi, P & G, Reckitt and Unilever. These market-leading, globally diversified, resilient companies make up approximately 28% of the portfolio.

I discussed Reckitt in last month's investment view. Management confirmed their confidence in managing recent price dynamics at their investor day at the end of last month, and have also increased full year 2021 revenue guidance in an encouraging trading update this month.

Below I discuss how the other four companies mentioned above are navigating the current environment.

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## Diageo

Diageo is well placed to deal with input cost inflation, thanks to its global leadership in the spirits category and its highly profitable, cash generative business model. As management put it in their recent trading update, *we are confident in our ability to take inflation in our stride whilst continuing to support our brands*. Brand loyalty has always been particularly strong in the drinks sector, with private-label alternatives to Johnnie Walker, Tanqueray, Guinness etc. remaining a very small part of the global market. The 'premiumisation' trend is also helpful from a pricing perspective, as consumers focus on higher-value, quality drinks, a trend that if anything has accelerated through the pandemic.

Diageo expects to grow revenue in the mid-single digits in the current financial year whilst also expanding operating margins at a good rate. Looking further ahead, Diageo's impossible to replicate portfolio of global brands enjoys compelling growth potential. The shares currently offer a 2.1% dividend yield<sup>ii</sup> and Diageo increased its dividend by +4% at the latest results, the 20<sup>th</sup> consecutive annual increase.

## PepsiCo

PepsiCo is a global market leader in both the global savoury snacks and soft drinks categories, with brands ranging from Lays, Walker Crisps, Quaker Oats, Lipton Ice Tea, Pepsi and 7Up. The company noted they had increased prices across their portfolio by +4% on average over the third quarter with little impact on consumer demand (revenue growth for the quarter was +9%). As with Diageo, PepsiCo are helped by the strength of brand loyalty in both the drinks and snacks category, with private-label representing a small portion of these categories, and purchases often unplanned and made on-the-go.

Thanks to this encouraging dynamic, the company expects to grow revenues by at least +8% and earnings by at least +11% for 2021 as a whole, therefore more than dealing with the recent rise in input costs they have seen. PepsiCo's dividend yield is currently 2.7%, and the company's latest dividend increase of +5% represents the 49<sup>th</sup> annual increase.

## P & G

P & G's portfolio (think Pampers, Gillette, Fairy, Olay etc.) is in good shape and, as with PepsiCo, management noted at recent results that consumer demand has held up very well in the recent pricing environment. There can be a lag getting prices through with some retailers, particularly in Continental Europe, whereas price increases tend to be taken in smaller, more regular increments in emerging markets. Notwithstanding some timing lag, the company expect to grow sales for the current financial year by between +2% and +4% (compared to very strong 2020 pandemic sales) and also expand margins, leading to earnings growth of between +3% and +6%.

P & G's dividend yield is currently 2.5%. The most recent increase of +7% was the 65<sup>th</sup> consecutive dividend increase.

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## Unilever

Evenlode Income's holding in Unilever has been the most negative contributor to the fund's return so far in 2021, with the company's share price falling -7% year-to-date. This month, Unilever reported year-to-date revenue growth of +4.4% and reiterated guidance for 2021 as a whole: to grow revenue within the long-term guidance range of +3% to 5%, with a broadly unchanged year-on-year profit margin. The company took pricing of +4% on average across its portfolio during the third quarter and, as with P & G, will continue to take measures over coming months.

The following quote from management gives a good sense of the ability of a company with Unilever's scale and experience to manage its way through volatile periods such as those of the last few months: *Supply chain disruption seems to be in the news daily, and we expect to be managing this for the balance of this year into at least the first half of next year... but Unilever manages this type of volatility well and our supply chain has again shown the necessary resilience to keep our on-shelf availability, the ultimate measure, at strong levels. Across our top 10 markets, on-shelf availability has been over 96% during the period, which is actually...an improvement on the same period in 2020.*

Looking further ahead, Unilever enjoys a strong global brand portfolio, with more than 80% of sales coming from brands that are number one or two in their markets, and management is taking steps to increasingly focus its portfolio on its strongest, highest growth brands. The company has a particularly healthy position in emerging markets, which in aggregate now account for more than 60% of profit. The company has been operating in many of these regions, such as India, Brazil and Indonesia, since the 1930s or earlier. During the pandemic, this emerging market exposure hasn't helped Unilever's relative performance versus some of its more US-biased peers, as US individuals have enjoyed more government support, deeper pockets, bigger cupboards, and faster-to-market vaccination programmes than people in other parts of the world. But over the next decade or two, Unilever's embedded presence in emerging markets is a rare and valuable thing.

Unilever's dividend yield is currently 3.8%, and the company has a long track record of growing earnings and dividends above the rate of inflation.

## Real Assets for The Long Haul

As discussed in last month's investment view, nobody quite knows what will happen to inflation from here. But we continue to think that good quality companies, with loyal customers and pricing power, are an attractive home for investors keen to protect the purchasing power of their savings over the long haul.

As the four companies mentioned above highlight, many quality companies also offer an interesting combination of dividend yield and real dividend growth prospects in today's stock market.

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## Twelfth Anniversary

Before signing off I would like to mention that the Evenlode Income fund was launched on 19th October 2009 and therefore had its twelfth anniversary this month. Over the last twelve years, the compound total return per annum after fees has been +11.4% p.a. for Evenlode compared to +7.2% p.a. for the FTSE All-Share.<sup>iii</sup>

These returns have been produced by investing in market-leading, asset-light companies, by taking a long-term view, and carefully managing fundamental and valuation risk along the way. We strongly believe this approach works well over time, but it also means the composition of the Evenlode Income portfolio looks quite different to the UK stock market. The fund's performance will often, therefore, fall in and out of fashion over shorter time periods as market trends wax and wane: something we have always been keen for our clients to understand.

Evenlode is an independent, employee-owned company based in a converted barn in the West Oxfordshire countryside with an ownership structure deliberately designed for the long-term. Our investment team of 15 takes a collegiate approach to managing Evenlode's three strategies: Evenlode Income, Evenlode Global Income and Evenlode Global Equity, which all share the same core investment process. We aim to provide a consistent, high-quality service: following Evenlode's long-term investment process, building good relationships with our co-investors, and communicating clearly along the way.

In short, we are here for the long haul, and we look forward to updating you on progress over the coming months and years.

## Hugh and the Evenlode team

26<sup>th</sup> October 2021

*Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 26<sup>th</sup> October 2021 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.*

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October 2021 – Consumer Brands

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

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<sup>i</sup> Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2020 to 22/10/2021. TB Evenlode Income B Inc.

<sup>ii</sup> Source: Evenlode, Factset, FY1 (for all dividend yields quoted in this piece)

<sup>iii</sup> Source: Evenlode, Financial Express, 19/10/2009 to 22/10/2021.