

Evenlode Investment View

September 2020 – Change, Adaption and Long-Term Growth



Following a very strong recovery in April and May from the lows of March, the UK stock market has drifted back a little over the summer months.

The market backdrop remains complex. Coronavirus cases have risen again, particularly in Europe, with further lockdown measures being reintroduced in several geographies, including the UK. This casts a shadow on the economic outlook, particularly for those consumer service sectors that have been at the front-line of this crisis since March (retail, hospitality, travel etc.). Meanwhile, the US election approaches, and trade tensions - between the US and China, but also in relation to Brexit - rumble on. More positively, global monetary and fiscal stimulus remains extremely accommodative, Covid vaccine programmes are progressing, and several segments of the global economy and stock market are quite well insulated from current conditions (in particular digital, healthcare and fast-moving consumer goods companies).

As I write, Evenlode Income has fallen -8.9% since the start of the year, compared to a fall of -19.8% for the FTSE All-Shareⁱ.

Weathering the Storm

As we often say at Evenlode, our aim at all times is to insulate investors as best as we can from a wide range of future outcomes, and whatever these outcomes may bring. Possible developments over the next few months and years include a big second Covid wave, a speedy mobilisation of vaccines and resolution to the crisis, prolonged recessionary conditions, a strong recovery, deflation, inflation and a difficult or smooth Brexit.

Insulation from these unknowns can't ever, of course, be perfect. But our aim is to ensure that the Evenlode Income portfolio retains several key qualities. In particular, we feel positive about its following featuresⁱⁱ:

- 🌱 A collection of market-leading companies with attractive long-term growth potential, healthy levels of cash generation and strong balance sheets.
- 🌱 A bedrock of repeat-purchase business models, which produce the majority of this cash flow.
- 🌱 For those companies most affected by the crisis, strong competitive and financial positions that should help them emerge in good shape.
- 🌱 Good diversification by geography and product category.

These characteristics take nothing away from the challenges that the world currently faces, but we do think they should be kept at the forefront of the long-term, patient investor's mind.

Themes to Outlast the Crisis

In the July investment view, I discussed four key corporate themes that have emerged or accelerated as a result of the crisis, and are also likely to outlast it:

- 🌱 A greater focus on hygiene and healthcare.

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- ♣ Accelerating digitalisation.
- ♣ Financial, operational and supply chain resilience.
- ♣ Sustainability and multi-stakeholder capitalism.

Recent meetings with companies confirm that these themes remain at the forefront of management teams' minds. We spoke, for instance, to specialist recruiter Hays earlier this month. Management noted that fees from technology recruitment were incredibly resilient over the first half of 2020, in the context of an overall recruitment market that saw significant Covid-related weakness. This sector now accounts for more than 25% of the company's overall fees, and technology recruitment is expected to grow to more than 30% of fees over the medium-term. This statistic demonstrates just how keen companies are to ensure their technology teams are as well resourced as possible, in order to provide the resilience and flexibility that they crave.

New Ways of Working

A fifth interesting theme to have emerged over recent months is the shift to a more permanent pattern of remote working, and the potential longer-term legacy this will leave on the global economy.

The message from management teams is quite consistent: the office is by no means 'dead' but an element of home working will continue, and the main purpose of the office space will increasingly shift towards employee collaboration, culture-building and training. As one chief executive put it to us, *people used to go to the office to work, and leave the office for team-building: now people will go to the office to team-build, and do their work at home*. This change comes with some complexities. Whilst an element of home-working can be incorporated successfully for many job roles, it won't be desirable for every company or every individual: the extent of home working will therefore need to be managed carefully. Offices will also need to be re-jigged, and in some cases consolidated (a process which has already begun). However, the message from almost every company we have talked to is that increased remote-working can be assimilated effectively, and staff surveys suggest that most employees have a preference for this hybrid model, even when the current crisis has dissipated.

Covid has also changed the way companies are thinking about marketing, sales and corporate travel. Many have seen a big drop in their travel and expenses costs this year, for obvious reasons. Having found increased digital interaction with customers effective, some of these changes may become permanent. Specialist engineers Rotork and Spectris have been able to use digital methods of communication to help their customers install and service products during lockdown, rather than always visiting their facilities (which are often in very remote locations). New product demonstrations have also moved online, which has in most cases worked quite well. Spectris are seeing increased participation from customers and have found it easier to reach key decision-makers.

In summary, the last few months has created some big cultural shifts in working trends, some of which will outlast the current crisis. These trends are creating challenges for companies and forcing them to adapt. But they are also creating opportunities for retaining happier, more productive staff, and for introducing more effective interactions with customers.

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This flexible-working example illustrates a broader point. The best companies have a habit of consistently adapting to what is thrown at them over the years, as economic, cultural (and epidemiological) trends continue to morph and evolve.

Even when, as an investor, one goes through periods of making few changes to a portfolio, under the surface there are millions of people (employees of the companies held in one's portfolio) getting up every morning and reacting to a changing world. This is not something that the short-term investor cares much about, but it matters for the long-term investor. I think, for instance, of the efforts digital businesses such as Relx, Sage and Microsoft are making to accelerate innovation of their digital products, the progress that companies such as P & G, Unilever and Bunnings are making on sustainable packaging and products, or the steady progress AstraZeneca and Roche have made to build their innovation pipelines over the last few years.

The recent crisis has thrown much at the companies in the Evenlode Income portfolio and no one knows, as usual, quite what the next few months will bring. We are, however, reassured with how they have coped, and feel positive on the aggregate portfolio's ability to adapt, invest and grow over the coming years.

Hugh and the Evenlode team
23rd September 2020

Please note, these views represent the opinions of Hugh Yarrow as at 23rd September 2020 and do not constitute investment advice.

ⁱ Source: Evenlode, Financial Express. TB Evenlode Income B Inc shares. All figures total return, bid-to-bid, GBP terms - 31/12/2019 to 23/09/2020. Past performance is not a reliable indicator of future performance.

ⁱⁱ Evenlode Income Portfolio: FCF (free cash flow) yield: FY1=4.3%, FY2 =5.4%. Net debt to EBITDA (earnings before interest, tax, depreciation and amortisation): FY1 =1.13x, FY2 = 0.91x. Underlying geographic revenue exposure: UK = 15%, Europe = 19%, Asia Pacific = 21%, Middle East and Africa 6%, Latin America 6%, North America = 33% (Source: Evenlode, Factset, 23rd September 2020).