# Evenlode Investment View

## November 2018 - Customer-Led Growth Strategies

EVENLODE
INVESTMENTS FOR LIFE

*'Not everything that can be counted counts, and not everything that counts can be counted'*

William Bruce Cameron

After a weak October, global stock markets have stabilised somewhat, but volatility has remained high thanks to plenty of economic and political crosscurrents. Worries over trade tariffs and a slowdown in the global economy continue, commodity prices have fallen, and (of more provincial concern) Brexit rumbles on in the background for UK investors. On the other hand, expectations for US interest rate rises have reduced a little, many emerging market currencies have staged a recovery since their late summer lows, and investors were relieved that the US mid-term elections passed with no big surprises.

Results updates from companies have been trickling in during November for the Evenlode Income portfolio. We have been encouraged by the reassuring progress made, particularly in regard to healthy free cash flow generation from a wide range of companies including Smith & Nephew, Compass Group, Howden Joinery, Informa, Burberry, Aveva, Sage, Euromoney, Spectris and Cisco.

Having traced a fairly erratic course during 2018, the FTSE All-Share's year-to-date return now stands at -5.2% compared to a return of +5.5% for the Evenlode Income fund*.

**The Unavoidable 'B' Word**

It has become a tired topic for many, but an update on the UK's attempts to extricate itself from the European Union feels appropriate at this juncture. The risks have been comprehensively reported on, and a general lack of clarity is creating some nervousness in the British business and investment community. In the context of this current situation, I think it is worth making two observations that are of relevance to investors in the Evenlode Income fund:

- We have added companies such as Page Group, Moneysupermarket, Howden Joinery, Hays, Savills, and Schroders to the portfolio in the last two years where depressed sentiment (caused at least in part by post-referendum uncertainty) has allowed us to initiate positions in high quality, market-leading businesses at attractive valuations.** All the above companies have net-cash balance sheets, consistently generate free cash flow and in our view have good prospects over the longer-term. We remain open to making further gradual changes to the portfolio if more opportunities emerge from Brexit-related uncertainty, as long as doing so makes sense in the overall context of the portfolio's diversification and risk profile.

- Although the Evenlode Income portfolio always has at least 80% of the fund in UK-listed stocks, it is globally diversified, with less than 20% of the portfolio's revenues currently derived from the UK economy. The balance of revenues comes from a broad spread of countries around the world. This clearly provides some insulation from a 'hard Brexit' scenario, in which these overseas earnings would become more valuable to the British investor if the pound depreciated. Furthermore, most of the UK multinationals we follow tend to have a relatively small percentage of manufacturing capacity in Britain, with supply chains that are relatively well hedged (i.e. production locations tend to approximately match the global sales footprint). For most of the companies we have spoken to over recent weeks, the impact of already-enacted US/China trade tariffs are – though manageable - of more significance than the risk posed by potential changes to trade agreements between the UK and other countries.

**Customer-Led Growth Strategies**

Though we have discussed Brexit with many companies over recent weeks, we have spent far more time discussing other business matters.

We have had some interesting discussions about long-term strategy, and in particular how companies are looking to build their relationships with customers. In my view this basic relationship between a business and a customer is one of the very most important factors to consider for long-term shareholders. Here are three examples from results this month:

**1) Aveva**
**Looking For More Ways To Be Helpful**

Aveva is a global market leader in engineering and industrial software. We reduced the fund's position in the company over the summer for dividend yield and valuation considerations, but continue to very much like Aveva's competitive position and long-term opportunities for growth. Recent results were a reminder of these attributes with revenue growth +11%, earnings growth of +54% and strong cash generation.

We are particularly impressed with the company's opportunities to create new products in markets adjacent to their core products, and in doing so expanding their relationship with existing customers. They are, for instance, using existing software products to collect data from industrial facilities which can then be used to help make better decisions. As management put it at results last week:

*[Our products] quickly snap onto the data streams coming out of an industrial environment. That includes both real-time and historical data from wide swaths of disparate end points. The data is then collected either on-premise or on the cloud, where machine learning and analytics are applied to detect unplanned downtime before it occurs.*

Saving downtime costs and improving efficiency at expensive industrial facilities such as power plants and oil refinieries is a very helpful service for Aveva's engineering clients, which has not been available to them in the past in this form. Given the cost savings available it is something they are prepared to pay a good price for, as the return on investment is typically well worth the outlay (in some examples, running costs and plant efficiency can be improved by 20% or more). This strategy is therefore a win-win for Aveva: customers are happy, loyalty increases, and Aveva's addressable market expands.

**2) Euromoney:**
**Embedded in the Work-Flow**

Business-to-business media company Euromoney has built a strong position in the provision of niche information and decision analytics to its business customers. Euromoney enjoys a large element of subscriptions which represent 56% of the company's revenue, and renewal rates are high. However, Euromoney point out that, whilst subscription revenues are great to have , of even more importance is both how embedded your products or services become in customer's day-to-day activities, and how valuable they are to your customer (whether they are paid for by subscription or not). Euromoney's strategic thrust is therefore on ensuring that their portfolio is well-placed in this regard.

The company's recently acquired Random Lengths brand is a good example. Random Lengths is the market leader in the provision of information to the wood products industry (i.e. quite a niche hidden champion!) This includes the provision of pricing indices for a range of timber products that are widely used by foresty products companies, and buyers of wood and cardboard products such as Starbucks and Amazon. These companies embed Random Lengths indices into their day-to-day contracts (and pay a small licence fee each time they are used) because it gives both sides clarity and transparency on fair prices. Euromoney enjoys market-leading positions in several other niche pricing markets with similarly attractive characteristics.

**3) Sage:**
**Start with Existing Customers**

Sage's share price has had a difficult time in 2018. The company reduced its sales guidance earlier in the year, which was then followed by the departure of the company's chief executive in August. As discussed in previous investment views, we acknowledge current challenges but continue to think there is much to like about Sage's business model and the growing global market it operates in. Last week, the company announced reassuring full year results. Thanks to the company's embedded relationships with existing customers renewal rates remain strong on Sage's software, organic revenue grew by +6.6%, and the company continues to generate high and stable levels of free cash flow.

Over coming years, Sage needs to make sure it doesn't take its customer base for granted, and new management laid out a customer-first approach at results last week. This new strategy is not revolutionary but is rather a subtle, and in my view, encouraging shift in tone. It is simple stuff - making sure feedback is taken seriously, investing in systems to improve customer data, investing in staff training, overhauling staff incentives and - crucially - making significant investments in innovation to ensure the Sage customer experience is as enjoyable as possible, both in terms of the functionality and user-friendliness of existing software, but also the ease of migration between Sage's different offerings as customer's requirements and preferences change. As new management point out, the value of keeping existing customers happy is extremely powerful. Firstly, they are happy to stay with you, and customer retention is very valuable in the software industry as the cost of acquiring a new customer will often represent one or two years of subscription value. Secondly, they will be more likely to use more of your services over time, which not only generates growth but helps deepen the customer relationship. Thirdly, they become advocates of the brand, which is the one of the most effective and cheapest ways of recruiting new customers. Sage has plenty to do over the next few years, which will involve some extra investment and some execution risk along the way. However, in my view, management's subtle shift in emphasis and the planned investments are sensible steps to take in the interests of both customers and long-term shareholders.

To conclude, customers matter. It sounds obvious, but sometimes gets forgotten in the hamster-wheel of quarterly earnings and the day-to-day newsflow that economic and political developments have a habit of producing. Companies that listen to customers, keep them happy, look for new ways to make their lives easier and thereby deepen relationships over time, will tend to be enjoyable to own for the patient investor.

**Hugh and the Evenlode Team**
**29th November 2018**

*Please note, these views represent the opinions of Hugh Yarrow as at 29th November 2018 and do not constitute investment advice.*

*Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2017 to 29/11/2019.

**Interestingly, though two of these (Howden and Moneysupermarket) are primarily UK domestic businesses, the others are global businesses with a good proportion of earnings coming from overseas, but where the element of UK exposure has not been helpful for sentiment. We find this quite an interesting situation. Take Hays and Page Group, for instance, which are often thought of as being quite 'UK-biased' companies and have been somewhat tarnished by Mr Market's 'Brexit brush'. Whilst they do enjoy a strong market position in the UK, they are market leaders globally now in the specialist recruitment market, thanks to international expansion over the years. They enjoy compelling opportunities for long-term structural growth in newer geographies, and the UK now represents less than 25% of revenue for both companies.