

The commentary below applies to the TB Evenlode Global Income portfolio. Market data is from FactSet and FE Analytics.

In last month's view we focused on the fast-moving consumer goods part of the portfolio, which despite operational challenges, has recently been something of a bright spot from both business resilience and market performance perspectives. With the most recent company updates consumer-facing businesses have continued to shine through their first quarter results; luxury goods juggernaut LVMH and cosmetics colossus L'Oréal have both posted strong revenue growth. Advertising agencies Publicis and Omnicom have reflected this continued buoyancy in their own results. In the business-to-business world data, analytics and risk management systems firm RELX confirmed continued growth across its operating divisions, including 'strong' growth in its risk segment driven by tools to help fight fraud and financial crime.

It is pleasing that these companies are performing well and seeing strong demand from their clients, and therefore benefitting our clients whose capital we invest in the corporations' stock. It speaks to the value proposition presented by their goods and services. We know, however, that things don't always go quite right, challenges come along and resilience and ability to adapt are always key. RELX's exhibitions business and LVMH's store portfolio were fundamentally challenged by covid lockdown restrictions for example. Publicis has fundamentally shifted its business model to focus on digital marketing and consultancy, a process that has taken many years, much merger and acquisition activity and a share price that at one point never seemed to rise. Only recently have the benefits of its corporate evolution made themselves clear.

For the rest of this investment view, we have selected three businesses from the portfolio where we see positive long-term prospects, but where there are current challenges. We hope readers will gain a sense of how we approach analysing companies in general, and how we manage risks and new information as it arises. This is particularly important when negative events occur but should not be forgotten when conditions are more benign.

Henkel

Henkel is a German multinational adhesives and consumer goods business, producing many brands that will be familiar including Loctite glue, Schwarzkopf hair care products, and Persil & Sun in laundry and washing.

Full-year results for 2022 tracked our expectations, with 8% group revenue growth. Underlying this though was a volume decline of 9% in the final quarter of the year. In part that is due to portfolio activity that has been ongoing for a while; in January 2022, Henkel announced a two-phase 'portfolio optimisation plan', within which they seek to merge the Beauty Care and Laundry & Home Care business units to create an integrated Consumer brands division to benefit from marketing, supply, and innovation synergies. Many larger consumer goods peers, such as Unilever, have recently gone the opposite route, breaking out divisions into distinct business units, but for the smaller consumer franchise at Henkel the consolidation makes more sense. Phase 1, the organisational setup of the integrated Consumer brands unit and disposal of low margin businesses is now live. Phase 2 is supply



optimisation, which involves improving efficiency of the in-house production setup and optimising the network of contract manufacturers has just started. This, alongside exposure to commodity cost inflation, volume deleverage, and retailer stocking has led to a challenging trading environment in the consumer business, and 2023 could see a continuation of these themes.

Following the full year results, the team met with the CEO Carsten Knobel in London. The CEO is very hands-on, specifically with the consumer portfolio overhaul, and highlighted the group's long-term scale to support growth alongside margin improvements as the new organisational structure beds in and, potentially, input cost inflation reduces. Following the results and meeting, the team believes that the longer-term prospects for the group are positive, without ignoring some of the challenges that have had to be grappled with. Away from the consumer-facing franchise Henkel are the clear global market leader in industrial adhesives. This is not just ordinary glue; most products are high performance, customised and technically complex. The business is in a unique position to benefit from positive trends around lighter yet stronger materials, energy efficiency and electrification. Add to this a conservative balance sheet, good opportunities for R&D innovation, the leaner portfolio of higher quality consumer products in a more efficient structure, and the result is a differentiated business set up well for the future.

adidas

adidas is a global sportswear company synonymous, in case you're in need of an introduction, with the brand's 'three stripes.' This iconic brand is the core of adidas' competitive advantage, supported by marketing and product development.

Recent years have been challenging for the company. The COVID pandemic shut down global retail before a boom in goods spending hit 'just-in-time' supply chains like a train. This extended lead times dramatically and resulted in over-ordering and excess inventories, which the industry is currently dealing with through discounting. In 2022, Ye's (previously known as Kanye West) inappropriate conduct and subsequent public backlash sunk adidas' profitable Yeezy sneaker franchise and Bjorn Gulden, from Puma, has now been appointed as CEO, bringing a different take on the firm's strategy. Add in severe cost inflation and a sudden zero-COVID lockdown in China and the overall outcome has been a tumultuous period for adidas' financial performance. For 2023, expectations are that the company will be around break-even. The period has also been tumultuous for the share price. From its pre-COVID high in January 2020 to the low in November 2022, the share price declined by approximately 70%.

The impact on the portfolio has been less damaging than that thanks to our risk management framework, maximum position sizing and valuation discipline. We initiated our position in March 2022 after the share price weakness had improved the valuation appeal, based on our long-term model. Given the external factors that have occurred, the contribution to the portfolio in the short-term has not been, it's fair to say, as we'd hoped. It remains a position in the fund because our priority is forward-looking analysis of fundamental risks, while being able to manage short-term volatility. adidas' core qualities remain and after our meeting with the new CEO and CFO we are comfortable that their



strategy makes sense. This meeting came after the full year results analysis, where we assessed our risk scores and maximum position size and meant we could approach the meeting with a clear set of questions that we wanted answering in order to confirm that our scoring was appropriate.

Looking to the immediate future, Bjorn is using 2023 to reset. Two key factors for the short-term are cash flow and debt. For cash flow, the dividend and inventory reduction will help to offset the expected profit decline. As an income fund, it is perhaps counterintuitive that we would be happy with a -79% dividend reduction, but given the disruption adidas has experienced, we would rather they invest for the long-term to secure good dividend growth in future years.

adidas represents the most acute example of near-term challenge within the portfolio. As well as looking at the risks faced by businesses individually, we also assess the aggregate risk profile of the portfolio. Within the context of a portfolio where the vast majority of holdings are performing fundamentally well, there is room for a small holding (<2% of the portfolio) such as this.

John Wiley

Although March is dominated by the flurry of full year results from companies who have December year ends, there are also a few that are part way through their reporting years. One of those is John Wiley, who reported their third quarter results in the second week of March. John Wiley are a US-based publisher of journals and books. The market within which they operate is mature and has also undergone some significant structural changes with the introduction of Open Access (OA). Open Access is a way of removing some of the barriers to published research by making the research findings more readily available to everyone. Through the Wiley model the author pays an Article Publication Charge (APC), and the article becomes freely available online for all to read. Although Wiley is the third largest journal publisher – the largest is another one of the TB Evenlode Global Income holdings RELX, with their publishing arm Elsevier – it is the lead publisher of several society-owned journals. This segment has now implemented an OA hybrid approach with almost all its major society journals and is an increasingly important string to the bow.

In terms of the way publishing in a journal usually works, a scientist will first identify a specific journal that they want to publish their research in. They will usually locate the correct journal as per the topic or theme of their research and then the scientist will write their manuscript for it to be submitted and reviewed before it finally goes onto be published. A very important part of this process is the peer-review system, which is a means of getting feedback from others in the field and helps provide validity to the quality of the research before it gets accepted for publication.

This provides background for the most recent quarter, which saw the pausing of a special issues programme as a result of the peer-review system becoming potentially compromised. The issue itself was related to a part of John Wiley's business known as Hindawi, a company they acquired in 2021 and operating in a high growth area for the group. John Wiley was not the only company affected by the issues; others in the market also felt the effects of some bad actors within the system. The company has put in positive steps to identify those misusing the system and introduced extra precautionary measures to prevent issues like this occurring again. Although a pain point for a portion of revenues



in the short-term, Wiley is confident that the improvements in oversight will help protect the integrity of these journals for the foreseeable, vital for trust in the system to be maintained.

As a result, we continue to believe that the company meets the Evenlode definition of quality. With a strong moat built on brand and a two-sided network effect helping create a base for over half of revenues to be recurring, we remain confident that Wiley will continue to be cash generative over the long term. Further, it is momentary short-term issues like these that can present the opportunity to us, for topping up our position in the company.

Painting a picture, staying invested

By painting a full and honest picture of a company within our investment process we can choose whether to stay invested in a company. We understand that there will always be uncertainty, and of course we would prefer it if the companies we invest in never faced any issues. Reality can get in the way of that fantasy, but our process is set up to be, we think, appropriately critical whilst not inducing panic every time a negative event occurs.

The overall performance of the portfolio has reflected positive and resilient performance for the vast majority of holdings in recent times, which have been testing at one point or another for most businesses. This is testament to their qualities, and a reminder that form can be temporary, and quality more permanent. It is our job to distinguish between the two.

Ben, Chris E., Bethan, Rob and the Evenlode team

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