

# Evenlode Global Income Investment View

December 2023 – Portfolio changes, and a reflection on 2023

*Market data is from Factset and FE Analytics.*

We end the year with a little activity in the Evenlode Global Income portfolio, having sold out of two positions and buying two others in their place through November and the early part of December. As we'll see these are not like-for-like swaps in terms of industry, but in the context of overall portfolio positioning they add some diversification and valuation appeal. Finding their place as small positions in the fund are US car mechanic tool provider Snap-on and Swiss logistics broker Kuehne & Nagel, and currently these are at a 'starter' position size of just above one percent of the portfolio each. Leaving the portfolio were PepsiCo and Henkel, the former having been a relatively small position for a while, and the latter a bit bigger. We'll come onto the reasons for the sales below, but first we will introduce the companies that we have bought on our clients' behalf. At the end we'll take a quick look back at the year as we enter the holiday season.

## **Snap-on**

Snap-on is a tools company whose main business services car mechanics in the US. It is a company that has been on our long list of ideas for a while, having screened well for its attractive returns on capital and cash flow characteristics. The business was founded in Wisconsin in 1920 providing wrenches with different sockets that 'snap-on' to interchangeable handles, hence the name. Snap-on currently operates three segments – Tools, Repair Systems and Information, and Commercial and Industrial.

Tools accounts for just under half of sales and operating profit and works on a franchise model, with franchisees selling directly to individual mechanics. The tools in question are often everyday, with wrenches, screwdrivers and hammers featuring amongst many others. This might not sound particularly glamorous, but for a mechanic who spends all day working with these items, usability, reliability and longevity are important – the latter particularly so as it is the mechanic who forks out to buy them in the first place. Therefore, brand and customer service are important parts of the company's competitive advantage. If and when a tool breaks or a new one is needed, downtime is costly and Snap-on is the only business with the scale and network density to deliver fast.

Repair Systems and Information accounts for about a third of sales and profit, selling largely to garage owners and managers. These bigger bits of kit allow for diagnosis of issues and provides repair procedures based on the company's extensive proprietary database of repair orders. There are thus switching costs in going to another provider, none of whom have as comprehensive a product. Lastly, Commercial and Industrial generates a quarter of sales, with the end user being non-auto e.g., aerospace, natural resources, and education.

Snap-on ultimately services car owners, so the stock of cars on the road is key to the business' future growth. With an electric vehicle transition gathering pace the type of tool needed by mechanics changes, and there will be a period where technicians need both types of tool. An interesting dynamic



is in collision repair, where the cost of repairing an electric vehicle is higher than for a combustion engine equivalent. Snap-on has strategically acquired businesses in this area.

From our investment criteria there is a lot to like about Snap-on. The tools are mission critical for the customer, and the customer is willing to pay a premium for quality and availability. This leads to attractive margins, and whilst the industry will continue to evolve with the changing nature of cars, there is a solid runway for growth despite it being the largest player. The company's stock has a 2.1% yield backed by solid cash flow.

### **Kuehne & Nagel**

Kuehne & Nagel (K+N) is an international freight forwarder incorporated in Switzerland. You may have seen their name on trucks if you've travelled near transport hubs, but the company in fact owns very little in the way of transportation assets. Rather, it acts as a middle-man matching senders with carriers and helping manage supply chain complexities such as regulatory requirements and solving problems as they arise. A global forwarder that can serve complex, large corporates needs scale and expertise across regions, helped by relationships within the logistics chain and technology to manage the process. Barriers to entry into this industry are low (one person with a computer and a phone can start) but barriers to scale are high, and higher the more complex the client's requirements. K+N, DSV and DHL are the main global players and below these are smaller niche 'corridor' (country-to-country) or sector specialists.

Drivers of revenue for K+N are the volume of goods shipped, and the complexity of the supply chain; the more complex the problem that the company solves for its client, the more it earns. Revenues are more closely linked to solving these problems than freight rates, which have been very volatile throughout and after the pandemic as we've noted on various occasions. While K+N's recent performance has correlated well with the extreme freight rate cycle we have experienced post-COVID, it actually reflects the concurrent supply chain 'complexity cycle' that has gripped the world. Pre-COVID, there is no correlation between freight rate changes and changes in K+N's pricing (gross profit per unit shipped). This means that whilst K+N is a cyclical company in that revenues are linked to volumes of global trade, it does not matter too much whether there is over- or under-capacity in the global logistics system and there are factors that act to reduce that cyclicity including the operation of a very strong balance sheet. However, business is still ultimately linked to the state of the global economy and to reflect that K+N operates a variable dividend policy, expected to yield about 3.5% in the coming year. We also reflect this fact in limiting the maximum position that we would hold in the company, an assessment that we make for any company based on the risks that we perceive.

### **PepsiCo**

Turning to the companies that have left the portfolio, PepsiCo has been a small position for some time, reflecting the stock's relative value compared to the broad range of opportunities in the



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consumer goods sector that is already well-represented in the portfolio. We think the company's prospects are good for its branded foods portfolio including the eponymous drink but also Quaker Oats products and Lays crisps, and we may well return to the company at some point if the valuation becomes more attractive.

## Henkel

Whilst we sold PepsiCo for reasons of valuation, we disposed of German industrial and consumer goods conglomerate Henkel for more fundamental reasons. About half of the business provides industrial adhesives into high performance applications; it is likely that your smartphone (assuming you have one) has some Henkel glue in it. This is an attractive business, which whilst a little cyclical has good long-term growth potential and differentiated products and technologies. More troublesome has been its consumer goods portfolio which contains brands such as Persil detergents, Schwarzkopf hair products and Pritt-Stick glue. Many of the brands are well known and have good market positions particularly in Europe, although the portfolio has been trimmed of its smaller and less successful products in recent years. This has left the portfolio looking somewhat sub-scale compared to larger rivals, and the company wants to address this in part by acquiring brands to add to its marketing and distribution platform. Whilst this strategy may be successful, we think there is risk in executing it given the capital that might be required to do so. Our decision has been informed by thorough analysis, including many meetings with management and calls with industry experts. The holding has not been a great performer for us and our clients, which is a little frustrating given that there are many attractive aspects to the business. Nevertheless, we feel there are plenty of opportunities elsewhere and are willing to move on from the company. We will continue to monitor it on our 'subs bench' of businesses, and as with any company we remain open to new developments and information as things progress.

## The portfolio, and looking back at 2023

These portfolio changes have resulted in the consumer goods exposure reducing by a couple of points to around 28%, and the industrials exposure increasing by a similar amount. As noted above the economic sensitivity of the portfolio is increased a little, but three quarters of the portfolio remains in companies that we judge to be less sensitive than average to the economic tides. Thus we expect steady progress from this collection of companies over time in terms of revenues, profitability and cash flow.

As we sit here in the middle of December we naturally reflect on the year just gone by, as ever in what seemed like a flash. At the time of writing the fund is up +8.3% in sterling for the year to date<sup>i</sup>, positive territory and a little ahead of other global equity income strategies<sup>ii</sup> but behind the comparator benchmark MSCI World index which is up +16.3%. Most recently news of the US Federal Reserve indicating that interest rates may fall next year has propelled the global equity market further upward. Whilst these factors move markets, we focus on the companies and their valuations. Where they are



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concerned operational challenges have eased, revenues have grown, cash flow is improving and valuations are long-term attractive.

As we move into 2024 we'll get more of an on-the-ground view of the global economy from companies. We will continue to watch market developments with interest and take action when we think the risk/reward balance is appropriate, as with the companies we've discussed above. We look forward to updating you as we go and would like to thank you for your continued interest and support over the last year.

Wishing you a merry Christmas period and a prosperous new year.

Ben, Bethan, Chris, Rob and the Evenlode team

18<sup>th</sup> December 2023

*Please note, these views represent the opinions of the Evenlode Team as of 18<sup>th</sup> December 2023 and do not constitute investment advice.*

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*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: FE Analytics. 31/12/2022 – 13/12/2023, WS Evenlode Global Income B Acc GBP units

<sup>ii</sup> As measured by the IA Global Equity Income sector, which was up +7.5% in sterling

