

Evenlode Investment View

November 2017 - Incrementalism



"I'm smart in spots and I stay around those spots"

Thomas J. Watson Sr., Founder of IBM

Richard Cousins gave his last results presentation before retiring as chief executive of Compass Group this week. Many years ago, in my pre-Evenlode days, I remember meeting Cousins several times when he was chief executive of the rather unpromising-sounding British Plaster Board plc (though as the great investor Peter Lynch used to point out, some of the most successful investments have the least interesting names). BPB was not endowed with the world's strongest portfolio of franchises, but in his low-key way Cousins nevertheless got on with executing a sensible, consistent strategy that proved highly rewarding for patient shareholders. It involved exiting the diverse set of businesses that BPB had ended up with to focus purely on investing consistently in the business in which it enjoyed a clear leadership position (yes, you guessed it: *making plasterboard*). His tenure ended prematurely when the company received a hostile approach in 2005 and was taken over: his management style represents what I like to call 'incrementalism', a mindset that is far removed from such shenanigans. At the time, when attempting to defend the company from the approach, he said of the process *I haven't really enjoyed it. People like me are designed to run businesses, not campaigns like this.*

Cousins subsequently arrived at Compass in 2006, at a time when the company was failing to realise its potential operationally and had become rather unfocused. Over subsequent years, a much more disciplined culture and management style has become deeply embedded within the company. In the first few years, Compass exited more than forty difficult, sub-scale businesses and began to focus on its market leading geographies and brands, where the potential to generate high returns on invested capital and long-term growth were far more attractive. Since then, disciplined incremental investment and bolt-on acquisitions have steadily expanded the company from these solid, market-leading foundations.

To paraphrase IBM's founder Thomas Watson, it can be highly productive for long-term shareholders when a management team understands 'the spots it is smart in' and stays close to them - the fruits of Compass's incrementalist strategy have been plentiful. Free cash flow and dividend growth per share have averaged +13% and +12% per annum respectively over the last decade. Part of the company's discipline has also involved a recognition that sometimes surplus cash is best returned to shareholders. Since 2006, Compass has deployed significant self-generated cash flow into organic investments and bolt-on acquisitions. However, the company has also returned £9bn of excess cash to shareholders in the form of ordinary dividends, special dividends and share buy-backs. This is quite an achievement, particularly given the fact that the whole Compass business was worth less than £5bn at the start of Cousin's tenure*.

Other examples of Evenlode holdings that have pursued a more incrementalist, disciplined approach in recent years include Smiths Group, Sage, Informa, UBM, Spectris, DMGT and Euromoney. Under current management, all these companies are investing consistently in areas of the portfolio that enjoy excellent leadership positions and good potential for growth, whilst products and services that don't fit the bill are de-emphasised or disposed. At their results presentation this month, Informa were asked whether the recent investment programme into digital capability and new product innovation would be tailing off given these new products are now beginning to come to market. But

as management put it, *it's not like we're going to go through this programme and stop. It's just the start of a cultural and operational change, we're looking to continuously update products across the portfolio.* This is 'incrementalism' in action.

It is true that some companies have inherently more attractive economics than others. At Evenlode, we spend much time thinking carefully about these characteristics and looking to identify them. However, no business is simply made great and stays great. Like gardeners, management teams need to give even the best franchise consistent, on-going care. Knowing which bits of a company to water and which bits to prune is a very important part of their job.

We wish Cousins and other low-key, incrementalist stewards of shareholder capital well for the future: may they continue to stay around the spots they are smart in.

Hugh Yarrow
Evenlode Investment View
24th November 2017

Please note, these views represent the opinions of Hugh Yarrow as a 24th November 2017 and do not constitute investment advice.

**Source: Canaccord, Factset, Evenlode Investment*