EVENLODE
GLOBAL INCOME FUND

EVENLODE INVESTMENT GLOBAL DIVIDEND SUSTAINABILITY REPORT 2019

TEN SUSTAINABLE GLOBAL DIVIDEND STREAMS FOR THE NEXT FIVE YEARS

SUMMARY:

Since we last published the Evenlode Global Dividend Sustainability Report there has been much geopolitical water under the bridge, from trade wars to Brexit, and towards the end of 2018 this was reflected in rising stock market volatility. In the 'real world' of business a benign global growth environment has supported steady corporate progress, although recently there is evidence of some sectors are coming off the boil after years of solid investment, in semiconductor manufacturing for example. Our search for reliable dividend streams has turned out companies with good cash flow and strong balance sheets, which have supported progress in dividend payouts over the last year. Adding in great competitive positions, these companies are set to deliver sustainable distributions to shareholders into the future.

EVENLODE INVESTMENT GLOBAL DIVIDEND SUSTAINABILITY REPORT 2019

A HERITAGE OF INCOME INVESTING

	Market Cap ($bn)	Local Dividend Currency Growth	Dividend Yield	1Y Total Return (to End-Oct 2018)	Net Debt/ EBITDA	Free Cash Flow Yield	Free Cash Flow Dividend Cover
Cisco	205	13.8%	2.9%	38.0%	-1.4	6.2%	2.1
Givaudan	23	3.6%	2.4%	12.7%	1.0	3.1%	1.3
Johnson & Johnson	379	7.1%	2.4%	3.1%	0.6	4.6%	1.9
Kone	22	6.5%	3.8%	-3.9%	-1.3	3.7%	1.0
Paychex	25	12.0%	3.3%	6.1%	-0.3	4.7%	1.4
PepsiCo	164	15.2%	3.1%	5.2%	1.5	4.1%	1.3
Relx	41	7.2%	2.5%	-8.3%	1.9	5.2%	2.1
Thomson Reuters	27	-0.4%	2.9%	5.0%	1.7	3.5%	1.2
Unilever	63	9.5%	3.1%	0.3%	1.9	4.6%	1.5
Wolters Kluwer	17	7.6%	1.9%	21.7%	1.7	7.3%	3.8
Average	97	8.2%	2.8%	8.0%	0.7	4.7%	1.8
MSCI World		9.0%	2.4%	5.1%	1.5	4.2%	1.8

Source: Factset, FE Analytics

Last year's sustainable dividend list turned in a solid performance in terms of dividend growth. The average increase of 8.2% reflects both the solid financial foundation and the underlying progress that the businesses have made in the year. The three businesses with he greatest growth are all US-based, and have benefited from the Tax Cuts and Jobs Act which was signed into law towards the end of 2017.

Topping the growth chart is PepsiCo, where demand for its 'guilt free' lines of lower sugar and fat products is driving growth, and the stable performance of the traditional soft drinks portfolio provides cash for investment in new areas and paying the dividend. At the other end of the scale with no growth is Thomson Reuters. One of the aims of our search is to deliver a growing income stream, so this appears disappointing on the face of it. However, there has been a major restructuring at the business, with the Finance & Risk division being placed into a joint venture with private equity firm Blackstone. This was the division with the greatest competitive pressures within the group, and has left behind a much more focused business with market leading positions, in the legal sphere with Westlaw for example. The company has committed to holding the dividend whilst the effects of the transaction work through.

In terms of total return, the sustainable dividend list delivered 8% on average, with two companies failing to get into positive territory. Finnish lift-maker Kone was weak as the impact of slow demand and price competition in China was absorbed by the market. Business-to-business media company Relx sank a little further, by 8%, in part due to concerns about the threat of free to use 'open access' content to its academic journals business Elsevier. We believe that these worries are valid but do not fundamentally change the business case for either Kone or Relx. As global market leaders in their (very different) fields, they have the capacity to adapt to changes in market conditions over the long term, as they continue to develop products that add value to the end user.

Comparing to the global market, the MSCI World index grew dividends by 9%, slightly ahead of our list. Some businesses are justifiably increasing from good business performance and/or growing from a low base of pay-outs, but more generally a robust global economy (perhaps in the face of headline-grabbing geopolitics and stock market wobbles) has helped. This is balanced by a lower headline yield versus our list, which goes some way to explaining the total return outperformance versus the market.

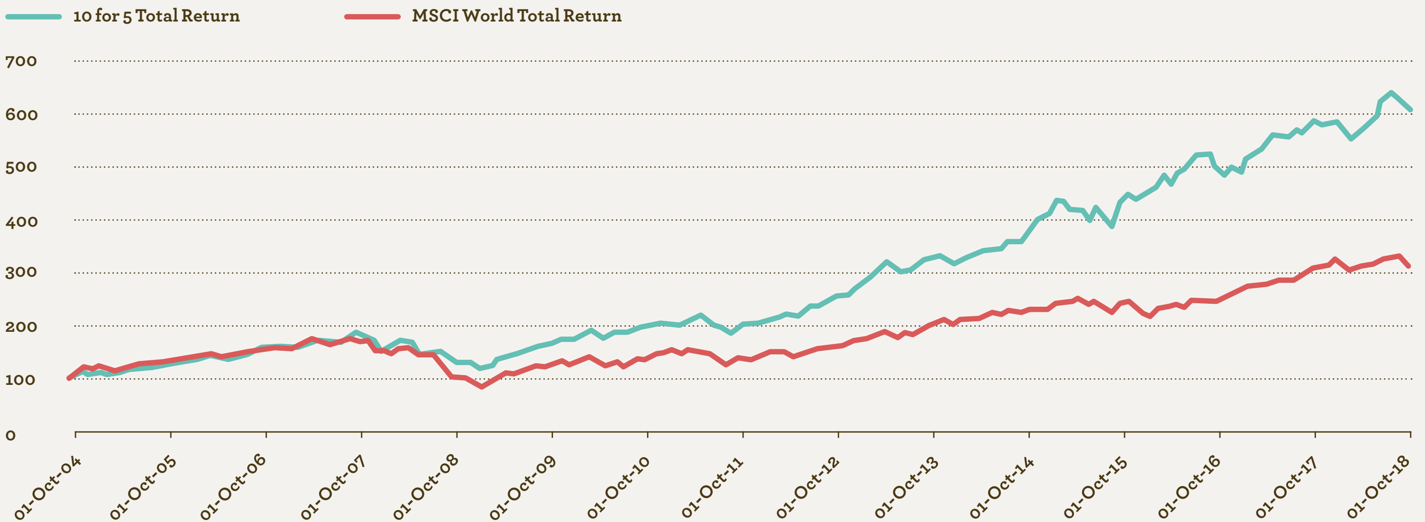
EVENLODE INVESTMENT GLOBAL DIVIDEND SUSTAINABILITY REPORT 2019

DEFENCE OVER OFFENCE

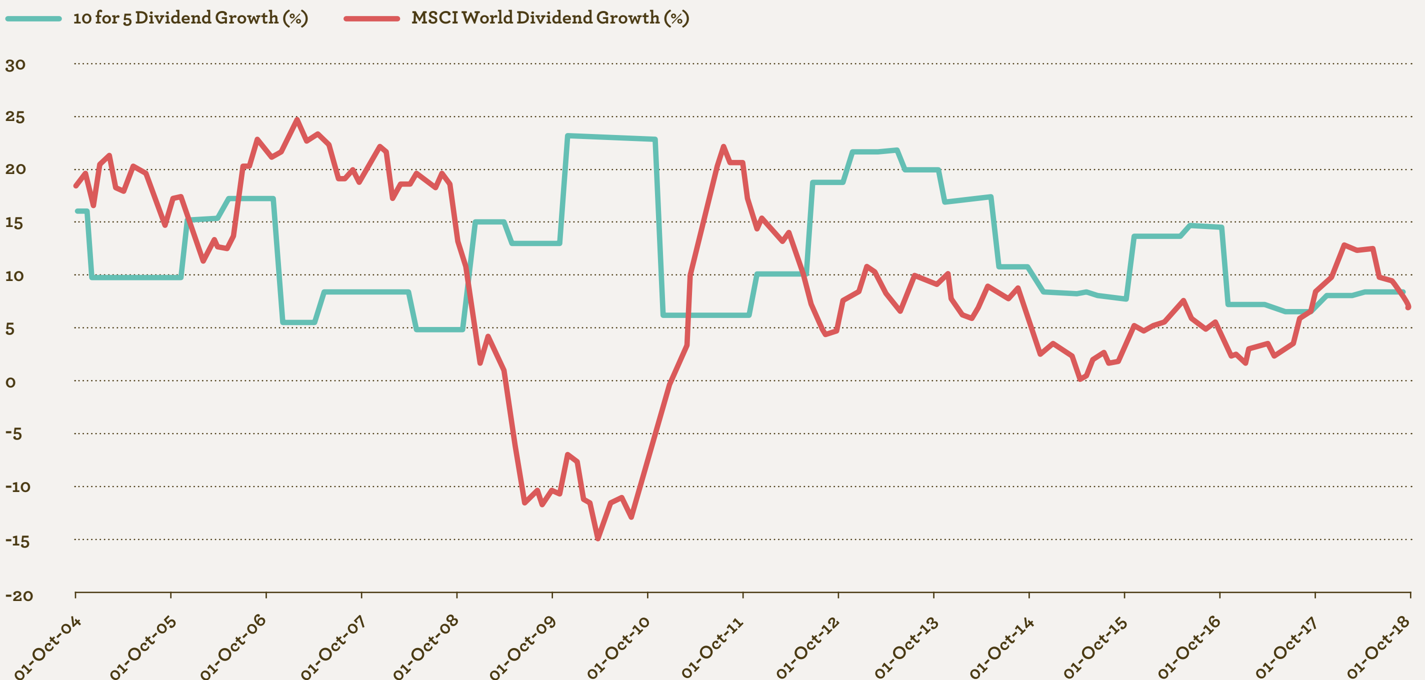
The review of one year's performance is interesting, but this is a list that is designed to sustain for half a decade or more.

It would be nice to have a crystal ball and gaze into the future of our ten selected companies, but we sadly lack such a device. However, we can get some context by looking at the past instead.

Total Return



Dividend Growth



Source: Factset

The charts above show dividend growth and total return over the last fifteen years for our list and the MSCI World index. In any given year the index may have been ahead in terms of dividend growth, sometimes behind. But what's more important over the long run is the consistency of the dividend; in any given year the aggregated list did not cut its payout, even during the great financial crisis of 2008-9. Looking back, we see it is during this period that the performance of our list started to positively deviate from the index. In other words, the companies on the list won by not losing.

COMPETITIVE YET PRUDENT

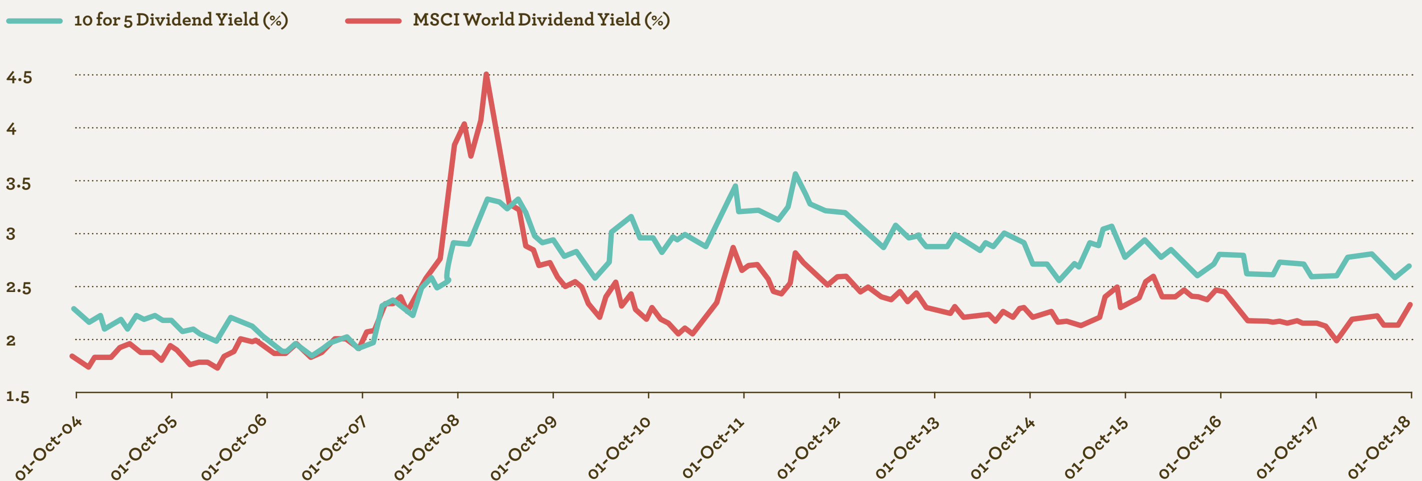
The businesses we seek out have strong competitive positions in their respective disciplines (a brief summary is provided for each business in our list below), within industries that tend to have robust demand profiles. The resulting 'defensiveness' leads to attractive and growing free cash flow, which funds the needs of the business and, of course, pays the dividend.

As well as prudently investing in their offerings to customers, these companies take care of their balance sheets. Taking on less debt means there are fewer people who can make a claim on the company's cash flow, leaving more of it for shareholders. The average net debt to EBITDA ratio (a measure of leverage) for these companies is 0.7x, less than half of the MSCI World index (source: Factset). Combined with, in our estimation, more stable cash flows than the average company, this points to a lower overall risk profile.

BALANCING INCOME & GROWTH

For these attractive characteristics, one might expect to pay a premium. However, the chart below shows that our list has historically had a superior yield to the market, aside from during the great financial crisis where the market yield proved illusory when dividends were subsequently cut. Partly that is due to these businesses being relatively mature, and therefore more able to give cash back to shareholders. However, our list is returning about the same amount of its free cash flow in the form of dividends as the global market average. So they are in fact investing for growth as well as giving cash to shareholders.

Dividend Yield



Source: Factset

Our list delivers a premium yield at 2.8%, against 2.4% for the MSCI World, but it is not the highest-yielding ten businesses that could be assembled. We look to balance a good yield today with the prospect of growth in the future. We believe that by doing that, attractive total returns can be achieved, particularly given the lowered fundamental risk being taken.

THE 2019 LIST

Of last year's list, there are two businesses that no longer meet our screening criteria. Dutch Media firm Wolters Kluwer's yield has dipped below the 2% cutoff applied last time around, standing at 1.9% at the time of writing, having increased in price during the year. We believe that the long term investment case for Wolters Kluwer remains sound, delivering software, data and analytics to a diverse range of end uses from healthcare to accountancy, and so it retains its place in the 2019 list.

As noted above, Thomson Reuters undertook a major transaction for its Finance & Risk division during 2018. We think that the transaction allows for a higher quality, more focused business and are supportive of it. However, whilst the effects work their way through the company's financials the dividend will not grow in the short term. Given our search for growing distributions, we have chosen to replace the business for our 2019 sustainable dividend edition.

Replacing Thomson Reuters is US-based financial service and technology firm Western Union. A mature business dominant in its niche, Western Union enables the transfer of money around the world, primarily to cash distributed to the end-customer through its global network of branches. A business based on cash might seem anachronistic in a digitising world, but the real strength of Western Union is in its ability of its network to deal with the sprawling and ever more complicated compliance surrounding cross-border movement of money. Over 100 compliance checks are completed in a matter of seconds on every transaction. Replicating this feat costs money and provides a significant barrier to entry from competition. The business can't ignore digitisation of course, and has facilities to send money digitally including westernunion.com which is growing by over 20% annually. In Kenya for example customers can receive money into M-Pesa mobile wallets. With a yield of 3.7% well covered by free cash flow, Western Union has scope to maintain and grow the dividend into the future.

BRIEF SUMMARY OF THE TEN STOCKS

CISCO

Cisco is the global market leader in the technologies that underpin the internet. With the advent of cloud computing, it has expanded into providing security services for networks, the cloud and the internet of things. This includes the ability to detect malicious threats in encrypted internet traffic. Cisco has a very strong balance sheet with $21bn of net cash, and its traditional business of selling switches and routers is transitioning to longer term subscription purchase models.

GIVAUDAN

Givaudan is the world's largest manufacturer of fragrance and flavour products. Selling into the food and cosmetics market and headquartered in Switzerland, the company's formulations are custom made and often the defining feature of a product. This gives the firm great integration into its customers' supply chain, as once the flavour of a product has been established as a winning formula the manufacturer is unlikely to want to change the supplier.

JOHNSON & JOHNSON

Often associated with its consumer products division, with iconic brands such as Listerine and Neutrogena, J&J is predominantly a pharmaceuticals and medical devices company. The company's Janssen pharmaceutical division generates 47% of revenues and has a broad portfolio of drugs treating a range of disease areas. Janssen is particularly strong in oncology and immunology. Medical Devices is similarly diversified, creating systems that aid surgery, diagnostics and wound care.

KONE

Finnish company Kone is one of the world's largest elevator manufacturers in a consolidated market, and the leading provider of new equipment in China. Customers need effective ways of getting people around their buildings, particularly for large scale projects, and want to use the best providers of people flow solutions. There is a growing regulatory imperative for ongoing maintenance, and services account for 46% of Kone's revenue, including modernisation of old equipment. The company runs with a strong balance sheet, which helps to shield the dividend during periods of slower construction activity.

PAYCHEX

Paychex is a US-focused provider of human resources services to small and medium sized businesses. A little over half of revenues are derived from payroll outsourcing, clearly an important function for any business and a task for which smaller firms are very willing to utilise a specialist. The other part of the business is other human resources services, such as pensions administration, and management of workplace policies. Once integrated into a client's business renewal rates are extremely high. The cash flows that back the 3% yield are very stable as a result.

PEPSICO

Something of a misnomer, Pepsico derives only 12% of sales from its eponymous drink. The company also owns a wide range of food and beverage brands including Tropicana, Lays, Doritos, Quaker Oats and Cheetos. A majority of revenue comes from North America, and 40% from the rest of the world. Twenty-two of PepsiCo's brands generate more than $1bn of sales annually, and the company's portfolio boasts four of the top ten retail brands across all categories.

RELX

Relx is an Anglo-Dutch media conglomerate operating across a number of different sectors. The academic publishing business Elsevier disseminates 16% of the world's scientific articles. Risk & Business Analytics provides services such as risk analysis tools to insurers, and anti-money laundering tools to banks. The Legal division operates the LexisNexis database for lawyers, which operates in a duopoly with Thomson Reuters' Westlaw. Finally, the firm's exhibitions business is the largest in the world, operating 'go to' events that are often monopolies in their given industry. Diversification and a large degree of subscription-based revenue give stability to the group's cash flows.

UNILEVER

Unilever's consumer products are instantly recognisable to the 2.5 billion people who use them globally every day. Selling products from Dove to Domestos, Lifebuoy to Lipton, this diversified consumer goods giant has a history stretching back to the 1880s. 55% of revenues are from emerging markets, and many brands have been present in their local market for decades or longer as a result of the firm's colonial heritage.

WESTERN UNION

Western Union is a leader in global money movement and payment services. The business is operated in three segments; Consumer-to-Consumer (79% revenue), Consumer-to-Business (12% revenue) and Business Solutions (7% revenue). The largest segment, Consumer-to-Consumer, enables global money transfers usually within minutes of transfer initiation. This utilises a physical network of over half a million agent locations in more than 200 countries and territories.

WOLTERS KLUWER

Wolters Kluwer is a Dutch information, software and services company servicing the legal, tax, accounting, finance, risk and healthcare sectors. Its products and services help healthcare professionals to make decisions, accountants to manage compliance and businesses manage their legal affairs, to name a few application areas. Knowledge and content in the relevant sectors combined with increasingly cloud based delivery enable Wolters Kluwer's products to become deeply embedded in their customers' operations, demonstrated by 78% of revenues coming from recurring sources such as subscriptions.

APPENDIX: OUR CRITERIA & SELECTION PROCESS

The above list of companies has been selected using a multi-factor market screen, using the following factors:

Risk/Factor	Metric	Comment
Quality compounders	Cash flow return on invested capital (CFROIC)	Quality companies are more likely to increase their dividend sustainably, thanks to the compounding of reinvested free cash flow over time.
Low or no debt	Net Debt/EBITDA	Companies that hold a high level of debt, relative to their potential earnings ability, risk having to sacrifice the dividend to meet interest payments.
Strong free cash flow cover	FCF / Dividend	Where cash entering the business is not sufficient to meet the cost of the dividend then it is unsustainable. Companies with high free cash flow coverage of their dividend have a higher current ability to raise the dividend.
Strong dividend history		A long-term track record of paying dividends through thick and thin is a good sign. We screened for companies that have not cut their dividend over at least the last 10 years.
Valuation	Dividend yield	Even the highest quality company is not a good investment at too high a starting valuation. Balancing attractive dividend growth with a solid starting yield is the key to income and growth investing. We have filtered the markets in the US, Canada, EU, Switzerland, Australia and Japan for companies on a dividend yield of more than 2%.

FURTHER INFORMATION

Interested in investing in the TB Evenlode Global Income Fund? Get in touch:

Tel +44(0)1608 695200
Email evenlode@evenlodeinvestment.com
Visit evenlodeinvestment.com/funds/how-to-invest

Disclaimer
TB Evenlode Global Income is a sub-fund of the TB Evenlode Investment Funds OEIC. Full details of TB Evenlode Global Income, including risk warnings, are published in the TB Evenlode Investment Funds Prospectus, the TB Evenlode Investment Funds Supplementary Information Document (SID) and the TB Evenlode Income Key Investor Information Documents (KIIDs), which are available on request and at www.evenlodeinvestment.com. TB Evenlode Global Income is subject to normal stock market fluctuations and other risks inherent in such investments. The value of your investment and the income derived from it can go down as well as up, and you may not get back the money you invested, you should therefore regard your investment as medium-to-long-term. As a concentrated portfolio of typically less than 40 investments, TB Evenlode Global Income carries more risk than a fund spread over a large number of stocks. Investments in overseas equities may be affected by changes in exchange rates, which could cause the value of your investment to increase or diminish. Every effort is taken to ensure the accuracy of the data used in this document but no warranties are given. Evenlode Investment Management Limited is authorised and regulated by the Financial Conduct Authority, No. 767844. T. Bailey Fund Services Limited is authorised and regulated by the Financial Conduct Authority, No. 190293