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[INTRODUCTION]
Juliet Schooling Latter (JSL): JSL: Hello, and welcome to the Investing on the go podcast. I'm Juliet Schooling Latter and today I'm joined by Brendan Gulston co-manager of Gresham House UK Multi Cap Income. Hi, Brendan.

Brendan Gulston (BG): Hi Juliet.

[INTERVIEW]
[0:17]

JSL: Last year was awful for dividends. Your target yield on the fund is 4% - how did it hold up and I wondered what your thoughts were on the outlook for dividends this year?

BG: Yeah. Last year was clearly a tough year for UK dividends. If you look across the entire UK equity market, then you'll see that the dividends fell 44% and two-thirds of companies either cut or canceled dividends between the second quarter and the fourth quarter of last year. Amongst that picture, the hardest hit sectors were banks, oil and gas, mining and consumer discretionary sectors, which may not come as a big surprise. And it's also worth mentioning that UK dividends did fall within every quarter of last year when you look across the entire UK market. And so the picture as you alluded to was quite bleak.

If you look at our portfolio, the income fund fared really strongly against that backdrop. So we look at the headline figure against a 44% decline, our dividend level declined, but it only declined by 17%.

I think what was sort of more interesting really is that if you look at the quarterly breakdown of how our fund was impacted, you look at the second quarter of the year, clearly when, you know, when the pandemic was basically in full force. Our fund was, our year on year income for the fund was down, not as much as the wider UK sector, but it nevertheless was down fairly heavily, but in Q3, our dividend amount actually grew year on year by 17% compared to a decline of almost 50% for the market. And what's interesting about that is that it's really consistent with the resilience of the portfolio companies that we have in the fund. And it demonstrates the, you know, what I suppose, what we've been talking about in terms of the type of businesses that we look for and the type of income streams that we target.

Because, you know, whilst the headline picture looks kind of negative overall for UK equities, actually, you know, within the portfolio, we saw a number of companies which were impacted by the pandemic and you know, which some paused dividends, but for the most part, those sort of dividends were pause really out of prudence since they started to work through what the picture was for their business, for the wider economy. And we, you know, subsequently we saw many businesses sort of implement cost cutting and actually emerge really trading quite strongly out of the pandemic in Q3 and Q4. And, you know, the metric that we looked at across our portfolio is that actually 80% of the businesses saw uninterrupted income stream. So, you know, we had a cohort which was basically completely unaffected. But as I said, there, was a sort of smaller cohort where they did pause dividends or cut dividends temporarily, but the, you know, the nature of those businesses and the nature of the fundamentals of the markets that they operate in, allowed them to resume dividends towards the end of the year. So, all in all, if you look at that from a fund perspective you know, as I said our dividends were down last year versus 2019. But we hit a dividend yield of 3.3% for the year. This year we're targeting, you know, back in line with our target of 4% yield.

[4:26]

JSL: That's good news for your investors. As a team, you tend to avoid cyclical companies, which are ones dependent on the health of the economy - do you think that could be a barrier to the performance of the fund as this year progresses, and everything reopens? Or will your bias towards small and mid-cap companies counterbalance that?

BG: So, you're right, we tend to avoid what I would call overly cyclical sectors or sectors or areas where external factors can heavily influence the investment case and can really determine whether a company or business succeeds or fails. Some examples of those are the banking sector, oil and gas and the mining sector.

For example, within oil & gas and mining, commodity prices have such a big effect on earnings and dividends and cash flows that those are outside of the control of the management team. And we feel that there's a [inaudible], to rely upon external factors and therefore the risk return balance doesn't work for us. So, we've not participated in those sectors historically.

But I think, you know, the important thing is that there's three important points to make - the first is we don't think that's too material a headwind to us because we've got a very large investment universe. So we invest across the market cap spectrum where there's over a thousand companies that we can invest into. And we're not, we're not kind of pigeon-holed by only being able to focus on a certain size of companies, for example. So, you know, this, sort of active exclusion is because we are, it's to do with how we're targeting sort of long-term risk adjusted returns, and we see that as being a key driver of our risk mitigation process. So, it's worth reiterating that we, you know, there are plenty of opportunities out there and we've got the platform, we've got the expertise in small cap and we've got the private equity network to be able to really diligence the entire space, the entire market cap spectrum. So, so I don't think from a kind of, from an opportunity perspective, we're going to be struggling to find things to invest in.

[7:00]

JSL: Now, I note you have an insurance company and an actuarial company in your top 10 - these are often professions that are thought of as rather boring. What makes these companies interesting investments?

BG: Well, often it's, often I've found that it's that kind of relatively boring businesses that can make actually quite attractive and quite exciting investments, but you know, let me take these businesses in turn so that the actuarial consulting business is a company called XPS. You know, the reason is it's a pensions consultancy business and it also does administration services for pensions as well. And the reason why it's interesting is because firstly, the market dynamics are really attractive. So, the pensions consultancy market has historically been dominated by some very large insurance companies like Willis & Owen. And essentially what XPS is doing is their client is the board of trustees for large defined benefit pension schemes. And they're providing them with advice and consultancy services around those schemes and that's… so that market is being dominated by much bigger players who are, who don't just do pensions consultancy, they do a wide range of insurance services.

And why XPS is interesting is because it focuses just on providing that type of advice to these clients. And it's not, it doesn't have distractions in terms of sort of business lines that it's focusing on. So, so we believe that creates an opportunity to provide kind of much more specialist and complex advice. And you know that is a barrier to entry in that is a core part of the value proposition. And we've seen them to displace kind of in terms of displacing some of the larger players on services work, we've seen that happen over the past few years. The other interesting points now about a market, it's obviously a very technical market and there's a lot of complexity and there's quite a bit of regulation change that is driving the kind of demand from customers.

I suppose the other point worth noting is just that the quality of earnings is quite visible for this business as well. So, you know, typically some of the work is sort of happens over a periodic has to happen every so often in order to meet various, you know, to meet various targets for valuation targets or, or whatever it is. But the, the way that the company looks at their earnings stream is really from a kind of monthly billing perspective. And they typically deem that revenue to be sort of repeat, or almost recurring to 24 months of consecutive billing. And, you know, that was, you know, historically has been over 80% of their revenue. So the quality of earnings we believe is, is quite attractive as well.

And then you mentioned the insurance business too.

That one is Randall & Quilter, which is a specialist insurance business. There's quite an exciting combination of both income and capital growth. So again, it's probably it might sound quite boring. I mean, it was very sort of technical and quite niche, you know, that was where we saw a real opportunity. And, you know, we thought if we can really get into the detail of the business and understand what the value proposition is then we can kind of where the, where the income streams are coming from and what the, what the sort of growth trajectories are, then it's going to be a really attractive investment. So ,we spent time really doing quite a lot of diligence on the business and referencing the team and the business itself.

They have one part of their business, which is a legacy acquisitions business, which basically buys legacy liability books off corporates that don't want to have the kind of, have to provide on their balance sheet. You know, multi-millions of pounds, you know, for a kind of legacy liability that's not core to their business. And they Randall & Quilter take that off their balance sheet. Then they manage it for them. And, you know, that's a business that's been operating for about 30 years, and they've got really solid track record and reputation in that market. And then they sort of leveraged their insurance expertise to launch another part of the business, which is a program management business in the US which is the real growth driver, it's in the US and Europe, it's the real growth driver of the business. And we felt that the market wasn't really scribing much value to that growth business. So it's an attractive combination of income and capital growth.

[12:42]

JSL: And I also have to ask about your holding in Strix a supplier of kettle safety controls. How on earth do you find a company like that?

BG: Yeah, so I think, I mean, I don't think anyone would seek to find a company like that really. It is you're right, it's very niche. So yeah, it's the global market leader in the manufacturing and distribution of kettle controls and the business, so we've been invested in, in Strix since it IPOed, in August 2017. It IPOed one pound a share, it's now trading at £2.76 a share and when it listed it listed at a really attractive valuation multiple, and an attractive dividend yield that, you know from memory the price earnings multiple was the high single digits. And the dividend yield was pretty similar to that. So, it was attractively priced and you know, it doesn't sound like a particularly exciting business, but ultimately our investment judgment on Strix was that it's got really strong market share, in a niche market, with high barriers to entry.

So, I suppose, you know, how do you come across a business like that to answer your question. We are very plugged into the broker and advisor network you know, across the market cap spectrum, but particularly given our sort of small and mid-cap heritage, we do see a large number of IPOs and fundraisings. But I think what's what was the kind of, what was the sort of critical catalyst for us was that Strix was owned by a variety of private equity houses. And we were able to specifically reference with one of the investor directors from a private equity house that was exiting the business. And he sat on the board for a number of years. We were able to speak to him directly through our network and to really test that critical judgment around, you know, what's the sustainability of the long-term income, what value would you be ascribing to growth, if any, and you know, how protected, ultimately how protected are the profits over the long term. And that was a crucial bit of diligence for us because, you know, we came out with the view that this may, this may grow, but it's not essential to grow, but the profit streams are really well protected by the market position. And by, you know, a number of other factors that we learned about the business.

And, you know, since IPO we've been proved wrong in terms of the capital growth, because as you've seen the shares have almost tripled, so you know, they have, they have managed to, will have managed not only to deliver the sustainable yield, but also to find capital growth opportunity. So it's, I suppose that has been quite a positive surprise for us.

[15:51]

JSL: Finally, I noticed that since October, Gresham House Energy Storage has been added to your top 10. Is this on the back of the UK building back better and greener, is there a trend you're playing here? And are there any other linked holdings in the fund?

BG: So, I wouldn't say it's specifically off the back of the UK build back better and greener. So Gresham House Energy Storage fund, is the energy storage sites that connect into the national grid. Some battery storage facilities that allow energy supply and demand to be adequately balanced by taking power off the grid and then pushing it back onto the grid.

So yeah, it wasn't specifically due to that initiative, but what we have been invested in that business for a long enough period of time. You know, we added to, we participated in the fundraising last year and added to our position. What we saw is really exciting with that business was what really was the overall trend. So, you know, the market trend, which we saw as being this convergence in terms of a shift to renewable energy sources, combined with the kind of overarching strategic government ESG initiatives that were some starting to play out.

What we thought was really interesting was that we looked at the UK energy market and the proportion of the UK energy market that's coming from renewables is rising dramatically. And, and there's this sort of longer term kind of transformational shift towards more flexible power generation. Whereas in the past it was, you know, it was reliant on coal and oil and gas, and now much more kind of stable power generation model. And this shift to renewables, what it does is it increases the volatility of supply because clearly renewable energy can't really be switched on and off as easily. So, you have higher variability and you have the higher need to balance supply and demand on the national grid. So, we saw that as just being a really long term structural growth opportunity and a structural trend that would kind of transform the industry.

What we liked about the Gresham House Energy Storage fund as well was, they had a really great market position. It was an early mover and it was growing really rapidly. And you know, the last meeting I had with them towards the end of last year, they had towards 25% of the market share in the UK, you know, they'd rapidly sort of either built out or acquired sites across the UK, which are in strategic locations where you can plug into the national grid, a bit like the electric vehicle charging stations, where, you know, you're seeing, there's a number of companies that are kind of buying up access to power supplies to then set up these electric vehicle charging stations, because they think they'll be strategic value in those sites. So, so we thought it was a really exciting market position and growth story as well.

From a fund perspective, you know, the yield's really attractive, there's a 7% yield target initially. Plus there's also this capital growth potential from an [inaudible] in the discount rate, which basically causes the value of the assets of the projects to increase over time. And, you know, as, as we've seen more interest in the sector, more players come into the sector ,you know, these assets are becoming more valuable, the discount rate is decreasing. And so it's a good mixture of both of those elements of the fund. And I suppose to answer the second part of your question, it does in terms of other, you know, it does play into a broader, I suppose, broader ESG trend, where we're seeing really long-term structural growth opportunities.

JSL: Interesting stuff. Brendan, thank you so much for your time today.

BG: Thank you.

JSL: If you'd like more information about Gresham House UK Multi Cap Income, please visit fundcalibre.com and don't forget to subscribe to the Investing on the go podcast.