

# Evenlode Investment View

August 2019 – Results Update

---



After another positive month in July, stock markets have fallen back during August as worries have returned over US/China trade tariffs and their knock-on impact on the global economy. The Federal Reserve reduced interest rates at the end of July, citing its own concerns that the economic outlook in both the US and around the world has cooled. As expectations for economic growth and interest rates fall, bond yields around the world have also declined again, with many developed world bonds currently offering a negative yield. In the UK, Brexit's trajectory remains hard to predict.

Despite the recent correction in stock markets, returns for the year remain strong. As I write, the Evenlode Income fund has risen +20.4% since the start of January compared to a rise of +9.8% for the FTSE All-Share<sup>i</sup>.

## Results

More than 80% of the Evenlode Income portfolio has reported results over recent weeks, and we have been busy digesting them and speaking to management teams. Overall the economic picture is mixed globally and there is a clear sense of caution regarding the general outlook amongst both customers and companies. This is particularly the case for industrial production markets in the US, Europe and China. However, there are pockets of growth and opportunity too, and we have been very reassured by the steady progress that the portfolio's diverse range of companies are making overall. Free cash flow generation remains strong with the fund's aggregate 2019 free cash flow yield standing at 5.0%<sup>ii</sup>. This stream of cash flow is growing at a steady rate and comfortably covers the fund's 3.0% dividend yield.

This month I would like to briefly discuss four themes we are thinking about across the consumer branded goods sector, a key sector for the Evenlode Income fund. Next month I will discuss some themes from the broader Evenlode Income portfolio that we find interesting.

## Consumer Branded Goods

The global consumer branded goods sector has been facing some challenges over recent years- a regular discussion point in these investment views. In particular, consumer preferences are changing (for example, demand for more natural and sustainable products is increasing at a rapid rate) and the percentage of products sold through digital channels continues to rise. Several of the fund's key positions in this sector have released trading updates over the last few weeks. Generally, performance has been steady despite a volatile world, which is a reminder that companies with the mindset to adapt, invest and evolve are coping with these challenges well. For instance Unilever, Pepsi, P & G and Diageo have reported organic revenue growth of +3.3%, +4.8%, +5% and +6.1% respectively<sup>iii</sup>.

Innovation is the first key theme worth mentioning. It remains the case that if companies are able to bring relevant, beneficial products to market, consumers remain happy to purchase them at a price that reflects these benefits. As P & G put it at recent results *we're in a fairly constructive environment where we and our competitors are trying to innovate to grow markets, and that's the game we like (growing the pie rather than playing a zero sum game)...* and when we offer products that have meaningful advantages in many of our big markets, consumers are trading up. Pepsi and Unilever management referenced similar trends. One key category of innovation reflecting changing consumer preferences has been the drive toward more natural and environmentally friendly products. A recent example is P & G's recently launched Pampers Pure brand. It offers baby wipes and nappies made from plant-based materials but with a similar

# Evenlode Investment View

August 2019 – Results Update

---



performance profile to other comparable products. The consumer response has been very positive, driving good sales growth for the brand.

This need for consistent, high quality innovation has led to a second related theme: market leaders are having to work harder than ever to make themselves as efficient and adaptable as possible: adaptability is essential to deliver the innovation that consumers desire. P & G have reorganised their management structure and made their innovation process more entrepreneurial: brands such as Pampers Pure and Tampax Pure have been created using this new approach. Unilever have been through a similar process which has resulted in the company's time-to-market for new launches halving over recent years. It has also helped Unilever launch 28 new brands since the beginning of 2017 (compared to only three new brand launches in the preceding decade).

A third theme has been the continued shift to digital sales. Unilever reported +30% growth in their e-commerce channel during the first half. Reassuringly, management point out that margins in e-commerce are more attractive than those generated from traditional channels. Unilever are putting significant resources into ensuring that the company's overall digital effort continues to accelerate. This includes the recruitment of 10,000 digital specialists over the 2019-2020 period, bringing the total number of digital specialists to about 20% of Unilever's total workforce. This effort is partly to continue to drive growth in digital sales. However, the digital effort also includes using software and data analytics to drive more consumer-friendly innovation, better operational efficiencies, bespoke digital marketing and improved customer feedback. The company now have 24 digital hubs up and running around the world and in terms of marketing, digital channels now represent 40% of media spend. P & G are seeing similar trends with global e-commerce sales growth of +35% over the last year (with this sales channel now representing 8% of the overall company's revenue) and significant digital investment in the business ongoing.

Finally, emerging markets remain an important theme for the sector, with the long-term opportunity substantial. Though economic conditions in this very disparate group of countries has been quite volatile recently, these regions continue to drive growth for the sector. Unilever's emerging markets business (now 60% of revenue) grew +6.2% in the first half of the year and Pepsi's by +8%. Diageo's equivalent division has grown by nearly +10% over the last year.

A poorer performer in this sector for Evenlode Income has been Reckitt Benckiser over recent months. The company reported organic revenue growth of only +1% during the first half due to several operational issues and a weak cold and flu season in the US market. Whilst we acknowledge these short-term issues, we continue to think Reckitt's high quality portfolio of health, hygiene and homecare brands and emerging market footprint provide good foundations for attractive long-term growth. We view the company's current valuation as compelling and have added to the fund's position over recent weeks.

## **Hugh and the Evenlode Team** **28th August 2019**

*Please note, these views represent the opinions of Hugh Yarrow as at 28th August 2019 and do not constitute investment advice.*

---

<sup>i</sup> Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2018 to 28/08/2019

# Evenlode Investment View

August 2019 – Results Update

---



---

<sup>ii</sup> Source: Evenlode, Factset, data as at 28th August 2019

<sup>iii</sup> Over their most recent reporting periods: First half results for Unilever/Pepsi and full year results for P & G and Diageo