Evenlode Investment View

September 2017 - Quiet Cash Generators

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Fundamental company news has been relatively limited so far in September, whilst global economic data has been mixed, but by no means terrible. In the UK, the Bank of England's policy makers have hinted they may consider an interest rate rise in coming months, which would reverse last year's post-referendum rate cut and represent the first rise in more than a decade. The pound has rallied in sympathy, and the UK stock market has fallen back given the global nature of its earnings exposure. 2017 returns remain positive overall though: at the time of writing, the UK market has risen +6.0% and Evenlode +9.4% year-to-date, both on a total return basis*.

Quiet Cash Generators

The most significant Evenlode news so far this month has been engineering software company Aveva's agreed merger with Schneider Software (Aveva shares have risen approximately +25% following the announcement). Assuming shareholders vote for the deal, Aveva will remain a listed UK company but will combine with Schneider's software franchise in order to broaden capability and geographical scale. Shareholders will also receive a significant cash payment in exchange for Schneider's stake in the enlarged business. Aveva (as a standalone entity or in combination with Schneider) is a high quality company representing many of the fundamental qualities we look for in an investment - a dominant player in its niche market, good structural growth potential (increasing digitisation, the internet of things etc.), a culture of consistent organic investment and a strong balance sheet.

Aveva also represents a good case study of what I describe as a 'quiet cash generator'. Its capital-light business model allows Aveva to consistently fund both its growth investments and dividends from internally generated cash. In fact, Aveva has never borrowed money, ever since its formation in the late 1960s as a Cambridge University spin-off. All its growth and shareholder returns have therefore been self-funded over subsequent years.

If such a company can continue to generate cash when facing difficult operating conditions it is all the more impressive. Aveva has managed this in recent years despite a backdrop of depressed spending in energy and industrial production markets. Such businesses may get a bit 'forgotten' from time-to-time, but are generally kind to shareholders over the long-run. Evenlode holdings EMIS and Ashmore have released results this month which demonstrate similar characterisitics. Both companies have faced difficult industry conditions of late and are not particularly 'fashionable' shares, but this has not stopped them converting profit consistently into cash. Looking longer-term, both enjoy a good competitive position in markets that should benefit from structural growth opportunities (the demand for joined up data and software analytics in the healthcare sector for EMIS, and the growing importance of emerging market capital pools in Ashmore's case).

In terms of new additions to the portfolio in 2017, cash generation remains a uniting feature - Smith & Nephew, Novartis, WPP and UBM are all businesses that are trading on high free cash flow yields, giving us confidence in the sustainability and growth prospects for their dividend streams**. This month we have also introduced a small holding in US technology business Cisco, another highly cash generative company with a dominant position globally in IT infrastructure networking. The share currently offers a dividend yield of more than 3.5%

that is very well covered by free cash flow. Cisco also enjoys a strong balance sheet with $35bn of net cash.

There are several other 'quiet cash generators' on our watch list that are looking quite interesting to us. We are actively researching these ideas and some may find their way into the portfolio over coming months. Our overall aim remains unchanged: to retain a portfolio of businesses that enjoy strong competitive positions and the potential to deliver healthy cash flow and dividends over coming years.

Hugh Yarrow
Fund Manager
20th September 2017

Please note, these views represent the personal opinions of Hugh Yarrow as at 21st September 2017 and do not constitute investment advice.

**Source: Financial Express,* total return figures from 31st December 2016 to 21st September 2017

**Free cash flow yield is an interesting measure - it is one of the only financial metrics that can simultaneously signal *quality* (i.e. it tells you whether a business is converting its earnings to cash) but also *value* (it tells you how many pence of spare cash you're receiving for every pound you spend on a share).