Marlborough International

Q&A: Marlborough Multi Cap Income investment update

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"We're continuing to find very interesting dividend-paying companies outside the FTSE 100."

Siddarth Chand Lall

Marlborough Multi Cap Income Fund Manager Siddarth Chand Lall talks about how, despite the economic impact of the pandemic, robust and well-managed companies are continuing to pay attractive dividends and explains the benefits of a multi-cap approach.

Has UK equity income changed forever?

"There has certainly been a change in the dividend landscape in the immediate term, with a company like Royal Dutch Shell dropping its dividend for the first time in its history and BT suspending its annual dividend for the first time since it was privatised in 1984.

"What the crisis has done is underline the risks of relying on a limited pool of large-cap dividend payers. It reveals that their dividend policies are not as reliable as many investors might have imagined.

"It's important to remember though that UK equity income is not just about the FTSE 100. In our fund, we hold a diversified portfolio of companies, with 120 holdings selected from an investable universe of more than 700 stocks spread across the market cap spectrum. Of those 120 stocks, only 35 have cut their dividends.

"We have a bias to small and mid-cap stocks and we continue to find very interesting dividend-paying companies outside the FTSE 100."

Are there particular sectors where dividends are holding up well or does it tend to be more about individual companies?

"The fact that one oil major, BP, continues to pay dividends, while another, Royal Dutch Shell, has cut, highlights that often it's about individual companies and their management, rather than sectors. While we hold BP, we'd sold out of Royal Dutch Shell before the dividend cut.

"Some sectors will perform better than others during the crisis. We believe technology and telecoms companies may be big beneficiaries, with remote working resulting in increased demand for broadband, server technology and videoconferencing facilities. There may be some companies that still cut dividends, perhaps where their management were never really committed to them, but we expect others to honour their commitments.

A good example is Zegona Communications, which is one of our holdings. It's listed in the UK but is essentially a shell that owns more than 20% of Spanish telecoms provider Euskaltel. It is benefiting from increased telephone and data usage. Zegona has confirmed it will continue to pay its dividends. We also hold Euskaltel separately and it too has reconfirmed dividends. On 1st June, Euskaltel's rival Masmovil received a takeover approach from private equity groups KKR, Cinven and Providence Equity Partners."

"On the flip side, there are sectors which have been hard hit, but where individual companies are continuing to pay their dividends. For example, while property companies generally have been suffering, the Supermarket Real Estate Investment Trust has benefited from a very specific focus on supermarkets and distribution centres. It has maintained its dividend policy and we added to our holding in a recent placing."

What has been your response when companies have cut dividends?

"When companies cut their dividends we do normally sell out. However, in the current environment a more pragmatic approach is required, especially as the market sell-off has created anomalies. If the stock is at an obvious discount to its intrinsic worth and backed by a strong management team then we may not sell simply because it has cut its dividend. PPHE Hotel Group, which operates the Park Plaza chain, is an example, and this has rallied c. 70% off its March lows so it would appear we were correct to hold on.

"WH Smith is a company where we've bought more despite a dividend cut. We took advantage of price weakness to add to our position in the retailer when the share price was below that offered in the recent placing. The shares are now comfortably above the placing price. The lockdown and travel restrictions hit WH Smith hard, with an 85% fall in company-wide sales in April, so the decision to put the dividend on hold was understandable. We continue to like the company's story and believe its airport and railway station shops will reap the benefits as more people begin travelling again, but it is a gradual process.

"In contrast, we sold our position in Softcat, a provider of IT infrastructure and services, after it cut its dividends, despite having net cash and previously having paid special dividends. The latest trading update showed that the business is in better health than management seemed to think, so perhaps they should have paid a dividend after all."

Have some company management teams been too quick to cancel dividends?

"It's definitely the case that a bit of a herd mentality kicked in. When companies saw other businesses cancelling their dividends, many followed suit and went straight to zero, without giving much consideration to a reduction in the level of dividends or looking at other options such as scrip dividends, where investors receive a small amount of new shares in place of the cash dividend.

"We also think it was slightly awkward for some of the brokers advising companies. When they were recommending that companies raise cash through a placing, they may have seen it as difficult to advise the management the business was strong enough to pay dividends at the same time."

When do you think it's acceptable to cancel dividends?

"For those companies with high gearing that are in genuine need of government funds and are resorting to bail-out schemes then, yes, cut the dividends. The same is true when companies have been furloughing staff or closing all stores or sites, meaning they have no earnings to pay dividends from. Then we totally understand and are sympathetic."

Have you learned lessons during the crisis?

"We recently added to Bloomsbury Publishing in a placing, despite it having put its cash dividend on hold. Our reasoning was that the company is investing in its digital division, which is likely to benefit from the crisis accelerating the adoption of digital forms of entertainment, and also because it considered a scrip dividend, where investors would receive new shares in place of the cash dividend.

"Usually a scrip dividend is treated as capital so it's not something we would ordinarily opt for. However, when it's paid in place of a cash dividend it can be distributed as income. According to fund auditors, there's an income equalisation mechanism to make allowance for this. So, we've learned that in the current climate a degree of flexibility around scrip dividends is helpful and it can contribute towards the income paid out by a fund."

Have you seen any companies raise dividends? If so, could you share some examples?

"Yes, despite the challenging economic backdrop, there are companies that have still been able to increase their dividends. Examples are Chesnara, which is a life and pensions consolidator; HomeServe, the insurance and home repairs group; Severn Trent, the water company; Anpario, which provides agricultural feed additives; and Sirius Real Estate, which invests in German business parks. As you can see they're from a range of different sectors and spread across the market cap spectrum."

Is the dividend still a business confidence signal?

"It's truer now than ever. Only the strongest companies can continue to pay a dividend after

the economic shock of this crisis. It usually indicates that they have good visibility over their earnings and/or they have enough liquidity to reinvest in their businesses without compromising growth options.

"These robust, well-managed companies operate in a broad range of sectors and are spread across the market cap spectrum, so our multi-cap approach is a strength for the fund. These companies are continuing to pay attractive dividends and, over time, they're likely to be appreciated even more and to continue to build a loyal following among investors."

Siddarth Chand Lall, 03/06/2020

Risk Warnings

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Investment in the Company should only be undertaken as part of a diversified investment portfolio. Investment in the Shares should be viewed as a medium to long term investment.

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