Marlborough
Fund Managers

Q&A: Marlborough Multi Cap Income, an eight-year track record of paying an attractive income

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"We continue to see well-managed companies trading successfully and announcing increased dividends."

Siddarth Chand Lall

Marlborough Multi Cap Income Manager Siddarth Chand Lall discusses the fund's track record of paying an attractive income and how his stock selection process is designed to achieve this on a sustainable basis.

The fund has just reached its eighth anniversary, how has it measured up to its income objective?

"Few investors talk about this, so it's easy to forget that funds in the UK Equity Income sector have their annual income objective defined by the Investment Association. In the early years, we had to achieve at least 110% of the FTSE All-Share historic yield, which we comfortably delivered.

"When a number of funds were ejected from the sector for failing this test over a three-year rolling period, the objective was changed to simply beating the index yield. Once again, I'm proud to say we've achieved this in every year.

"In fact, the following table shows that we've continued to deliver on the original, higher hurdle even though it's no longer a sector requirement."

Date	FTSE All Share Yield (%)	90% of FTSE All Share Yield	110% of FTSE All Share Yield	Fund Year End Yield (%)	% of FTSE All Share Yield
31/07/2012	3.6	3.2	4.0	4.7	131%
31/07/2013	3.3	3.0	3.6	4.2	127%
31/07/2014	3.3	3.0	3.6	4.4	133%
31/07/2015	3.4	3.1	3.7	4.3	126%
31/07/2016	3.5	3.2	3.9	4.8	137%
31/07/2017	3.7	3.3	4.1	4.4	119%
31/07/2018	3.6	3.2	4.0	4.4	122%
7 Year Average	**3.5**	**3.1**	**3.8**	**4.5**	**128%**

Source: Investment Association

How is your stock selection process designed to achieve a sustainable income for investors?

"We look for companies with healthy balance sheets. Preferably that means net cash, however, we understand that some business models allow for modest debt, whilst retaining the ability to pay a sustainable dividend.

"We like companies with free cash flow that comfortably covers the dividend even after they've invested in growth and serviced any interest payments.

"What is also helpful is a business having a track record of maintaining their dividend in tougher conditions, either because of the defensible nature of their earnings or by using cash on the balance sheet to temporarily fund an uncovered dividend.

"On the other hand, some sectors are highly cyclical and known for dividend cuts. One example is mining companies and for that exact reason we have very little exposure to this sector.

"We also look closely at the prospects for dividend growth. We analyse the potential for future earnings and cash flow growth, comparing our own calculations with those of analysts. Where there is net cash we will investigate the possibility of an increased dividend payout ratio or special dividends.

"Part of our investment process is to meet the company's management team, which is an opportunity to learn more about the business model and hear their plans for the future. It also allows us to assess their commitment to the dividend. Is it considered important or will they cut the dividend if they need funds for acquisitions? Once we've invested, we'll meet the management team each year to follow up on results.

"Some equity income managers will adopt a barbell approach, where a number of holdings pay no dividend and others have a high yield, but that's not a strategy we use. All of our companies contribute income to the fund and if a stock's yield drops below 2% we'll usually look to scale back the position.

"Ensuring all of our stocks contribute income in this way reduces dividend concentration, where you're reliant on a limited number of companies for payouts, and helps to manage risk."

How has your multi-cap approach contributed to the fund's income track record?

"The fund's bias to small and mid-cap companies is unusual in the UK Equity Income sector, where most funds are largely focused on FTSE 100 dividend payers.

"Our wider remit gives us the freedom to invest in more than 700 dividend-paying companies, whereas if you're only investing in the FTSE 100 you have 90 or so dividend-paying stocks to choose from.

"Profitable smaller companies are typically at an earlier stage in their earnings lifecycle. This should translate into greater long-term cash flow growth, relative to their more mature large-cap counterparts. In theory, this can also translate into dividend growth.

"We do hold some FTSE 100 companies, where they meet our investment criteria. However, by focusing on small and mid-caps we've protected the portfolio from some high-profile dividend cuts at companies like Vodafone, Marks and Spencer, Provident Financial, Pearson and Rolls Royce.

"There may be more to come. The Financial Times reported that Jan du Plessis, Chairman of BT (another FTSE 100 company) recently said, the business may consider reducing its dividend.

"In the UK, there's a high level of dividend concentration, with 15 FTSE 100 companies paying around 60% of the dividends for the whole market. In some funds, a number of these companies will dominate their top ten holdings.

"We want to avoid being too dependent on a limited number of companies. Our 20 largest holdings contribute only around 40% of the fund's total dividends and our portfolio is highly diversified. We hold 113 stocks and only a handful of positions make up more than 2% of the overall fund, with even our largest holding being just 2.9%."

Can you give an example of the sort of company you're looking for?

"Bloomsbury Publishing is well known as the publisher of the Harry Potter books, but the business has diversified over the past decade with the development of its academic and professional division, while continuing to add new best-selling authors to its consumer division.

"The company has a large portfolio of titles and it's a global business, with 64% of the group's revenues generated overseas.

"Last year Bloomsbury increased adjusted earnings per share by 8% and grew the total dividend per share by 6%. That means it's delivered dividend growth every year in the 24 years since listing. Following another year of strong cash generation, the company has also increased its net cash position to £27.6m.

"The digital transformation in the academic and professional division has the potential to translate into higher margins, driving earnings over the next few years. Meanwhile the strong balance sheet provides firepower if Bloomsbury decides to pursue further acquisitions, while also providing security for the dividend."

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How would you characterise the investment outlook?

"Global macroeconomic concerns have combined with Brexit uncertainty to weigh on investor sentiment towards UK equities, which are trading at a significant discount to both historic averages and comparable developed markets.

"That creates opportunities, particularly among UK small and mid-caps. For those taking a selective approach, it's possible to find quality, dividend-paying companies at reasonable valuations.

"Despite the uncertain backdrop, we continue to see well-managed companies trading successfully and announcing increased dividends."

Risk Warnings

Capital is at risk. The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest. Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our funds invest for the long-term and may not be appropriate for investors who plan to take money out within five years. The fund will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events. The fund will invest in the shares of smaller companies which are more volatile over shorter time periods. The fund invests mainly in the UK, therefore, investments will be vulnerable to sentiment in that market, which may strongly affect the value of the fund. All or part of the fees and expenses may be charged to the capital of the fund rather than being deducted from income. Future capital growth may be constrained as a result of this. In certain market conditions some assets in the fund may be less liquid and therefore more difficult to sell at their true value or in a timely manner.

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