QUARTERLY INVESTMENT REPORT

March 2024

Don't have all your investments pointing in the same direction – this seems to us to be a sensible philosophy. The last decade has seen stellar gains by certain types of stocks, particularly a combination of US, tech, and growth. On the back of these gains, a significant portion of many investors' holdings are pointing in the same direction. Will the best returns come from a different direction over the next decade?

Quite possibly. Let's look at a concrete example, in the form of Kennox's holding Quadient. Overlooked but growing again, Quadient is now hitting the sweet spot of revenue growth combined with expanding margins.

As a refresher, Quadient's original business is postal services, such as franking, or folding and inserting post into envelopes. This mail-related business remains hugely cash generative, and clients continue to appreciate the services which are inexpensive compared to the cost of sending employees to queue to buy stamps, or to stuff envelopes manually. Due to the continuing decline in letter volume, the mail-related business will shrink over the longer term, but not as quickly as one might think. That market is shrinking at low single digits per year, offset for Quadient by market share gains against weaker competitors. 2023 revenues fell by just 0.2%.

What is exciting is that Quadient has spent the last five years building up two new business lines. The first of these, the parcel lockers business, looks well positioned as it has been able to carve out a niche as an independent provider and has shown some big client wins, locking in sticky recurring revenues.

However, it's the Intelligent Communication Automation (ICA) business line that looks especially interesting. This business supports both big and small businesses "in all aspects of customer communication and financial automation". For bigger companies, often financial services and insurance companies, this means services such as client on-boarding or the treatment of all the innumerable steps to clear an insurance claim. For smaller businesses, Quadient offers services for business process automation, examples being the full processes for invoicing, accounts payable or accounts receivable. With Quadient's help, these systems are an enormous benefit to its clients – cloud-based, paperless, and integrated into other IT systems. To give an idea of the scale, Quadient's solutions treat a billion client-facing & critical business interactions a day, with four thousand businesses already integrated onto the Quadient platform.

Due to the disruption and distraction involved, companies are disinclined to chop and change systems once adopted, making the business dependable. As for growth, thousands of small companies have yet to adopt these efficient processes and are increasingly being encouraged to do so by the obvious attractions, but also by governments and regulation. Quadient's products are designed to be quick to install & integrate and are especially well placed for this environment. As a software business, it is also wonderfully scalable. With a largely fixed cost base, incremental revenue gains come at a staggering 40% EBIT margin even allowing for additional investment. ICA has turned profitable at this relatively early stage of adoption, a great success, and the stickiness of clients and a likely increased uptake make the outlook especially rosy.

The five years that it took to establish these new business lines is a painstakingly long time for the market to wait, and so naturally the market's attention has been elsewhere – there aren't many investors out there even considering companies that aren't growing and preferably growing quickly.

Therein lies the value. As seen in its latest results, Quadient has put in the hard yards and is now well-positioned in fast growth areas with a world class ICA business (that is very likely to be worth more than the entire market cap of Quadient). With modest assumptions it is likely that Quadient will grow profits and cash flows by 20% per annum over the next few years. Trading at meagre valuations (Quadient is on just 8x trailing earnings), the risk to reward is especially attractive.

Quadient sits in the portfolio alongside stocks such as Youngone in South Korea (which has more net cash & financial investments than the market cap, and trades on under 4x trailing earnings), Sky in New Zealand (expecting a doubling of the dividend yield soon to over 10%, on 8x trailing earnings), and Stella International in Hong Kong (whose share price has been rising recently but remains on an 8% dividend yield, on 9x trailing earnings). These are particularly appealing situations, each offering limited downside risk with substantial upside potential, yet unnoticed by the markets. So far.

It's worth saying a word on gold, whose strength has even been making it into the headlines recently. We live in a world where inflation has returned, where governments continue to attempt to do (and spend) more not less, and most importantly, we live in a financial system that has grown both public and private debts to all-time highs, levels usually seen only at the end of long and expensive wars. It is an increasingly bold bet to say that none of this will ever matter. With this backdrop in place for the indeterminate future, the tailwinds for an asset like gold look likely to continue.

Our holding in Agnico Eagle has gone well since purchase a year ago. Production and costs are coming in nicely, and Agnico's assets remain high quality, well situated near to each other, and in especially safe jurisdictions.

Newmont on the other hand has been going through a more difficult patch. After strong profits in 2019, 2020 and 2021, the last couple of years have seen costs and capital investment come in higher, certainly than we were expecting, and these both squeeze cash flow generation. Newmont recently followed this up with a cut in dividend per share on the back of the increased number of shares due to the Newcrest acquisition.

We're sticking with Newmont, the world's largest gold miner. The shares are very inexpensive if they can even come close to its earnings level of 2019-2021 (at about 12x, and that didn't include the Newcrest assets). If, as we expect, this bumpiness in its production pipeline proves temporary and with a tailwind in the form of the gold price, we feel this is well worth the wait.

Overall, the Fund's dividend yield remains at historic high levels (at 3.5% net of all fees) and valuations remain inexpensive (at c. 10x trailing earnings and a 10% free cash flow yield). This offers a good starting point for returns. And it's even better coming from holdings such Quadient and the others mentioned above – not pointed in the same direction as much of the market, unloved and very likely to thrive, come rain or shine.

Fund Data – 28 March 2024

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS	
	CLASS I	CLASS A
YTD	2.1%	2.1%
2023	8.0%	8.2%
2022	12.6%	12.9%
2021	10.1%	10.5%
2020	-11.1%	-10.9%
2019	4.8%	5.1%
2018	-2.2%	-2.0%
2017	2.5%	2.6%
2016	35.8%	36.2%
2015	-4.0%	-3.8%
2014	-1.1%	-0.9%
2013	15%	4.3%*
2012	10%	N/A
2011	-4.0%	N/A
2010	12%*	N/A
2009	N/A	N/A

Source: Kennox. Performance figures are total return generated from the accumulation units since their launch (29 April 2013), and from the income shares prior to that. * Share classes launched mid-year: Class I on 12 May 2010; and Class A on 29 April 2013.

Top 10 Holdings

STOCK	REGION	SECTOR	MARKET CAP (US$M)	WEIGHT (%)
SHELL	UK	Energy	219,000	7.2
STELLA INTERNATIONAL	Asia	Consumer Discretionary	1,500	6.7
NEWMONT CORP	N. America	Materials	42,000	5.9
EQUINOR	Europe	Energy	82,500	4.8
FUKUDA DENSHI	Japan	Health Care	1,500	4.7
SINGAPORE TELECOM	Asia	Communication Services	31,000	4.3
AGNICO EAGLE MINES	N. America	Materials	30,500	4.2
CANON MARKETING	Japan	Information Technology	3,500	4.1
YOUNGONE HOLDINGS	Asia	Consumer Discretionary	900	4.0
LG CORP	Asia	Industrials	10,000	3.5
TOTAL TOP 10				**49.5**
19 OTHER HOLDINGS				48.8
CASH				1.7

Unit Prices

As at 28 March 2024:

- Class I shares:
    - Income: 135.90 pence (unit price at inception, 12 May 2010: 85.46 pence)
    - Accumulation: 179.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A shares:
    - Income: 136.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
    - Accumulation: 183.30 pence (unit price at inception, 29 April 2013: 104.3 pence)

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If you have any questions on Kennox or the Kennox Strategic Value Fund, please contact us on +44 (0) 131 563 5440 or email at clients@kennox.co.uk. Our website is www.kennox.co.uk

We do not track, nor are we constrained by, a benchmark. Reference to the MSCI World and MSCI World Value indices are for comparative purposes only.