QUARTERLY INVESTMENT REPORT

September 2023

Dare we say it but it has been an agreeable time of late for investors such as Kennox. Finding an increasing number of quality opportunities, we added three new names to the portfolio in the spring (discussed last quarter here). Amongst our existing holdings, several companies are seeing a broadening dislocation between burgeoning operations and stagnant share prices – managements are genuinely scratching their heads as to why the market is not marking up their lowly share prices alongside improving outlooks. Frustrating as this is in the short term it is also a very powerful indicator for the future potential of the shares, and hence of the portfolio. Overall, the performance of the fund has ticked up recently, even in the face of market volatility. Lastly, the dividend yield on the fund is at all-time highs, an encouraging sign.

On the disjoint between the underlying operations and share price mentioned above, a good case study is New Zealand's **Sky Network Television**. The company has seen off their strongest competitor, the incumbent telecom Spark, which has withdrawn from sports streaming; Sky has locked in the bulk of both sport and entertainment content rights at reasonable prices; it has a balanced offering between satellite and streaming especially via their new delivery platform, "Sky Pod"; it has been able to raise its prices; the company even has a pot of net cash on the balance sheet (about 15% of the market cap), just in case. Yet the company trades at under 8x trailing earnings. The company has higher than normal investment plans for the next eighteen to twenty-four months, but as that falls away the company is confident that there will be sufficient cash flow to be able to double the dividend, from the current 6% yield to a mouth-watering 12%. It is impossible to know when the market will consider this to be important, but we are clear that opportunities such as this offer tremendous risk to reward: a leader in their field trading at very attractive valuations, with growth potential (especially in their cash flows), paying us good dividends while we wait.

We also spoke with **Quadient's** management over the quarter. The company has done a good job in the last few years, evolving its new and traditional businesses. Their new segments, Intelligent Communication Automation (ICA) and Parcel Lockers, are gaining traction and the offerings are compelling, as shown by the strong recurring revenues (at about 70%). The ICA business is especially well placed, providing services for the core functions of its SME clients, scalable with a sticky client base. It is pleasing to see growth in this segment now falling through to the bottom line, as we are past the inflection point after higher initial investments. Turning to the traditional mail-related business where Quadient has a dominant position but in a market in slow decline, the company has grown market share and generated strong cash flows. It has been aided in this by its parcel solutions, a market that has obvious attractions. Overall, Quadient is a robust and cash-generating business, but the market is assigning it a stingy multiple of around 8x current earnings. If the business continues to show growth in EBIT, as it is doing at present, it would not be difficult to see the shares re-rated to 12x, still inexpensive for a growing business, and 50% above current prices.

There is now a cluster of these sorts of names at the top of the portfolio: idiosyncratic, stock-pickers' stocks that are underappreciated and offering an uncorrelated return opportunity. **Stella International**, a leader in its niche, continues to yield c. 11%, covered by earnings and cash flow. **Youngone Holdings** continues to trade at a negative enterprise value, i.e. the cash on the balance sheet is higher than the market cap, and trades at under 5x trailing earnings, again for a strong niche player. **Fukuda Denshi's** share price has been strong of late but is still trading for less than 10x trailing earnings, available at book value, with about 1/3rd of the market cap in net cash on the balance sheet.

We should also mention the opportunity in energy, as **Shell** and **Equinor** remain the top holdings. Climate change continues to be a central issue for humanity, but it is crucial that we seek out pragmatic not idealistic solutions. Investors are coming to realise that the answer to this thorny and complex problem is not as simple as buying a Tesla and selling your Shell shares. We need to address all three aspects of the energy trilemma – affordability and reliability as well as climate change – for the smooth functioning of our society. Until any transition is complete, underinvesting in fossil fuels is a risky proposition, as is becoming reliant on less scrupulous providers.

Responsible operators such as Shell and Equinor unquestionably fulfil a core role in our society. Turning to the economics of the industry, the shares are available to investors at very attractive prices. For instance, in the first and second quarters when oil was trading in the low $70's, Shell was still able to generate a FCF yield around 15%. If fossil fuels remain an integral part of the wider energy landscape for the foreseeable future (which is almost inevitable), Shell looks extraordinarily inexpensive.

How is it possible that opportunities such as those described above exist? Surely the market is efficient, or at least more efficient than this? The answer lies in the behavioural aspects of investing. Kennox and similar investors, for instance, did not have an easy time between late 2016 and late 2021. Performance tracked sideways and being invested in the undiscovered and downtrodden was a slog. Meanwhile, others were making out like proverbial bandits. It turns out that difficult year after difficult year drives many out from the area, exiting in despair or attracted elsewhere to where markets are fast and exciting. Fair enough. As fewer are willing to commit their investments to the opportunities, prices languish to extreme levels. Those bold enough, and able to hold their nerve, find extraordinary opportunities. This is where we find ourselves now – and so the investment cycle continues.

We are living in a time when the market is wrestling with a possible change in monetary regime, away from the last four decades of increasing debt, extremely easy money, and low inflation. Societal issues such as climate change, war, and protectionism further obscure the outlook. We find the sorts of opportunities described above especially fulfilling, both on a rational and on an emotional level, comforting in these times.

Fund Data – 30 September 2023

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS	
	CLASS I	CLASS A
YTD	4.0%	4.2%
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: Bloomberg. 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	211,500	7.5
EQUINOR	Europe	Energy	100,000	6.4
STELLA INTERNATIONAL	Asia	Consumer Discretionary	800	4.5
NEWMONT CORP	N. America	Materials	29,500	4.4
SINGAPORE TELECOM	Asia	Communication Services	29,500	4.3
FUKUDA DENSHI	Japan	Health Care	1,500	4.0
YOUNGONE HOLDINGS	Asia	Consumer Discretionary	800	4.0
BP	UK	Energy	110,500	3.9
CANON MARKETING	Japan	Information Technology	3,500	3.9
STAR MICRONICS	Japan	Industrials	500	3.7
TOTAL TOP 10				**46.4**
21 OTHER HOLDINGS				52.9
CASH				0.7

Unit Prices

As at 30 September 2023:

- Class I Share Class:
  - Income: 131.30 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 169.00 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 131.50 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 172.80 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