R.C.B Primary Opportunities

Q&A

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How common are primary opportunities?

Generally speaking, it's not unusual for fund managers to look at a primary opportunity in isolation. But we're the only fund manager that specialises in primary offerings, using this as the basis of our investment strategy.

Opportunities occur when a company is raising money; that's the catalyst for us to consider an investment. This might be an initial public offering (IPO) or, if already listed, when raising money for expansion/acquisition purposes, or for research and development, or companies raising money through a rights issue.

If the latter of these opportunities arise and should shareholders not exercise their rights, the overhang, known as 'the rump', is then placed with institutional investors such as ourselves. We believe this overhang naturally depresses a company's share price. Finally, we also consider large sell-downs by known sellers, such as private equity or the founders.

What are you looking in IPOs?

That's true; 2017 was a pretty busy year for IPOs and we anticipate 2018 to follow suit as companies seek new investment to grow and take advantage of a growing global economy.

We look at and consider IPOs from all UK sectors. Preferably companies with a market capitalisation over £100 million, are growing, cash generative, expect to pay a dividend and are reasonably rated.

Sabre Insurance, a motorcar insurance company, floated in December. It was modestly priced, growing its niche insurance book and offered a very attractive dividend yield of around 6%. It's already up around 15% since its float.

Another, Sumo Digital, a video games developer, is a leader in its sector and has good growth characteristics for this area of the market. Multi-year growth is expected from this industry.

Imminent IPOs we're considering are JTC, a financial services company providing fund administrative support, and Chargemaster – the largest developer, supplier and installer of electric charging points for vehicles in the UK, with a growing presence in Europe also. Both will have a market capitalisation well over £100 million, with Chargemaster likely to prove one of the most popular IPOs of 2018.

There's been some sell-downs by private equity and founders. Despite recent market volatility, companies have continued to press ahead with raising money. Two companies we recently purchased are animal veterinary company CVS, which was raising money for acquisition purposes, and Clipper Logistics, who provide online return solutions to major retailers such as ASOS and John Lewis, as well as other well-known major retailers.

Your long-term performance has been good. Why is this?

When we buy into a company, we buy in the knowledge there's been full disclosure to the market; therefore, we are able to assess its true worth. Couple this with the discount to the prevailing market price, we're afforded a margin of error that eludes most other investors, creating an additional margin of safety from a price and valuation perspective. Meaning that our process has an element of inbuilt downside protection should the market have a drawdown, such as recently experienced.

Simply, we're buying these stocks in the primary market at a discount, i.e. cheaper than your typical investor; so we wouldn't expect companies we've recently bought to fall by as much as the market, which is one reason we've managed to limit drawdowns of late.

Do you think this gives you an advantage over other fund managers?

Yes, definitely. Especially with IPOs, as we're buying in at ground level. If these companies succeed, grow their profits and pay bigger dividends, the primary process affords us a price advantage that investors will benefit from over time.

Is there a temptation to take profits immediately after stocks have gone public?

Absolutely not! Our due diligence prior to purchase is very strict, we have high conviction in the companies we hold and expect to own these shares for the long term. The cycle of success, means companies will ultimately come back to the market and raise more money to expand further. As investors we would like to be supportive of that and in doing so, we too will benefit. So, no, if we think it's a good company, doing what it set out to do at IPO, that we still consider is reasonably valued, we would expect to continue to hold it.

How can the fund complement an investor portfolio? Does it offer something different?

Yes, absolutely! To reiterate my earlier point, when companies first come to market or look to raise capital there is full disclosure. Our primary opportunities process affords us the ability to analyse this information and meet the management thereby unearthing good companies at an early stage. Our longevity in primary markets led to the launch of our MFM UK Primary Opportunities fund in 1996, (previously known as the Quantock fund), providing retail investors access to an otherwise institutional arena.

We're the only fund manager focusing solely on primary opportunities, so we provide differentiation from traditionally holding UK stocks or funds. We buy into opportunities not available to most investors and at a discount to the prevailing market price. Often, we are buying newly issued shares which do not incur stamp duty or broker commission, so by keeping the expenses of the fund at a minimum, this in turn positively aids performance returns.

Holding on to our position in successful companies means that around 50% of the portfolio (24 stocks) is in the FTSE 100; the balance, i.e. 50%, is held outside of that, of which 30%, as many as 35 stocks, are small-caps, the latter allowing us to get in at ground level and find those multi-year growth stories.

This also means we have a high active share, so the fund doesn't perform like a tracker on the upside or the downside. Of course, I have some of the large constituents of the FTSE 100 in the portfolio acquired as part of our primary opportunities process, for good reason; yield being one factor and flight to quality being another should market confidence wane. I happen to think they're good quality companies.

The result is that we have a very distinctive UK equity fund that focuses on primary opportunities. So certainly, I think the ability to give investors access to these sort of opportunities means that the fund will complement investors current UK equity exposure and provide greater downside protection, which can be a bit of a crowded trade with so many managers focusing on the same types of companies and investment ideas.

The MFM UK Primary Opportunities Fund as at 19 February 2018, has returned 59.71% over five years and 35.41% over three years** compared with 48.95% and 20.76% to the IA All Companies Sector, placing the Fund 2nd and 1st quartile respectively over these periods.*
** Source: FE Trustnet, 20/02/2013-19/02/2018*
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Fund/Benchmark Name	28/02/2017 to 28/02/2018	28/02/2016 to 28/02/2017	28/02/2015 to 28/02/2016	28/02/2014 to 28/02/2015	28/02/2013 to 28/02/2014
MFM UK Primary Opportunities	11.56	25.11	-2.63	1.78	16.09
IA UK All Companies	6.59	19.18	-5.42	3.76	19.43
FTSE All Share	4.40	22.88	-7.37	5.56	13.29

Source: FE 2018