

Q & A



Primary
R.C.B. Opportunities

OLIVER BROWN

LEAD FUND MANAGER, MF UK PRIMARY
OPPORTUNITIES FUND

HOW DOES THE MF UK PRIMARY OPPORTUNITIES FUND OPERATE?

Our strategy is simple; companies use primary markets to raise 'new' capital for acquisition, R&D and working capital for either expansion or debt reduction. Every company during its economic cycle is likely to have at least one primary event, our process helps identify good quality companies from which to populate our Fund. If I'm not entirely convinced about the investment case, there'll be other opportunities to invest later in a company's life.

Our first investment opportunity occurs at IPO (Initial Public Offering), when a company is preparing to

list. Post-flotation a company may return to the primary market, to raise new money for acquisition or expansion. We'll want to understand why they're raising capital, how this capital is to be deployed and whether it potentially is a profitable purchase for us.

Secondary placings or large sell-downs occur when groups such as private equity or company founders look to reduce their exposure. Here we'd want to know why they're selling. Other opportunities include a rights issue, if some shareholders don't exercise their rights, the surplus stock known as 'the rump', are offered to institutional investors such as ourselves. In all instances, we look to buy good companies at a discount to the prevailing

market price or what the market considers to be fair value.

HOW DO YOU SCREEN FOR THOSE OPPORTUNITIES AND KNOW THEY ARE TAKING PLACE?

Our strength in part is due to our long-term relationships with the investment banks. They approach us when they've a company that is looking to raise capital. Whilst every opportunity is given consideration, we may not invest, but we'll certainly learn something about the company and sector that will be useful going forward.

Our own research uncovers companies that may be looking to raise money, in this instance we'll make our interest known to the house broker.

We'd always insist on speaking with management before making a firm decision. Given all this, there's not many primary opportunities we don't hear about.

HOW DOES THIS INSTITUTIONAL ELEMENT GIVE YOU A 'FIRST MOVER ADVANTAGE' OVER OTHER RETAIL FUNDS?

The primary market is typically the preserve of institutions, who have sufficient funds to 'bulk' buy, thereby negotiating a 'wholesale' price for a

company's shares, often at a steep discount to what they'd pay after listing on the secondary market (The London Stock Exchange).

Via our Fund, investors benefit from institutional pricing and cost savings provided by this market segment, which aids performance and buffers returns in falling markets. Thus, providing a 'first mover advantage.' Our approach illustrates perfectly the essence of 'collective investment.'

Performance has been very strong, but it's also quite different from the benchmark proving we're not swimming with the crowd and relying on market beta for returns.

HOW MANY IPOs ARE YOU LOOKING AT PER YEAR? WHAT DO YOU LOOK FOR IN PROSPECTIVE COMPANIES?

The number of company flotations varies from year to year, 2018 looks strong, although recent market turbulence may hold some companies back. Typically, I look at over a dozen IPOs and I'm pretty much aware of every IPO that comes to the London market.

In terms of what I look for, the minimum market-cap of a company tends to be around £100m. They'd need to

demonstrate that they're not only profitable but growing their profits too. Valuations need to be reasonable, with the ability to pay dividends, if not now, at some point in the near future. Hence, we focus on the quality end of the IPO market, where these companies tend to deploy this capital raised more effectively. We avoid very high risk, such as biotech and I'm not a fan of business plans.

We recently purchased JTC, a Jersey-based financial services firm, employees still own a large part of the business, 2017 revenues grew by 17% and it listed with a value of £310m.

HOW LONG HAS R.C. BROWN BEEN INVESTING IN THIS WAY?

Almost three decades for institutional clients, shortly after, in 1996, we launched the Fund. I've been involved with R.C. Brown and the Fund for twelve years, in May 2013 I took over as Lead Fund Manager. I've certainly learnt a lot. My first priority was to achieve a smoother ride for investors by addressing the consistency of the Fund's outperformance – our five-year numbers illustrate our success.

WHAT'S CHANGED SINCE YOU TOOK OVER AS LEAD

FUND MANAGER FIVE YEARS AGO?

Quite a lot actually. We needed greater diversification.

Our process review identified that we were taking larger positions than was necessary, particularly in mid and small-caps, so we reduced our weighting from near 65% to near 50% in favour of larger capitalised companies. Initial positions taken in small caps were reduced from 2.5% to 1.5%, thereby increasing the number of small-caps held and by default increasing the overall number of stocks in the portfolio to around 75. Finally, we raised the market-cap bar from £50m to over £100m, addressing liquidity.

In terms of exiting a position I'm pretty ruthless should a company disappoint. Primary market transaction costs are minimal, so this is of no major concern, allowing me the freedom to be truly active.

Therefore, I'm constantly seeking opportunities that potentially may out-perform my current holdings.

The Fund's alpha is first quartile over one and three years, volatility has also reduced to lower than that of the market, (FE Trustnet, March 26th 2018.) This all stacks up into a very compelling story.