



Results analysis: Schroder Income Growth

Recent outperformance stems from strong stock selection, modest gearing and a recovery in the trust’s small- and mid-cap stocks...

Update
12 November 2024

- Schroder Income Growth (SCF) has released its financial results for the year ending 31/08/2024, reporting NAV total returns of 19.0% and a share price total return of 17.7%, outperforming the FTSE All-Share Index’s 17.0% return.
- Outperformance stemmed from several factors, including the trust’s modest gearing, which averaged 13.5% over the period, enhancing returns by 2.6%.
- Manager Sue Noffke’s strong stock selection within the financial and consumer staples sectors further boosted performance, as well as the portfolio’s exposure to small- and mid-cap stocks, which outperformed their larger counterparts.
- SCF is celebrating its 29th consecutive year of dividend growth, raising the dividend per share to 14.2p, a 2.9% increase compared to 2023. During the same period, earnings per share fell by 11.5%, meaning the total dividend was 82% covered by earnings. After the payment of the fourth and final dividend, the trust’s revenue reserve sat at £5.7m, representing roughly seven months of the annual dividend.
- Income generated from the portfolio faced pressure for two main reasons: a decline in income from the mining sector; and an increased preference among companies within the portfolio for greater allocation of capital towards share buybacks, given valuations, rather than increasing dividend distributions.
- SCF’s discount averaged 9.6% during the financial year, although it currently trades at approximately 11.4%. During its financial year, the board repurchased 38,000 shares – the first time since 2008 – and have since bought back an additional 8,000 shares, aiming to enhance the asset value per share.
- Chairman Ewen Cameron Watt commented, “The UK equity market continues to offer attractive value to investors, particularly given its lower valuations compared to global peers... Your investment manager has made significant

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changes to the portfolio in response to the evolving environment and the ongoing oversight and experience of the team should give investors some comfort.”

Kepler View

We think the recent results from **Schroder Income Growth (SCF)** are strong, showcasing solid relative performance amid a challenging landscape marked by geopolitical tensions, polarised political climates, uncertainties around the speed of interest rate cuts, and sluggish global growth. We think this success is largely to lead manager Sue Noffke’s disciplined approach. Her unwavering focus on UK companies with resilient business models and solid fundamentals, has proven effective. Outperformance over the period stems primarily from strong stock selection but has also been enhanced by the trusts’ modest gearing.



Whilst the UK market has been perceived as a home for out-of-favour, downtrodden sectors that have struggled over the last decade, Sue views the sector's current undervaluation as an opportunity rather than a limitation, recognising the potential for long-term recovery and value creation within this overlooked market. Whilst some companies' low valuations are justified, she believes many are not necessarily undervalued due to weak fundamentals; instead, many have withstood prolonged macroeconomic pressures. As such, she has identified several companies trading at discounts, that also exhibit strong fundamentals, representing re-rating opportunities as the market corrects its mispricing over time.

An example is Inchcape, an automotive distributor added to the portfolio earlier this year, which is capturing market share from its competitors and generating attractive returns on capital. Despite its strengths, it sits at a depressed valuation, which Sue believes reflects the market's undue focus on broader sector challenges. Not every portfolio adjustment has worked as anticipated, however. Diageo, initially acquired for its re-rating potential, encountered greater-than-expected headwinds from destocking. In response, Sue quickly divested the position, reallocating capital to stronger opportunities. Whilst this quick turnaround is unusual for Sue, it's encouraging to see that when something goes wrong decisive action is taken.

Over the period, SCF raised its dividend for the 29th consecutive year, despite a notable drop in earnings, which the board supplement with reserves. Earnings from the mining sector fell by two-thirds, impacting the portfolio's income. As such, Sue increased the allocation to financials, including initiating a new position in Standard Chartered, which made up for some, but not all, of the shortfall from the mining sector. Additionally, 29 companies in the portfolio conducted share buybacks, favouring them over dividends. Whilst this wouldn't be good every year, Sue views these buybacks positively as they signal acknowledgment of the favourable valuations in the UK market. All else being equal, she highlights that buybacks can enhance future earnings and dividends per share, supporting shareholder returns over time.

Overall, we believe Sue and her team have built a well-diversified portfolio, offering long-term investors an appealing combination of income and growth potential. Given present valuations, Sue and her team are optimistic about the opportunity set, something they believe is also supported by recent bid activity which has reached its highest level since 2018, indicating increased interest and investment, and aligns well with those seeking exposure to undervalued UK assets. Additionally, greater exposure to small- and mid-cap stocks has allowed SCF to benefit from recent upswings in these areas, which, whilst potentially

increasing short-term volatility, has supported SCF's objectives over time and sets it apart from many equity income peers, offering differentiated income and return opportunities.

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