Results analysis: Schroder Income Growth

SCF is rebalancing the pattern of income, ensuring a more consistent, even spread over the four interims throughout its FY2025 and beyond...

Update
15 May 2025

- Schroder Income Growth (SCF) has released its half-year results for the six months to 28/02/2025, reporting NAV total returns of 2.9% and a share price total return of 1.8%, compared to the FTSE All-Share Index's 5.2% return.

- Its allocation to small- and mid-cap stocks proved a headwind over the six months, as they lagged large-caps, weighing on relative performance.

- Stock selection within financials was a bright spot—three of the trust's top five performers were financials: Standard Chartered, 3i Group, and Lloyds Banking Group. However, this was offset by adverse stock picking in consumer discretionary, industrials and consumer staples.

- Earnings fell by 3.9% over the period, largely due to capital allocation trends, with more companies favouring share buybacks over dividends, particularly special dividends.

- Despite this earnings dip, the board raised the first and second interim dividends to 3.25p per share, up from 2.50p, citing this decision as a reflection of their desire to rebalance the pattern of income more evenly through the year. As such, they anticipate a greater portion of the total dividend will be paid across the first three interims, with the fourth likely to be lower.

- SCF's discount stood at 11.6% at the period end, prompting the board to buy back 211,100 shares, or 0.3% of issued share capital. At the time of writing, the discount has narrowed to 7.7%. The board is adopting a more active approach to discount management, aiming to reduce volatility and maintain the discount within a single-digit range under normal market conditions.

- Additionally, the board have announced a number of changes to reduce SCF's fees. First, management fees will fall from 0.45% to 0.40%, effective from 01/09/2025, and will be charged on the lesser of market capitalisation or NAV. Second, the separate fee for secretarial and administration services will be removed. The board estimates that, all other things being equal, this could result in savings of over£300,000 for shareholders—equivalent to around 0.4p per share, assuming a prevailing 10% discount to NAV.

- Matt Bennison has been formally appointed as Co-Manager of the trust. Matt has actively assisted Sue in the management of the portfolio since September 2017 and is a key member of the Schroder UK equities team.

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- **Chairman Ewen Cameron Watt commented: "Mid- and small-cap exposure proved a drag against a backdrop of higher macroeconomic and geopolitical risk. However, the freedom to invest across the market capitalisation spectrum has been a key driver of longer-term total return and could also prove positive in the future if the new UK government can succeed in its mission to return the country to a stable path of economic growth."**

Kepler View

As the Chairman notes, **Schroder Income Growth (SCF)** performed well in its 2024 financial year, outpacing the index primarily through strong stock selection, particularly within financials. However, the first half of FY 2025, the six months to 28/02/2025, has brought renewed volatility and uncertainty to the table, on both the domestic and the geopolitical stage. The period began on a positive note, with falling rates and optimism around a pro-growth agenda from the incoming government. But reality saw expectations quickly falter, with escalating geopolitical uncertainties, trade tensions, and subdued sentiment towards UK equities coming to the fore. Growth forecasts were revised down and inflation pressures resurfaced, slowing the anticipated pace of interest rate cuts.

Together, these factors weighed on the trust's performance, particularly its allocation to the more domestically oriented small- and mid-cap stocks. Despite attractive valuations—both in absolute terms and relative to large caps—and robust fundamentals, heightened uncertainty triggered a flight to defensiveness and liquidity. This was reflected in index performance: the FTSE 250 ex IT and FTSE SmallCap ex IT declined by 4.2% and 7.3%, respectively, whilst the FTSE 100 delivered a positive return of 6.5%. SCF's overweight to small- and mid-caps—and corresponding underweight to large caps—was therefore a key driver of relative underperformance.

Stock selection in financials was strong with Standard Chartered sitting as top contributor over the period. Following a period of restructuring, the bank has returned to growth, supported by improving cash flows and sizeable share buybacks. 3i Group was another standout delivering strong NAV growth, largely driven by its asset, Action—the European discount retailer—which continues to expand steadily across Europe with robust earnings and cash reserves. However, this was offset by adverse stock selection in other sectors like industrials and consumer staples

Since launch, SCF has built a robust track record of delivering real dividend growth ahead of CPI inflation. That trend continued during SCF's FY2024 and marked the trust's 29th consecutive annual dividend increase. So far in FY2025 this looks set to continue, with the first and second interim dividends climbing to 3.25p per share, up from 2.5p. However, the growing preference among companies for share buybacks over special dividends has applied pressure to near-term income. Over the reported period, 24 holdings (roughly 60% of the portfolio by average weight) conducted share buybacks. One example, Hollywood Bowl, reduced its final divided and decided to forgo any special dividend.

To support the dividend, the board drew on revenue reserves. But after paying the first two interim dividends, reserves stood at 7.8p per share—equivalent to just 57% of last year's total dividend. To help strengthen income generation, Sue has increased exposure to financials—an area offering strong yields, attractive valuations, and sound fundamentals. Moreover, she continues to ensure the portfolio blends dependable income generators with a mix of high yielders and lower-yielding names that offer stronger capital and dividend growth potential over time. We also note the board's effort to smooth income delivery by rebalancing payments more evenly across all four dividends, reducing reliance on a large final payout.

Despite ongoing challenges, we believe the UK market presents an intriguing opportunity. Equity valuations, notably mid-caps, remain attractive, both relative to their own historic levels and to global markets, whilst underlying fundamentals remain robust. These market dislocations have created attractive entry points for active stock pickers, something Sue has taken advantage of. She has been selective here—trimming large-cap holdings like BT Group on strength and redeploying capital into compelling mid-cap opportunities such as TP ICAP, drawn by its robust performance and 15%+ dividend growth track record.

Whilst a tilt toward smaller companies may increase short-term volatility, it has historically supported long-term outperformance of the FTSE All-Share and contributed to SCF's near three-decade dividend growth. Given current mid-cap valuations, their yield premium over the FTSE 100, and potential for earnings growth, we think SCF's positioning remains attractive in the current environment—offering meaningful upside if sentiment turns but also a way to enhance the portfolio's underlying earnings power.

Overall, in our view, this consistency—combined with a diversified portfolio blending high-quality income generators, selective high-yielders and higher-growth lower-yielders—could appeal to long-term investors seeking differentiated income with growth potential, supported further by the boards decision to reduce costs and adopt a more active approach regarding the trust's discount management.

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