Results analysis: Schroder Income Growth

SCF's Sue Noffke has increasingly found opportunities in the out-of-favour small and mid-cap space amidst attractive valuations...

Update
30 April 2024

- **Schroder Income Growth (SCF) released its half-year results covering the six months to end of February 2024. Over this period, it delivered NAV total returns of 1.9% and a share price total return of -0.3%, compared to a 3.9% total return from the FTSE All-Share Index.**
- **Underperformance stemmed from adverse stock selection within certain sectors including consumer discretionary, notably via two stocks, Pets at Home and Burberry. Regulatory scrutiny affected Pets at Home, while Burberry faced challenges in the luxury goods market.**
- **However, under Sue's tenure to 26/04/2024, NAV total returns remain ahead of the benchmark, with SCF delivering 153.9% versus the FTSE All-Share's total return of 126.7%.**
- **The board will pay out four interim dividends over the full financial year, having so far paid two equal dividends of 2.5p per share. The third interim dividend of 2.5p is expected to be paid in July, though there is no confirmation on the final dividend amount.**
- **The board have increased SCF's dividend for 28 consecutive years and remain committed to delivering portfolio income supported, when necessary, using revenue reserves to provide growing income for shareholders. As at the end of the period, revenue reserves accounted for approximately 86% of last year's dividend.**
- **SCF's gearing averaged 13.6% over the period, and made a modest contribution to returns, net of financing costs. As of 26/04/2024, gearing has decreased slightly to around 13.0%.**
- **SCF's discount widened from 8.9% to 11.1% over the period, above its five-year average and the AIC UK equity income sector average. Consequently, the board initiated its first share buyback since 2008, repurchasing 38,000 shares.**
- **Chairman Ewen Cameron Watt commented, "While there may still be a degree of uncertainty in the economic outlook, your Company's reserves remain healthy. Your Board will not hesitate to use these reserves if necessary to continue to deliver on your Company's investment mandate of raising dividends, even if such increases lag the growth rate of inflation for now."**

Analysts:
Josef Licsauer
josef@keplerpartners.com

Kepler View

Schroder Income Growth (SCF) focuses on generating real growth, in both income and capital over the long run. Under Sue Noffke's tenure, she's demonstrated consistency and discipline in her approach throughout different market cycles, resulting in an impressive outperformance of the FTSE All-Share Index.

However, recent performance, notably over the six-month period to end of February 2024, has faced challenges. SCF lagged the FTSE All-Share by two percentage points, primarily driven by adverse stock selection in a few sectors, including consumer discretionary. Within this sector, two stocks notably detracted from returns: Burberry and Pets at Home. Additionally, not owning two large-cap industrial stocks, Rolls Royce and BAE Systems, also hurt returns. Both businesses saw orderbooks strengthened amid a strong post-covid recovery in civil and defence aerospace end markets.

Amidst these challenges, however, several stocks performed well, such as Hollywood Bowl and RELX. The former saw its shares re-rate materially down to a combination of its post-covid recovery, the acquisition of Ten Entertainment Group, and promotion from the Smaller Companies Index to the FTSE 250 Index. RELX's historic investments in AI, cutting-edge technologies and digital tools drove accelerated growth across its various business segments, which boosted its share price.

Given recent market volatility, and historically low UK equity valuations, Sue observed, "There remains a noticeable disconnect between company fundamentals and valuations. The UK stock market presents an attractive opportunity for forward returns, particularly in the Small and Mid-Cap area." Consequently, several names were added to the portfolio, including Inchcape and Smith and Nephew. Inchcape, which is taking share in the automotive market and generating attractive returns on capital, is perceived by Sue's as undervalued by the market. Smith and Nephew's addition was driven by compressed share valuations relative to its own history and to international peers. Its recent sales growth acceleration and positive operational leverage, along with cost benefits from restructuring programmes, should boost margins and improve valuations.

Whilst some holdings posted notable increases in dividends in the period, eight portfolio holdings held their dividend level with prior years. Among these, seven opted to reward shareholders additionally through a share buyback programme, indicating that their boards believe their shares to be undervalued. Oil major Shell, Empiric Student Properties and budget hotel company Whitbread paid notably increased dividends. Shell also conducted a significant share buyback of $3.5 billion. Electricity energy provider SSE reduced its dividend by one third, seeking to balance income to shareholders with the capital required to take advantage of the many investment opportunities afforded by the energy transition whilst maintaining a strong balance sheet.

We believe that Sue and her team have built a well-diversified portfolio, poised to deliver a growing income ahead of inflation along with capital growth. Given present valuations, Sue and her team are optimistic about the opportunity set and believe the portfolio is in a good place, with a number of stocks being added at valuations not seen for a long time. In our view, having a greater exposure to small- and medium-sized companies has provided support for the delivery of SCF's objectives over time, and it may lead to heightened short-term volatility compared to a portfolio focused solely on large-cap stocks.

Click here to read the HY report on RNS

Click here to read our latest research on SCF

Click here to add SCF to your watchlist

Disclaimer

This report has been issued by Kepler Partners LLP. **The analyst who has prepared this report is aware that Kepler Partners LLP has a relationship with the company covered in this report and/or a conflict of interest which may impair the objectivity of the research.**

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street , London W1S 2GF with registered number OC334771.