Majedie Investments

MAJE's discount has narrowed materially since the appointment of its new managers...

Update
06 June 2024

Overview

Having been under Marylebone Partners' management for nearly 16 months, the team have made substantial progress in overhauling the strategy of Majedie Investments (MAJE). There is no directly comparable proposition available to allocators in the listed sector today. Offering investors a liquid endowment-style investment solution, MAJE has the potential to provide exposure to genuinely differentiated sources of returns across their three distinct strategies: specialist external managers, direct equity investments and hard-to-access special investments.

As discussed in **Portfolio**, the managers have largely completed their planned transition; however, they have continued to make adjustments across each of these strategies over the first half of the financial year with the addition of the CQS Credit MA Fund to the external manager allocation and technology and services provider Computacenter Plc to the direct equity bucket. While there has been some development of their special investment allocation, notably a co-investment in the debt and public equity of Frontier Communications Inc, they are yet to reach their target allocation of 20%, sitting currently at around 13%. A combination of investments returning cash more quickly than expected and higher entry requirements to the portfolio have slowed progress towards this target.

The evolution of the strategy means MAJE now targets annualised total returns of CPI +4% over five-year rolling periods, including an annual **Dividend** calculated at 3% of NAV. While it may take time to build a track record delivering on these aims, the managers have made a good start. Their focus on investing in a differentiated portfolio of (largely) equities to deliver inflation-beating returns over the long term reflects a commitment to provide strong absolute returns rather than focussing on relative returns against a specific benchmark . Since taking over the strategy in January 2023 MAJE has generated a NAV total return of 9.2% and a share price total return of 31%, as at 31/03/2024. Moreover, their emphasis on high-quality and differentiated investments has boosted performance this year, with contributions coming from a range of lowly correlated underlying holdings (see **Performance**).

Currently, MAJE trades at a **Discount** of 11.4%, significantly narrower than its peak of 30.8% prior to the announcement of Marylebone Partners' appointment.

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Analyst's View

MAJE's new managers bring extensive experience in running similar strategies to the table, as well as a vast network of trusted managers they can draw on for differentiated investment opportunities, most of which don't tend to feature on other investors' radars. This approach has resulted in a portfolio that stands apart from conventional strategies in the listed market, leading us to think MAJE could be an intriguing proposition for investors seeking a source of differentiated returns or a complementary strategy to a standard equity allocation.

Naturally, a stewardship of 16 months isn't long, so we think it's reasonable to expect some investors to gain more confidence in the managers and become more comfortable with the portfolio's differentiated strategy as a longer track record is established. In our view, the return target of CPI +4% is ambitious, yet, if it can be achieved, seems attractive. While future **Dividends** will be lower than previously, MAJE now aims to pay 3% of NAV annually on a quarterly basis. Furthermore, it retains substantial revenue reserves and therefore the dividend should provide a dependable income source.

Overall, we think the first year of the managers' tenure represents a solid foundation for showcasing the potential of a liquid endowment-style model. If the managers deliver in line with their objectives, there's scope for the current 11.4% **Discount** to narrow further.

BULL
Distinctive liquid endowment-style approach offers differentiated sources of return across equities and credit with all underlying holdings regularly marked to market
Extensive resources and highly experienced team provide deeper coverage of opportunities in less-common parts of the market
Discount may continue to narrow as investors gain confidence in new strategy

BEAR
Special investment allocation is reliant on flow of investable opportunities
May take time for investors to build confidence around a new strategy
Relatively high KID RIY, although this reflects an existing debenture repayable in 2025 and may be offset by the future value of the stake owned by MAJE in Marylebone Partners LLP

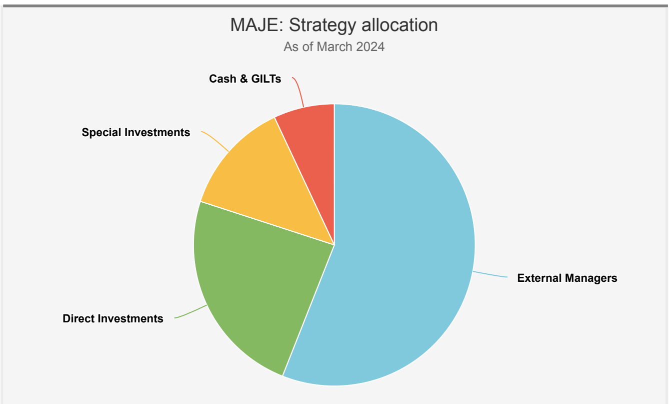
Portfolio

The board of Majedie Investments (MAJE) appointed Marylebone Partners LLP as its new investment manager in late January 2023, following a formal review of the arrangements with its external advisor, JPM Cazenove. Marylebone Partners, led by CIO and founding partner Dan Higgins, has implemented a complete overhaul of the strategy since taking over. Working closely with the board, the **Dividend** policy and **Performance** targets were revised, leading to significant changes across the portfolio. MAJE targets an annualised total return of at least 4% above the UK Consumer Price Index (CPI) over five-year rolling periods, and its annual dividend will equate to 3% of NAV, remaining a core part of MAJE's total returns.

Before we delve into the specific portfolio changes, it's important to reiterate that the new managers are employing a strategy offering investors a liquid endowment-style investment solution. The 'endowment' element of the strategy means a truly long-term investment strategy that allows investors to invest in differentiated and sometimes alternative return sources, avoiding market timing or tactical trading in favour of active fundamental strategies designed to compound returns. However, the managers refrain from allocating to deeply illiquid and hard-to-price asset classes such as private equity, venture capital, unlisted equities or infrastructure, as they believe it is not necessary to lock up capital for extended periods to generate attractive returns. In the managers' view, this approach and subsequent adjustments to the portfolio, mean there is potential to prosper during a regime in which the conventional 60/40 portfolios may face challenges, and thus provide differentiated sources of return.

Regarding the changes to the portfolio, the managers have now largely completed the transition, categorising in it into three fundamental investment strategies: specialist external managers, direct equity investments and hard-to-access special investments. Below, we've included a graph illustrating the composition of the portfolio as of the end of March 2024.

Fig.1: Strategy Allocation



Source: Morningstar

The allocation to external fund managers currently makes up around 56% of the portfolio, providing investors exposure to third-party managers in specialist areas. Roughly half of this allocation comprises eight equity-centric funds run by managers who aim to extract alpha in structurally inefficient sectors and regions, or through distinct styles. The remaining half consists of five specialist credit funds run by managers focussed on stressed and distressed credit in US, European and emerging markets.

Paradigm BioCapital Partners and Helikon Investments are examples of the equity exposure within this part of the portfolio. Paradigm focusses on SMID cap biotech, operating in a highly inefficient yet opportunity-rich sector. Meanwhile, Helikon is a European special situations fund, currently hard closed to new investors. It exploits the dislocation between price and valuation in both the developed and emerging European regions, with a preference for certain sectors, including financials and real estate.

On the credit side, the allocation includes the Millstreet Credit Fund, which targets credit instruments issued by medium-sized market cap companies, including senior secured notes with short duration and high coupons, offering potential for mid-teen total return. The allocation to external managers hasn't changed drastically this year, although the managers aim to gradually reduce the exposure over time in favour of special investments, a move that would reduce ongoing costs over time (see **Charges**). However, the team have added the CQS Credit MA Fund, recently benefitting from its short-duration bias that boosted the performance from its investment-grade allocation.

The allocation to special investments provides investors exposure to very hard-to-reach areas of the market – particularly for retail investors. These are typically co-investment opportunities sourced from Marylebone's extensive network, which has been built up over two decades. The managers believe these have the potential to generate higher levels of return, as they are targeting an IRR of over 20% with the aim of realising each investment within three years. This allocation includes equities and credit held either directly or through special purpose vehicles and thematic funds. The opportunities sought are relatively liquid and priced on public markets.

Co-investments are a key aspect to the special investments' allocation. These investments are typically reserved for institutional or ultra-high-net-worth investors and are made alongside a chosen partner who is looking to raise additional capital to invest in an idea. One example is Project Cauldron, which was a co-investment in the public equity of Alkami Technology. Alkami is a high-quality software business with a sticky customer base, poised, in the managers' eyes, for strong long-term growth.

This opportunity was presented to the team by a trusted manager based in Dallas, Texas, who pointed out that amidst concerns around the software as a service sector in the past year, Alkami's share price had weakened, falling to trough levels. The potential for cost cutting and economies of scale could therefore drive an increase in profitability.

The allocation to special investments currently equates to approximately 13% of the portfolio but is expected to make up 20% over time. The managers had anticipated being closer to 20% by now, but a combination of investments returning cash more quickly than expected and a high threshold to enter the portfolio have extended the timeline. However, there have been a few notable changes, such as Project Fibre (a co-investment in the debt and public equity of Frontier Communications Inc). Frontier, a pure-play broadband provider, has made significant strides in upgrading its network from copper to fibre, yet this transformation has gone relatively unnoticed by the market. Frontier Communications is still perceived as an over-leveraged legacy provider; however, the idea sponsor believes Frontier's cash flows should improve materially as capex requirements decrease and profits rise from an improving customer mix and higher penetration rates.

The final allocation is to direct public equity investments, with opportunities meticulously selected based on what the team believe to be the best fundamental characteristics, including revenue growth, business quality, high return on capital and strong earnings and cash flows. The focus is on identifying high-quality companies that are unappreciated by the market. As of the end of March 2024, this allocation represented around 24% of the portfolio, featuring businesses like Wabtec Inc, Breedon Plc and Thermo Fisher Scientific Inc. The team have been active during this period, adding several new names to the portfolio, including Evolent Health Inc, Computacenter Plc and Cancom NV. Cancom is a European company assisting in the commission and development of IT infrastructure. With recent changes in management and it seemingly fitting into the beginnings of a turnaround, the Marylebone team see significant upside potential.

Furthermore, the team adheres to a strict valuation discipline, meaning they won't hesitate to exit a position when it reaches their target price or if there's a change in thesis. The recent purchases mentioned above have been funded through the sale of several positions, including Sage Group Plc and Pernod Ricard SA.

The managers currently hold approximately 7% in cash, which will be used to fund additional special investment opportunities. For the time being, however, the cash has been invested in short-dated gilts, earning around 4.5% interest.

All in all, much has evolved since the new managers took over in January 2023. We think the changes have left MAJE's portfolio well balanced, providing investors with exposure to genuine sources of differentiated returns. Furthermore, the adjustments to the performance target and dividend policy seem sensible but will need time to bear fruit, with some investors likely to become more comfortable as the managers establish a track record behind the trust. That said, the change in management appears to have been well received by investors thus far, evidenced by a material narrowing of the **Discount**, and the new allocations to the three fundamental strategies has led to an improvement in performance.

Gearing

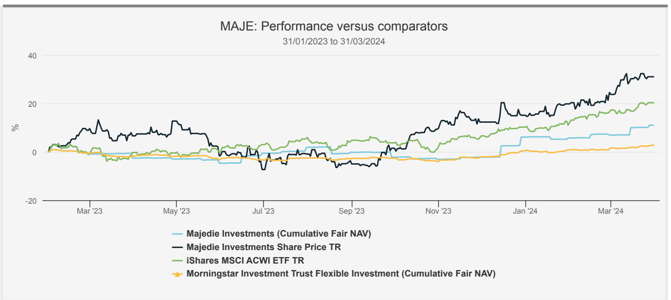
The board believes gearing can enhance returns over the long term, as long as the funding cost makes sense in the context of the strategy. MAJE currently holds a long-term debenture of £20.7m, paying interest at a rate of 7.25% and set to mature in 2025. Discussions between the board and managers around the renewal of this debt have begun, with both parties observing that interest rates remain stubbornly high and they are therefore considering all options. MAJE's current net gearing is 10%, consistent with its five-year average.

Performance

Marylebone Partners took over as MAJE's investment manager in late January 2023, initiating a complete overhaul of the strategy, resulting in significant adjustments to the **Portfolio** and revisions to the **Dividend** policy. Under the new management, new performance targets have been introduced, whereby the success of the strategy will be measured against a total return target of the UK Consumer Price Index (CPI) of +4% over five-year rolling periods. The team has prior experience in running other mandates with similar CPI targets, the track record of which we discussed in greater detail in our **previous note**.

From the change in investment manager until 31/03/2024, MAJE has delivered NAV total returns of 11.3% and a 31.6% increase in its share price total return, and a material narrowing of the Discount. This compares to the 20.3% share price return from an ETF tracking the MSCI All-Country World Index and 3.0% NAV return from the Morningstar Investment Trust Flexible sector. Although the portfolio hasn't kept pace with recent markets, it is important to note that the managers focus is on investing to deliver absolute, inflation-beating returns for investors, rather than focussing on relative returns against a specific benchmark.

Fig.2: Performance Since Manager Takeover



Source: Morningstar
Past performance is not a reliable indicator of future results.

While we think it's useful to review the period under the new managers' stewardship, it's important to consider that due to the extensive overhaul of the strategy, the managers have stated it will be at least a year before the portfolio fully reflects the long-term strategy they intend to employ. That said, the six months of the trust's financial year to 31/03/2024 provides some insights into what investors might expect going forward. Over this period, MAJE delivered a NAV total return of 13.3%, outperforming the Flexible sector's NAV return of 5.9% and performing close to the iShares MSCI ACWI ETF's return of 16.0%. This signifies a solid absolute return against a backdrop in which a dovish tone from central banks, combined with improving sentiment towards the economy, has led to a rally in global risk assets.

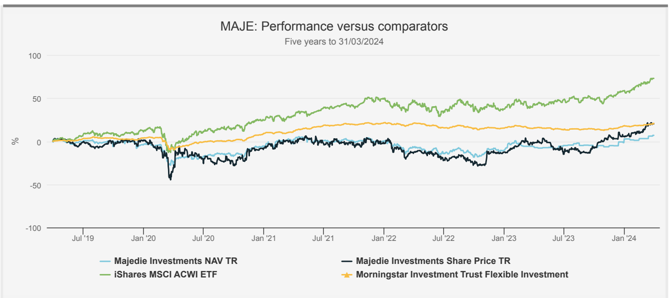
The managers' emphasis on high-quality and differentiated investments drove performance over the period, with notable contributions from both external manager and direct investment segments. Within external managers, several equity-centric funds delivered strong returns, with the Helikon Long/Short Equity Fund, focussing on European value, leading the performance table. The Paradigm BioCapital Partners Fund wasn't far behind, as it gained due to clinical and commercial data lifting several of its core positions. Additionally, the portfolio's allocation to absolute-return/specialist-credit strategies, such as Millstreet Credit Fund, garnered solid gains as yields compressed and spreads tightened into the end of 2023.

Direct investments also performed well in absolute terms as portfolio companies demonstrated their earnings power and resilience. Performance was also broad based, with both 'growth' and 'value' stocks making contributions. Strong performers include KBR Inc, a provider of scientific, technology and engineering solutions to governments and commercial customers worldwide, and Alight Inc, a technology company. Conversely, Basic-Fit, a European budget gym operator, emerged as the largest detractor, although the managers maintain confidence in its long-term growth potential.

Performance from the special investments varied during the period, with Project Bungalow (an activist co-investment in the public equity of Shake Shack Inc) performing exceptionally well, allowing Dan to pare back the position. Project Diameter (an activist co-investment in the public equity of Concentrix Corporation) was the main detractor, primarily due to lowered guidance from management and the perceived potential threat that artificial intelligence could present to the business model. However, Concentrix is a market leader in a highly fragmented segment of the business services sector where economies of scale are a significant competitive advantage. With high rates of customer retention and consistently strong ROIC, it is trading at a significant discount to fair value and the team's investment thesis is unchanged.

Given the managers' relatively short tenure of approximately 16 months, MAJE's five-year performance clearly offers limited insights, given it is not representative of the strategy moving forward. Nonetheless, for the sake of completeness, we've included MAJE's performance over the past five years below. MAJE generated a NAV total return of 6.9% over the period, in contrast to the 20.9% generated by its new peer group, the AIC Flexible Investment Trust sector, and the 72.9% generated by the ETF tracking the MSCI All-Country World Index.

Fig.3: Five-Year Performance



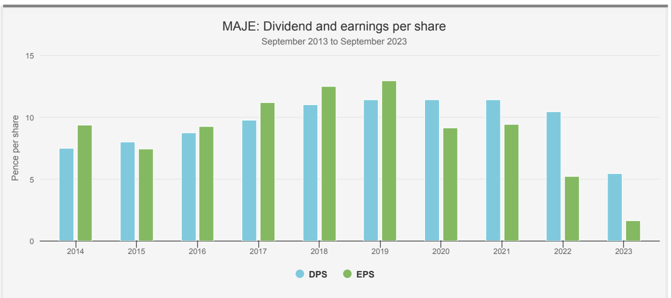
Source: Morningstar
Past performance is not a reliable indicator of future results.

Dividend

MAJE's new investment managers have revamped the investment policy, leading to revised **Performance** targets, significant **Portfolio** turnover and a shift in dividend policy. Dividends are now paid out quarterly, amounting to around 0.75% of the relevant quarter-end net asset value, and a total dividend yield equating to 3% of NAV over the financial year. The board argues this level sets a base for sustainable and progressive long-term dividends moving forward.

These changes have resulted in a decrease in dividends compared to the old strategy that was in place prior to their appointment, as illustrated in the graph below. We think this reflects both the reduced focus on income and the sale of the Liontrust holding, which was a relatively high yielding stock. The dividend is supported by substantial revenue reserves of £16.7m, over 5x the current annual dividend distribution. The strength of these reserves will underpin the trust's dividend policy during any periods where the income from investment is insufficient to cover the annual distribution. In MAJE's latest interim results covering six months to March 2024, two dividends of 1.9p and 2.0p have so far been declared, a progression from the quarterly payments of 1.8p paid in the last financial year.

Fig.4: EPS & DPS



Source:Morningstar

Management

Marylebone Partners LLP, established in 2013, were appointed as the investment manager of MAJE in January 2023. The one distinguishing feature is their ability to access differentiated fundamental investments, often unavailable to other investors and allocators alike. Backed by a team of seasoned professionals, led by Marylebone's founding partner and Chief Investment Officer Dan Higgins, they bring a wealth of experience to the table in uncovering these opportunities. Moreover, Dan's background, including his tenure as CIO of Fauchier Partners an alternatives investment manager, has enabled him to cultivate a network of high-quality fund managers, both long/short and long only, in specialist areas across the globe. These connections form a crucial part to the generation of Marylebone's eclectic range of specialist investment opportunities. Dan has extensive previous experience of closed-ended fund structures, notably through Fauchier Partners' flagship listed vehicle, The Absolute Return Trust Limited.

Dan is supported by three fellow partners and senior investment analysts, Olivia Macdonald, Arjun Menon and James Bloomer. Olivia joined the team in 2017, bringing experience from a position in the Wellcome Trust's investment team, where she focussed on private and public direct investment opportunities. Before that, she worked in sell-side equities research and asset management at Goldman Sachs. Arjun joined in 2021, having several years of equity research and accountancy experience, which he applies to his primary focus on direct investments in public equities. James has been at Marylebone since 2017 and focusses on fundamental equity and credit strategies alongside co-investments. MAJE owns a 7.5% stake in Marylebone Partners' equity, which is designed to align the interests of MAJE's shareholders with those of the new managers.

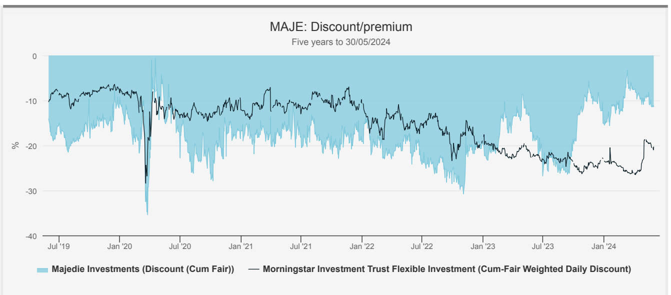
Discount

In November 2022 Marylebone Partners was announced as the investment manager for MAJE and assumed full control by the end of January 2023. Since the announcement and subsequent assumption of management responsibilities, the trust's discount has come in materially, having traded at 30.8% at its widest point to 11.4% at the time of writing. This is notably narrower than its five-year average of 17.6% and the AIC Flexible sector's average of 15.2% according to Morningstar, as at 30/05/2024.

Following recent discussions with the team, it seems shareholders have responded positively to the change in management, given that thus far the changes made have resulted to improvements in both share price and NAV **Performance**. We think that a combination of these factors has caused the discount to narrow, though it may take some time for investors to get comfortable with the new managers while they build up a track record with MAJE. Nevertheless, given the uniqueness of the new strategy, with no discernible comparisons of existing propositions in the listed sector today, we think there's potential for the discount to trade closer to par if the managers deliver on their targets and continue to build a strong investor following.

While there's no formal discount control policy in place, the board regularly monitors its level and retains the ability to buy back shares if necessary. The company gained approval from the AGM to buy back up to 14.99% of the Company's existing share capital. Over the last financial year and in the current one, the board has not bought back any shares for cancellation, and we note that its ability to buy back shares is in part limited by the significant shareholding of the Barlow family.

Fig.5: Discount



Source: Morningstar. NB: MAJE was admitted to the Flexible sector following Marylebone's appointment, previously belonging to the Global Equity Income sector.

Charges

MAJE's latest KID RIY is 3.63%, of which 1.11% is the interest cost of the debenture repayable in 2025. Excluding this, the RIY would be 2.5%, including the external managers' fees, which the board anticipate will fall as the special investment allocation increases . The current KID RIY of 3.63% is higher compared to the 2.52% weighted average for the peer group, according to JPMorgan Cazenove. However, we note that methodologies of calculating KID RIY figures may vary. The costs are somewhat mitigated by the potential future value of the stake owned by Majedie in Marylebone Partners. The fees paid to Marylebone Partners are charged at 0.9% of market capitalisation, hence incentivising a narrower discount, and are tiered as the Company grows, showing an alignment of interests. MAJE's latest ongoing charges figure (OCF) stands at 2.0%.

ESG

While environmental, social and environmental (ESG) issues are not the sole drivers behind the managers' investment approach, they are thoroughly considered and fully integrated into the strategy. The team believe that a sustainable investment mindset aligns with good performance outcomes over time and its incorporation into the research process is helpful when it comes to identifying opportunities and risks that might otherwise be overlooked or underestimated by the market.

Rather than excluding investment opportunities outright, the team believe in driving change through proactive yet pragmatic engagement across each of the three fundamental strategies that make up the **Portfolio**. They collaborate closely with their external managers to ensure thorough due diligence is being carried out, thus enhancing their understanding of the ESG risks/ opportunities, while also being able to evaluate the quality of each of the external managers' firm, team, investment philosophy and process. For direct investments, the team assesses a company's people and culture, strategy and operating practices, as well as governance and disclosure practices.

The investment team utilise third-party data, including ESG research and insights from Morningstar's Sustainalytics, along with independent research and views from within their extensive network. This helps them form their own opinions on sustainability issues. However, at this stage it's challenging to comment on the status of MAJE's sustainability characteristics, as the portfolio is still in the early stages of its transitionary phase and the new strategy has not yet received any external ESG ratings, at the time of writing.

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