Temple Bar quarterly newsletter

Issue 13
July 2024

Dear investor,

Welcome to the latest issue of Temple Bar's quarterly newsletter.

In this quarter's feature article, Co-Portfolio Manager Ian Lance, revisits the opportunity that continues to exist in attractively-valued UK equities, drawing comparisons to the aftermath of the dotcom bubble in the early years of the new Millenium.

We also provide a link to a recent update video, produced in collaboration with Doceo and further thoughts from the portfolio managers on recent bid activity within the portfolio.

We remain open to your feedback on all matters relating to the trust. Please feel free to email us at TempleBar@Redwheel.com or by any of the other means of contacting us that are detailed on our website.

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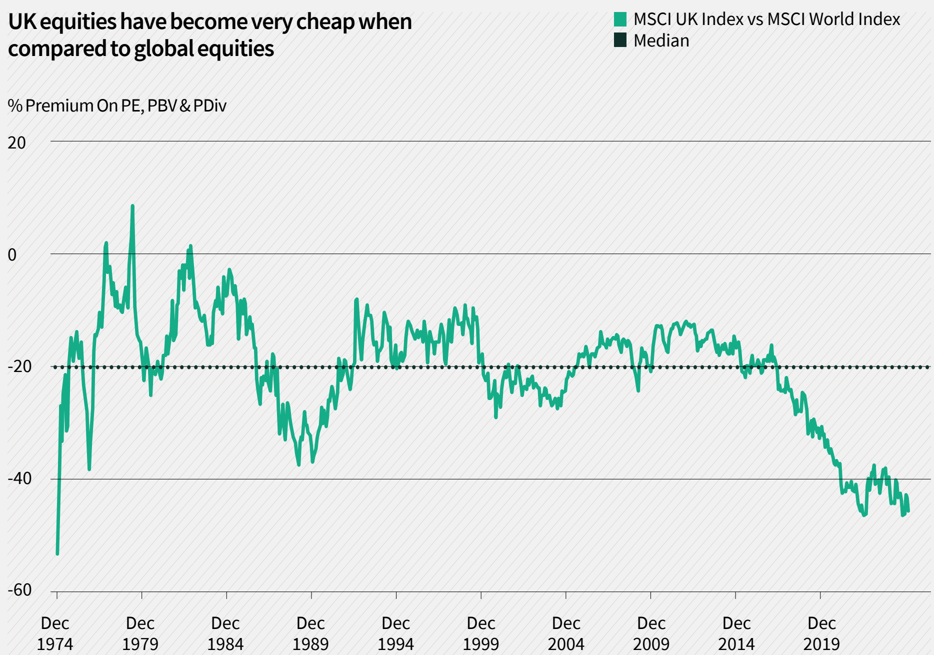
TEMPLE BAR
Investment Trust Plc

THE RETURN OF THE TOTAL RETURN KINGS

As you will have gathered from previous Temple Bar newsletters, we have spent the last few years demonstrating how cheap the UK equity market has become, both in absolute terms, but particularly when compared to the US equity market.

UK equities have become very cheap when compared to global equities



Source: Morgan Stanley, 30 June 2024. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part. No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.

Whilst there are many theories to explain the lacklustre returns from UK equities (for example, sector composition, Brexit, political uncertainty), they can be more simply explained by money flows. Many UK pension funds have spent the last few decades selling equities to buy bonds and reducing their UK holdings in favour of global equities. Meanwhile, large wealth managers have also typically been allocating money towards globally-diversified portfolios. Since the UK represents just 3% of the MSCI World Index, compared to the US weight of 70%[1], this has inevitably meant selling UK equities and buying US equities. In both directions, these trades have paid little heed to valuation.

When we highlight the very low valuations on offer in the UK equity market, however, the first question we are asked by many clients is, "what is going to change this?". This is a fair question and, although it may be hard to envisage a scenario in which all the money that has departed the UK suddenly comes back in, there are two mechanisms currently at play that can potentially realise the value in UK equities without the need for large money flows back into the market.

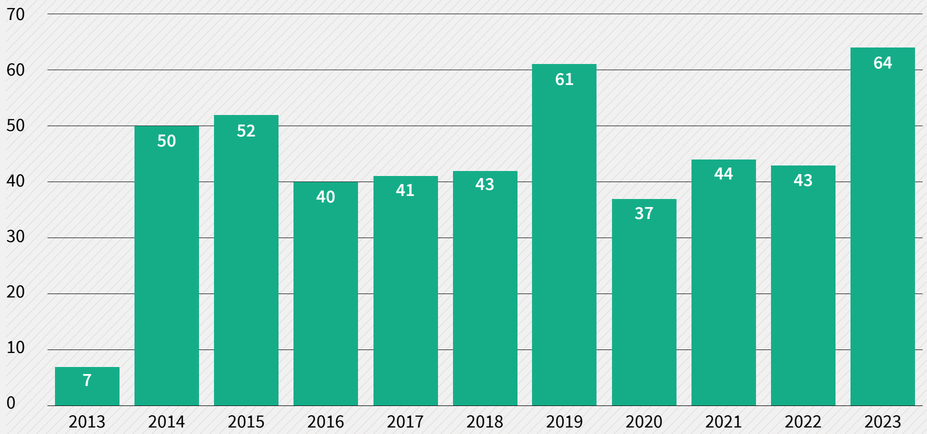
[1] Source: MSCI as at 5 April 2024

Catalyst 1: corporate takeovers

The relentless selling of UK equities has driven valuations to such low levels that overseas corporates have spotted an opportunity to acquire UK assets at prices that offer serious future return potential. The chart below shows the number of annual takeovers in the UK market, with 2023 becoming a record year. This momentum has accelerated in 2024, with a series of bids for high profile UK businesses including Currys, Direct Line, Redrow, IDS (Royal Mail), Anglo American, Hargreaves Lansdown and Britvic, several of which we have held in the Temple Bar portfolio.

Elevated takeover activity in the UK suggests overseas corporates are stepping in

Annual number of takeovers in the UK stock market



Source: Redwheel, Factset, 31 December 2023. The information show above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice.

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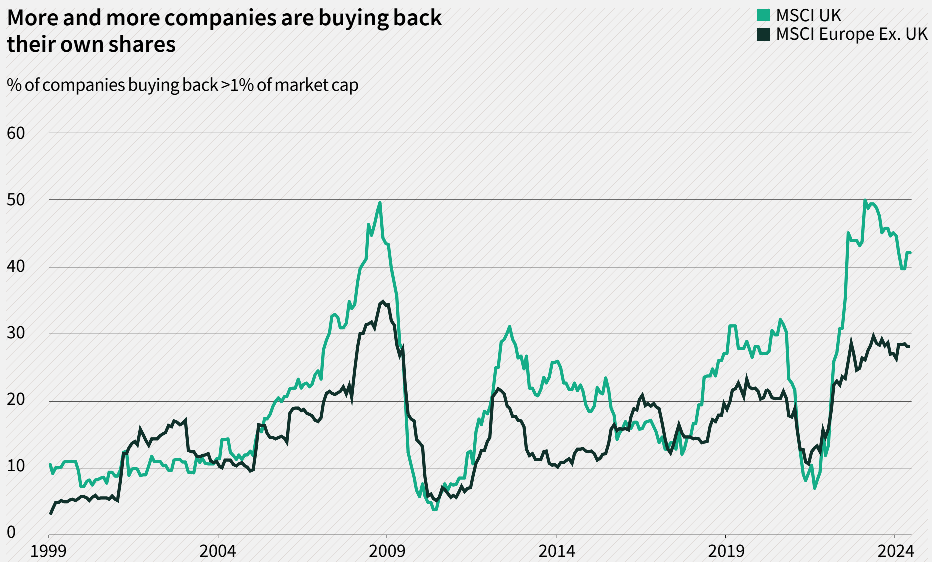
Catalyst 2: share buybacks

Meeting the CEOs of the companies we invest in has been quite a depressing experience in recent years since many feel that they are doing a very good job of running their company and yet continue to watch their share prices fall. Our advice has been to not take the low share price personally, but rather to use it to the advantage of the company's shareholders through share buybacks.

The chart below suggests that this message is finally starting to hit home as half of UK companies bought back shares in the last twelve months, the highest percentage of any market in the world.

More and more companies are buying back their own shares

% of companies buying back >1% of market cap



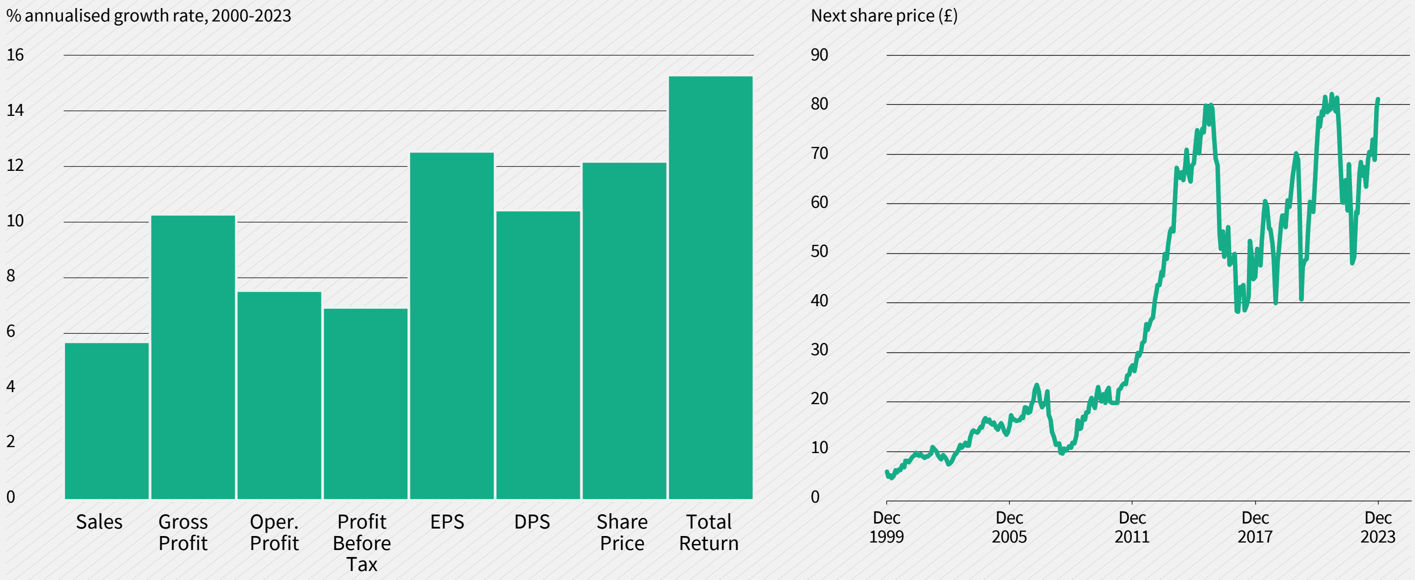
Source: Morgan Stanley, 30 June 2024. The information shown above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice.

Share buybacks represent an excellent way of creating shareholder value, as long as those shares are bought back at a price that is lower than their intrinsic value.

As we explained in our January 2023 newsletter, share buybacks represent an excellent use of capital for creating shareholder value, as long as those shares are bought back at a price that is lower than their intrinsic value. We used Next as a case study, demonstrating that, by buying back two-thirds of its shares in issue since 2000, it has produced a total return for investors of 16% per annum, and seen its share price rise from £5 to £80, despite only growing sales at 5% per annum.

[2] Source: Koyfin over six months to 30 June in capital return, UK sterling terms. Past performance is not a guide to future returns.

Next plc - a case study in how share buybacks add value



Source: Bloomberg, Redwheel, 1 January 2000 to 31 December 2023. The information shown above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part. No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.

We hope that it should be fairly obvious that, if these companies continue to buy back shares at the rate of the last two years, it seems likely that their share prices will eventually respond.

The return of the total return kings?

We believe that the conditions today are reminiscent of those that existed in 2000. Then, like now, the majority of investors were focusing on the growth prospects of technology companies and paying very high valuations for them. Conversely, they had seemingly little interest in investing in old economy sectors such as energy, financials and autos and had driven the valuations of these parts of the market to very depressed levels.

So, which companies today look well placed to be the "next Next", and thus have the potential to reward their shareholders with attractive total returns in the future? The table on the next page contains some of the companies we hold in the Temple Bar portfolio, which we believe could produce attractive total returns for their investors.

Column one shows the earnings that these companies have generated in the last two years as a percentage of their current market capitalisation. It is worth noting that some of these companies have generated between 40-50% of their market cap during this time (20-25% per annum), placing them in a favourable position to return cash to their shareholders.

The second column looks at whether they have been doing that by showing the dividends that these companies have paid as a percentage of today's market cap. Several of these companies have paid out between 10-14% in the last two years, which in its own right, is an attractive return.

Column three shows share buybacks as a percentage of market cap and, again, some of these figures strike us a truly impressive. BP and Shell have bought back 17% of their market cap in two years, whilst NatWest has bought back nearly 30% of its market cap in just two years.

The final column then adds together the dividends plus share buybacks to show the total cash return these companies have given their shareholders over the last two years as a percentage of today's market cap, with a range of figures from 19-39%.

Several Temple Bar holdings are making significant returns to shareholders

Company	2 yr earnings per share yield	2 yr dividend paid/accrued	Share buyback return 2 yr	2yr cash shareholder yield
Energy				
BP	41%	9%	20%	29%
Shell	33%	8%	20%	28%
Total	39%	11%	13%	24%
Consumer Durables				
Stellantis	65%	15%	4%	19%
Banks				
Barclays	33%	8%	12%	20%
NatWest	29%	10%	29%	39%
Standard Chartered	34%	6%	21%	27%
Insurance				
NN Group	31%	14%	12%	26%

Source: Redwheel, Company Report & Accounts, 4 June 2024. Past performance is not a guide to the future. The price of investments and the income from them may fall as well as rise and investors may not get back the full amount invested. The information shown above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice.

We hope that it should be fairly obvious that, if these companies continue to buy back shares at the rate of the last two years, it seems likely that their share prices will eventually respond. Buying back shares increases their earnings and dividends on a per share basis and, eventually, the market must take notice of this. If their share prices do not rise, then their price-to-earnings ratios and dividend yields will eventually reach ridiculous levels. Some investors would argue that they already have – indeed, with the likes of Barclays and Natwest up 40% and 49% respectively year-to-date[2], we may have already seen the start of this value realisation process unfolding.

Conclusion

We believe that the market is currently offering up some incredible opportunities for investors, not because there is anything fundamentally wrong with these businesses, but rather through neglect. What we have hopefully demonstrated, however, is that companies have the ability to use this low valuation to change the fundamentals of their business.

Just as in 2000, investors are so entranced with the potential growth being offered by US technology companies, that they are ignoring some of the real bargains to be found in sectors such as energy and financials, which are the two largest sectors in the Temple Bar portfolio. By taking advantage of their low valuations and buying back their own shares, businesses such as BP, Shell, Barclays and Natwest have the potential to become the "new total return kings".

[2] Source: Koyfin over six months to 30 June in capital return, UK sterling terms. Past performance is not a guide to future returns.

RESPONSE TO THE OFFER FOR IDS (FORMERLY ROYAL MAIL GROUP)

During the quarter, another Temple Bar portfolio holdings received an opportunistic takeover bid, prompting portfolio managers Nick Purves and Ian Lance to publicly comment on the implications of the bid for the Royal Mail and the need for urgent reform of the Universal Service Obligation. The text below is from an article published on the Redwheel and Temple Bar websites on 22 April 2024.

“We note the statement from the Board of IDS confirming that, on 9 April 2024, it received a preliminary and conditional non-binding proposal from EP Group regarding a possible cash offer for the entire issued and to be issued share capital of International Distribution Services plc (IDS) not already owned by EP Corporate Group a.s. (EP Group) and its affiliates, namely VESA Equity Investment S.à r.l (VESA Equity) at 320 pence per share.

Redwheel is third largest shareholder in IDS (behind Vesa and Schroders) and owns 63,754,494 shares (6.65% of company) on behalf of its investors as at 19 April 2024. We wish to make the following points in response to the offer from EP Group.

We are in full agreement with the Board, together with its advisers, that the possible offer of 320 pence per share significantly undervalues IDS and its future prospects. Accordingly, we support the Board’s decision to unanimously reject the proposal on 11 April 2024.

We call upon Ofcom to reflect on both the timing and the level of this offer which we regard as opportunistic. The share price of IDS has fallen by 62% from 573 pence on 14 June 2021 to 214 pence immediately prior to the announcement of the potential offer and is still substantially below the IPO price of 330 pence set ten years ago. We believe this reflects the current financial situation of Royal Mail which posted losses of £419 million in financial year 2022/23 and losses of £319 million in the first six months of the 2023/24 financial year. This has meant shareholders have seen very weak returns, and no dividend since September 2022.

We also note that parent company IDS plc’s credit rating of BBB is on negative watch. Royal Mail’s financial position has affected the Group’s credit rating and puts at risk Royal Mail’s financial stability and IDS’ ability to attract funding from the capital markets, the main rationale for the IPO in 2013. We believe that, unless steps are taken to improve the profitability of the Royal Mail, it may not be a sustainable business in the long-term and could remain vulnerable to corporate predators which we believe is not in the interests of shareholders, customers, or employees.

In order to make Royal Mail a sustainable business for the benefit of all stakeholders, we believe steps must be taken to return the business to profitability, and we also believe the Universal Service Obligation (USO) – the legal requirement for Royal Mail to deliver to the United Kingdom’s 32 million addresses six days a week – now needs urgent reform. Letter volumes have declined from 20 billion at their peak in 2004/5 to seven billion in the last financial year and are likely to continue to fall. The USO means Royal Mail must maintain a high fixed cost network without the revenue to sustain it. Ofcom recognised this when it calculated that providing the current USO to the UK has a net cost to Royal Mail of £325m to £675m every year (source: Ofcom). We agree with Ofcom that “providing the USO imposes a significant net cost on Royal Mail and that it is “likely to be unfair” that Royal Mail’s shareholders bear this cost. The scale of the net cost, coupled with the underlying financial performance of Royal Mail, demonstrates the urgency for USO reform. Whilst we do not have a firm view on which of the options for change outlined by Ofcom is more appropriate – we leave that to Royal Mail to propose – we would urge that change to the USO needs to be meaningful, provide long-term relief from the material and unreasonable cost burden, and be implemented rapidly.

Finally, we do not believe it is in the interests of the shareholders, employees, or customers of Royal Mail for it to be broken up or sold off. Our preferred option would be for the company to remain together, and we believe if Ofcom is willing to reform the USO, it has a sustainable future in which all stakeholders may benefit. We welcome the changes agreed with the Communication Workers Union in July 2023, and note that they are already starting to show genuine results in terms of improved quality of service for customers e.g. sick absence has reduced by c.25% by end of December 2023 compared to prior year (source: IDS). In addition, workers are benefitting from increased recruitment of permanent employees on new, more flexible contracts, and reduced reliance on agency staff.

In conclusion, we believe that progress is already being made to transform Royal Mail into a profitable and sustainable business, but we would urge Ofcom to reform the USO in order to make Royal Mail profitable once more and ensure its long-term sustainability as an independent business which has the potential to benefit all stakeholders.”

OTHER NEWS

Update video, May 2024

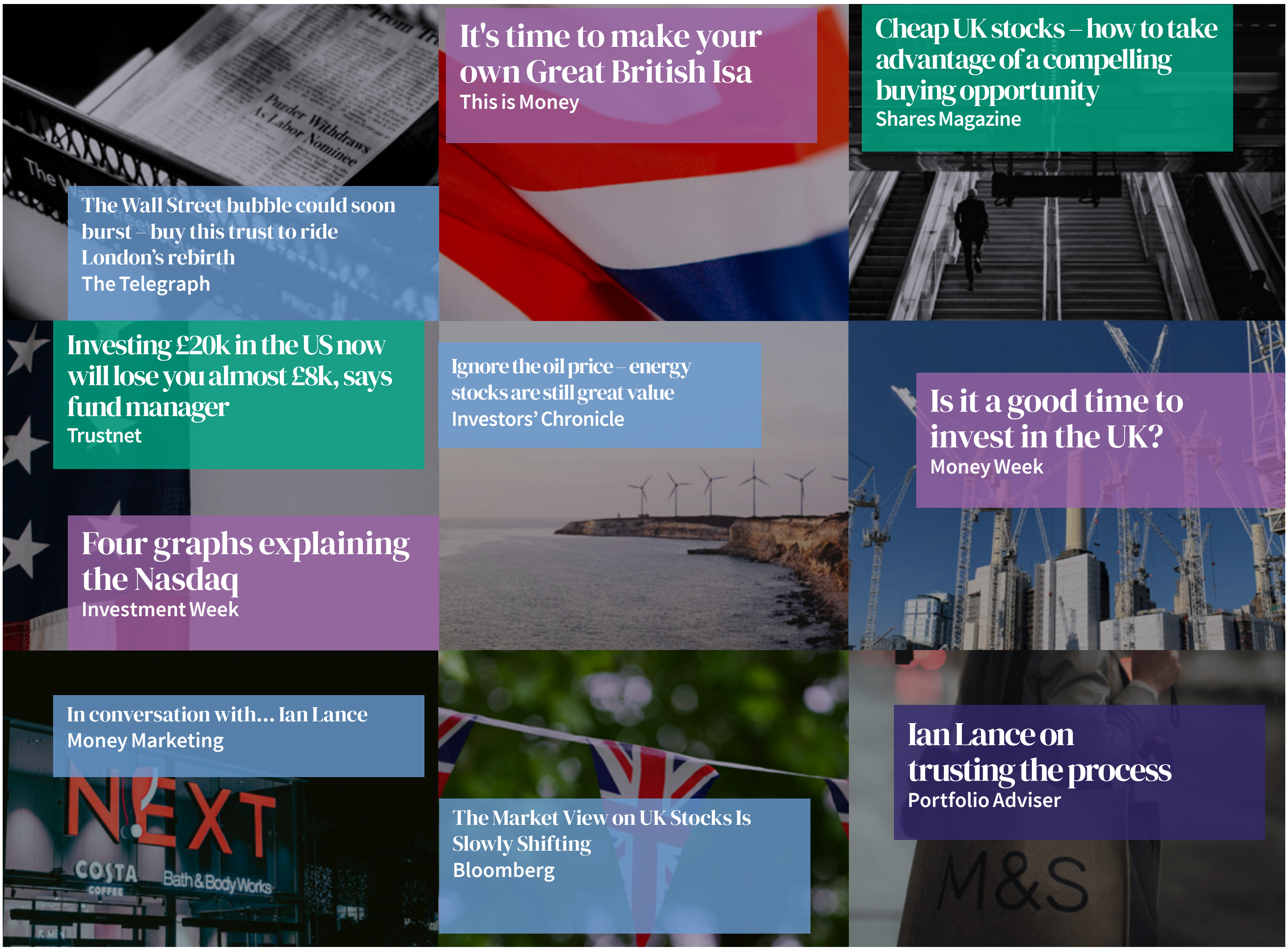
Ian Lance provided an update on recent performance, current strategy and the outlook for Temple Bar shareholders, in a recent video recorded for the Doceo investment trust platform. You can access the film on the Temple Bar website by following the link below.

https://www.templebarinvestments.co.uk/media/insights/ian-lance-update-video-may-2024/

Temple Bar in the news

Further positive media coverage of Trust has continued in recent months, with Ian and Nick contributing to a range of publications, including . . .

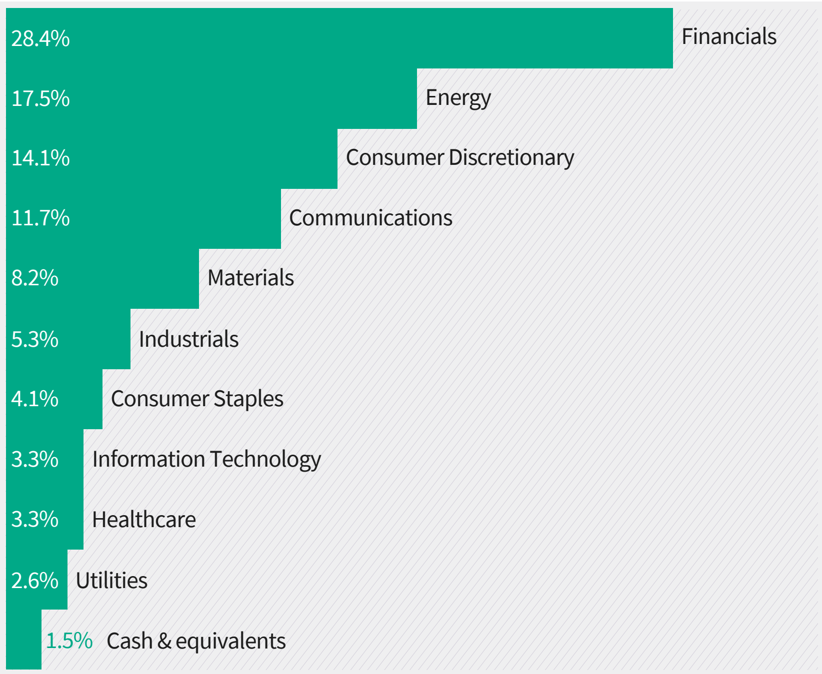
A curated selection from this coverage is provided below.



The Temple Bar portfolio

Data as at 30 June 2024

Top 10 equity holdings		(%)
Shell	Energy	6.8
NatWest	Financials	6.4
BP	Energy	5.7
ITV	Communications	5.1
Barclays	Financials	5.0
TotalEnergies	Energy	4.9
Aviva	Financials	4.5
Anglo American	Materials	4.4
NN	Financials	4.1
Marks & Spencer	Consumer Staples	4.1
Total		**51.0**



Performance, price and yield information is sourced from Morningstar as at 30.06.24.

Financial data	
Gross Assets	£864.3m
Share price (p)	259.00
NAV (p) (cum income, debt at mkt)*	280.18
Premium/(Discount), Cum income (%)*	(7.6)
Historic net yield (%)	3.8
Net gearing (%)*	6.6

*Calculated with debt at fair value

Dividend history

Type	Amount (p)	XD date	Pay date
1st interim – 2024	2.50	30.05.24	28.06.24
4th interim – 2023	2.50	07.03.24	02.04.24
3rd interim – 2023	2.50	30.11.23	29.12.23
2nd interim – 2023	2.30	24.08.23	29.09.23

Performance (total return)

Past performance is not a guide to future performance. The value of investments and the income from them may fall as well as rise and is not guaranteed; an investor may receive back less than the original amount invested. This Trust may not be appropriate for investors who plan to withdraw their money within the short to medium term.

Performance (total return)

Cumulative returns (%)

	Share price	NAV	FTSE All-Share
1 month	-4.6	-3.8	-1.2
3 months	8.7	5.4	3.7
3 year	36.7	33.9	23.9
5 year	26.0	31.4	30.9
10 year	54.6	66.7	77.8
Since 30/10/2020	113.7	111.2	61.24

Rolling 12 month returns (%)

	Share price	NAV	FTSE All-Share
30.06.23 - 30.06.24	21.8	22.9	13.0
30.06.22 - 30.06.23	6.0	8.7	7.9
30.06.21 - 30.06.22	5.8	0.2	1.6
30.06.20 - 30.06.21	44.5	41.5	21.5
30.06.19 - 30.06.20	-36.2	-30.6	-13.0

Important information

Past performance is not a guide to the future. The price of investments and the income from them may fall as well as rise and investors may not get back the full amount invested. Forecasts and estimates are based upon subjective assumptions about circumstances and events that may not yet have taken place and may never do so.

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