Temple Bar Investment Trust PLC – Monthly update 28th February 2013

Trust Facts

Launch date: 1926

Wind-up date: None

Year end:
31st December

Dividends paid:
March & September

AGM:
March

Benchmark:
FTSE All-Share

ISA status:
May be held in an ISA

Capital Structure:

Share class	No. in issue	Sedol
Ordinary	60,751,367*	0882532

*200,000 shares issued 27th Feb

Debt:
5.5% Debenture Stock 2021 £38m
9.875% Debenture Stock 2017 £25m

Charges:
Management fee: 0.35% per annum based on the value of the investments of the Company.
Ongoing charges: 0.51% (December 2012)

Board of Directors:
John Reeve (Chairman)
Arthur Copple
Richard Jewson
June de Moller
Martin Riley
David Webster

Auditors: Ernst & Young LLP

Investment Manager:
Investec Asset Management Ltd

Registrars: Equiniti Ltd

Savings Scheme Administrator:
Equiniti Financial Services Ltd

Secretary:
Investec Asset Management Ltd

Stockbrokers:
JPMorgan Cazenove

Bankers & Custodian: HSBC Bank Plc

Solicitors: Eversheds

Trust Objective

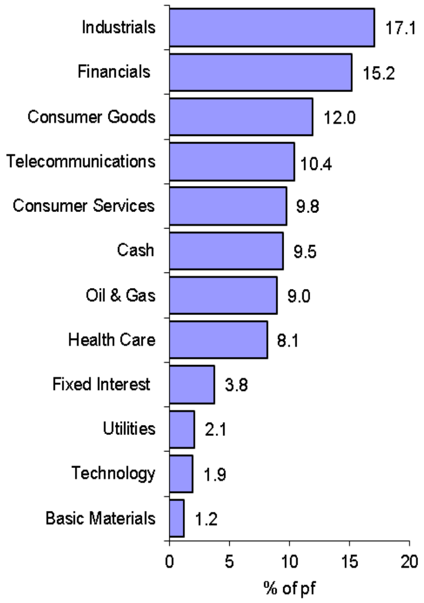
To provide growth in income and capital to achieve a long term total return greater than the benchmark FTSE All-Share Index, through investment primarily in UK securities. The Company's policy is to invest in a broad spread of securities with typically the majority of the portfolio selected from the constituents of the FTSE 100 Index.

Top ten equity holdings (%) *

HSBC Holdings PLC	7.9
GlaxoSmithKline PLC	7.5
Royal Dutch Shell PLC (CL B)	6.8
Vodafone Group PLC	6.2
Signet Jewelers Ltd.	6.1
Unilever PLC	4.6
Grafton Group PLC	4.5
BT Group PLC	4.1
Travis Perkins PLC	3.5
QinetiQ Group PLC	3.0
	54.2

* % of total assets, including cash

Sector Analysis



Financial data

Total Assets (£m)	714.83
Share price (p)	1108.00
NAV (p) (ex income, debt at mkt)	1047.29
Premium/(Discount) (%)	5.8
Historic net yield (%)	3.31

Performance

Share Price % change

	TBIT	All-Share *
1 month	2.8	1.9
3 months	11.5	9.3
1 year	18.2	10.0
3 years	43.3	22.4
5 years	59.9	11.2

* Capital return only

NAV total return % change

	TBIT	All-Share *
1 month	2.0	2.3
3 months	10.2	9.9
1 year	22.7	14.1
3 years	52.2	35.5
5 years	84.8	33.8

* Total return

Source: Thomson Datastream, Investec

Dividend History

Type	Amount (p)	Ex date	Pay date
Final	22.00	13-Mar-13	28-Mar-13
Interim	14.65	21-Sep-12	28-Sep-12

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Manager's Commentary

With 20/20 hindsight goggles firmly attached it might seem obvious that HMV was doomed and that its recent move into administration in early 2013 was inevitable. However, as recently as November 2009, when it had a market capitalisation of £500m, over 2/3 of investment bank analysts were bullish on the stock. As innocent bystanders its demise provides us with an interesting case study into how not to do contrarian investing.

The lessons we take:

1.**Under-estimate the speed of technological development at your peril.** When technology gets its teeth into a business it doesn't usually let go. Even when music was already being widely downloaded and starting to affect sales of CDs (it accounted for 8% of the purchased music market in 2008), HMV management had a number of plausible arguments countering those suggesting that downloading was set to explode. And as for downloading films, this was considered almost laughable:

'A full length feature film is usually of the magnitude of 2000MB and would take around 2 hours 15 minutes [to download]… with the ongoing move to HD movies, these files are c15,000MB and therefore almost un-downloadable, taking nearly 17 hours.

Once downloading is available in an easier and quicker form, questions still remain on how to use the media. Most downloading will be done by computer, often in the home office and rarely is this connected to the family television to enable a quality viewing experience.'

Excerpt from an investment bank report April 2008.

2. **It is very hard for management to cannibalise its own business however much they may claim they are willing to consider all strategic options**. Objectively assessing the risks of a disruptive technology to a business from within and acting on them is very difficult if embracing that technology risks cannibalising the current business. It is no surprise that companies such as easjet, Ryanair, J D Wetherspoon and Direct Line attacked incumbents with clean sheets of paper and no concerns about protecting a super-profitable book of business.

3. **Management confidence is often misplaced**. Commentators often take comfort from management of a struggling business buying shares, as the HMV chairman did repeatedly, or simply committing themselves to the company. Simon Fox, the then chief executive of HMV was widely reported to have withdrawn from the running to become chief executive of ITV in 2009, '…opting instead to stick with the group [HMV] as it moves into the third and final year of a turnaround programme.' (Source: Daily Telegraph , August 2009). Perhaps he just liked the commute or perhaps he really was optimistic about the turnaround. But those who took his decision as a reason for increased confidence in HMV's future were wrong.

4**. And even if the management is good (which is very difficult to assess as an outsider) that many not be sufficient**. 'When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.' Warren Buffett

5. **Businesses in difficulties often try and buy their way out of trouble**. HMV purchased MAMA, a company which ran concert venues in a deal valued at £46m in December 2009. Perhaps this wasn't such a bad area to have exposure to – although the losses HMV took in some start up festivals suggest they were very late to that party. They were certainly not an opportunistic buyer of this business.

6. **Or spend their way out of trouble in other ways**. Struggling retailers can always be guaranteed to spend a fair amount on store refits. HMV introduced a Next Generation Store in 2007 with a games area, internet access, a kids area, a smoothie bar, an iPod and Mobile phone concessions which it decided to roll-out at great expense to many of its stores. As we have written before, these refits typically fail to generate the returns initially indicated and can be viewed as a necessary cost of maintaining sales rather than growing them. Similarly, HMV decided to adapt some excess space in stores to use for cinemas. These were not as attractive in practice as they had been on spreadsheet. Perhaps this is a touch unfair to HMV as they were at least proactively dealing with a problem.

7. **Being the last man standing isn't always enough**. Through the demise of Woolworths, Zavvi, Fopp, Borders and the purchase of Ottakar's, HMV was the last man standing (or to be more exact the clear market leader) in high street retailing of books and music. As we have written before regarding buggy whip manufacturers, this is often a title not worth holding. Rather than suggesting the likelihood of increasing profits it is just as likely to be intimating an anachronistic business model.

8. **Irrational competitors can destroy industry profitability**. HMV was unfortunate enough to compete against Amazon –hell bent on sales rather than profits it seems – and the large superstores, happy to discount products heavily simply to attract more customers. If such competitors have deep pockets and there is no regulatory protection against their pricing strategies they create significant obstacles to the rational players remaining profitable.

9. **Some businesses consume cash as they shrink**. At the time of its IPO in 2002, one positive reason for buying HMV's shares was that as it grew and opened more stores it became more cash generative as its customers paid before the suppliers demanded payment. Unfortunately, the opposite was true as stores were sold and suppliers were paid back.

10. **Balance sheet ratios can change dramatically as a company's financial position comes into doubt**. With sales approaching £2bn, HMV was always in hock to its suppliers (to the tune of over £200m). If these suppliers became concerned about HMV's solvency they were at liberty to ask for quicker payment – thus pushing up the HMV's cash requirements.

11. **Taking on too many battles simultaneously can stretch management**. HMV was battling structural issues in its eponymous stores in the UK, Asia and Canada and also in Waterstone's. Is it easier to admit defeat in one or two areas and focus on bigger battles? Many successful recoveries seem to centre on disposals rather than acquisitions.

12**. Cost savings can be ephemeral if they are made to ensure comparison with businesses with different cost bases**

13. **Cut a dividend early**. It is never easy for a Board to cut or even pass a dividend. It is a sign of failure, a show of no confidence and will usually go down badly with shareholders. Typically by the time action is taken it is too little too late.

14. **The curse of rental liabilities**. Like most retailers, HMV was able to finance its high growth rate by leasing its stores as opposed to buying them. Unfortunately this created a massive long-dated liability of over £1bn which made it costly to close stores – as rent and rates must continue to be paid – but also created a further cost disadvantage against on-line competitors.

15. **Balance sheets aren't always as strong as they look**. HMV management were not necessarily evasive on this issue but as with many companies, their financial year- end was at a well- chosen point of the year and therefore not a great indication of its through the year financial strength. A few straightforward calculations or questions would clarify this; a simple computer screen would not.

16**. Don't bet on the cavalry arriving on time**. Perhaps HMV were unlucky. They had long complained about the VAT loophole which allowed cheap imports of DVDs and CDs from the Channel Islands and about the laxity of downloading laws. There also seemed a rational argument for the large music suppliers to support the largest retailer as these companies needed a high street presence to display their artists. All of these potential positives did in fact finally come – but too late. Perhaps these bets should be regarded as nice to have for the shareholder rather than must have. If shares look cheap assuming bad luck rather than good luck then the downside risk is probably less.

17**. Cheapness isn't always enough**. HMV shares over the years were always attractive in terms of P/E, EV/EBIT, dividend yield and EV/sales. Clearly, these simplistic and popular measures are not always enough.

18**. It is very difficult to manage a business affected by price deflation**. A lot of costs such as rates, rents and wages can be inflation linked. This combination can be very hard to juggle without significant volume increases as prices fall

19. **Having highly incentivised management does not increase the chances of success.** In fact, if management view a remuneration package as a 'heads we win, tails we don't lose' option they can take on much more risk than is desirable for long-term shareholders – whose risk reward pay-offs are much more different.

20. **Retailing is a much riskier business than it seems**. The recent demise of Blockbuster, Jessops, Comet and HMV is shocking and doubtless partly due to the significant increase in on-line shopping. However, retailers have always come and gone. Where are Rumbelows, Freeman Hardy Willis and John Collier? Many retailers are selling volatile fashion items and others are simply acting as a commodity distributor for a brand - often with little barriers to entry and high barriers to exit. Is it any surprise many do not last the course?

21. **Low margin businesses leave little room for error and can quickly fall into loss.**