temple bar Investment Trust PLC – Monthly update 31 March 2015

Trust Facts

Launch date: 1926

Wind-up date: None

Year end:
31 December

Dividends paid:
Quarterly in March, June, September and December

AGM:
March

Benchmark:
FTSE All-Share

ISA status:
May be held in an ISA

Capital Structure:

Share class	No. in issue	Sedol
Ordinary	66,872,765	0882532

Debt:
9.875% Debenture Stock 2017 £25m
5.50% Debenture Stock 2021 £38m
4.05% Private Placement Loan 2028 £50m

Charges:
Ongoing charge: 0.48%* (31.12.14)
*Includes a management fee of 0.35%

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

Auditors: Ernst & Young LLP

Investment Manager:
Investec Fund Managers Ltd

Registrars: Equiniti Ltd

Savings Scheme Administrator:
Equiniti Financial Services Ltd

Secretary:
Investec Asset Management Ltd

Stockbrokers: JPMorgan Cazenove

Depositary & Custodian: HSBC Bank Plc

Trust Objective

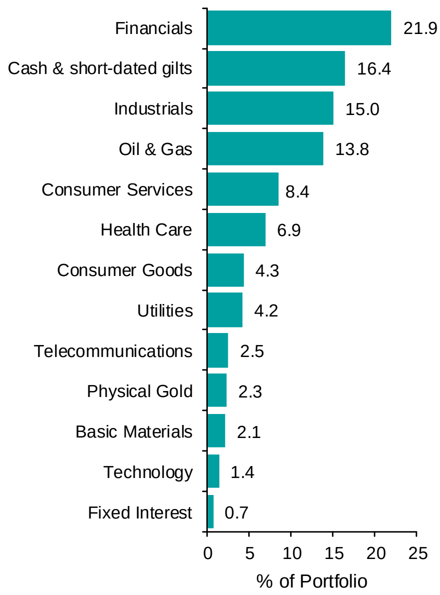
To provide growth in income and capital to achieve a long term total return greater than the benchmark FTSE All-Share Index, through investment primarily in UK securities. The Company's policy is to invest in a broad spread of securities with typically the majority of the portfolio selected from the constituents of the FTSE 350 Index.

Top Ten Equity Holdings (%) [1]

HSBC Holdings Plc	7.7
GlaxoSmithKline Plc	6.9
Royal Dutch Shell Plc Class B	6.8
BP Plc	6.0
Grafton Group Plc	5.0
Lloyds Banking Group Plc	3.6
British American Tobacco Plc	3.3
Royal Bank of Scotland Group Plc	2.7
Direct Line Insurance Group Plc	2.6
BT Group Plc	2.5
Total	47.1

[1] % of total assets, including cash

Sector Analysis



Financial Data

Total Assets (£m)	908.8
Share price (p)	1164.0
NAV (p) (ex income, debt at market value)	1194.6
Premium/(Discount), ex income (%)	(2.6)
NAV (p) (cum income, debt at market value)	1206.7
Premium/(Discount), cum income (%)	(3.5)
Historic net yield (%)	3.3

Dividend History

Type	Amount (p)	XD date	Pay date
Interim	15.55	10-Sep-14	30-Sep-14
Final	23.33	12-Mar-15	31-Mar-15

Performance

Share Price % change

	Trust	FTSE All-Share [2]
1 month	-1.8	-2.2
3 months	-2.3	3.7
1 year	-3.8	3.0
3 years	26.2	22.0
5 years	49.8	25.9

[2] Capital return only

NAV total return % change

	Trust	FTSE All-Share [3]
1 month	-1.0	-1.7
3 months	4.8	4.7
1 year	2.6	6.6
3 years	48.1	35.4
5 years	73.6	49.3

[3] Total return

Performance, Price and Yield information is sourced from Morningstar as at 31.03.15.

Past performance should not be taken as a guide to the future and dividend growth is not guaranteed. The value of your shares in Temple Bar and the income from them can fall as well as rise and you may lose money. This Trust may not be appropriate for investors who plan to withdraw their money within the short to medium term.

A portion (60%) of the Trust's management and financing expenses are charged to its capital account rather than to its income, which has the effect of increasing the Trust's income (which may be taxable) whilst reducing its capital to an equivalent extent. This could constrain future capital and income growth.

The effect of borrowings to finance the Trust's investments is to magnify the volatility of its price and potential capital gains and losses. We recommend that you seek independent financial advice to ensure this Trust is suitable for your investment needs.

Manager's Commentary

As value investors we are often asked how we spot companies in structural decline – the 'cheap for a reason' stocks. We have written before on this topic and clearly while there is no fool proof method to guarantee avoidance, we have over the years spotted some common themes among these doomed companies. Obviously, the evidence we build is as outsiders. Even if we talk to management teams of these companies as they unwind we are not typically privy to their inner thoughts. So when a book is published about a company's downfall and is written by an insider it is useful to see if we can gain any additional insights as to the characteristics we should be alert to. 'Good to Great to Gone: The 60 Year Rise and Fall of Circuit City (2012)', by Alan Wurtzel, their previous CEO and Chairman, is a recent example of such a publication.

Circuit City was one of 11 companies highlighted by Jim Collins in his best-seller Good to Great (2001). Those chosen few have since had a mixed time, with Circuit City bringing up the rear by virtue of its bankruptcy in 2009. Alan Wurtzel's book details the path to greatness and beyond and is all the more interesting because Wurtzel's father founded the electrical goods chain, while Wurtzel junior was chief executive in the glory days and remained on the board as the company began to unwind. He, therefore, has a unique view of the major factors that determined the company's demise.

Circuit City was founded as Wards in 1949 by Sam Wurtzel, who saw and grasped the opportunity to sell televisions to the public at large. The business was launched in Richmond, Virginia, in the US, where it had an exclusive franchise to sell Olympic TVs, but by 1952 was selling a wider variety of both brands and appliances. Wurtzel understood the importance of the sales pitch and carefully trained his salesmen in all aspects of sales to encourage prospective customers to trade up from the cheap offer that had originally enticed them into the shop. Having dominated the Richmond market, Wurtzel and Abraham Hecht (his partner) expanded into the rest of Virginia, but encountered difficulties in terms of competition, suppliers, personnel and information systems.

These missteps encouraged Wurtzel to modernise his approach. He brought in IBM punch card equipment to deal with inventory and to develop a clear culture and created a human resources role very early in the company's development, covering everything from recruitment to compensation.

The development of discounters, retailers selling at prices below the manufacturer's list price, provided the next step-up for Wurtzel's business empire. Colour TVs were sweeping across the USA and pop music encouraging the young to spend heavily on music equipment. The first discount stores were almost bazaar-like, and Wards, typically, took space of about 3,000 square feet in a 100,000 square feet development.

Not one short of optimism, Wurtzel felt that four stores in Richmond and a couple of departments in the discount stores and a clear need for further capital justified a public quote. Its owners gave up 40% of their capital in 1961 for just over half a million dollars. Unlike later years, Sam and Hecht created a challenging and demanding board to whom they answered.

As the 1960s developed, Wards used its shares to buy smaller competitors and also moved into a variety of other retail businesses with no obvious underlying strategy other than earnings and profit growth.

The 1970s were a great time to be selling electrical products to the American public. For example, household penetration rates of colour TVs soared from 36% in 1970 to 68% in 1975, whilst freezers and microwaves became commonplace. In 1972, Sam Wurtzel handed over management to his son Alan, who developed a strategy focusing on the roll-out of warehouse showrooms. Simultaneously, he simplified the business by exiting from some of the marginal or lossmaking areas which the company had bought in its acquisition drive.

The recession of the mid-1970s, together with very high interest rates, was a disaster for Wards, and conditions became even tougher when all their discount store landlords went bankrupt in 1975. The company just avoided going into Chapter 11, but still underwent significant change, closing a number of department stores and making significant redundancies.

By 1977, Wards was the leading independent retailer of TVs and appliances in the US. Sales were $72m and profits were $1.2 million. Between 1978 and 2000, Wards changed its name to Circuit City and increased sales to $10.6 billion and earnings to $327 million, helped by store growth, introduction of consumer finance and warranties, population increases, greater use of technology in the home and lower prices. Some of the growth was extraordinary; Wards' same store sales in 1984 and 1985 grew 41% and 37%, respectively.

Superstores was the next development for the industry, typically for Circuit City stores of 34,000 square feet, with many products on show and in working order. It wasn't always smooth progress though; withdrawal from the New York market and a decision to build up in Los Angeles concerned shareholders, and the company's stock price dropped 40% in 1985-86.

Wurtzel had had enough and left in 1987, but not before ensuring the company had strong IT, distribution and new management. He left at a time when the company had approximately $1 billion of sales and profits of $35 million, and, in the five years between 1983 and 1987, Circuit City provided the highest return of any company on the New York Stock Exchange.

Wurtzel handed over to Rick Sharp, who focused on rapid growth. In 1986, the company served only 13% of the population. Sharp wanted to double sales in three years and achieved this through growth to 125 superstores. Over the next five years, sales almost tripled and the number of superstores increased to 312. This growth continued and actually accelerated in the 1990s, with more than 60 new stores being opened each year from 1994 to 1997. With hindsight, Wurtzel believes this rapid growth created some significant problems for the future as some stores were opened in less than prime space (to ensure expansion plans promised to Wall Street were met).

The yield information has been calculated as at 31.03.15. All other information is from Investec Asset Management at 31.03.15.

Telephone calls may be recorded for training and quality assurance purposes.

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Management convinced themselves they would have first-mover advantage in new markets and that this would intimidate others from competing, but Best Buy's model was proving superior to Circuit City's and by moving second they were able to find better-quality space, which, given their superior sales per store, was easily affordable. The long leases that Circuit City took on these stores also reduced its flexibility as cities and suburbs changed over the years. Finally, the stores were built with large stock rooms and inflexible fixtures and fittings, which made them hard and expensive to reconfigure as the electrical goods market evolved.

Sharp also created a bank that allowed Circuit City to credit check customers and finance them without relying on external finance providers. This and an own-label credit card operation grew extraordinarily quickly and became a very profitable part of the company – so profitable, in fact, that the company's senior management (the chief executive and financial director) hid some of the profits in the core business from the operating executives. Wurtzel calculates the bank profits actually equalled the group's profits in many years, but, given this information was not widely spread, the apparent high store profits generated too much confidence, not just in Wall Street, but among most of the company's senior management itself.

Circuit City always had an unhealthy interest in selling extended service policies to its customers. Although these were very profitable, the business was over reliant on them, and, to an extent, this profitability drove business decisions. For example, management decided that no product could be bought in self-service; everything required interaction with a commission-hungry salesman. Customers, therefore, were courted by someone wishing to encourage them to buy a high-commission product and an insurance policy with it. This contrasted with Best Buy's principles of offering cheap products, with self-service, and resulted in customers spending much more time and money in a Best Buy store. Circuit City also developed a margin obsession and avoided low margin products (for example, CDs), which, despite the product's low profitability, Best Buy stocked to entice customers into its stores. Just to add salt to the wound, Best Buy introduced interest free credit, but the bank within Circuit City would not subsidise the branches with a similar offer, and the branches could not afford to pay for the incentive.

Sharp realised Circuit City's high growth would eventually slow and, consequently, searched for a new growth vehicle. The final choice was inspired and executed brilliantly. CarMax was created to break into the used car market, selling cars at fixed prices with various warranties and money back policies. By the mid-1990s, CarMax had four stores and had done an IPO with a market value of almost $2 billion (Circuit City sold 22.5%).

Perhaps drunk on this successful diversification, Sharp moved into DIVX – a machine that allowed DVDs to be watched for a certain limited period. However, this created issues in terms of persuading the film studios, machine suppliers and competitors to assist in various ways. After four years of development and a massive amount of management time, the project was written off at a cost of $350 million.

Having turned down the chance to buy Best Buy for $30 million in 1988, Circuit City then watched as its nemesis grew over the next decade from 24 to 272 stores. Using cheap prices and avoiding extended sales policies, Best Buy's sales exploded, but profits were absolutely minimal. Wall Street, as always, thinking long term, brushed this off and happily financed the company's growth. In 1996, Best Buy found itself in significant financial trouble, but, as it had done a number of times over the years, successfully restructured its business, and, within three years, was again profitable (for an electrical retailer anyway).

Best Buy wasn't the only company struggling; many other electrical retailers went bankrupt in the 1990s. Circuit City had always brushed off the relevance of these competitors, and although it latterly recognised the strength of Best Buy, there was little change of strategy to counter its advance. Wurtzel believes that senior management were too busy vying for the top job to properly challenge assumptions, that Sharp was perhaps bored and that the board had limited retail experience, was short of independent thinkers and as a group struggled to have its voice heard by the executive board members. Despite all these issues (but remembering the massive bull market), when Sharp retired in June 2000, having presided over an extraordinary period of growth, the shares were very close to their all-time high.

With the stock flying high (and Wurtzel having sold "most of my stock years earlier") Wurtzel identifies Circuit City's problems as 'an aging store base, a failing marketing strategy, an expensive workforce, and an increasingly out-of-date management information system'. Against this was a company with over $10 billion of sales, strong market positions, cash on the balance sheet and a saleable asset in the CarMax stake and credit card business.

It is interesting to see how these major weaknesses played out.

Marketing – new external management was brought in, but seemed overly concerned about the softer issues rather than trying to sell electrical items at low prices.

Stores – here the rapid growth of the 1980s and 1990s caught up with the business. Various efforts were made to find a new concept store. When eventually a new successful format was found, it was rolled our far too quickly and at much reduced cost. A hurried decision was also made to stop selling appliances (like fridges) which accounted for around 15% of sales. A consultant reported to the company that one-third of stores needed relocating, but the costs of doing so reduced executive enthusiasm.

Staffing – Circuit City had always paid staff well and widely used commissions. However, customers disliked the hard sell, and so management decided to fire 3,900 of its highest-paid commissioned sales personnel. This was handled in an extremely employee-unfriendly way.

In 2004, after the board employed headhunters to find the next chief executive, Phil Schoonover was lifted from Best Buy, coming with a great track record and reputation. He was later joined by eight senior Best Buy colleagues (including the heads of merchandise, retail, supply chain and finance).

Systems – needed upgrading badly and a decision was made to outsource point-of-sale systems to IBM. This exercise went massively over budget and over time as did another project to upgrade supply chain technology.

Management also decided to make an acquisition in 2005. InterTAN was a 970-store consumer electronics chain based in Canada. Although 'only' costing $300 million, this proved both a waste of money and an unnecessary distraction for management.

As CarMax grew, its management and investment bankers pushed Circuit City to allow its independence, and, in 2002, the company was totally separated from its owner (CarMax continues to thrive to this day and any Circuit City shareholder who held onto their CarMax shares has generated excellent returns (CarMax now has a market cap of approximately $14 billion)).

In the 2000s the Circuit City credit card business demanded additional capital as increasing delinquencies forced the company to add cash to its securitised agreements. With regulatory pressure building too, Circuit City sold off its financing businesses.

Schoonover became chief executive in March 2006. Sales were $11.6 billion and earnings $151 million, the highest since 2000 (and, given the absence of the finance business, the stores were perhaps more profitable than in many years). Schoonover had participated in the Best Buy turnaround in the mid-1990s and had surrounded himself with a familiar team. The shares traded at $31, a level it had not seen for six years. However, trouble was not far behind. Wurtzel highlights a number of missteps, but reserves most surprise for Schoonover's over-zealous method of price matching against web competition which did not even have the product in stock and an over-enthusiastic move into smaller stores with little planning. While Wurtzel is sympathetic to any failings of the previous chief executives, Schoonover receives both barrels: "It would be hard to overestimate the damage that Phil Schoonover inflicted on Circuit City. Some of his strategic decisions… had merit. The rest were either too late or poorly executed. On the other hand, he pursued reckless spending…and…reckless stock buybacks. Most important, he destroyed the Circuit City culture."

Mainly due to the sales of the financial business, the Circuit City balance sheet remained strong in the 2000s. In fact, so strong that it carried out share buybacks even when the company was loss-making. Between 2003 and 2007, almost $1 billion was spent, buying back 18% of the company. During the same period, $365 million had been spent on IT and $587 million on store expansion and remodelling. Whilst Schoonover's operating and managerial failures were clearly important, this haemorrhaging of cash undoubtedly dragged Circuit City down much faster than might have happened otherwise. The financial crisis clearly occurred at just the wrong time for a struggling company, and refinancing in any sensible way proved impossible. By January 2009, Circuit City had gone.

The lessons

Wurtzel looks back at the successes and failures of Circuit City and shapes them in terms of managerial lessons. It is, however, perhaps interesting to see what lessons investors, particularly value investors, can take from them:

Top-line growth isn't always enough. Throughout the history of Circuit City, demand was very high for the products it sold and, despite product price deflation, new product innovation continued to drive demand in real terms. Despite this, the industry players were often barely profitable, and several went bankrupt. Customers, manufacturers, landlords and banks seemed to do better than the retailers over this long period.

A strong balance sheet, therefore, seems essential for these retailers. Circuit City met this requirement for most of its history, but then lost its 'corporate memory' and used its cash very aggressively.

Short-term wins can come at the expense of long-term gains. The share buybacks were disastrous, but probably applauded at the time by short-term investors.

Long-term gains can be missed if short-term earnings are the focus. Management appeared to understand the needs for an overhaul of the estate, but, faced with high costs and the likely short-term impact on the share price, went for low cost and unsuccessful alternatives.

Proven management does not always succeed. Schoonover had been through a successful restructuring at Best Buy and brought the company's most senior employees from there with him. His CV could not have been stronger or more relevant. However, he failed spectacularly.

An obsession with margin expansion can alienate customers in a number of ways. Circuit City customers were annoyed by commission-hungry salesmen and affected by the lack of appliances and CDs. They were consequently lost as customers. Low-margin products served a purpose.

Companies can do the wrong thing and 'get away' with it, both operationally and in share price terms, for many years. Wurtzel traced the decline to the rapid growth in store numbers in the early 1990s.

Acquisitions at a time when a company is in difficulty are generally unwise, and, perhaps, a sign that management is either desperate or unaware of the current challenges.

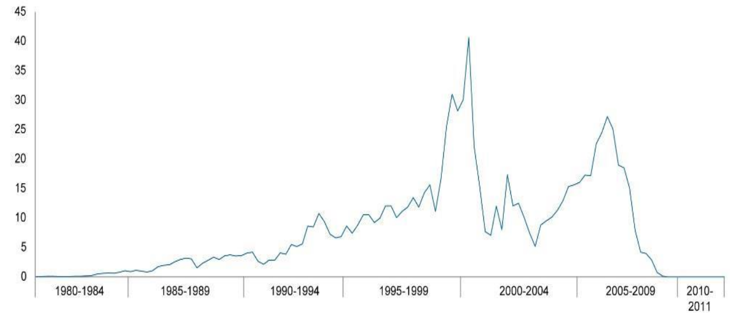
Even if personnel changes are essential, if they are handled unsympathetically they can badly damage staff morale. When Best Buy restructured in the 1990s, it brought in consultants to deal with the personnel issues. Circuit City, on the other hand, appeared to celebrate the cost-cutting.

Not everything reverts to the mean. Especially if bankruptcy intervenes.

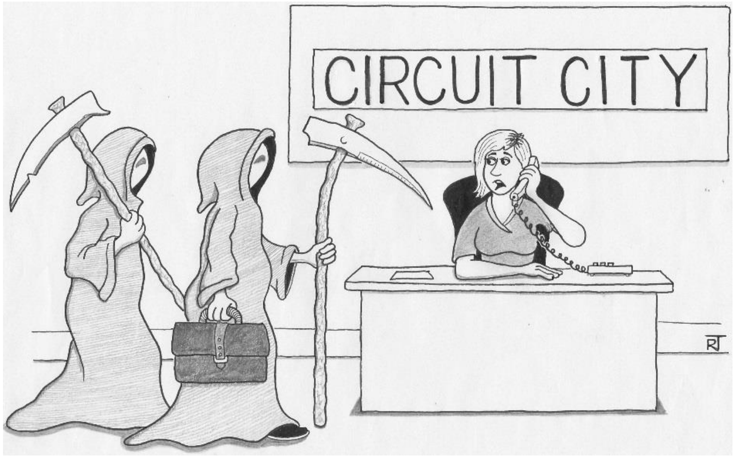
Comparisons with peers can be overdone. Circuit City was never able to narrow the massive gap in sales per store with Best Buy. Relative underperformance deteriorated over many years.

Even successful management can become bored with the continuing challenges or stale in their outlook.

Circuit City's share price history



Source: Bloomberg



"The company auditors are in reception sir"
