

# Finsbury Growth & Income Trust

A concentrated portfolio with a convincing record

Finsbury Growth & Income Trust (FGT) is differentiated by its concentrated portfolio, low turnover (c 6% a year over 13 years) and strong long-term record of outperformance. Manager Nick Train looks to buy mainly UK companies with strong brands and intellectual property, and hold them for the very long term to achieve growth in both capital and income. The trust has increased in size significantly over the past three years, with an active programme of share issuance to manage the premium to net asset value.

12 months ending	FGT share price (%)	FGT NAV (%)	FTSE All-Share Index (%)	FTSE 350 Index (%)	MSCI World Index (%)
31/05/11	33.9	29.4	20.4	20.3	13.6
31/05/12	(1.6)	(1.2)	(8.0)	(8.0)	(4.3)
31/05/13	47.6	45.8	30.1	29.9	30.5
31/05/14	13.8	14.5	8.9	8.7	8.0

Source: Thomson Datastream. Note: Total return basis.

## Strategy: Long-term capital and income growth

FGT aims to achieve capital and income growth from a portfolio of mainly UK stocks, with a focus on buying companies at less than their intrinsic value and holding them for the very long term to allow returns to compound. It is a concentrated portfolio, currently with 24 quoted equity holdings, around 50% of which are FTSE 100 stocks, although it holds none of the mega-cap oil, banking or pharmaceutical companies. The strategy has extremely low turnover, with no new stocks bought since 2011, and only one position exited over the past year.

## Market outlook: Patience needed to bypass volatility

After a strong performance from UK stocks in recent years, the FTSE 100 is beginning to flirt with the all-time high reached in December 1999. But higher-yielding stocks in particular (as measured by the FTSE 350 Higher Yield Index) look favourably valued relative to their history since 2000, suggesting further total return upside for value investors with a long-term horizon. Volatility may persist in the short to medium term, exacerbated by uneven policy action in both developed and emerging markets, with the US and UK beginning to look to monetary tightening just as China and the EU move to a more accommodative stance.

## Valuation: Premium kept in check by issuance

Demand for FGT's shares has been consistently strong, reflected in an average premium to net asset value of 0.6% (including income, with debt at market value) over the past year and also over three years. In order to manage demand and maintain liquidity in the trust's shares, the board has put in place an active programme of share issuance. Over 12 months to 6 June 2014, 16.4m new shares were issued at a premium to net asset value, raising £81m and increasing the number of shares in issue by 21% to 94.6m. At 11 June the shares stood at a cumulative premium of 0.1%. Based on the 11 June share price, FGT has a yield of 2.1%.

## Investment trusts

12 June 2014

<b>Price</b>	<b>525.5p</b>
<b>Market cap*</b>	<b>£498m</b>
<b>AUM</b>	<b>£513m</b>

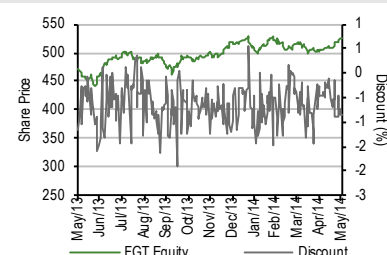
NAV*	521.01p
Premium to NAV	0.9%
NAV**	525.20p
Premium to NAV	0.1%
Yield	2.1%

\*Excluding income. \*\*Including income. Data at 11 June 2014.

Ordinary shares in issue	94.7m
Code	FGT

Primary exchange	LSE
AIC sector	UK Equity Income

## Share price/discount performance\*



\*Including income. Positive values indicate a discount; negative values indicate a premium.

## Three-year cumulative perf. graph



52-week high/low	529.5p	440p
NAV* high/low	525.13p	431.76p

\*Adjusted for debt at market value, excluding income.

## Gearing

Gross	5.0%
Net	5.0%

## Analysts

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[Edison profile page](#)

**Exhibit 1: Trust at a glance**
**Investment objective and fund background**

FGT's investment objective is to achieve capital and income growth and provide shareholders with a total return above that of the FTSE All-Share Index. It invests principally in the securities of UK-quoted companies, but up to a maximum of 20% can be invested in non-UK-quoted companies at acquisition. FTSE 100 companies normally represent 50-100% of the portfolio, with at least 70% usually invested in FTSE 350 companies.

**Recent developments**

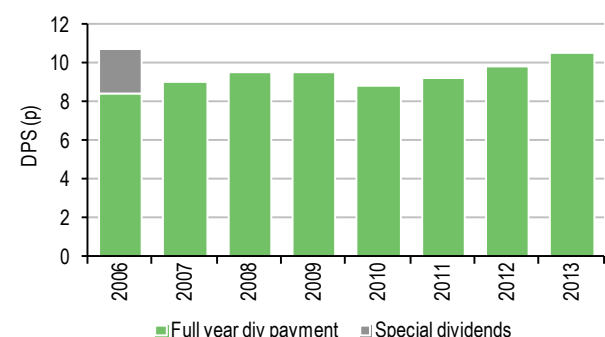
30 April 2014: Half-year results published for the six months ended 31 March. NAV TR +9.9% compared with +4.8% for FTSE All-Share.

18 March 2014: First interim dividend of 5.1p (2013: 4.8p) declared for the year to 30 September 2014.

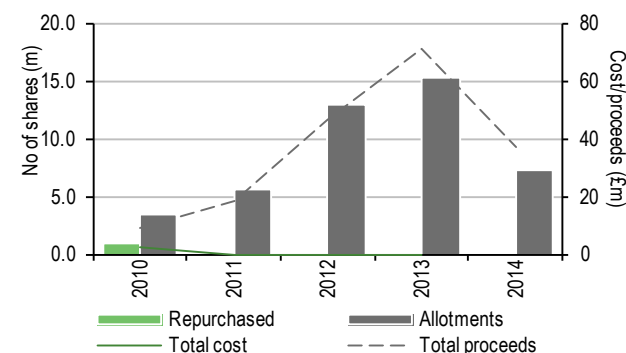
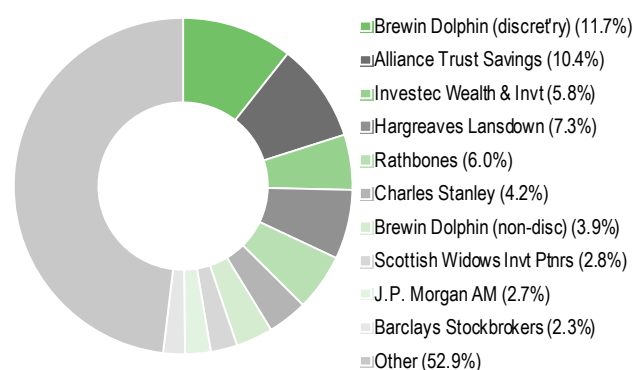
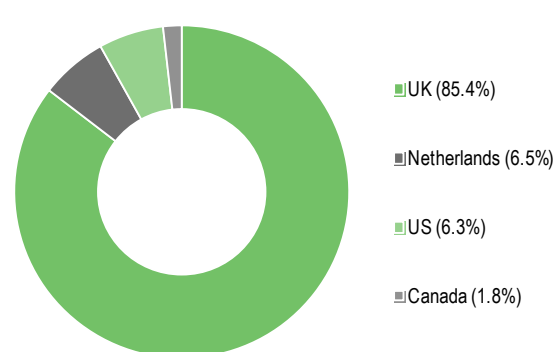
Forthcoming		Capital structure		Fund details	
AGM	January 2015	Ongoing charges	0.8%	Group	Frostrow Capital LLP
Preliminary results	December 2014	Net gearing	5.0%	Manager	Lindsell Train
Year end	30 September	Annual mgmt fee	£70k + 0.6% market cap	Address	25 Southampton Buildings, London, WC2A 1AL, UK
Dividend paid	May, October	Performance fee	15% above RPI + 6%	Phone	+44 (0)20 3008 4910
Launch date	January 1926	Trust life	Indefinite	Website	<a href="http://www.finsburygt.com">www.finsburygt.com</a>
Continuation vote	None	Loan facilities	Up to £50m revolving		

**Dividend policy and history**

Two dividends annually, paid in May and October. The dividend is expected to rise over the longer term.


**Share buyback policy and history**

Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 10% of issued share capital.


**Shareholder base (as at 30 April 2014)**

**Distribution of portfolio (as at 30 April 2014)**

**Top 10 holdings (as at 30 April 2014)**

Company	Country	Sector	Portfolio weight %	
			30 April 2014	30 April 2013
Unilever	UK	Household goods	9.3	9.7
Diageo	UK	Beverages	8.5	9.5
Pearson	UK	Media	6.8	6.7
Heineken	Netherlands	Beverages	6.5	7.8
Reed Elsevier	UK	Media	6.1	4.5
A.G. Barr	UK	Beverages	5.5	6.4
London Stock Exchange	UK	Stock exchanges	5.5	4.7
Schroders	UK	Asset management	5.4	5.6
Sage Group	UK	Software	5.4	n/a
Daily Mail & General Trust	UK	Media	5.2	4.7
<b>Top 10 % of portfolio</b>			<b>64.2</b>	<b>64.1</b>
<b>Cash</b>			<b>0.0</b>	<b>0.8</b>

Source: Finsbury Growth & Income Trust, Edison Investment Research

## Outlook: Value stocks could still perform

It is hard to argue with the thesis that buying good companies when they are cheap and holding them over a very long period will produce superior investment returns. Using the FTSE 350 Higher Yield Index as a proxy for a value benchmark, the chart on the left in Exhibit 2 shows that total returns from this value-biased index have surpassed those from the FTSE All-Share over 14 years to early June, in spite of higher-yielding stocks falling further than the market as a whole during the financial crisis.

The chart on the right shows valuation and dividend yield over the same period. While P/E ratios for the two indices converged for a large part of the period under consideration, the data suggests the higher yield index offers better value in current and historical terms: the FTSE 350 HY P/E of 11.3x at 2 June was 14% below its 14-year average, while the FTSE All-Share P/E of 14.9x was only 3.4% below average. Dividend yields on both indices, at 4.6% for the FTSE 350 HY and 3.3% for the All-Share, were modestly above long-term averages of 4.4% and 3.2% respectively.

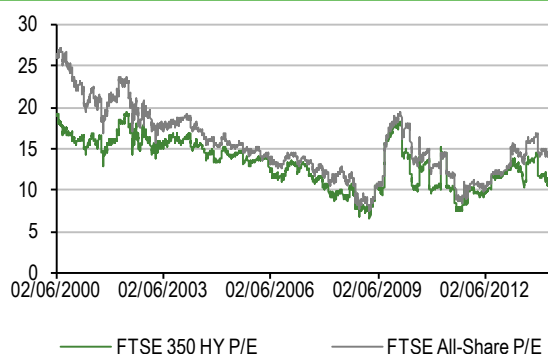
With markets on both sides of the Atlantic flirting with or exceeding their all-time highs, investors may fear buying at the top. However, investment in a fund with a long-term approach and a clear focus on value and sustainable differentiation seems a reasonable option for those sharing the view that market timing is challenging.

**Exhibit 2: FTSE 350 Higher Yield vs FTSE All-Share – performance and valuation over 14 years**

FTSE 350 Higher Yield and FTSE All-Share total returns, indexed to 100



FTSE 350 Higher Yield and FTSE All-Share P/E ratio (current)



Source: Thomson Datastream. Note: Data from 2 June 2000 to 2 June 2014.

## Fund profile: Buy great stocks and hold them forever

FGT was launched in 1926 and has been managed since 2000 by Nick Train of investment boutique Lindsell Train, which he co-founded with ex-GT colleague Michael Lindsell. The pair are adherents of the investment approach of Warren Buffett, summed up as 'buy shares in great businesses for less than they are worth, and hold them forever'. This translates into a very low-turnover portfolio, with no new holdings bought since 2011, one full exit in the past year, and just six of the 24 quoted stocks having changed their weight in the portfolio by more than one percentage point over the 12 months to 31 March 2014. Turnover has averaged less than 6% a year since Lindsell Train's appointment.

## The fund manager: Nick Train

### The manager's view: Forged in the white heat of technology

Train sees globalisation and technological change as two of the biggest factors driving the corporate landscape, and says that understanding whether holdings will be advantaged or

threatened by the internet and digital technology is a key driver of investment decisions. Regardless of their market sector, many of FGT's holdings can be viewed as technology plays, from Hargreaves Lansdown (whose online investment platform gives it 'a massive competitive advantage') to media stock Pearson and luxury goods retailer Burberry (see Current portfolio positioning, below). Companies with iconic and enduring consumer brands – such as Marmite, Guinness or Cadbury – should also be long-term beneficiaries of increasing global prosperity.

## Asset allocation

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### Investment process: Focus on long-term value creation

FGT is a concentrated portfolio of mainly UK stocks chosen for their ability to grow and compound over time. Manager Nick Train uses fundamental analysis to value companies and will look to buy stocks he feels are undervalued relative to their long-term prospects. His philosophy is influenced by long-term value investors like Sir John Templeton, Peter Lynch and Warren Buffett. Train describes his approach as more a 'state of mind' than a process, and seeks to avoid 'bad behaviours' such as trading too actively. Growth in dividends (preferably with the potential to achieve 5%+ a year) is a key selection criterion, although Train says dividends themselves are secondary to long-term value creation.

The manager focuses on quality companies with strong brands or intellectual property that can stand the test of time. He dislikes capital-intensive industries and stocks where growth is relatively expensive, and prefers those that can grow their earnings year-on-year to more cyclical situations. Three factors underpin Train's long-term bullish view of equity markets:

- the rapid pace of technological change, meaning some of the biggest companies of the next 20 years probably do not yet exist;
- a growing world population with growing prosperity, leading to new markets and new consumers for brands like Guinness and Unilever's personal care products; and
- the continued risks to the real value of cash and bonds, providing a reason to make long-term allocations to equities.

Train is a very long-term holder of shares, preferring to run winners rather than try to lock in profits. However, the significant expansion of FGT through share issuance has provided him with a means of rebalancing the portfolio somewhat, allocating more of the new money to stocks such as Burberry (see Current portfolio positioning) and consequently reducing the weighting to financial stocks, which had performed strongly.

The FGT portfolio is similar to that of the open-ended CF Lindsell Train UK Equity fund, and there is also some commonality of holdings across other Lindsell Train portfolios, meaning the firm can hold significant stakes in its portfolio companies. However, given the long-term philosophy, stakes are seldom disposed of entirely. Train says the key to achieving an exit from companies where he feels long-term strategic value has been reached is to sacrifice a little potential upside and sell stocks while there is still strong appetite from the market. This was illustrated by the disposal of FGT's stake in brewery Marston's in the second half of 2013.

### Current portfolio positioning

At 30 April 2014 FGT held 24 quoted equity investments, plus two small positions in convertible and preference stock of Celtic FC, and a small stake (0.1%) in the unquoted Frostrow Capital, which provides fund administration and marketing services to FGT and other trusts. FGT's investment policy states that 50-100% of assets will normally be in FTSE 100 companies (or overseas-listed equivalents), with at least 70% in FTSE 350 or equivalent companies. At 31 March (the latest date for which full portfolio information is available), 81.6% was held in FTSE 350 stocks. 54.8% was in FTSE 100 stocks, with 14.4% in overseas-listed large-caps (the three US holdings, Mondelēz, Dr

Pepper-Snapple and Kraft Foods, are all the legacy of a position in Cadbury Schweppes). However, the weighting to mega-caps is low: Diageo, the 11th biggest stock in the FTSE 100, is the largest company held, and the average market cap of stocks in the FGT portfolio is £10.7bn, compared with £18.7bn for whole FTSE 100, and £73bn for the biggest 10 stocks in the index.

**Exhibit 3: Sector allocations as at 30 April 2014**

	Portfolio weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/benchmark weight
Consumer Goods	40.3	13.9	26.4	2.9
Consumer Services	28.5	10.4	18.1	2.7
Financials	20.7	24.3	-3.6	0.9
Technology	10.5	1.3	9.2	8.0
Oil & gas	0.0	15.3	-15.3	0.0
Industrials	0.0	10.0	-10.0	0.0
Healthcare	0.0	8.3	-8.3	0.0
Basic Materials	0.0	8.2	-8.2	0.0
Telecoms	0.0	4.5	-4.5	0.0
Utilities	0.0	3.8	-3.8	0.0
Cash	0.0	0.0	0.0	N/A
	<b>100.0</b>	<b>100.0</b>	<b>0.0</b>	

Source: Finsbury Growth & Income Trust, Bloomberg, Edison Investment Research

With such a concentrated portfolio, industry weightings are markedly different from the benchmark FTSE All-Share Index. Reflecting Train's focus on intellectual property (including strong consumer brands) and technological change, there are high weightings to consumer goods and services (including media stocks), financials and technology, while more cyclical and capital-intensive sectors such as oil and gas, basic materials and industrials are absent. The portfolio is currently fully invested with no cash holding.

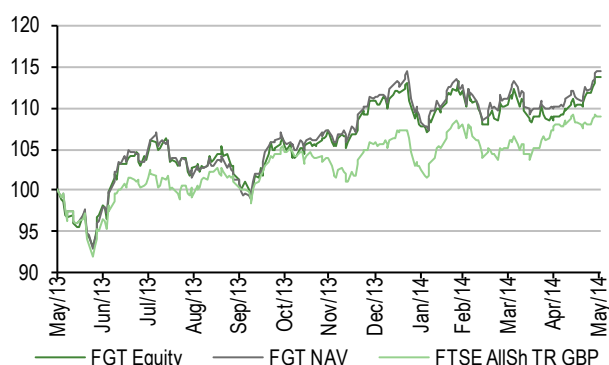
Train has recently increased his allocation to Burberry, which now stands just outside the top 10 holdings. This is in response to a combination of the firm's strong brand and its deployment of digital technology, with a strong online community both through the firm's own website and via its social media presence, and the use of iPad ordering in stores enabling it to maintain lower stock levels in expensive locations, thus improving its operating margins.

Another favoured name is Pearson, which Train says is being undervalued by the market in relation to the growth opportunity from digital. The stock has sold off recently but Train remains optimistic that its heavy investment in technology will allow it to emerge as the leader in the digitisation of education in the US and around the world.

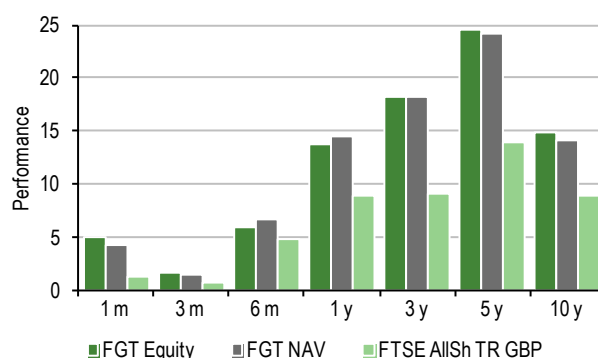
## Performance: Ahead of benchmark over all periods

**Exhibit 4: Investment trust performance to 31 May 2014**

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)\*



Source: Thomson Datastream, Edison Investment Research. Note: \*Three, five and 10 years annualised.

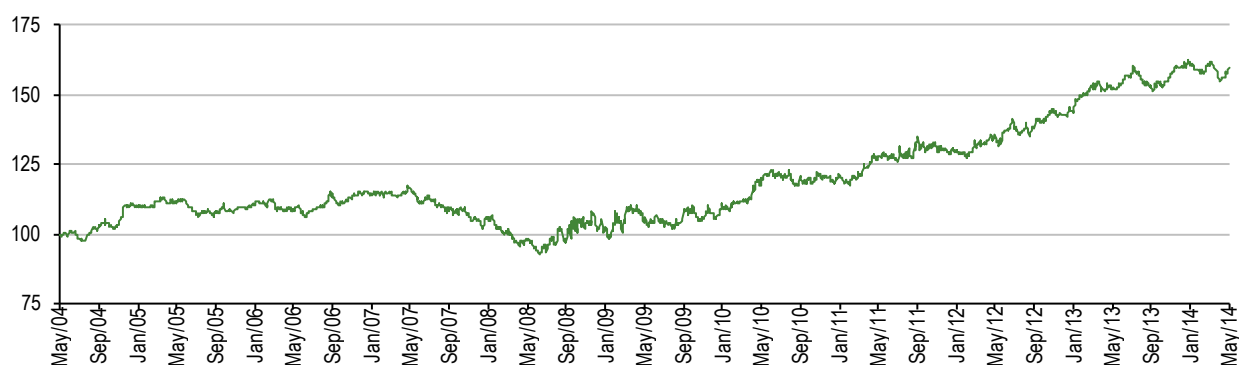
FGT has an exceptional longer-term performance record, producing annualised returns in excess of 10% on both a share price and NAV basis over one, three, five and 10 years, and comfortably outperforming the FTSE All-Share index benchmark over all these periods (Exhibits 4, 5 and 6). As Exhibit 5 shows, the trust has also outperformed the MSCI World Index over most periods. Performance over the past five years has been particularly strong, and Train has warned investors against extrapolating the trend of extreme outperformance into the future, although in line with his long-term investment philosophy he has also stated that the current portfolio is unlikely to look very different in a year's time.

**Exhibit 5: Share price and NAV total return performance relative to benchmarks (%) to 31 May 2014**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All Share index	3.6	0.8	1.2	4.6	26.8	55.6	69.9
NAV relative to FTSE All Share index	2.8	0.7	1.9	5.2	26.6	53.1	59.9
Price relative to FTSE 350 index	3.5	0.7	1.2	4.7	27.1	56.2	69.4
NAV relative to FTSE 350 index	2.8	0.6	1.9	5.3	26.9	53.7	59.5
Price relative to MSCI World index	2.2	(1.6)	1.6	5.4	22.5	54.5	71.4
NAV relative to MSCI World index	1.5	(1.7)	2.3	6.0	22.3	52.0	61.4

Source: Thomson Datastream, Edison Investment Research. Note: Geometric calculation.

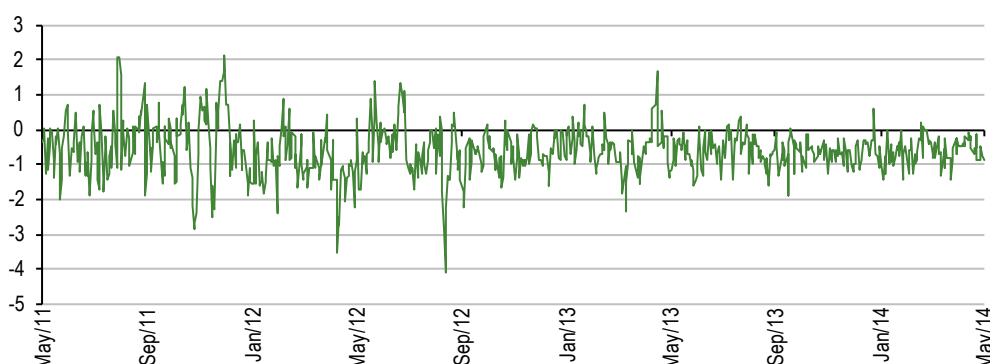
**Exhibit 6: FGT NAV total return vs FTSE All-Share total return, over 10 years, rebased to 100**



Source: Thomson Datastream, Edison Investment Research

## Discount: Active issuance keeps shares close to par

**Exhibit 7: Discount over three years**



Source: Thomson Datastream, Edison Investment Research. Note: Positive values indicate a discount; negative values indicate a premium. Discount with debt at fair value, including income.

FGT has an active discount management policy and will buy back shares if the discount to net asset value exceeds 5%. In practice, the trust's shares have traded more or less consistently at a premium for some time (Exhibit 7). In order to satisfy demand, FGT has been issuing shares, through its authority to allot up to 10% of share capital as well as through new block listing facilities.



Shares are issued at a premium to NAV in order to enhance rather than erode the NAV per share of existing shares. Over 12 months to 6 June 2014, 16.4m new shares have been issued.

On a cum-fair basis FGT was trading at a 0.1% premium at 11 June, having traded in a range between a discount of 0.6% and a premium of 1.9% over one year. The average premium over both one and three years was 0.6%. Over 10 years the shares have traded at an average discount of 0.9%.

## Capital structure and fees

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FGT is a conventional trust with one class of share. It has an active programme of share issuance in order to manage its premium to net asset value, and over 12 months to 6 June 2014 it has increased the number of shares in issue by 21% to 94.6m, raising £81.4m.

The trust's gearing policy states that it employs long-term gearing, usually in the range of 5-25% in normal market conditions. The current net gearing of 5% is at the bottom of this range and it has dipped below this level in recent months, partly as a result of the expansion of the asset base. FGT has a three-year, £30m loan facility with Scotiabank, with the option to draw a further £20m. The investment manager has currently drawn £20.8m of the facility. Based on net assets of £475m at 29 May, the maximum gearing that could be achieved with the £30m loan is 6.3%, or 10.5% if the full £50m were drawn. Train says he would view a setback in the market or in an individual company he favoured as grounds for increasing gearing.

Lindsell Train Investment Management receives an investment management fee of 0.45% of FGT's market capitalisation per annum, while Frostrow Capital, which provides company secretarial, administration and marketing services, receives an annual fee of £70,000 plus 0.15% of market cap. Ongoing charges at the 30 September 2013 year-end were 0.8% compared with 0.9% a year earlier.

If the adjusted market capitalisation of the trust rises by more than an absolute hurdle of 6% + RPI over the financial year, a performance fee of 15% of the outperformance is payable (85% to Lindsell Train and 15% to Frostrow), subject to a cap on total fees of 1.25% of market capitalisation. The performance fee was last paid in 2007. The 2013 performance hurdle of 602.18p per share was some way ahead of the trust's actual market cap per share of 479p at the year end. While FGT's performance has been strong, this gap reflects the fact that the trust experienced a spell of negative returns during the financial crisis, while the hurdle rises at an absolute level each year.

## Dividend policy and record: Set fair for further growth

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FGT seeks to provide a growing income alongside capital growth, and has maintained or increased its dividend in nine of the past 10 years (there was a slight dip in 2010 following the suspension of dividends on Lloyds Bank preference shares). Dividends are paid twice a year, with a first interim paid in May and a second in October. The full-year dividend for the year ended 30 September 2013 was 10.5p. The first interim dividend for 2014, at 5.1p, is 6.3% higher than last year's first interim of 4.8p. Provided there is no dramatic drop in revenues to the portfolio in the second half of the year, it should be possible for FGT at least to maintain its dividend for the full year to 30 September.

While share issuance has benefits in terms of managing the premium to net asset value, creating liquidity and spreading fixed costs over a larger asset base, it can have a dilutive effect on revenue reserves. However, an increase in portfolio revenues for the six months ended 31 March 2014 (+15% on the same period a year earlier) has dampened this effect, and the revenue reserve amounted to 7.2p a share at 31 March 2014 compared with 6.7p a share at 31 March 2013. Based on the 29 May share price, FGT has a yield of 2.1%.

## Peer group comparison

There are 24 trusts in the Association of Investment Companies' UK Equity Income sector, and Exhibit 8 shows those with more than £200m market capitalisation. FGT has performed strongly against the group, particularly over periods longer than one year, ranking seventh for net asset value total return over one year, second over three years, third over five years and (not shown in the table) first over 10 years. The discount/premium and ongoing charges are mid-range within the group. The yield is the lowest in the sector, reflecting strong capital performance and the fact the trust targets growth of capital and income, rather than a set level of yield. Risk-adjusted performance as measured by the Sharpe ratio is 11th over one year and second over three years.

**Exhibit 8: UK Equity Income investment trusts**

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount (-) /premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
<b>Finsbury Growth &amp; Income</b>	<b>493.8</b>	<b>12.8</b>	<b>65.2</b>	<b>193.5</b>	<b>0.9</b>	<b>Yes</b>	<b>0.6</b>	<b>105.0</b>	<b>2.1</b>	<b>1.0</b>	<b>1.5</b>
City of London	1095.6	10.9	47.0	129.0	0.4	No	1.6	108.0	3.8	0.8	1.1
Diverse Income Trust	270.0	29.6	83.0	--	1.8	No	1.7	99.0	2.6	4.5	--
Dunedin Income Growth	421.4	9.1	41.3	122.1	0.6	No	-2.2	106.0	4.0	0.6	0.8
Edinburgh Investment	1191.2	11.0	51.0	138.7	0.7	No	-3.8	116.0	3.9	1.0	1.3
F&C Capital & Income	245.9	6.8	31.6	87.1	0.7	No	1.4	104.0	3.6	0.6	0.8
JPMorgan Claverhouse	332.1	11.8	40.4	108.4	0.7	Yes	-3.9	116.0	3.3	1.1	0.8
Lowland	393.0	19.3	65.2	224.3	0.6	Yes	2.9	111.0	2.5	1.7	1.3
Merchants Trust	538.4	8.8	43.4	132.2	0.6	No	1.0	120.0	4.6	0.8	0.8
Murray Income Trust	542.8	9.5	42.3	124.7	0.8	No	-2.9	106.0	3.8	0.7	0.9
Perpetual Income & Growth	912.1	16.1	61.7	147.7	0.9	Yes	-1.4	114.0	3.0	1.6	1.6
Temple Bar	802.4	9.0	50.3	139.6	0.5	No	1.7	98.0	3.1	1.1	1.2
<b>Sector weighted average</b>		<b>12.2</b>	<b>50.8</b>	<b>139.6</b>	<b>0.8</b>		<b>-0.6</b>	<b>111.6</b>	<b>3.5</b>	<b>1.1</b>	<b>1.1</b>
<b>FGT rank in sector</b>	<b>7</b>	<b>7</b>	<b>2</b>	<b>3</b>	<b>14</b>		<b>10</b>	<b>17</b>	<b>24</b>	<b>11</b>	<b>2</b>

Source: Morningstar, 30 May 2014, Edison Investment Research. Note: Excludes trusts with less than £200m market cap. Notes: TR = net asset value total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds.

## The board

FGT has five directors. Chairman Anthony Townsend joined the board in 2005 and became chairman in 2008. John Allard and Vanessa Renwick have been directors since 2000, while David Hunt joined the board in 2006 and Neil Collins was appointed in 2008.

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