

Finsbury Growth & Income Trust

Strong record of capital and dividend growth

Finsbury Growth & Income Trust (FGT) has a distinguished track record of outperformance – its NAV total returns are above those of the FTSE All-Share index benchmark over one, three, five and 10 years. It also ranks first over these periods when comparing its performance with that of its 10 larger-cap peers in the AIC UK Equity Income sector. Manager Nick Train highlights the trust's 7.7% dividend growth in FY18, which was fully covered by revenue. He says this growth rate is very encouraging compared to the much lower levels of UK inflation and interest rates, and illustrates the strong cash flow being generated by portfolio companies, which he argues should continue to support FGT's annual distributions.

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	FTSE 350 (%)	MSCI World (%)
30/11/14	11.2	12.3	4.7	4.8	14.5
30/11/15	9.7	9.2	0.6	0.4	3.9
30/11/16	9.3	9.0	9.8	9.7	25.0
30/11/17	22.0	22.4	13.4	13.1	14.8
30/11/18	5.3	5.5	(1.5)	(1.4)	6.8

Source: Thomson Datastream. Note: All % on a total-return basis in pounds sterling.

Investment strategy: Very concentrated portfolio

Train runs a very concentrated fund of c 25 primarily UK-listed companies. He seeks quality firms, trading at a discount to their perceived intrinsic value, that he can 'hold forever'. The manager is only invested in four of the 10 available sectors (consumer goods, financials, consumer services and technology), and holdings tend to fall into one of three themes: global consumer brands; owners of media/software intellectual property; and capital market proxies. Gearing of up to 25% of NAV is permitted, and up to 10% may be held in cash (although the manager prefers to remain fully invested); at end-October, net gearing was 2.8%.

Market outlook: Volatility offers potential opportunity

Global equities, including shares of companies listed in the UK, have experienced higher levels of volatility in 2018 compared with a particularly benign period in 2017. Investor concerns include the US/China trade dispute and rising US interest rates, along with uncertainty around Brexit, which is affecting sentiment and spending decisions. However, UK corporate earnings have remained robust, meaning that share price weakness has resulted in more attractive equity valuations. This environment may provide an opportunity for active managers with a disciplined approach to stock selection and a longer-term investment horizon.

Valuation: Regularly trades close to NAV

FGT is trading at a 1.4% premium to cum-income NAV, which is towards the high end of the range of the last five years (1.6% premium to a 1.5% discount). The board actively issues shares when there are unfulfilled buy orders in the market. As a result of strong investor demand, in FY18 the number of shares in issue increased by 22.0%. FGT has a progressive dividend policy, aiming to grow the annual distribution at a rate higher than UK inflation; its current yield is 2.0%.

Investment trusts

10 December 2018

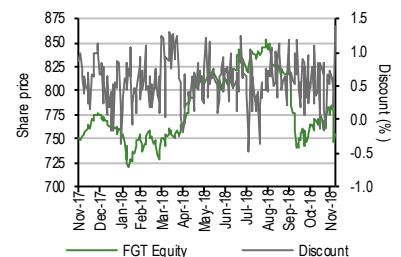
Price 755.0p
Market cap £1,344m
AUM £1,367m

NAV* 742.5p
 Premium to NAV 1.7%
 NAV** 744.7p
 Premium to NAV 1.4%

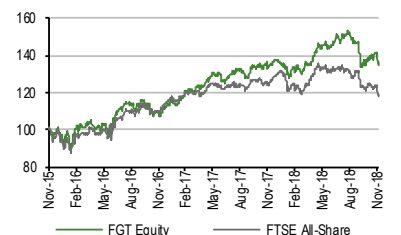
*Excluding income. **Including income. As at 6 December 2018.

Yield 2.0%
 Ordinary shares in issue 178.0m
 Code FGT
 Primary exchange LSE
 AIC sector UK Equity Income
 Benchmark FTSE All-Share

Share price/discount performance



Three-year performance vs index



52-week high/low 854.0p 721.0p
 NAV** high/low 849.8p 715.5p

**Including income.

Gearing

Gross* 2.8%
 Net* 2.8%

*As at 31 October 2018.

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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%, at the time of acquisition, can be invested in non-UK quoted companies. FTSE 100 companies normally represent 50–100% of the portfolio, with at least 70% usually invested in FTSE 350 companies.

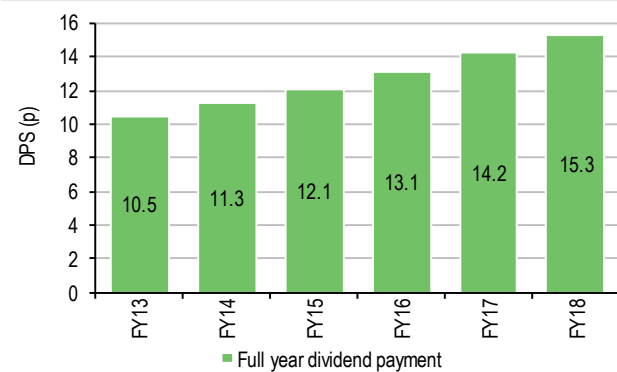
Recent developments

- 25 September 2018: announcement of second interim dividend of 8.1p (+9.5% year-on-year).
- 21 May 2018: six-month results to 30 March 2018. NAV TR +2.1% versus benchmark TR -2.3%. Share price TR +2.8%.
- 14 March 2018: announcement of first interim dividend of 7.2p (+5.9% year-on-year).
- 31 January 2018: announcement that John Allard and Vanessa Renwick have retired as independent non-executive directors, with immediate effect.

Forthcoming		Capital structure		Fund details	
AGM	January 2019	Ongoing charges	0.68% (H118)	Group	Frostrow Capital
Final results	December 2018	Net gearing	2.8%	Manager	Lindsell Train
Year end	30 September	Annual mgmt fee	Tiered (see page 7)	Address	25 Southampton Buildings, London, WC2A 1AL
Dividend paid	May, November	Performance fee	None	Phone	+44 (0)20 3008 4910
Launch date	January 1926	Trust life	Indefinite	Website	www.finsburygt.com
Continuation vote	None	Loan facilities	£75m (see page 7)		

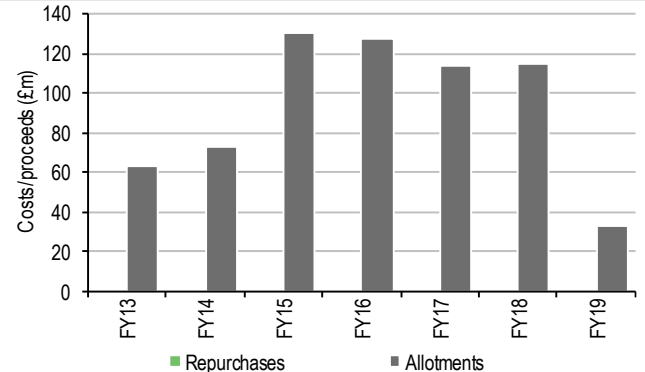
Dividend policy and history (financial years)

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

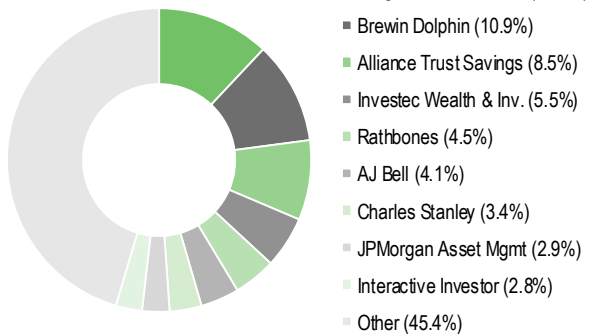


Share buyback policy and history (financial years)

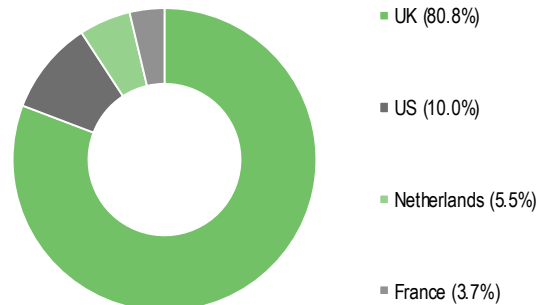
Renewed annually, the trust has the authority to purchase up to 14.99% and allot up to 10% of issued share capital.



Shareholder base (as at 31 October 2018)



Portfolio exposure by geography (as at 31 October 2018)



Top 10 holdings (as at 31 October 2018)

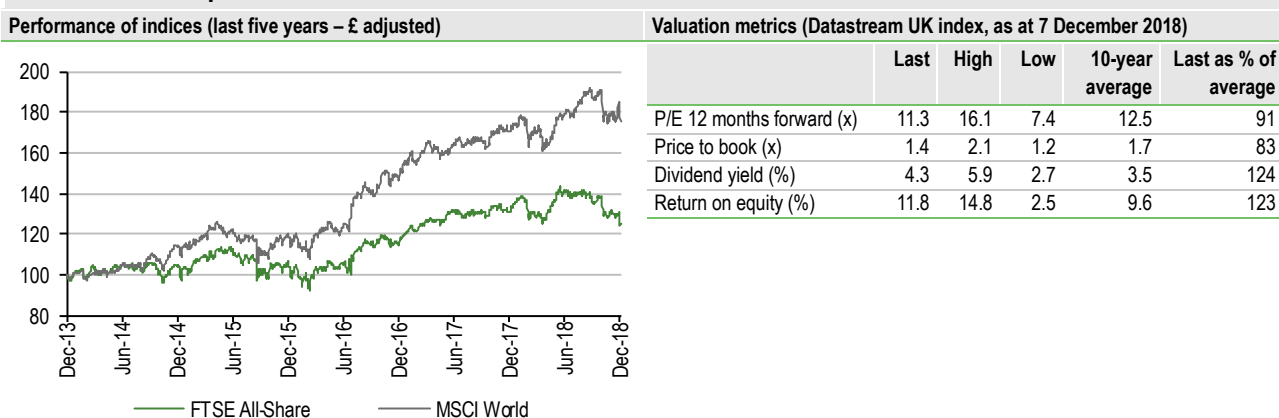
Company	Country	Sector	Portfolio weight %	
			31 October 2018	31 October 2017
Diageo	UK	Consumer goods	10.4	10.0
RELX	UK	Consumer services	9.9	9.6
Unilever	UK	Consumer goods	9.9	9.6
London Stock Exchange	UK	Financials	8.4	8.1
Hargreaves Lansdown	UK	Financials	8.1	7.4
Mondelēz International	US	Consumer goods	8.0	5.7
Burberry Group	UK	Consumer goods	7.1	7.1
Schroders	UK	Financials	6.8	6.3
Heineken	Netherlands	Consumer goods	5.6	6.1
Sage Group	UK	Technology	5.0	5.9
Top 10 (% of holdings)			79.2	75.8

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

Market outlook: Valuations looking more attractive

Exhibit 2 (left-hand side) shows the performance of UK and global equities (in sterling terms) over the last five years. While overseas equities have outperformed over the period, until the recent stock market decline, UK investors had also enjoyed a decent average annual total return. Global stock markets have returned to a more normal level of share price volatility after a particularly benign period in 2017; investor concerns include the risks to economic growth due to trade frictions and rising interest rates. Within the UK there is also uncertainty over Brexit, which is causing delays to both individual and corporate spending decisions. Weakness in the UK stock market has led to more attractive equity valuations as, so far, corporate earnings have remained robust. Looking at the valuation of the Datastream UK index (table below), compared to around six months ago, the forward P/E multiple has declined by two-and-a-half points; UK stocks are now trading at a discount to their 10-year average rather than a higher than 10% premium, which may provide an opportunity for skilled stock pickers taking a longer-term view.

Exhibit 2: Market performance and valuation



Source: Thomson Datastream, Edison Investment Research

Fund profile: Concentrated fund with long-term focus

FGT was launched in 1926 and is listed on the Main Market of the London Stock Exchange. Since 2000, the trust has been managed by Nick Train, a co-founder of specialist investment manager Lindsell Train, who aims to generate long-term growth in capital and income from a concentrated portfolio of c 25 equities. The trust is primarily invested in UK-listed companies, although 20% (at the time of acquisition) may be held in firms listed overseas. Position sizes are usually at least 1% of the portfolio unless they are being built or disposed of. Typically, securities in FTSE 100 companies and comparable stocks listed on an overseas exchange will represent between 50% and 100% of the portfolio, while securities in FTSE 350 companies and their overseas equivalents will represent at least 70%. Gearing of up to 25% of NAV is permitted (2.8% at end-October 2018), and 10% may be held in cash, although the manager prefers to stay fully invested. A key feature of FGT is its low portfolio turnover, which averages c 5% pa, implying a typical holding period of 20 years. The trust is benchmarked against the FTSE All-Share index, which it has outperformed over the last one, three, five and 10 years. Over time, FGT has grown significantly, due to capital appreciation and share issuance to meet ongoing investor demand; assets under management are now c £1.4bn versus £64m in 2000. The manager regularly invests his own money in the trust; this has continued during the period of increased stock market volatility in recent months, as Train says that it is important for a fund manager to have 'skin in the game'.

The fund manager: Nick Train

The manager's view: Focus on companies, not the macro

While 2018 has generally been a tough year for active portfolio managers, due to an increase in stock market volatility, Train is encouraged by the level of merger and acquisition (M&A) activity so far this year. He says that data from Bloomberg show the level of announced deals is greater than in 2017, which itself was a period of high M&A volumes. The manager notes that a lot of deal newsflow has been in the US, where the stock market has been relatively buoyant, unlike in the UK where political concerns have kept M&A activity somewhat depressed. However, he notes that there have recently been two deals announced in the biotech sector, which may signal a pickup in bid activity in the coming year if the UK political environment stabilises.

Train says there are macroeconomic issues that may cause investors to question whether wealth creation is sustainable, such as Brexit, international politics and rising interest rates. However, he stresses the importance of focusing on individual companies, noting that almost without exception, the businesses represented in FGT's portfolio are delivering good news and encouraging trading statements. The manager believes that this is far more important than worrying about short-term macro issues. As an example, Train is encouraged to note that in the 12 months ending June 2018, global shipments of Scotch whisky were 12% higher year-on-year, compared with a 5% increase in the 12 months to June 2017. He says that demand for Scotch whisky and other premium spirits remains strong in Asia, particularly in China, confirming the long-term trend of rising wealth in emerging markets. The manager comments that this environment is very positive for FGT's top holding, Diageo, which is the world's largest Scotch whisky producer. Train also highlights the significant appreciation in the share prices of football clubs in August 2018, including FGT holding Manchester United, after Amazon won a package of Premiership football rights; he says this illustrates the value embedded in companies that own the most-watched entertainment/content.

The manager highlights FGT's long-term dividend growth record (the FY18 total distribution will be 7.7% higher year on year, in line with the c 7–8% increases in each of the last five years). He says that in FY01, the year he was appointed the trust's manager, the annual dividend was 3.2p and has now grown to 15.3p – nearly a fivefold increase. Train considers this to be the best long-term measure of the wealth generated for FGT's shareholders, and he is hopeful that this steady pace of value creation can continue.

Asset allocation

Investment process: Fundamental and long-term approach

Train seeks to generate long-term growth in capital and income from a concentrated portfolio of c 25 high-quality companies with strong brands or franchises that he can 'hold forever'. He has an unconstrained approach, investing in just four of the 10 industry sectors (consumer goods, financials, consumer services and technology, see Exhibit 3). There are three broad themes within the portfolio: global consumer brands, owners of media/software intellectual property, and capital market proxies. FGT's portfolio has an active share above 90% – this is a measure of how a portfolio differs from its benchmark, with 0% representing full index replication, and 100% no commonality.

The manager defines quality companies as having the following characteristics:

- durability, companies that can prosper through multiple business cycles;
- high return on equity, firms with sustainable long-term earnings growth; and
- low capital intensity with high free cash flow generation.

Train aims to buy stocks that are trading at a discount to his estimate of their intrinsic worth. Long-term portfolio turnover of c 5% pa is very low compared with the industry average. The most recent addition to the portfolio was football club Manchester United in 2017; this was the first new holding since spirits producer Rémy Cointreau was added in 2015. There have been three complete disposals in 2018 (Dr Pepper Snapple and Fidessa, which were taken over, and Kraft Heinz). Portfolio companies have been established on average for c 150 years, and c 50% of holdings are majority family-owned.

Current portfolio positioning

Train runs a very concentrated portfolio; at end-October 2018, FGT's top 10 positions made up nearly 80% of the portfolio (Exhibit 1). In terms of sector exposure (Exhibit 3), over the last 12 months technology exposure has reduced by 3.2pp, with modest increases across the other three sectors in which the trust is invested. In aggregate, the six sectors where FGT has no exposure make up nearly half of the benchmark.

	Portfolio end-October 2018	Portfolio end-October 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
Consumer goods	47.3	46.2	1.1	14.1	33.2	3.4
Financials	26.3	25.0	1.3	25.4	0.9	1.0
Consumer services	21.4	20.6	0.8	11.2	10.2	1.9
Technology	5.0	8.2	(3.2)	0.9	4.2	5.9
Utilities	0.0	0.0	0.0	2.7	(2.7)	0.0
Telecommunications	0.0	0.0	0.0	2.9	(2.9)	0.0
Basic materials	0.0	0.0	0.0	7.6	(7.6)	0.0
Healthcare	0.0	0.0	0.0	9.8	(9.8)	0.0
Industrials	0.0	0.0	0.0	10.8	(10.8)	0.0
Oil & gas	0.0	0.0	0.0	14.7	(14.7)	0.0
	100.0	100.0		100.0		

Source: Finsbury Growth & Income Trust, Edison Investment Research

In keeping with the manager's strategy of adding to FGT's positions during periods of individual share price weakness, Train has been actively buying shares in Schroders, which has performed poorly in 2018 along with other asset managers such as Jupiter and Standard Life Aberdeen. In October, Schroders formally announced a partnership with Lloyds Banking Group to bolster its wealth management operations. It will take a 49.9% stake in a financial planning joint venture in return for a 19.9% stake in its UK wealth management business. Schroders will also manage £67bn of Scottish Widows assets when Lloyds' contract with Standard Life Aberdeen comes to an end. Train welcomes the news, believing the deal is a significant transaction for both parties, offering the potential for larger inflows, while confirming the value of Schroders' brand name and expertise. He holds two lines of Schroders stock within FGT's portfolio, voting and non-voting shares. The position in the non-voting shares was initiated earlier in 2018 when they were trading at a wide discount to the voting shares. The manager explains that the non-voting shares offer the same dividend and economic interest as the voting shares, but as they were trading at a discount, they offered a higher dividend yield.

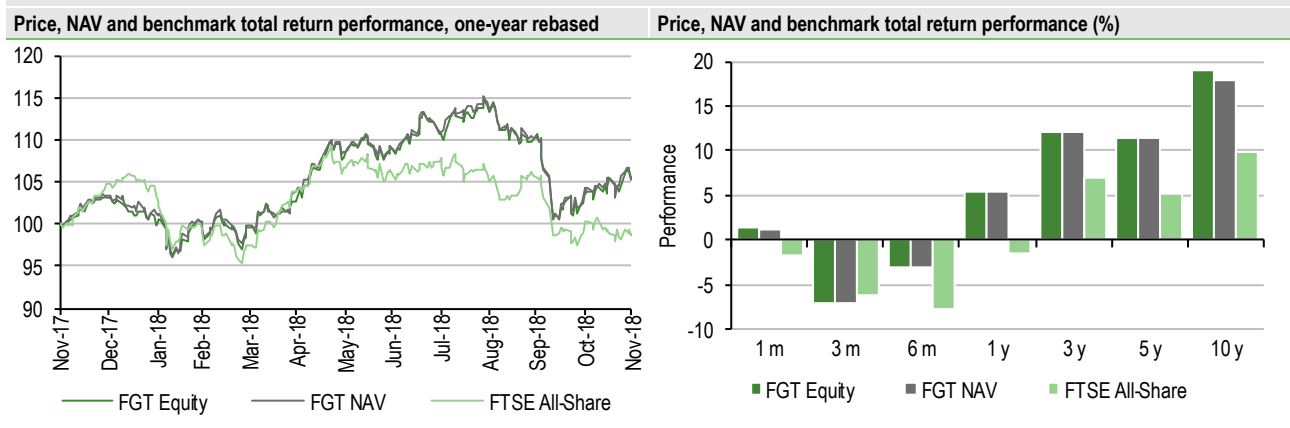
Train has also been building up FGT's position in Mondelēz International, whose share price has been weak for most of this year. He says the traditional US packaged food companies have struggled due to low volumes and pricing pressure, as in the 21st century people want fresh food with provenance, rather than the processed, packaged food that was popular in the last century. However, he is encouraged by Mondelēz's product portfolio – a significant percentage of revenues are generated from chocolate, confectionery and snacking, which are less affected by sluggish volume growth and competition from own-label products. He says the firm's two core product lines, Cadbury and Oreos, are 'fantastic global brands'. In addition, unlike its peers, the majority of Mondelēz's sales are generated outside the US, giving it exposure to higher-growth markets. The

manager believes that the company's share price had been unduly punished by investors, and he notes that the stock's performance has recently improved.

Performance: Very strong investment track record

Over the 12 months to 30 November, FGT's NAV and share price total returns of +5.5% and +5.3% respectively are ahead of the benchmark's -1.5% total return. Train notes the superior performance of classic defensive stocks within the portfolio, such as Diageo, RELX and Unilever, during the period of increased stock market volatility in recent months.

Exhibit 4: Investment trust performance to 30 November 2018



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

FGT has an enviable performance track record. It has outperformed the FTSE All-Share index over all periods shown (with the exception of the last three months) in both NAV and share price terms. Its 10-year record is particularly notable, outperforming the benchmark by an average of more than 10pp a year.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	3.0	(1.1)	5.1	6.9	14.6	32.7	122.7
NAV relative to FTSE All-Share	2.8	(1.1)	5.1	7.0	14.8	33.5	103.7
Price relative to FTSE 350	3.0	(1.1)	5.1	6.8	14.8	33.2	125.2
NAV relative to FTSE 350	2.8	(1.1)	5.1	6.9	15.0	34.0	106.0
Price relative to MSCI World	(0.0)	(3.4)	(5.6)	(1.4)	(8.3)	(5.9)	59.9
NAV relative to MSCI World	(0.2)	(3.4)	(5.6)	(1.3)	(8.2)	(5.4)	46.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2018. Geometric calculation.

Exhibit 6: NAV total return performance relative to benchmark over 10 years

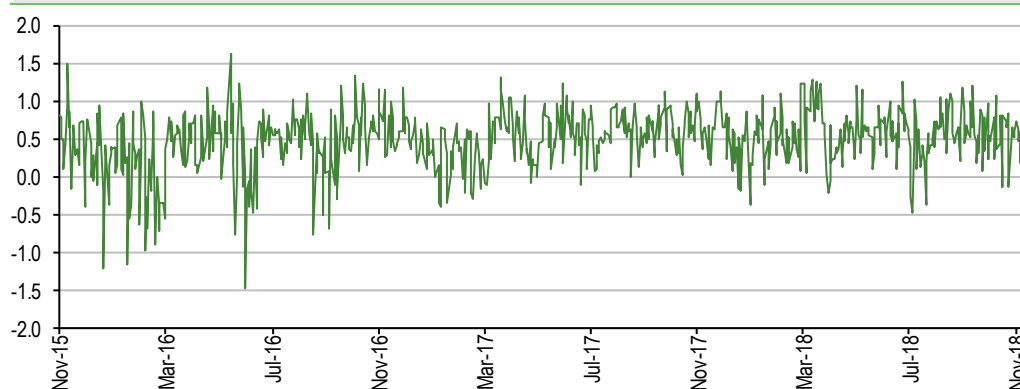


Source: Thomson Datastream, Edison Investment Research

Discount: Active discount/premium control mechanism

In 2004, FGT's board introduced a discount control mechanism, repurchasing shares when the discount reaches 5% (no shares have been bought back since FY10), while issuing shares at a small premium when there are unfulfilled buy orders in the market. So far in FY19, 4.3m shares (2.5% of the end-FY18 share base) have been issued, raising gross proceeds of £32.7m. In FY18, FGT's share count increased by 22.0%, reflecting very healthy demand for its shares. The trust is currently trading at a 1.4% premium to cum-income NAV, near the top end of a narrow range of a 1.6% premium to a 1.5% discount over the last five years. Over the last one, three and five years, FGT has traded at average premiums of 0.6%, 0.5% and 0.5% respectively.

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

FGT is a conventional investment trust, with one class of share; there are 178.0m ordinary shares in issue. The trust has a £75m multicurrency revolving credit facility with Scotiabank Europe (plus a further £25m facility if required), with an interest rate of three-year Libor +1.05% pa, maturing in October 2019. Net gearing was 2.8% at end-October 2018. Lindsell Train receives an annual fee of 0.450% pa of FGT's market capitalisation up to £1bn, reducing to 0.405% pa above £1bn (no performance fee is payable). Frostrow Capital is the trust's Alternative Investment Fund Manager and is paid 0.150% pa of FGT's market capitalisation up to £1bn, reducing to 0.135% pa above £1bn. In FY17, FGT's ongoing charges were 0.71%, which was 3bp lower versus 0.74% in FY16. In H118, ongoing charges were 0.68%.

Dividend policy and record

FGT pays semi-annual dividends in May and October. The trust has a progressive distribution policy, aiming to grow annual dividends at a rate higher than UK inflation. The FY18 dividend of 15.3p per share is 7.7% higher year on year, broadly in line with the 7.8% five-year compound annual growth rate. Befitting a trust with a focus on capital growth as well as income, FGT's current 2.0% dividend yield is below its UK Equity Income selected peer group average (Exhibit 8).

Peer group comparison

FGT is a constituent of the AIC UK Equity Income sector. This is a relatively large group made up of 24 funds, so in Exhibit 8 we show the 11 largest trusts, which have market caps greater than

£300m. The trust has a solid record of outperformance; its NAV total return ranks first out of the selected peer group over all periods shown: +7.8pp versus the mean over one year (the only fund to have delivered a positive return over this period), +22.4pp over three years, +40.5pp over five years and +198.2pp over 10 years. Due to its active discount control mechanism, FGT usually trades close to its NAV (on average the peers trade at a 4.3% discount), its ongoing charge is in line with the peer group average, and it has a lower-than-average level of gearing. In keeping with its mandate to generate both capital growth and income, FGT's dividend yield is around half the peer group average.

Exhibit 8: Selected peer group as at 7 December 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Finsbury Growth & Income	1,343.8	0.9	36.6	68.1	427.9	0.6	0.7	No	102	2.0
City of London	1,381.5	(6.6)	12.0	28.1	193.3	1.4	0.4	No	111	4.7
Diverse Income Trust	351.5	(7.4)	8.9	36.7		(1.0)	1.1	No	100	3.5
Dunedin Income Growth	352.9	(6.9)	18.7	17.5	174.3	(7.0)	0.6	No	116	5.6
Edinburgh Investment Trust	1,194.4	(8.6)	2.8	32.2	195.4	(8.3)	0.6	No	109	4.6
JPMorgan Claverhouse	378.1	(9.3)	12.3	24.7	190.8	(1.6)	0.8	No	103	4.1
Lowland	350.6	(9.3)	14.6	22.6	337.1	(6.8)	0.6	Yes	113	4.2
Merchants Trust	483.3	(8.0)	12.7	14.4	170.8	(0.8)	0.6	No	118	5.7
Murray Income Trust	473.4	(3.9)	21.6	24.3	185.5	(8.8)	0.7	No	105	4.6
Perpetual Income & Growth	754.5	(9.3)	(3.5)	17.6	195.2	(11.3)	0.7	No	114	4.5
Temple Bar	775.7	(7.0)	19.2	18.0	226.7	(3.9)	0.5	No	107	3.8
Average (11 funds)	712.7	(6.9)	14.2	27.6	229.7	(4.3)	0.7		109	4.3
Trust rank in selected peer group	2	1	1	1	1	2	4		10	11

Source: Morningstar, Edison Investment Research. Note: *Performance data to 6 December 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are six non-executive directors on FGT's board. Anthony Townsend (chairman) re-joined the board on 1 February 2005 and assumed his current role on 30 January 2008. Neil Collins has served on the board since 30 January 2008, David Hunt since 6 July 2006 and Simon Hayes since 29 June 2015. The two most recently appointed directors are Kate Cornish-Bowden and Lorna Tilbian, who both joined the board on 26 October 2017.

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