2024 NO. 1

PEREGRINE & BLACK

INVESTMENT MANAGEMENT

CLIENT LETTER

28 February 2024

A view from the desk . . .

> The ultimate rags-to-riches fairy tale - from a council house in Leeds to selling the £1billion business he built from scratch.
>
> **- The Sun, 2023**

This week I had the opportunity to visit a warehouse site of one of the investments that I hold for clients (more of which later) and it got me to thinking about how we find our investment ideas.

I have now been part of the financial services industry for over 30 years, and the variety of sources, and avenues taken, that have often brought me to my most successful investment ideas over those three decades still never fails to surprise me. Most often these will simply be via the most conventional routes, such as research from specialist investment firms whose job it is to bring ideas to us or by attending conferences where fund managers and individual companies will present the case for investing with them. However, sometimes the catalyst for investing in a great business can be slightly more "off piste", so to speak.

For example, a little under 20 years ago, one of my clients living locally to me in Tunbridge Wells, explained that he was about to retire from running what was a third-generation family-owned undertakers. As his sons had no interest in entering the funeral industry, he had decided to sell his firm to a company that had relatively recently entered the UK market and was looking to acquire franchises as part of a major expansion. He expressed an interest in buying some shares in this company, and by coincidence it just so happened that one of my then colleagues at Rathbones sent an email later that day to say that he was meeting the management of a small funeral services business called Dignity in our offices and was looking for people to join him.

As this was the acquiror of my client's business, I signed up to attend and was immediately struck by the fact that the management team sat in front of us were not undertakers as I had perhaps naively anticipated, but instead were quite simply businessman with accountancy backgrounds. What they saw in Dignity was a financial opportunity to create a much larger franchise-based business whereby they could exhibit some control over the pricing of funeral services via their purchase of crematoriums across the country. I trusted the management to succeed, and they quickly expanded from around 100 funeral directors to about 500 by the time that I sold the shares that we had purchased (for my client and others) a few years later, wherein we had tripled our original investment. Of course, not all investment ideas work as well as this (or at all), but it is very satisfying when they do.

As a result, I often say that "some of my best ideas come from my clients", but it was another idea that came from left of the centre that served me well more recently that I will look at now, and this very much originated out of one my own real passions.

As a child growing up just 5 miles west of Chepstow Racecourse, I took a very keen interest (my parents would have said obsession!) in horse racing at an early age. My mum still recalls me filling small exercise books with drawings of racing colours and recording results as early as my junior school days. I had career aspirations to be a jockey, and after one summer when one of my pals and I volunteered at a stable close to the racecourse (largely shovelling waste material!), we were both invited back the following summer to see how well we could ride, and whether being an apprentice jockey might become a genuine ambition. My pal went on to become a jockey - indeed, he became a very successful one, riding the winners of the 2000 Guineas and the Gold Cup at Royal Ascot during a glittering career, which only came to an end when he encountered issues with retaining the low weight that flat jockeys need to be successful. He is now a highly respected racing journalist.

Unfortunately for my dreams, both weight and height (specifically the latter) thwarted any hopes that I had almost immediately, as I grew from 5'3" to 5’8”, that winter......and whilst I then went on to play a pretty high standard of rugby, the 14-year-old me knew that being a jockey was no longer a viable option.

However, horse racing had become (and always will be) a hugely significant part of my life. Simply put, I adore racing and today I help run a 12,000 member Facebook group dedicated to the "Sport of Kings". My interest has always been wider than simply what happens on the track, though, as I have been just as greatly intrigued by the sport’s participants and how they came to be involved in the game that I love.

And once such character, who came onto my radar in 2019 is Steve Parkin. His profile rose within racing as horses under the name of the Leeds-based company he founded – Clipper Logistics – started to run well in, and even win, some high-profile races. As a result, my curiosity in him meant that I started to research his company and saw that it was a rapidly expanding logistics business fulfilling contracts for some of the UK retail industry's biggest names via its warehousing and delivery services.

It already had the profile of the sort of business that I could look to include within investment portfolios for some of my clients, but I was looking for one last piece of the jigsaw puzzle – where would long-term growth come from? I quickly got my answer when Clipper’s fortunes took a significant step forward as a major beneficiary from the “New World” that arose so rapidly four years ago as lockdowns followed the arrival of the coronavirus.

Not only was the company given a contract by the NHS for the delivery of personal protective equipment to NHS trusts and care homes in March 2020, but there was also the explosion that came with online retail and e-commerce as we became a nation of lockdown shoppers stuck at home with lots of free time to look for bargains.....

Clipper was perfectly placed to benefit from this and on the back of the research I had done pre-pandemic, I first bought shares for clients where it was suitable for their portfolios in June 2020. I was a very happy "holder” of the shares right up to May 2022 when Clipper Logistics was acquired by the much larger US business GXO Logistics. For Mr Parkin having founded Clipper Group in 1992 with one van delivering clothing for fashion stores this was “the ultimate rags-to-riches fairy tale - from a council house in Leeds to selling the £1billion business he built from scratch.” (The Sun 2023)

For my clients, the value realised was up to double the price paid for their initial purchases and I continue to be an investor in GXO Logistics, which is why I was invited to an Investor Day organised by Legal & General Investment Management at their largest UK warehouse in the East Midlands yesterday.

We are all acutely aware of the transformative nature of technology in all that we do, with the pandemic acting

as such an accelerating catalyst. Consequently, from the investment standpoint, I am always looking to invest in those future themes which will benefit from the new “industrial revolution” that we are living through. Artificial intelligence, automation and the growth of e-commerce, are all major driving forces behind GXO who utilise collaborative robots, vision scanners, automated guided vehicles (AGVs) and goods-to-person robots in their global activities.

The visit was a great opportunity to meet some of the UK management team and take a guided look around this particular warehouse which is solely used for their contract with Nestlé. All the Easter Eggs have now left the premises, but they are already full steam ahead with Christmas 2024 distributions of Quality Street! GXO operates in 27 countries, with over 1000 warehouses covering a total of warehouse space in excess of 200 million ft.². Whilst the operation is necessarily "technology heavy and people light", they still employ 130,000 people globally.

The East Midlands site forms part of a huge industrial park, and the warehouse was sandwiched between an even larger Amazon one and another operated by DHL. As well as Nestlé, GXO is partnered with some of the world’s largest companies such as Loreal, LVMH and Samsung, whilst in the UK they work very closely with the likes of Marks & Spencer, ASOS, Sainsbury's and Costa Coffee. This particular warehouse covers 608,570 ft.², which to use a normal comparison that even I could understand, would equate to around eight full-sized football pitches. However, given that some of the storage cages are up to 35 metres high, it is difficult to give a real feel of just quite how big this facility is. With pallets of goods, being transported rapidly around the building via monorail, and then AI and robotic technology, unpacking, and restocking, these pallets, the best way of describing the warehousing is like a giant game of Tetris.

The shift to e-commerce and online shopping does not exhibit signs of abating anytime soon. In 2022, 126 parcels were delivered in the UK every second. This requires increasingly sophisticated warehouse technology and fulfilment centres, and as consumers are becoming more demanding and sophisticated (now expecting real time tracking of parcels with visibility second-by-second to know exactly where their delivery is), what is known as "last mile delivery” is also a key requirement. GXO's localised network has a key competitive advantage here, as does the fact that whilst the global average for automation of warehouses is 10%, GXO believes that this figure is closer to 30% for them. Building upon the old Clipper "returns" business (i.e. facilitating the collection of goods that are no longer wanted, and are returned), GXO is also industry leading with regards to environmental goals. 96% of fashion items that are returned are either re-packaged and re-sold or recycled, which compares very favourably to an industry average of just 75%.

As someone who views the investment world in a "Thematic" way, looking to take advantage of secular trends and capture such trends to reflect how the world is changing, GXO plays into many of these themes, e.g., technological progress, AI, robotics and e-commerce. As a direct equity, GXO might not be a suitable investment for all our client portfolios, but I know that it will feature within many of the global growth and infrastructure focused investment funds that we do hold for clients.

We also look forward to the themes that will drive the economic and investment world of the future. Economies are complex systems in constant flux. Some economic changes are cyclical, but many are structural. The world several decades from now will be very different to the one anticipated by forecasters today. For example, climate change – and actions to mitigate its effects – is perhaps the central challenge of our time, and the green transition will have major implications for several commodity-producing economies in the coming decades. However, for most economies, the overall macro consequences will probably be small.

Neil Shearing is the Chief Economist at Capital Economics, and he has written of the four key factors that they believe will fundamentally shape the global economy over the next 25 years.

The first is the AI revolution. Thev support the case for AI optimism, but also warn that new technologies take time to be widely adopted. “Any boost to productivity growth is therefore only likely to come through later this decade or in the early 2030s. More fundamentally, the scale of the subsequent boost to growth will vary substantially between different economies.

In the US, we estimate that the AI revolution could lift productivity growth by up to 1.5% a year in the decade after widespread adoption”. However, they anticipate that the impact on the euro-zone and China will be significantly smaller.

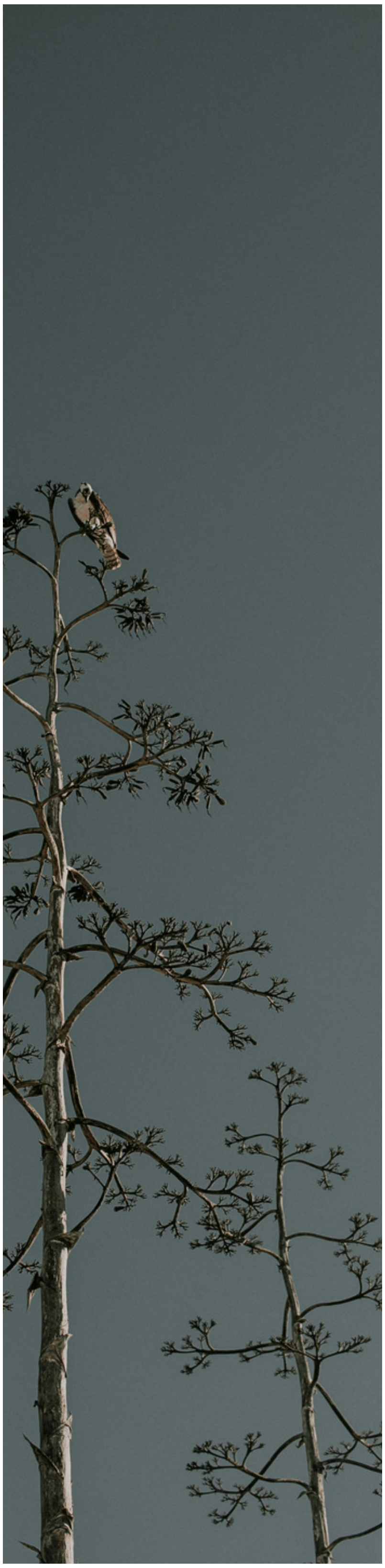
Global fracturing will also play a major role in shaping the long-term outlook. “It is now widely accepted that the era of hyper-globalization is dead, but there is no agreement on what will follow”. Capital Economics view is that “the world is splitting into two blocs: one that aligns primarily with the US, and another aligned with China. Policy decisions and economic outcomes within these blocs will be shaped increasingly by geo-political considerations.”

“The form that this fracturing takes is probably the single most important factor affecting the global economic outlook over the next 25 years. It is also perhaps the most uncertain. Our forecasts assume a relatively benign form of fracturing concentrated primarily in sectors where national security concerns are greatest. The disruption in areas like batteries, biotech, data and chip-making will be wrenching. But this is not globalisation in reverse.”

However, they also believe that “more malign forms of fracturing are possible. The blocs themselves could fragment, perhaps because the US turns inwards and embraces isolationism. This would undermine the US bloc’s current advantages of size and economic diversity. A second more malign form of fracturing would arise if it broadened beyond areas of national security, or if the two blocs came into direct conflict. In any of these cases, the hit to global activity would be substantially greater than we have assumed in our forecasts.”

Irrespective of its form, one of the key conclusions of their analysis is that China has more to lose than the US from global fracturing. This is important because it will compound existing structural challenges facing China’s economy and this is their third key factor.

The final theme of the Capital Economics long-run analysis is greater inflation volatility and



higher real interest rates. "The surge in prices in 2022-23 led many to declare the start of a new era of higher inflation. Our view is that, paradoxically, the sheer scale and speed of the rise in inflation over the past couple of years has lowered the chances of a prolonged period of higher inflation over the medium term. This is because it has spurred central banks into action." However, they envisage "a period of greater inflation volatility as the global economy becomes subject to more frequent supply shocks, including from fracturing and climate-related extreme weather events."

Finally, they tell us that "the nature of risks facing the global economy will alter. Many argue that the threats facing the world economy are now greater than ever before, or that the outlook is particularly uncertain. In truth, the outlook is always uncertain. Rather, it is the form of these risks that is changing. The major event of the past 20 years was the Global Financial Crisis, which brought the global economy to its knees and left 15 years of perilously weak growth in its wake. However, the financial system is now on a stronger footing and private sector balance sheets look healthier. We expect that the bubble around AI stocks will continue to inflate, but do not expect that its eventual bursting will cripple the real economy." They conclude that the "interaction between politics and economics is more important than ever" and this is likely to be something I return to in my next quarterly commentary. In his annual letter to investors in his company Berkshire Hathaway, the "grandfather" of modern investment Warren Buffet wrote: "For whatever reasons, markets now exhibit far more casino-like behaviour than they did when I was young," It is hard to disagree with this. As I wrote in November: "As investors we are paid to take calculated risk and we have to balance growth potential versus downside mitigation." This continues to be the case as where there are opportunities there will also always be risks and we continue to be grateful that it is Peregrine & Black that you have asked to be stewards of your capital in these turbulent times.

Please rest assured that we are constantly looking to evolve our investment research process as we endeavour to unearth ideas for your capital that allow us to remain at the forefront of portfolio management. We work hard to unearth opportunities and add value beyond the mainstream and feel that "thematics" can be a big part of this going forward, be it in the fields of robotics and e-commerce as outlined here, or the importance of cyber security and data protection, or the economic emergence of India as it seeks to straddle the global fracturing that Mr Shearing refers to. Hopefully, this "essay" offers an insight into how we have tried to achieve this over the years.

As ever, if you have any thoughts or questions relating to this commentary do let me or your Peregrine & Black Investment Manager or Financial Planner know.

Graham Withers

PEREGRINE & BLACK	+44(0)203 750 1801
contactus@peregrineblack.com	8 St James's Square London SW1Y 4JU
	peregrineblack.com