"Same But Different"

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Carillion's demise has not been far from the headlines over recent months and whilst I could use it as an excuse to talk about my favourite "too much debt everywhere" topic, I thought it may be more interesting to discuss how we have used this to make a positive investment decision (Carillion is not a company we have ever held).

A blanket reaction

The knee-jerk reaction to the Carillion debacle was for investors to sell everything and anything related to the UK construction industry, with share prices coming under significant pressure. The conclusion was simple: investors had thrown them all in the same bucket and decided that they were all going to go the same way as Carillion. There wasn't anything too sophisticated or considered about it.

In many ways this isn't surprising, holding periods of shares have fallen, ETF's and passive funds dominate daily volume and the clamour for performance over increasingly short periods means that investors took the view that it wasn't a risk they wanted to take.

This, we have always believed, creates opportunity. We want to find good quality businesses but we don't want to overpay for them and this lends itself to looking in un-loved parts of the market or areas where uncertainty is currently elevated. This is exactly what we believe is the case with Costain.

Carillion doesn't equal the UK construction sector

Costain is an engineering and construction group, same as Carillion. It operates in the UK, same as Carillion, but this is where similarities end. I highlight just a few key differences below:

- 90% of Costain's revenue is generated from what are called "target cost, cost reimbursable contract structures", which in essence means they share with any cost savings, but also crucially, cost over-runs with the customer. It also means payment is received on completion of milestones as projects advance, rather than solely on completion. This significantly de-risks the business away from fixed price contracts and provides stability in group margins. This is not to say individual contract issues don't arise.
- Costain is debt free and has net cash on its balance sheet – well over £100 million, which is more than a quarter of its market capitalisation.
- Costain has a long-standing management team that is very cautious in its approach to running the business.

So whilst it is the same as Carillion in terms of the general market segment it operates in, pretty much everything else is different.

Continued

Our commonality is low

We will continue to seek opportunities to invest in such companies and shy away from well-loved parts of the market where investor exuberance makes capital preservation nigh on impossible. This is why the F&C UK Mid Cap Fund has very limited stock commonality with many other UK mid cap funds.

We believe that the key points that differentiate us from our peers include:

- A focused portfolio of quality companies at the right price
- Keen eye on capital preservation
- Strong sell discipline

We are a mid-cap fund but, like Costain, we are different to peers.

Risk Warning

The value of investments and income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

Investments in smaller companies carry a higher degree of risk as their shares may be less liquid and investment values can be volatile.

BMO Global Asset Management