

Transcript of conference call for the new Rathbone Recovery Fund Thursday 17th September 2009

Julian Chillingworth: I am joined on this conference call by **Marina Bond**, co-investment manager, who specialises in the mid and small cap area, and assistant fund manager **Alan Dobbie** who specialises in Europe and supports our large cap exposure.

What is a recovery situation?

Generally speaking, this is a company whose potential recovery value is unappreciated by the market. The 'recovery' element can be dissected into different areas. We can have a macroeconomic recovery situation, so those companies and sectors that will benefit from an uptick in economic activity. Stock-specific recovery situations are those which have been previously failed by the management and/or business model, or where a one-off event has caused a collapse in the share price. Finally, there are sentiment-driven situations, the prime example being the technology sector.

Investment process

Our stock selection is not about buying cheap stocks that lack fundamentals and risk us falling into a 'value trap'. It is about recognising an undervalued stock and seeing that value gain over time. The first question we ask when we are looking at a company is why have the shares fallen? In other words, what type of recovery situation is it (as above)? We then look for that all-important catalyst, for example, a positive shift in the macro environment. There might be a collapse in competition; a management change in the offing; a change in the business model, or a return of confidence in the sector. One or all of these things could drive the stock price higher.

Structure of the portfolio

We must emphasise that this is a long-term investment vehicle, and not about short-term trading. We believe that there are going to be great opportunities throughout this cycle to invest in undervalued situations in various guises. The portfolio is a focussed list of 50-60 names. The average holding size for larger companies will be around 4%, and for smaller, mid-cap names will be 1-2%. Its benchmark is the IMA All Companies sector, but this is very much a stock-picking fund, and the benchmark is used for comparison purposes only. We're not anchoring sectors or weightings within those particular sectors. We have the freedom to invest across a vast universe, so we use both qualitative and quantitative measures to reduce that universe, which ranges from the FTSE All-Share index to AIM, and Europe.

Stock examples


Marina Bond: We like to hold stocks at different stages in the recovery cycle in order to balance the fund and spread the risk. *Pace* is an example of a latter-stage recovery story. Pace designs the technology for TV set-top boxes. It's a high-grade market, with obvious growth coming from the growing number of pay-TV

subscribers. Pace has been gaining market share. This is partly due to an acquisition, but also because they are able to bring new items to the market ahead of their peers - key for their clients. This business is very different from what it was in 2000, and has a broad client base. New management arrived in April 2006, who made the company more commercial. Barriers to entry are high - it's very hard to dislodge Pace's technology without inconveniencing existing users. This company has good organic, top-line growth. There have already been several analysts' upgrades this year. Visibility extends to about 18 months; margins are improving, and we believe they are set to improve further as management has been reducing costs. Key is the balance sheet, which is strong. Pace has net cash and no debt. Despite a strong run this year, we believe the shares have further to go. This is a company that's been turned around, but we're only just seeing the fruits of that coming through. It's in a fast growing niche market; it has high barriers to entry; significant top-line growth; it has cash and the valuation is still attractive.

An example of an earlier stage-restructuring story that we've been playing further down the market cap scale is **Hyder Consulting**. Hyder is an engineer which, like any other economically-sensitive stock, has been hard hit. This company has got a new chief executive who has been simplifying and restructuring the business, and using the recession to do so. The balance sheet is strong, and crucially, the cash collection has improved significantly since he arrived. The dividend has increased 50% - an indicator of the financial strength. Again, the shares have started to climb, but the valuation remains reasonably attractive. There are still risks to the top-line on the macro side, but this is an earlier stage turnaround story, and there's still much to do in terms of operational improvements.

Alan Dobbie: *Carnival* is listed in both London and New York and is, by far, the biggest operator in the \$23 billion global cruise market. Along with Royal Caribbean, it controls 70%+ of the global market, giving them significant advantage in terms of scale, distribution and access to capital. Why do we think Carnival is a recovery stock? Well, it fits most neatly into the macroeconomic recovery classification. It's a consumer cyclical; it's highly correlated to GDP, and because the majority of its passengers are from North America, it's also very sensitive to the discretionary spending habits of the US consumer. The company experienced a tough 2008, but the shares have started to perform well in the last few weeks as the market factors in a more benign macroeconomic environment going forward. On the industry and the stock-specific level, that scenario could influence the share price over the longer term. The cruise industry has traditionally increased capacity to further satisfy demand, because of the long lead times associated with ordering and building liners. There are a number of ships that were ordered during more bullish times, and are due to be delivered in the next two or three years. Should the macro environment remain weak, then this has got the potential to create over-capacity in the near term, but we believe that this risk is now factored in. However, on the positive side, Carnival has several levers it could pull on over the longer term which could have a significant impact on the returns it generates. These include shifting from using travel agents to a more direct distribution model, or increasing penetration in non-US countries. In conclusion, there are some near-term headwinds for the stock; however, because of its market position, solid balance sheet and tools for increasing returns, Carnival looks a good investment at the current price.

Julian Chillingworth: We believe this is an excellent time to be embarking on a recovery fund. Investors are starting to believe in a pick-up in G7 economic activity as we head into 2010. With that comes great opportunity. There are some very interesting under-valued situations out there, across all the areas we have mentioned. We bring to this fund an extremely experienced fund management team. I have 30 years experience of managing money in the UK and international equity markets. Marina brings with her almost 10 years experience, and Alan has 4 years experience. We think that it is unusual to find such a strong team



in other investment houses running a fund of this size. It is both nimble and focussed. It's very much a structured investment process, using both qualitative and quantitative screens. Finally, we believe that this is a vehicle that's going to provide investors with good returns over the short, medium and the long term.

Julian Chillingworth (Chief Investment Officer)

Marina Bond (Investment Manager)

Alan Dobbie (Assistant Fund Manager)

Should you require any further information, or wish to raise any points from this call, please contact one of our sales representatives or ring the help line 020 7399 0399.

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