



Rathbones Specialist Tax Portfolio Service (STPS)

Business relief (inheritance tax relief) mandates

Q1 2020 report

Portfolio strategy

This portfolio takes a long-term approach to investing and targets AIM-quoted companies that should qualify for relief from inheritance tax. A near-fully invested position is held throughout, and new money is invested quickly to ensure investors reach the two-year holding threshold for tax relief as soon as possible.

The Alternative Investment Market (AIM)

AIM launched in 1995 to help smaller companies access capital with greater regulatory flexibility than the main market. Since then, AIM has grown from 10 companies with a total value of £82 million, to 843 companies valued at £74 billion. In 2019, 23 companies were floated on AIM, accounting for 12.7% of all new money raised in that year; a characteristic of a maturing exchange not reliant on initial public offerings (IPO). The alternative exchange remains a venue for early-stage IPOs, while home to 12 companies valued at over £1 billion.

The Rathbones investment philosophy

Our philosophy is to target profitable and established UK-based AIM-quoted companies with sustainable growth and strong competitive advantages, whether secured through acquisition or investment in innovation. These are companies we hope to be talking about for decades to come, so it's vital we have confidence in their management.

Our portfolio is spread nationwide and across sectors, generating a meaningful proportion of its revenues from doing business overseas. This is a bottom-up stock selection approach that has little direct exposure to the consumer, avoiding airlines, retailers and pawnbrokers. Banks, resources, recruiters and car dealerships are excluded too.

Market commentary

Markets began the year well, moving higher in January following an easing of US/China trade tensions and a

decisive Conservative victory. Confident investors were blinkered by the superior equity returns and shrugged off reports of a respiratory viral outbreak in China...but that attitude didn't last long. Fears of a global coronavirus pandemic had unfolded by the end of February, prompting a sell-off of historic proportions. This was down to the astonishing speed of viral transmission and the unknown depth of the economic fallout which bears little resemblance to previous recessions. Large-scale fiscal and monetary intervention by central banks and governments supplied vital liquidity to financial markets and interest rates were slashed around the world. The UK's Monetary Policy Committee cut rates down to an all-time low of 0.1%. According to the Office for Budgetary Responsibility, shuttering the UK could contract the economy by 35% in the second quarter, a figure the Bank of England's deputy governor believed was "not an unrealistic number".

The US was faced with similar economic challenges. A 'whatever it takes' approach was taken by the Federal Reserve as it expanded measures to support credit, while Congress agreed a bailout equivalent to 10% of the country's GDP.

Lockdown restrictions are unlikely to be fully eased until we've found a vaccine or therapeutic solution and have rolled out comprehensive testing programmes. If lives start going back to normal too soon, we'll likely see a second wave of infections. Since 23 March, investor sentiment has bettered, reflecting an improving view of government response and the potential for a flattening of the infection curve as long-term investors bought into the idea of a V-shape recovery. The immediate economic pain caused by the near-term shut down and social distancing will - in investors' minds - have reversed itself over the next 24 months.

Investment manager's commentary

The first quarter could almost have been an exercise in behavioural economics as some investors flouted their normal rules in response to great market highs and lows. The fear of missing out drove markets to peak in February, followed by a dash to safe havens in the eye of the corona storm. It isn't easy to remove emotion from investment decisions in tumultuous times and investors can find comfort in following the crowd. Overestimating the near-term and underestimating the longer-term opportunity is a common accusation levelled at markets and one which plays out time and time again.

Capital markets have played their part too; they've provided capital to cure overleveraged balance sheets and ease working-capital constraints. That's a theme likely to continue as dilution is considered an acceptable trade-off for investors. To preserve cash, dividends are being cut or deferred by businesses of every size, even those that are well financed and generating cash. There are examples of management pay being cut too and we will continue to review this. Both moves are good examples of trying to do the right thing, but not all cuts are the same. Corporates with exposure to COVID-19 through drug development, testing or services have been in demand in what could be an exceptional 2020 for them.

Durable businesses are central to my investment philosophy; weathering the storm is key. Cash-rich companies (many of our companies have net cash balance sheets) with attractive free-cash-flow profiles provide a degree of assurance in these uncertain times. Our portfolio has zero exposure to retail, and neither do we hold any airlines, pubs, oil and gas, recruiters or car dealerships. These sectors have experienced sharp de-ratings so far this year.

Our main sector exposures are pharmaceutical and biotechnology, software and computer services and support services, likely beneficiaries of longer-term structural growth trends.

EMIS Health joined forces with Nuffield Department of Primary Care Health Sciences at the University of Oxford and the Royal College of General Practitioners to help develop a deeper understanding of the COVID-19 pandemic in general practice. EMIS, a healthcare software business, has an enviable return on assets record combined with a high recurring revenue profile; while there may be some disruption to new sales, EMIS maintains a cash-rich balance sheet.

All this time at home has exposed the resilience of some sectors, one of which is video gaming. Digital game downloads have spiked dramatically during lockdown. We've some exposure to this sector through Keywords Studios and Sumo Group. Neither business is reliant on the success of individual game titles, instead they're both valuable partners in game development and ride the structural growth theme of outsourcing.

Another beneficiary of lockdown is the telecoms sector as working from home is now a reality for many and remote-working demands have increased considerably. Telecoms service provider, Gamma Communications, offers unified-communications-as-a-service bundles to its customers which incorporate voice and video conferencing. Gamma also has significant cash reserves which will assure investors that recent acquisitions, including developments

in Europe, can be self-financed without resorting to bank lending.

We mentioned that corporates with direct exposure to COVID-19 through healthcare could have an exceptional year, of which outsourced drug safety monitoring (pharmacovigilance) and contract research specialist, Ergomed, is one. The business has announced a clinical development program for a namlumab antibody therapy, aimed at treating patients with rapidly worsening COVID-19 before ventilation and admission to intensive care. Winning coronavirus-related work is not central to the company's investment case. It's well-positioned as a mid-tier consolidator with net cash on the balance sheet.

A new name being introduced to portfolios is Bioventix, a biotechnology business founded back in 2003. It creates and supplies high-affinity sheep monoclonal antibodies for use on blood-testing machines in hospitals and other laboratories internationally. Their kits can test for: drugs, vitamin D, fertility (testosterone, progesterone and oestradiol), troponin (to help diagnose a heart attack), NT proBNP (heart failure) and T3 (thyroid function). Manufacturers of blood-testing equipment require regulatory approval which can take up to a lengthy five years, so once a Bioventix kit has been approved, manufacturers are unlikely to switch suppliers. This supplier loyalty forms a strong economic moat and means there's a reliable recurring revenue stream with a royalty from each test used, making the business highly cash generative. The team of skilled scientists creates the antibodies which generate a high margin whilst also working on new products, including a pollution-testing kit.

Spring 2020 Budget

This year's March Budget delivered no specific announcements about AIM-quoted Business Relief strategies, putting an end to speculation of significant Inheritance Tax reform...at least for now. The Chancellor may outline a wider agenda in his next Budget in the autumn and cover the government's economic and tax plans. It's likely this would prompt further speculation. Our advisers closely reviewed the Finance Bill which revealed further details of the Chancellor's speech. This did give us a bit more granularity on policy, however nothing adverse was found in the report.

ESG

We believe that incorporating environmental, social and governance (ESG) considerations into investing and ownership can positively impact performance, so we're exploring ways to analyse these types of factors alongside financial ones as part of our investment process. Poor management of ESG-related risks can lead to a divergence in the best interests of management, shareholders and other stakeholders.

We're developing a governance risk evaluation tool and database which includes 29 governance risk indicators across four broad areas: audit, board structure, ownership and executive pay. This process will continue to evolve in light of environmental and social considerations. We believe this approach will become second nature for smaller company managers and will ultimately increase transparency and confidence, as well as enabling us to meet our responsibilities as members of the United Nations' Principles of Responsible Investment (UNPRI).

Ivan Teare, Chartered FCSI
Investment Director - Specialist Tax Portfolio Service
Telephone: 0151 236 6666

Important information

This document is published by Rathbone Investment Management and does not constitute a solicitation, nor a personal recommendation for the purchase or sale of any investment; investments or investment services referred to may not be suitable for all investors. No consideration has been given to the particular investment objectives, financial situations or particular needs of any recipient and you should take appropriate professional advice before acting. The price or value of investments, and the income derived from them, can go down as well as up and an investor may get back less than the amount invested. Tax regimes, bases and reliefs may change in the future. Rathbone Investment Management will not, by virtue of distribution of this document, be responsible to any other person for providing the protections afforded to customers or for advising on any investment.

Rathbone Investment Management, and its associated companies, directors, representatives, employees and clients may have positions in, be materially interested in or have provided advice or investment services in relation to the investments mentioned or related investments and may from time to time purchase or dispose of any such securities. Neither Rathbone Investment Management nor any associated company, director, representative or employee accepts any liability for any direct or consequential loss arising from the use of information contained in this document, provided that nothing in this document shall exclude or restrict any duty or liability which Rathbone Investment Management may have to its customers under the UK regulatory system.

We are covered by the Financial Services Compensation Scheme. The FSCS can pay compensation to investors if a bank is unable to meet its financial obligations.

For further information (including the amounts covered and the eligibility to claim) please refer to the FSCS website www.fscs.org.uk.

Unless otherwise stated, the information in this document was valid as at 31 December 2019. Not all the services and investments described are regulated by the Financial Conduct Authority (FCA). Rathbone Brothers Plc is independently owned, is the sole shareholder in each of its subsidiary businesses and is listed on the London Stock Exchange.

Rathbones is a trading name of Rathbone Investment Management Limited. Rathbone Investment Management Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW.

Registered in England No. 01448919. Rathbone Investment Management Limited is a wholly owned subsidiary of Rathbone Brothers Plc. Head office: 8 Finsbury Circus, London EC2M 7AZ. The information and opinions expressed herein are considered valid at publication, but are subject to change without notice and their accuracy and completeness cannot be guaranteed. No part of this document may be reproduced in any manner without prior permission.