

Schroder UK Mid Cap (SCP)

28/11/2024

Results analysis from Kepler Trust Intelligence

Schroder UK Mid Cap (SCP) released its financial results for the year ending 30/09/2024, with NAV total return of 17.3%, versus 21.4% for the FTSE 250 ex-Investment Trusts index.

Relative returns were impacted by a shift in the mid-cap sector that favoured interest rate-sensitive companies with weaker balance sheets, to which SCP has limited exposure.

The proposed final dividend, combined with the interim dividend already paid on 09/08/2024 should bring total dividends for the year to 21.5p per share. However, with revenue return per share of 20.54p, the dividend is not fully covered.

The discount slightly widened during the year from 12% to 12.3% (as of 30/09/2024). However, since the publication of the annual report, the discount has narrowed slightly to 11.3% by 26/11/2024.

Net gearing increased to 9.5% as of 30/09/2024, up from 6.8% at the end of the previous year, and was a net benefit to performance as a result of the rising market.

The managers have taken advantage of attractive prices to add companies benefitting from structural growth in market niches.

Outgoing chairman Robert Talbut discussed the valuation opportunity stating: "We continue to remain optimistic about the outlook for UK mid-caps and the company's portfolio holdings, which are largely focused upon longer term growth businesses."

Kepler View

Whilst SCP has delivered strong return in absolute terms, the managers underperformed the benchmark by 4.1 percentage points. With the Bank of England lowering interest rates, cyclical companies, to which SCP typically has low exposure, have benefited from a tailwind. However, this may only be a temporary drawback as the companies SCP invests in should be less reliant on monetary policy to deliver long-term returns.

The managers believe that recent upgrades in forecasts for the UK economy forecasts may counter bearish structural arguments against UK equities. They also consider FTSE 250 companies to be undervalued relative to their FTSE 100 peers and expect the valuation gap between FTSE 250 and FTSE 100 stocks to close over time. Moreover, they argue M&A could further support performance going forward. In our view, these factors could provide support for a long-term recovery of UK mid-caps.

The paid and proposed dividends for the financial year 2024 total 21.5p per share, up from 20.5p in 2023. With revenue per share at 20.54p during the period, the dividend is not fully covered. However, we note that the trust has revenue reserves equal to more than 100% of the dividends paid in 2024. The dividend has been increased regularly since inception and is, in our opinion, one of the differentiating features of SCP, despite not being an explicit goal of the managers.

Despite the strong absolute performance, SCP's shares still trade at a double-digit discount. We believe this discount presents an attractive entry point for long-term investors.

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