

Evenlode Investment View

March 2017 - Data, Data, Data



“Data! Data! Data! I can’t make bricks without clay!”

Sherlock Holmes, *The Adventure of the Copper Beeches*

One of the clearest ‘growth runways’ we are seeing across the Evenlode portfolio is that of digital analytics. The amount of data in the world is growing rapidly (90% of all the data that exists today has been created in the last two years) and this explosive growth is set to continue, not least due to the increasing connectivity of physical objects (i.e. *the internet of things*)*. Analytic technologies allow companies to collect, organise and make sense of this growing pool of data, adding value to both their customers and their own operations.

This trend is becoming increasingly difficult to ignore and is by no means restricted to the ‘software’ sector as traditionally defined: as the venture capitalist Marc Andreessen puts it, *software is eating the world*. Digital analytics is becoming ubiquitous in pretty much any industry one can imagine, often with transformative effects for both efficiency and product quality (providing growth opportunities), whilst also having implications for the competitive landscape in some industries (creating potential threats).

This month I’d like to highlight some examples of this technology at work in various areas of the Evenlode portfolio:

Professional Services

Sectors such as law, accountancy, financial services and academia have seen increasing usage of digital analytics over recent years: helping lawyers to win cases, small businesses to spend less time on their accounts, insurers to price risk more effectively, academics to collaborate with colleagues etc. Several Evenlode holdings provide digital offerings in these areas (including Sage, Informa, Euromoney, DMGT and Relx) and are seeing steady demand growth from customers. Supplying digital products to professional service customers also produces attractive economics: subscription-backed, predictable cash-flows and good customer loyalty.

All these companies except Sage are classified as ‘media’ companies, but software and data is crucial to their franchises, and they are developing increasingly sophisticated products that harness machine learning and ‘big data’ technologies to add further insight to customers. Relx, for instance, now employs 7,000 technologists (data scientists, software developers etc.), a quarter of the company’s total workforce.

Cognitive Technology and Big Data

The most cutting-edge usage of digital analytics technology in the portfolio is found (perhaps obviously) in the software sector. Microsoft and IBM offer two of the market leading propositions globally, bringing together cognitive computing, proprietary data sets and cloud infrastructure at scale to form the backbone of applications for many organisations. These technologies are providing both compelling opportunities for long-term growth and a defence against competitive threats. IBM’s Watson, for instance, is using its innovative machine-learning algorithms to help doctors optimise cancer treatment plans. Having been ‘fed’ information on up-to-date cancer research, Watson can suggest treatment plans tailored to individual patients. In 30% of cases, it has been shown to provide additional treatment options missed by its human counterparts.

Healthcare

More generally, digital innovation in healthcare is becoming increasingly widespread. Pharmaceutical companies are harnessing the field of bioinformatics, which uses software algorithms to interpret biological data such as human genomes. This is leading to a more structured approach to drug development and the potential for more personalised, effective gene therapies in areas such as cancer and dementia.

In the medical devices sector, Smith & Nephew's Navio robotics products use software analytics to construct three dimensional models of knee joints. This equipment helps knee surgeons perform their operations more quickly and more effectively. It is a natural extension of Smith & Nephew's product range given their strong existing position in the orthopaedics sector, and the close relationships they have built with the surgeon community over many years.

Another example is software company EMIS, which enjoys a dominant position in many areas of UK healthcare such as GP and pharmacy software. EMIS is improving the connectivity and data analytics of this ecosystem, providing significant cost savings and better patient outcomes as a result.

Engineering

Even in some of the most 'old-fashioned' sectors, a digital transformation is underway. Speciality engineer Rotork is in the process of launching a data analytics product this year, with interesting growth potential. Rotork sells mission-critical products (actuators, gears etc.) that help improve the safety and efficiency of large-scale facilities such as petrochemical plants, nuclear power stations and water desalination plants. The company's new 'internet of things', (essentially a marriage of product connectivity, cloud infrastructure and data analytics) allows them to feed back data to customers to give deeper insight into the status and performance of facilities, helping to reduce unplanned shutdowns and extend plant life. As Rotork management put it at recent results, *'we are getting to the point where we can phone a customer up and say, 'if you don't repair or do some work on this valve, it's going to fail next Wednesday'. And if it fails next Wednesday, that causes a plant shutdown. That information is worth quite something to the customer'*. Other Evenlode engineering holdings such as Spectris and Smiths Group are utilising predictive analytics in areas such as test/measurement and security/counter-terrorism.

Consumer Goods

Not even low ticket branded goods such as shampoo, soap or drinks have fully escaped this trend. Consumer brands are adapting to a new world of digital marketing, social media and online sales. Diageo, for instance, is increasing its North American digital marketing expenditure fivefold this year. At the same time, these companies are increasingly utilising data analytics to run their own operations, improving efficiency, management information and customer feedback loops. Unilever's IT system processes 30,000 transactions per minute throughout its value chain and is capable of producing real-time demand planning, raw material price management, product costing and cash-flow forecasts.

What's New Today Will Be Embedded Tomorrow

Any new or evolving technology creates both opportunities and threats to any one individual company, and the risk of disintermediation and technological obsolescence is something we give a lot of thought to at Evenlode. There is no perfect defence against innovations such as digital analytics, but we think some businesses are better placed to capitalise on these trends than others. Two factors in particular stand out:

-A strong economic moat (thanks to brands/reputation, customer embeddedness, R & D expertise, entrenched distribution etc.)

-A culture within a business to look to the future, continually adapt and evolve, and consistently invest for the long-term.

This second bullet point is an important one. 'Artificial Intelligence' (AI) has become something of a buzzword in venture capital, corporate and investment circles over the last couple of years, and digital analytics is a form of AI. But as the legendary computer scientist John McCarthy (known as the 'father of AI') has pointed out, society tends to stop thinking of algorithm-based achievements as AI once they become mainstream and embedded in day-to-day life**. Back in the 1950s, an electronic calculator or an Excel spreadsheet would have certainly been considered artificial intelligence, but we now take these products for granted (as we will in the future for today's algorithmic-innovations).

As time grinds on, companies therefore need to keep evolving to remain relevant to their customers (even those that enjoy dominant market positions in slow-moving sectors), so consistent investment is key for their long-term health. At Evenlode we have a preference for asset-light companies that are able to invest incrementally in this way, but also - crucially - at rates that should yield high and compounding cash returns over the long-term, thereby laying the foundations for sustainable dividend growth.

This sentiment will strike long-haul Evenlode investors as a familiar refrain, but to paraphrase Sherlock Holmes, *'you know our methods, Watson'*.

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Please note, these views represent the personal opinions of Hugh Yarrow as at 23rd March 2017 and do not constitute investment advice.

*See, for instance, the IDC Digital Universe Study: <https://www.emc.com/leadership/digital-universe/2014iview/executive-summary.htm>

**Nick Bostrom's book *Superintelligence* includes an interesting discussion on this topic.