

Investors can tap into juicy yields in overlooked companies' debt and equity



A professional investor tells us where he'd put his money. This week: Ian "Franco" Francis, fund manager, Manulife CQS New City High Yield Fund

Manulife CQS New City High Yield Fund (LSE: NCYF) aims to provide investors with a high gross dividend yield (currently 8.8%) and the potential for capital growth by investing mainly in undervalued, high-yielding fixed-interest securities. Around 87% of the portfolio is in fixed-interest securities, with 13% in equities (there is a 20% limit on equity exposure). With respect to currencies, 69% of the portfolio is in sterling, 18% in US dollars and 13% in euros.

As one of the smaller fixed-income funds, NCYF can participate in highly attractive small corporate-bond issues, which are often inaccessible to larger funds owing to their minimum-size requirements. The manager's prudent risk-management focus has resulted in only three defaults since the fund's inception in 2007 and enabled NCYF to increase the dividend every year for 18 years.

Taking on the big banks

The largest holding is Shawbrook Group 12.103% Perpetual. Shawbrook is a challenger bank offering lending and savings services for commercial (real-estate and smaller companies) and retail (mortgage- and consumer-finance) customers. It is highly profitable, and its organic growth has been boosted by acquisitions in areas such as vehicle finance and smaller-company lending. Its Common Equity Tier 1 ratio (a gauge of a bank's core capital adequacy) hovers around a comfortable 13% (3% is the minimum requirement).

The balance sheet and loan book have more than doubled in the last five years to £20bn and £17bn respectively. As is true of most challenger or specialist lenders, underwriting at Shawbrook is often manual, reflected in robust net-interest margins of 400 basis points, and a moderate cost of risk of 40 basis points.

The funding side is driven by retail savings, mostly fixed-rate and term, and 90% of the £16.7bn of retail-savings deposits are small enough to be insured by the Financial Services Compensation Scheme. The bank's lack of coverage by equity analysts and infrequent smaller bond deals means it is often overlooked.

Consider also Stonegate 10.75% 2029. The firm operates a network of pubs, clubs and bars. It is a large player in a fragmented market with a market share of 10%; a supportive sponsor, as demonstrated by its last £250m equity injection; good asset coverage, with £3.2bn of real estate; and an improved financial



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profile. Although Stonegate still faces headwinds and the environment remains volatile, the company is advancing on its initiatives to optimise its assets through the conversion of pubs, disposals, and reducing the number of late-night venues.

There is also a focus on bolstering its appeal to customers, price increases with limited volume elasticity, and cost control. All these factors should lead to an improved free cash-flow profile. The group has no near-term maturities, while liquidity remains adequate. We believe that at 10.75% the bonds remain attractive.

Frontline (NYSE: FRO), the largest equity holding, is a world-leading shipping group transporting crude oil and refined products with a modern, energy-efficient fleet of tankers. Frontline is a beneficiary of sanctions against Russia and Indian refiners shifting some of their imports into the compliant market.

Should the war in Ukraine end, any exports of Russian crude would need compliant, insurable ships rather than the uninsured dark fleet currently used. We are also seeing a major increase in exports from West Africa to Asia, a highly profitable route for shippers. The high payout ratio makes this stock attractive for income investors.

"Stonegate, which runs a network of clubs and pubs, has consolidated its assets"

