Juno Investment Partners is challenging the notion that big dividend payouts are always good news for investors. Mona Dohle reports

Doubting dividends

Dividend returns have become an in increasingly important point of attraction for European investors.

However, Frans Jurgens, partner and fund manager at Juno Investment Partners (Juno), argues it may be important to challenge this perspective.

The manager derives its name from the ancient Roman goddess, Juno, also known as Juno Moneta. In Roman mythology, she was famous for her capacity to warn of mischief and impending doom. This characteristic seemed apt to describe Juno's stock picking ambitions.

A RELIABLE INDICATOR?

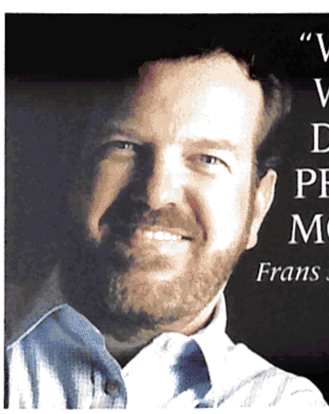
With bond yields at historic lows and equites prone to volatility, a focus on dividend returns promises stability. But is it always a reliable indicator of the structural health of a company?

"There is nothing worse for me than a company which has falling returns on capital and is at the same time handing out increasing dividends to investors, in some cases even financed by loans. What this says to me is that the board has no new ideas or interest to invest in or innovate their business, a clear warning signal," argues Jurgens.

Instead, returns on capital are a decisive selection criterion for the fund, which holds a concentrated portfolio of European small cap stocks.

"We like companies which can demonstrate a predictable business model and an above average return on capital. Our average return on capital is currently at 27%, compared to an average of 9% in the market. We actually prefer it if a company reinvests returns rather than handing them out as dividends," he argues.

"Of course if you have a business with a low capital intensity which doesn't need a lot of reinvestments, a dividend payout can make sense, but the exclusive focus of dividend returns among investors is dangerous because it can undermine the structural health of a business," he argues.



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A FAMILY AFFAIR

With a concentrated portfolio of 12-15 companies, the selection process is heavily dependent on mutual trust. The majority of Juno's holdings are family businesses, because they tend to comply with key criteria such as the focus on reinvestments and the management holding a significant amount of shares in its own company.

"It is often assumed that a maximum level of diversification reduces risk but to us risk lies precisely in the unknown. How can you really know each individual company in your portfolio if you are holding shares from 250 companies?" Jurgens says.

Instead, the fund focuses on European small cap companies which have low debt levels and excess cash and are consequently not often followed by analysts.

"I'd rather sit in an analyst meeting of the company with two people than with 200, it shows that we have an information advantage."

"We are not activist investors, if we feel that we have to intervene, something has gone fundamentally wrong, for example if the management says one thing and does another. We would rather divest than initiate a conflict with the management, which would imply that we know more about the business than they do," explains Jurgens.

Nevertheless, the fund has a rather low turnover, with the average holding period of stocks currently at five years. Examples of reasons to sell are, according to Jurgens, either companies which have an inconsistent management style or are performing too well on the stock market, suggesting that they may have reached a peak in the market cycle.

In line with this conviction-based, bottom up approach to selection, the fund pursues a long only strategy.

"Out of principle, we don't use derivatives, they can cost a lot of time and distraction, where we should be focusing on the progress of the underlying profitability rather than having to obsess about immediate changes in share prices," he emphasises. ■