Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

2nd December 2016

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	6752.93	▼-1.12	▼-2.37	▲5.59	7097.5	5536.97	10/10/16	11/2/16
FTSE 250	17497.3	▼-0.53	▼-0.148	▼-0.111	18342.1	14967.9	4/10/16	27/6/16
FTSE SmallCap	4914.95	▼-0.125	▼-1.1	▲6.95	5051.49	4145.59	10/10/16	12/2/16
FTSE AIM 100	3890.92	▼-1.01	▼-1.2	▲11.5	3993.45	3075.85	4/10/16	11/2/16
S&P 500	2198.81	▼-0.268	▲4.12	▲4.57	2213.35	1829.08	25/11/16	11/2/16
UK Treasury 10 Year Par Yield	1.41	▼-3.42	▲8.46	▼-20.3	2	0.61	30/12/15	12/8/16
Brent Oil Spot $	$51.505	▲5.36	▲7.51	▲16.3	$52.915	$27.765	10/10/16	20/1/16
Gold Spot $ per oz	$1172.51	▼-1.16	▼-8.96	▲9.58	$1366.48	$1053.12	6/7/16	17/12/15
GBP/USD - US $ per £	1.25775	▲1.01	▲2.79	▼-16.6	1.52215	1.21697	11/12/15	27/10/16
GBP/EUR - Euros per £	1.1835	▲0.365	▲6.93	▼-16.6	1.4187	1.1066	1/12/15	13/10/16

Stock markets are down slightly on the week. I can't help feeling that they are struggling for a reason to rally. We've had the earnings based, pound devaluation rally and the Trump effect but a lot of shares have had a good run and are due a pause for breath.

The big move of the week has been the price of oil moving up by more than 10%. This came after OPEC agreed to cut production levels. The oil price is now at its highest for the year and could lead to increases in fuel prices which will eat into household spending power. Gold continues to lose ground. If sustained, it will also increase UK inflation.

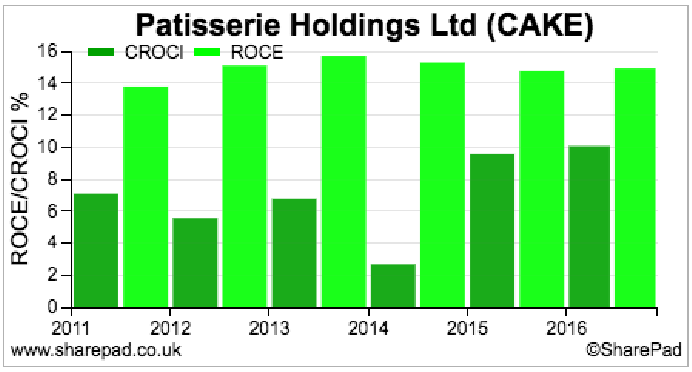
The pound continues to strengthen against the US dollar and the euro. The pound has appreciated by nearly 7% against the euro during the last month. If the Italian government loses its referendum this Sunday and the prime minister resigns then next week could be a hectic week on the markets. People will start worrying about the solvency of Italian banks again and a possible referendum on Italy's membership of the euro. This could lead to further gains for the pound against the euro as the pound will seem a relatively safer place to park money.

Share Discussion: Patisserie Holdings (LSE:CAKE)

This week's full year results from up-market cake shop owner Patisserie Valerie showed another good year of progress. Sales were up 13% and EPS was up by over 20%.

I see this company as a play on the growing trend of *premiumisation* of products - in this case, cakes and sandwiches. The company believes that its products are 'affordable treats' and that there is plenty of scope to expand and grow. It currently has 184 shops and is opening up new ones at a rate of 20 a year. It thinks that there is room for another 250 shops in the UK - primarily through its Patisserie Valerie brand.

Patisserie Holdings is a good business. Its return on capital (which takes into account its rented shops) has been steady at around 15% for the last few years whilst it has been investing heavily.



The company seems to be able to get its new shops up and running very quickly. They are immediately profitable in the first week of trading and the cost of investment is paid back within two years. That's a very good performance.

However, the company does not give away some important information which investors take for granted when looking at other retailers. The results statement makes no mention of like-for-like sales so it is impossible to know how much growth is coming from new stores and from existing ones. This is disappointing.

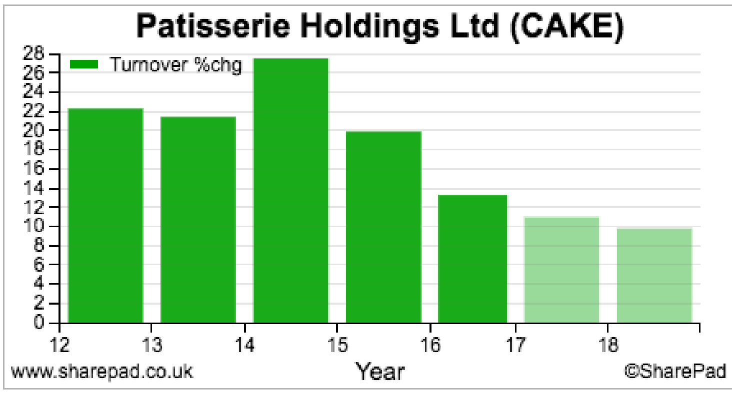
I am naturally wary of retailing companies which are opening lots of new stores. This is because they can give the impression of rapid sales and profit growth through a natural maturation process. This occurs as it can typically take 1-2 years for a new shop to reach its potential sales level.

If a business is opening lots of shops then there are lots maturing at the same time which gives the impression of growth. When the shops reach maturity, growth slows down or goes into reverse.

As the number of new shops becomes a smaller proportion of the overall business the company growth rates naturally slow down.

Investors need to be aware that this might be happening. Companies such as Restaurant Group (LSE:RTN) grew rapidly as it was opening new stores and its shares traded at high valuations. It has now stopped growing and its valuation has collapsed. (Click here to read my analysis of RTN.)

I am not saying that this will happen with Patisserie Holdings but there is a risk that it might. The lack of like-for-like sales disclosure means that outside investors can't monitor this risk as well as they can with other retailers. What is clear is that the rate of overall sales growth is slowing down and City analysts expect this to continue.



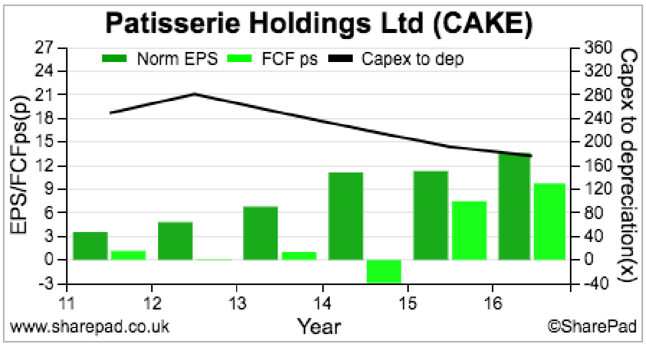
However, if you dig deeper into the company's results statement you will see that all its pre-tax profit growth has come from Patisserie Valerie. Its other brands are not growing much, if at all.

Brand	PTP 2016 (£'000)	PTP 2015 (£'000)
Patisserie Valerie	13,813	10,899
Druckers	1,213	1,216
Baker & Spice	1,111	1,104
Flour Power	534	637
Philpotts	1,208	1,114
Overhead	-675	-413
Total	**17,704**	**14,457**

The company has had very consistent profit margins, which is encouraging.

During the last couple of years, profit margins have been helped by falling ingredients costs. That benefit has now disappeared as food ingredients prices are rising again. Wage costs are also rising, but the company is confident that it can offset these pressures.

The company's expansion is also making some clever use of sites. It has been growing its number of concessions in Debenhams which can give it a presence on the high street at favourable rents. These concessions have been doing well.



It is also getting better at producing free cash flow as capex spending moderates. Free cash flow per share has seen significant improvements during the last couple of years.

City analysts forecast continued strong revenue and profits growth for the next three years. Given the company's comments on rising cost pressures, I do slightly question consensus forecasts for profit margin progression. 18.3% and 18.5% assumed in 2018 and 2019 look a little high to me which suggests that there is scope for profit forecasts to be trimmed slightly.

Patisserie Holdings Ltd (CAKE)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	30/9/14	30/9/15	30/9/16	1/9/17	1/9/18	1/9/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	76.6	91.9	104.1	115.6	127.0	137.9
%chg	▲27.5	▲19.9	▲13.3	▲11.0	▲9.8	▲8.6
EBIT	12.1	14.6	17.2	19.7	23.2	25.5
EBIT margin	15.8	15.9	16.5	17.0	18.3	18.5
EPS(p)	11.1	11.3	13.6	16.2	18.7	20.5
EPS % chg	▲63.2	▲2.0	▲20.1	▲19.1	▲15.4	▲9.6
DPS(p)	-	1.7	3.0	3.5	4.2	5.2
DPS % chg	-	-	▲79.6	▲16.7	▲20.0	▲23.8
Dividend cover	-	6.8	4.5	4.6	4.5	3.9

Despite the business performing well, Patisserie Holdings' share price performance has been rather lacklustre. When I last looked at the shares back in August 2015 (click **here** to read my analysis) they were trading at 300p and were on a forecast PE ratio of 26.5 times. At 295p now they trade on a forecast PE of 18.2 times.

This is a more reasonable rating and represents a PEG ratio of less than 1.0 which growth company investors might find appealing. However, the company during the last year is a fine example of how PE compression can mean that overpaying for growth can lead to very disappointing returns for shareholders.

Share Discussion: Are KCOM shares a yield trap?

Half year results from Hull based telecom firm KCOM (LSE:KCOM) showed a business that is facing up to a lot of challenges. It is currently shrinking with operating profit falling by 28% and EPS falling by 27.2%.

The company has a monopoly in supplying phone and broadband internet services in Hull and parts of East Yorkshire. It is facing up to the same kind of problems as legacy operators such as BT - namely falling voice revenues as people increasingly ditch their landlines in favour of mobile phones.

KCOM is now investing heavily in fibre-optic broadband in a push to grow its revenues. This is taking a toll on its free cash flow but it has to do this to future-proof its business as customers increasingly demand high-speed internet to stream films, games and TV programmes.

The company also has an IT solutions business with some big customers such as HMRC. This is where any future profits growth is likely to come from.

At the moment it seems that KCOM is running hard to stand still. It has combined its Telecom and IT businesses under a single KCOM brand in order to cut costs but this company needs revenue growth and no-one is expecting any based on analyst's forecasts.

EPS is expected to be no higher in 2018 than it was in 2016 which brings into the question of how sustainable its dividend is likely to be. The shares have a high dividend yield primarily because they offer no dividend growth.

KCOM Group PLC (KCOM)

← Prev Next →	2013	2014	2015	2016	2017	2018
Fiscal period ending	31/3/13	31/3/14	31/3/15	31/3/16	1/3/17	1/3/18
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS						
Turnover	372.9	370.7	348.0	349.2	335.6	336.1
%chg	▼-3.7	▼-0.6	▼-6.1	▲0.4	▼-3.9	▲0.1
EBIT	54.2	53.9	57.6	52.3	39.6	37.4
EBIT margin	14.5	14.5	16.6	15.0	11.8	11.1
EPS(p)	7.4	7.4	9.3	6.0	7.4	5.8
EPS % chg	▼-2.8	▼0.0	▲26.0	▼-35.8	▲23.7	▼-21.6
DPS(p)	4.4	4.9	5.4	5.9	6.0	6.0
DPS % chg	▲11.0	▲9.9	▲10.0	▲10.1	▲1.5	▼0.0
Dividend cover	1.7	1.5	1.7	1.0	1.2	1.0

The company has confirmed its intention to pay a 6p dividend in 2017 and 2018. Based on EPS forecast, this would mean it would be paying an uncovered dividend in 2018. This exposes the risk that the dividend might have to be cut.

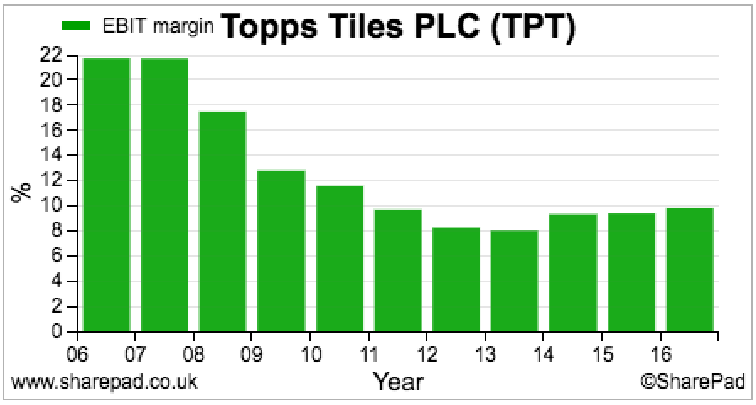
That said, the company is not carrying lots of debt on its balance sheet, especially for a telecoms company. Its **net debt to EBITDA** ratio is currently running at 0.66 compared with Vodafone and BT at over 2.0. Its pension fund deficit also looks to be manageable. This means that KCOM might choose to borrow in order to maintain its dividend whilst waiting to see if its IT business can grow and its investment in fibre can pay off.

Share Discussion: Topps Tiles (LSE:TPT)

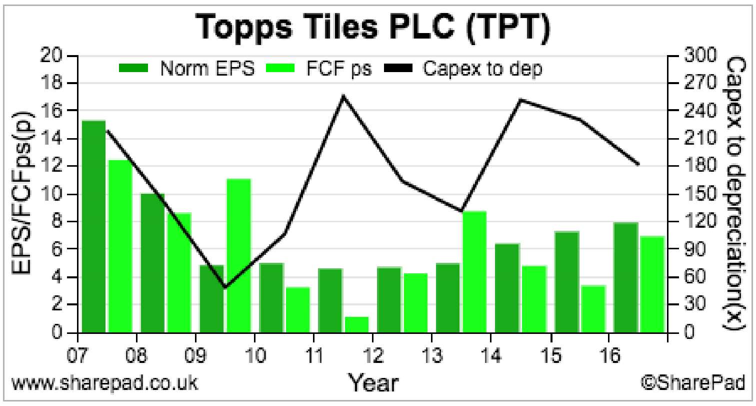
Topps Tiles' share price was hammered during the last recession and housing market downturn. The last year has seen its shares virtually halve in price as investors seem worried that tough times are likely to return.

This may seem very unfair as the company seems to have done a very good job at turning itself into a very competent retailer. This week's 2016 results revealed that like-for-like sales had grown by a very creditable 4.2% with total sales at record levels.

The company is nowhere near as profitable as it was ten years ago but it has been making steady progress. Profit margins have been trending upwards.



2016 also saw a very creditable free cash flow performance which fed through to a dividend increase of 16.7%.



That said, Topps makes it clear that its fortunes are very dependent on the state of consumer confidence and the UK housing market. It doesn't matter how good its strategy has been in areas such as improving its stores and growing its sales with the building trade, if consumer confidence and the housing market dip it is likely to make less money.

On these two important measures, the company has been very cautious in its latest results statement. It has cited falling consumer confidence during the second half of 2016 and points to a flattening housing market in terms of the number of transactions.

It also seems that like-for-like sales have fallen significantly. They increased by 4.7% during the first half of 2016 and by 3.8% during the second half. The first eight weeks of its 2016/17 financial year (starting Oct 2016) has seen LFL sales growing by just 0.8% - a significant slowdown.

LFL sales are a key measure to watch with retailers because their profits are very sensitive to changes in sales (this is known as operational gearing). A fall in LFL can see a significant fall in profits.

Looking at profit forecasts for Topps, it seems that analysts still expect a strong year of EPS growth in 2017. Analysts who have updated their forecasts after the results have not reduced them. I think that a slowing LFL sales number puts these forecasts at risk of being cut.

If the analysts are right then Topps' shares at 88.6p are trading on a forecast PE of 9.1 times and offer a forecast dividend yield of 4.5%. Its finances are strong with fixed charge cover of 1.8 times. The shares are risky given its operational gearing but the valuation might appeal to bargain hunters.

Topps Tiles PLC (TPT)

← Prev Next →	2013	2014	2015	2016	2017	2018
Fiscal period ending	28/9/13	27/9/14	3/10/15	1/10/16	1/10/17	1/10/18
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS						
Turnover	177.8	195.2	212.2	215.0	224.1	233.5
%chg	-	-	-	▲1.3	▲4.2	▲4.2
EBIT	14.3	18.2	19.9	21.1	24.5	26.1
EBIT margin	8.0	9.3	9.4	9.8	10.9	11.2
EPS(p)	5.0	6.4	7.3	7.9	9.7	10.5
EPS % chg	-	-	-	▲8.8	▲22.8	▲8.2

Filter of the week - Cheap shares with improving fundamentals

This week's filter is a very simple one that can be performed in both SharePad and ShareScope. It is one favoured by value investors who look for shares trading below their net asset value per share (NAVps) – i.e. a P/NAV ratio of less than 1.0.

Because shares with a P/NAV of less than 1.0 are often companies in difficulty, this screen adds a criteria based on something called the Piotroski F-score. The F-Score looks at certain parts of a company's accounts to see if financial performance is improving. By combining a cheap valuation with improving fundamentals you might be able to find a winning share.

At the moment there are 36 shares trading on the London stock exchange with a P/NAV of less than 1.0 and a high Piotroski F-Score of more than 7. To learn more about this screening approach check out my article **How to use asset values to pick shares**.

Phil Oakley - Low P/NAV with improving fundamentals Add criteria i Exit

Price to NAV Min: 0 Max: 0.99 Edit

Piotroski F-score Min: 7 Max: Edit

No.	TIDM	Name	Market Cap. (m)	Price to NAV	Piotroski F-score
1	NRR	NewRiver REIT PLC	£781.8	0.9	7
2	ETI	Enterprise Inns PLC	£530.0	0.4	7
3	HGM	Highland Gold Mining Ltd	£420.3	0.8	7
4	GDG	Green Dragon Gas Ltd	£284.8	0.6	7
5	HSW	Hostelworld Group PLC	£232.2	0.4	7
6	EXI	Exillon Energy PLC	£189.8	0.8	7
7	GEMD	Gem Diamonds Ltd	£149.8	0.8	7
8	MMH	Marshall Motor Holdings ...	£109.1	0.6	8
9	KSK	KSK Power Ventur PLC	£107.8	0.6	7
10	FLYB	Flybe Group PLC	£95.3	0.6	7
11	AFRK	Afarak Group PLC	£89.3	0.7	8
12	CMS	Communisis PLC	£76.9	0.6	7
13	EHG	Elegant Hotels Group PLC	£60.8	0.7	8
14	TSG	Trans-Siberian Gold PLC	£47.9	0.9	8
15	JEL	Jersey Electricity Compa...	£47.7	0.9	9
16	LAKE	Lakehouse PLC	£46.1	0.5	8
17	MBH	Michelmersh Brick Holdi...	£40.5	0.8	8
18	PIL	Produce Investments PLC	£40.1	0.8	7
19	VOG	Victoria Oil & Gas PLC	£37.2	0.4	7
20	SNX	Synectics PLC	£34.5	0.9	9
21	AVG	Avingtrans PLC	£33.9	0.8	7
22	BQE	Bioquell PLC	£31.8	0.9	7
23	JWNG	Jaywing PLC	£27.2	0.8	8
24	RGD	Real Good Food Compa...	£27.2	0.3	8
25	AFS	Amiad Water Systems Ltd	£26.3	0.7	8
26	WTM	Waterman Group PLC	£25.7	0.9	8
27	SLP	Sylvania Platinum Ltd	£22.0	0.3	8
28	VLE	Volvere PLC	£21.2	0.9	7
29	KAKU	Kakuzi Ltd	£18.1	0.8	7
30	PHO	Peel Hotels PLC	£16.7	0.7	8
31	JPR	Johnston Press PLC	£14.6	0.06	7
32	GDP	Goldplat PLC	£9.0	0.6	7
33	TXH	Tex Holdings PLC	£7.4	0.8	7
34	AUK	Aukett Swanke Group PLC	£5.6	0.9	7
35	OXF	Oxford Technology 4 Ve...	£4.6	0.6	7
36	UVEL	UniVision Engineering Ltd	£2.9	0.6	7

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