Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

20th January 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7208.44	▼-1.15	▲2.73	▲22.7	7337.81	5536.97	13/1/17	11/2/16
FTSE 250	18223.7	▼-0.436	▲2.48	▲13.1	18413.3	14967.9	10/1/17	27/6/16
FTSE SmallCap	5238.27	▼-0.149	▲3.28	▲21.2	5274.5	4145.59	16/1/17	12/2/16
FTSE AIM 100	4163.21	▼-0.15	▲4.75	▲27.4	4195.34	3075.85	16/1/17	11/2/16
S&P 500	2271.89	▲0.0639	▲0.414	▲20.8	2276.98	1829.08	6/1/17	11/2/16
UK Treasury 10 Year Par Yield	1.34	▲0.752	▼-6.94	▼-22.5	1.74	0.61	22/1/16	12/8/16
Brent Oil Spot $	$54.245	▼-3.32	▼-1.49	▲88.6	$56.965	$27.765	29/12/16	20/1/16
Gold Spot $ per oz	$1203.18	▲0.573	▲5.66	▲10.6	$1366.48	$1087.97	6/7/16	19/1/16
GBP/USD - US $ per £	1.23132	▲1.21	▼-0.601	▼-13.2	1.47895	1.20401	22/6/16	16/1/17
GBP/EUR - Euros per £	1.1591	▲1.14	▼-2.66	▼-10.8	1.3238	1.1066	1/2/16	13/10/16

A fairly quiet week on the markets. The stock market has stopped rising but hasn't fallen that much. The oil price has fallen slightly, whilst gold continues to make gains.

Despite falling significantly at the end of last week, the pound has made gains against both the dollar and the euro.

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	KMR	Kenmare Resources PLC	▲21.3
2	GHG	Georgia Healthcare Group PLC	▲15.6
3	CMS	Communisis PLC	▲12.9
4	SHI	SIG PLC	▲11.9
5	MONY	Moneysupermarket.com Group PLC	▲11.8
6	HFD	Halfords Group PLC	▲10.6
7	RNO	Renold PLC	▲9.5
8	GFTU	Grafton Group PLC	▲9.02
9	CMBN	Cambian Group PLC	▲8.94
10	FDM	FDM Group Holdings PLC	▲8.55

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	SIV	St Ives PLC	▼-40.5
2	PSON	Pearson PLC	▼-27.8
3	PETS	Pets at Home Group PLC	▼-9.74
4	DNLM	Dunelm Group PLC	▼-9.54
5	ISAT	Inmarsat PLC	▼-7.91
6	SGP	SuperGroup PLC	▼-7.71
7	PFD	Premier Foods PLC	▼-7.46
8	AMFW	Amec Foster Wheeler PLC	▼-6.96
9	HSS	HSS Hire Group PLC	▼-6.89
10	GMS	Gulf Marine Services PLC	▼-6.88

If you haven't already done so, don't forget to check out my free **Step-by-Step Guide to Investment Analysis**, It's a comprehensive handbook aimed at helping you identify high-quality stocks for your portfolio - without any of the jargon. You can read it for free **here**.

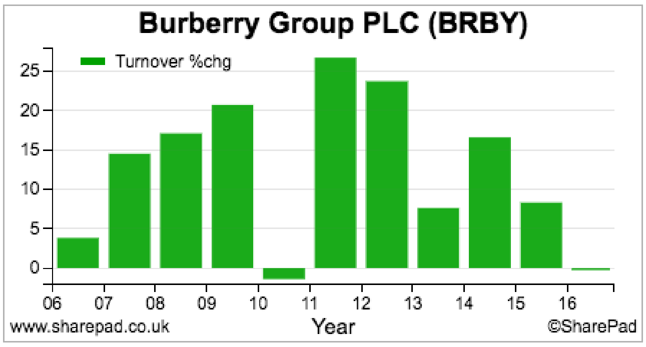
Share Discussion: Burberry (LSE:BRBY)

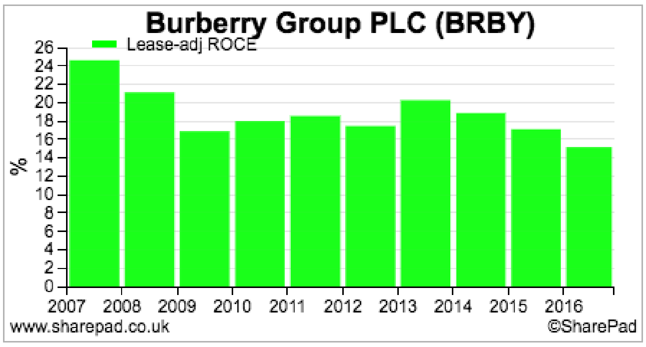
Not so long ago, Burberry was seen as a very dependable share to own. Its luxury brand of clothes, bags and fashion accessories were very appealing to affluent customers around the world. The long-term outlook for the shares seemed promising.

Then life began to get a little difficult for Burberry in 2016. Its sales stopped growing and its profits fell. Investors began to question the effectiveness of its business strategy and management changes were announced.

The share price spent most of 2015 falling but has bounced strongly since last summer. This is mainly due to the fall in the value of the pound since the EU referendum in June. Burberry makes most of its money overseas and the lower value of the pound has made its overseas earnings more valuable when they are translated back into pounds.

This is a nice benefit for Burberry but it cannot rely on favourable exchange rates to boost its profits every year. It needs to show investors that it can get back to sustainable sales and profits growth.

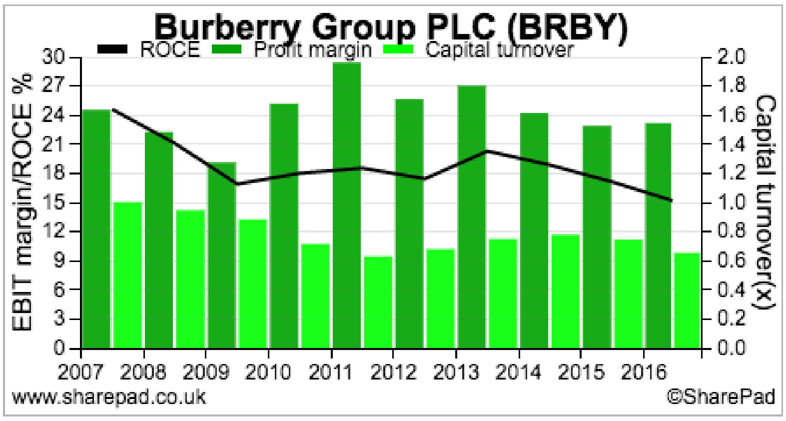




Burberry retains many of the hallmarks of a very decent business. ROCE has been consistently high, albeit lower than it was a decade ago and cash flow remains good.

However, look a little closely at how Burberry generates its ROCE and there is a worrying development.

The darker bars in the chart on the right show that Burberry's profit margins have been falling. Some City analysts think that the company has a cost problem and is inefficient. The company is looking to cut costs but in my opinion the key issue with Burberry is sales growth.



This week's third quarter trading statement revealed a mixed picture on this. Like-for-like sales growth at constant exchange rates in its retail business was a reasonable 3%. Overall sales growth was 22% due to a fall in the value of the pound.

The UK has been the star performer with sales growth of 40% as the weak pound has made places like London more attractive to rich tourists who tend to buy Burberry's products. Sales growth in China was also good.

But the key US market saw a disappointing sales performance and Europe remained weak. There was better news from online sales where there was growth in every region. If Burberry - like many retailers - is to prosper in the future then having a good internet sales operation will be essential.

Management said that profits for the year to March 2017 will be in line with current expectations, which is probably why the share price reacted well on the day of the announcement.

Burberry Group PLC (BRBY)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	31/3/14	31/3/15	31/3/16	1/3/17	1/3/18	1/3/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	2,329.8	2,523.2	2,514.7	2,653.4	2,759.3	2,988.4
%chg	▲16.6	▲8.3	▼-0.3	▲5.5	▲4.0	▲8.3
EBITDA	585.2	580.3	572.6	564.6	598.8	672.1
EBIT	446.6	441.7	425.5	435.9	466.4	526.8
EBIT margin	19.2	17.5	16.9	16.4	16.9	17.6
EPS(p)	75.5	76.5	75.3	73.2	78.6	90.4
EPS % chg	▼-3.7	▲1.3	▼-1.5	▼-2.8	▲7.4	▲15.0
DPS(p)	32.0	35.2	37.0	38.5	42.0	45.0
DPS % chg	▲10.3	▲10.0	▲5.1	▲4.1	▲9.1	▲7.1
Dividend cover	2.4	2.2	2.0	1.9	1.9	2.0

If you look at the current forecasts from City analysts then trading profit (EBIT) is only expected to be marginally higher than last year. Yet there has been around a £120m boost to profits from the falling value of the pound. Strip this effect out and Burberry's profits are not growing.

Yet the shares at 1686p are trading on 21.5 times March 2018 forecast earnings per share (EPS). That's a high valuation for a company which is struggling to grow its trading profits. I am also inclined to be slightly sceptical of profit forecasts for the year to March 2019 which assume an acceleration in sales growth from current levels and an improvement in profit margins.

Burberry's ROCE suggests it is a high quality business. This can justify a high valuation for its shares on the stock exchange but it needs a combination of a high ROCE and growth in order to do so. Not growth from exchange rate gains but from selling more stuff profitably.

It seems that management still has a lot of work to do here.

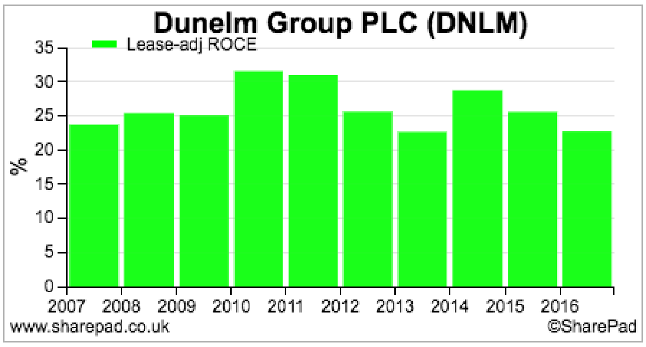
Share Discussion: Dunelm Group (LSE:DNLM)

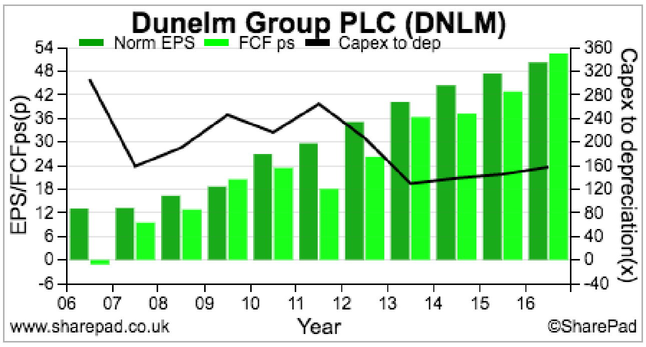
One of the first things that I do when I am looking for shares to invest in is to screen for companies with high and stable returns on capital employed (ROCE). I want to see consistent ROCE adjusted for hidden debts (or leases) of over 15% for the last 10 years.

In particular, I pay a lot of attention to how a company performs during a recession. Put simply, I do not want to see that there was a sharp fall off in ROCE in 2008 or 2009. If I do then I will move on to the next share. My investing strategy is based on owning highly resilient and high ROCE companies for a long time.

One of the companies that fits this ROCE criteria very well is leading homewares retailer Dunelm Group as shown in the chart below.

It also seems to have been reasonably good at turning most its profits into free cash flow which is another feature that I look for.





Yet, Dunelm shares have fallen significantly in price since last summer. On the day of the EU referendum (23rd June), its closing share price was 966p. This equated to around 18 times expected July 2017 EPS. Since then, the company's trading performance has worsened and analysts have cut their forecasts. At the time of writing, the shares are 670p and are on a July 2017 PE of 14.6 times.

Last week's second quarter trading update showed that the company is still having a tough time, although not as tough as the first quarter. As far as I can see, Dunelm is going through a typical phase that is experienced by many retailing companies:

- Open up lots of new stores.
- Those new stores mature and give the impression of strong like-for-like sales (LFL) growth.
- The store base gets to a big enough size so that opening new stores has a reduced effect on the overall performance of the company.
- LFL growth rates slow down or even start shrinking.

Over my 20 year investing career I have seen this happen so many times with retailers and pub companies. Growth is dependent on spending lots of money on opening new outlets which masks the fact that the underlying business isn't actually growing that much.

During the build out phase, analysts and investors think they are purchasing a genuine growth business and bid up the price and valuation of the shares. Sooner or later, the capex driven growth loses it effectiveness and the shares lose their attraction.

A look at Dunelm's recent LFL sales performance suggests that this scenario could be playing out.

Period	LFL Sales (%)
Q1 2016	5.5
Q2 2016	3.9
Q3 2016	1.1
Q4 2016	-0.6
Q1 2017	-3.8
Q2 2017	0.2

To be fair to Dunelm, it has done a very good job with its store roll out. It has a very good business model of selling lots of homeware products at attractive prices. It has opened up over 60 new stores during the last five years and has been able to sustain levels of ROCE that most retailers would love to have. Of the bricks and mortar retailers, I think only Next has been able to produce better sustainable ROCE figures than Dunelm.

Like Next, Dunelm seems to be struggling to adapt to a changing retail market. Rising levels of urban congestion and poor parking availability mean that lots of people do not want to visit retail stores. Instead they want to shop online. When you have 157 stores of around 30,000 square feet each - and the overhead that goes with it - that's not a good position to be in.

In fact, you get the distinct impression that the management would not open any more stores if they could based on this comment in last week's trading statement:

> *"We are now legally committed to a further seven new stores of which five are due to open in the current financial year."*

Unsurprisingly, lots of time and resources are going into the online and home delivery side of the business. This is still less than 10% of total sales but it did grow by 21% in the second quarter. This part of the business will be the key to restoring Dunelm's fortunes.

One cloud on the horizon is the rising inflation caused by the fall in the value of the pound. This will increase Dunelm's buying costs and could hurt its profit margins. It could also reduce the amount of disposable income its customers have in their pockets.

Dunelm shares could be an interesting investment at the right price as I think it is a good business. It needs to start growing its profits again.

Dunelm Group PLC (DNLM)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	28/6/14	4/7/15	2/7/16	1/7/17	1/7/18	1/7/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	730.2	835.8	880.9	969.3	1,072.5	1,159.7
%chg	-	-	-	▲10.0	▲10.6	▲8.1
EBITDA	137.3	144.2	154.3	153.6	171.9	-
EBIT	117.0	122.7	129.0	116.0	135.2	147.5
EBIT margin	16.0	14.7	14.6	12.0	12.6	12.7
EPS(p)	44.4	47.4	50.3	45.8	53.3	58.7
EPS % chg	-	-	-	▼-8.9	▲16.4	▲10.1
DPS(p)	20.0	21.5	25.1	25.5	26.7	28.5
DPS % chg	-	-	-	▲1.6	▲4.7	▲6.7
Dividend cover	2.2	2.2	2.0	1.8	2.0	2.1

However, I have a couple of concerns. Firstly, I think consensus profit forecasts for 2018 and 2019 could be too high given current rates of underlying growth. Secondly, the shares aren't particularly cheap. The shares of Next, which has similar problems to Dunelm, can be bought for less than 10 times forecast earnings compared with a PE of 14.6 for Dunelm.

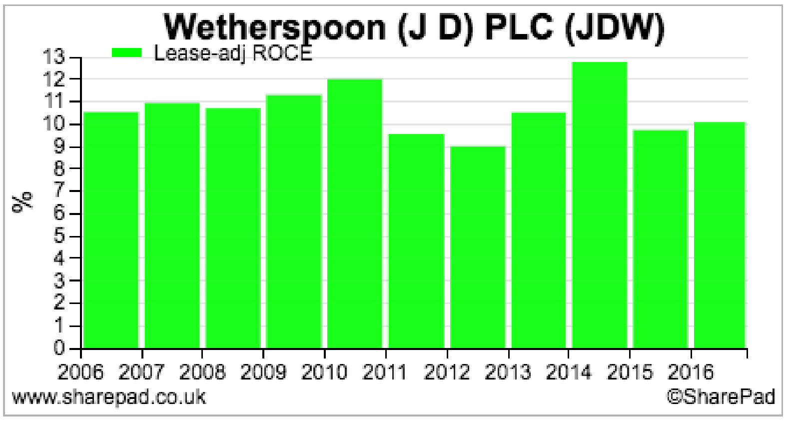
Share Discussion: JD Wetherspoon (LSE:JDW)

One of the best ways to understand a company as a potential investment is to be a customer of it. If you like a company's products then there's a good chance that other people might do as well. You can learn a lot from this approach.

When it comes to pubs, in my opinion there is potentially a lot to like about JD Wetherspoon. It offers drinks and food at value for money prices; it trains it staff well and keeps its pubs in good condition so that they are nice places to visit.

This has proven to be a decent business strategy for the company. It has the highest and most consistent ROCE of all the major pub companies but I would not go as far as saying that it is an outstanding business - ROCE is just over 10%.

However, it achieves this ROCE by selling a lot more beer and food per £1 of money invested (its capital turnover) than other managed pub operators who rely more on high profit margins to make their returns. Wetherspoons is doing this by selling cheaper beer and food than its competitors.



TIDM	Name	Lease-adj EBIT margin (7x, 7%)	Lease-adj Capital turnover (7x, 7%)	**Lease-adj ROCE (7x, 7%)**
JDW	Wetherspoon (J D) PLC	9.7	1.0	10.1
GNK	Greene King PLC	20.6	0.5	9.9
FSTA	Fuller Smith & Turner PLC	15.1	0.6	8.7
MAB	Mitchells & Butlers PLC	17.1	0.4	7.1
ETI	Enterprise Inns PLC	46.0	0.2	6.9
MARS	Marston's PLC	18.8	0.3	6.5

This week's second quarter trading update showed that Wetherspoon is doing well. Like-for-like sales were up by 3.2% for the quarter and by 3.4% for the year as a whole. Encouragingly, it said that profit margins were 1.7% higher than a year ago.

However, it did sound a note of caution on its outlook for the second half of its financial year:

"As previously indicated, the Company anticipates significantly higher costs in the second half of the financial year. On an annualised basis, these are expected to rise by about 4% for wages, by GBP7m for business rates and by GBP2m for the Apprenticeship Levy, in addition to cost increases at around the level of inflation in other areas. As previously announced, the Company intends to increase the level of capital investment in existing pubs from GBP34m in 2015/6 to around GBP60m in the current year.

"In view of these additional costs and our expectation that like-for-like sales will be lower in the next six months, the Company remains cautious about the second half of the year. Nevertheless, as a result of modestly better-than-expected year-to-date sales, we currently anticipate a slightly improved trading outcome for the current financial year, compared with our expectations at the last update."

Wetherspoon (J D) PLC (JDW)

← Prev Next →		2014	2015	2016	2017	2018	2019
Fiscal period ending		27/7/14	26/7/15	24/7/16	1/7/17	1/7/18	1/7/19
£ millions unless stated		Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS							
Turnover		1,409.3	1,513.9	1,595.2	1,615.8	1,659.2	1,711.2
%chg		-	-	▲5.4	▲1.3	▲2.7	▲3.1
EBITDA		176.1	173.9	190.4	190.6	196.1	200.7
EBIT		118.4	107.3	118.2	112.7	114.4	119.6
EBIT margin		8.4	7.1	7.4	7.0	6.9	7.0
EPS(p)		33.9	48.6	51.3	52.1	54.7	59.4
EPS % chg		-	-	▲5.6	▲1.5	▲5.0	▲8.6
DPS(p)		12.0	12.0	12.0	12.0	12.0	12.0
DPS % chg		-	-	▼0.0	▼0.0	▼0.0	▼0.0
Dividend cover		2.8	4.0	4.3	4.3	4.6	5.0

Wetherspoon shares are richly valued on 18 times forecast EPS at a share price of 935p. That's not very cheap especially as profits are not expected to grow that much. That said, if the UK is to experience a period of higher inflation which eats into consumers' disposable incomes then Wetherspoon's value for money offering could see it taking customers from its rivals.

Filter of the week - buying companies for nothing

Can you buy a company for nothing? The answer is that you can. There are some companies out there where the value of their net cash balances (cash less debt) is more than the market value of all their shares. This means that they have negative enterprise values implying that you can buy the company for free.

This screen is a form of extreme bargain hunting which comes with a few caveats:

- Year end debt and cash balances might be higher than balances throughout the year. This would increase enterprise value (EV).
- EV usually ignores hidden debts.
- The company may have large outstanding creditors that have not been paid yet.
- The company's prospects may be so woeful that it isn't really worth much at all.

All this considered, you might just unearth an overlooked and unloved bargain from this filter.

Happy hunting!

No.	TIDM	Name	**Market Cap. (m)**	Enterprise value
1	WTG	Watchstone Group PLC	£87.3	-14.9
2	ACHL	Asian Citrus Holdings Ltd	£67.2	-17.3
3	AVG	Avingtrans PLC	£36.5	-14.6
4	SEY	Sterling Energy PLC	£34.9	-31.7
5	BQE	Bioquell PLC	£29.8	-17.8
6	CAD	Cadogan Petroleum PLC	£22.5	-1.9
7	ETX	e-Therapeutics PLC	£22.5	-2.4
8	CHAR	Chariot Oil & Gas Ltd	£21.8	-5.0
9	FJET	Fastjet PLC	£17.2	-6.5
10	AFG	Aquatic Foods Group PLC	£15.9	-19.5
11	ADGO	Adgorithms Ltd	£13.6	-7.4
12	THAL	Thalassa Holdings Ltd	£12.6	-1.1
13	RPT	Regal Petroleum PLC	£12.1	-1.3
14	EME	Empyrean Energy PLC	£8.9	-3.3
15	JSI	Jiasen International Hold…	£6.7	-26.4
16	TPOP	Peoples Operator Holdin…	£6.6	-4.3
17	GED	Global Energy Develop…	£6.1	-11.1
18	BLUR	blur Group PLC	£4.6	-0.2
19	GBP	Global Petroleum Ltd	£3.8	-3.8
20	XTR	Xtract Resources PLC	£3.5	-0.3
21	OTM	Ottoman Fund (The) Ltd	£2.9	-4.3
22	TRC	Trinity Capital PLC/Fund	£2.1	-3.6
23	MSMN	Mosman Oil & Gas Ltd	£1.9	-0.3
24	HPAC	Hermes Pacific Investme…	£1.9	-2.0
25	CSFG	CSF Group PLC	£1.7	-9.7
26	PSPI	Public Service Propertie…	£1.0	-5.1
27	AUCT	Auctus Growth PLC	£0.9	-0.1
28	INFA	Infrastrata PLC	£0.9	-0.2
29	WORK	Work Group PLC	£0.9	-0.8
30	HID	Hidong Estate PLC	£0.9	-1.1
31	SRO	Spitfire Oil Ltd	£0.8	-1.3
32	WALG	Walcom Group Ltd	£0.8	-0.1
33	OPRA	Opera Investments PLC	£0.8	-0.1
34	DP2A	Downing Two VCT PLC A	£0.6	-2.4
35	DP2C	Downing Two VCT PLC C	£0.6	-2.4

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