Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

3rd March 2017

Market overview

Stock markets have hit new highs this week. I feel as we are entering a period where investors are in danger of being overly exuberant. Company results are generally satisfactory but the movement in share prices looks to be getting ahead of them.

I am not particularly bearish but it does make me nervous when shares just keep going up day after day. Some form of correction is possible after such a strong run but predicting when this might happen is impossible.

I have been reading some commentary on the risks of political upsets in the French and Dutch elections but would not see that as a reason to get nervous. Companies will keep on selling stuff no matter who runs a country in most cases.

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7382.35	▲1.53	▲3.38	▲20.1	7382.9	5923.53	1/3/17	14/6/16
FTSE 250	18950.8	▲1.65	▲3.79	▲13.3	18983	14967.9	1/3/17	27/6/16
FTSE SmallCap	5355.49	▲0.513	▲2.34	▲20.9	5358.95	4272.07	1/3/17	27/6/16
FTSE AIM 100	4407.03	▲1.08	▲3.28	▲34.4	4407.03	3188.77	2/3/17	27/6/16
S&P 500	2395.96	▲1.36	▲5.05	▲20.6	2395.96	1979.26	1/3/17	8/3/16
UK Treasury 10 Year Par Yield	1.1	▼-7.56	▼-22.5	▼-26.7	1.72	0.61	26/4/16	12/8/16
Brent Oil Spot $	$56.605	▲0.221	▼-0.264	▲52.8	$56.965	$37.055	29/12/16	3/3/16
Gold Spot $ per oz	$1243.98	▼-0.435	▲2.41	▲0.232	$1366.48	$1128.22	6/7/16	15/12/16
GBP/USD - US $ per £	1.22665	▼-2.29	▼-2.02	▼-12.9	1.47895	1.20401	22/6/16	16/1/17
GBP/EUR - Euros per £	1.1666	▼-1.65	▲0.284	▼-9.94	1.3174	1.1066	25/5/16	13/10/16

There has been a fall in the pound this week. It is now close to its one year low against the US dollar and will no doubt boost the profits of overseas earners if it is sustained at this level. However, it would also put upwards pressure on inflation as well by increasing the prices of imported goods.

There has also been a sharp decline in the yield on UK 10 year government bonds this week. I have no idea why this has happened, but it is potentially bad news for companies with big pension fund deficits - lower bond yields tend to increase them.

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	VSVS	Vesuvius PLC	▲21.6
2	COB	Cobham PLC	▲19.7
3	BOY	Bodycote PLC	▲15.3
4	MGGT	Meggitt PLC	▲14.1
5	CTR	Charles Taylor PLC	▲13.4
6	MCB	McBride PLC	▲13.1
7	OXB	Oxford BioMedica PLC	▲11.3
8	DPH	Dechra Pharmaceuticals PLC	▲10.4
9	MLC	Millennium & Copthorne Hotels PLC	▲9.61
10	IMI	IMI PLC	▲9.54

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	TNI	Trinity Mirror PLC	▼-16.2
2	IPF	International Personal Finance PLC	▼-15.2
3	PMO	Premier Oil PLC	▼-13
4	GOG	Go-Ahead Group (The) PLC	▼-11.2
5	IPO	IP Group PLC	▼-10.1
6	KAZ	KAZ Minerals PLC	▼-9.08
7	CEY	Centamin PLC	▼-8.64
8	CAR	Carclo PLC	▼-8.44
9	CPI	Capita PLC	▼-7.73
10	LMI	Lonmin PLC	▼-7.16

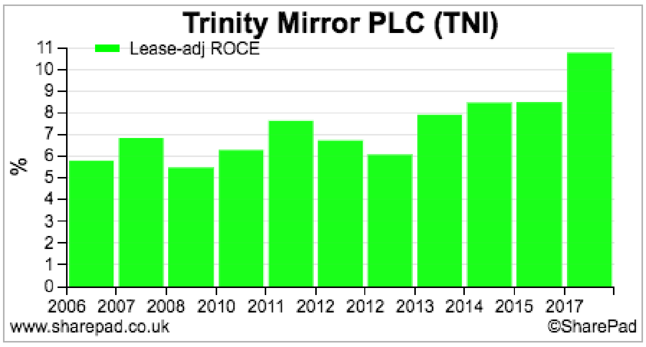
Share Discussion: Trinity Mirror (LSE:TNI)

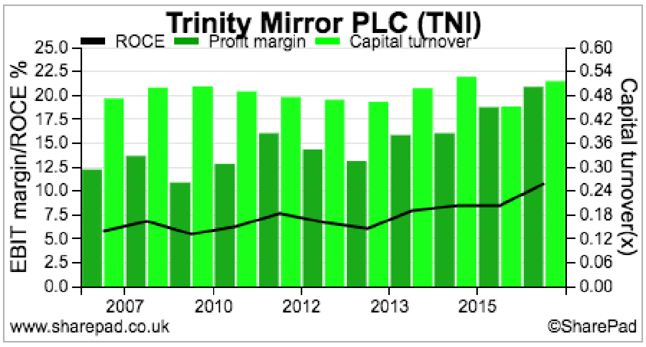
If you are screening the stock market and looking for very cheap shares then it's likely that Trinity Mirror will make it onto your list of shares to look at. Apart from times of stock market panics, the shares of good quality companies rarely trade at very cheap valuations. In more normal times, cheap valuations are often associated with companies in some kind of trouble.

Trinity Mirror has been in difficulty for some time. As people continue to read fewer newspapers, the circulation of its print titles have continued to decline. If that wasn't bad enough, the company is burdened with a huge final salary pension black hole - a legacy from the days when it employed a lot more journalists than it does today.

These two issues have weighed heavily on the company's share price in recent times as investors have questioned its future prospects.

As you can see from the chart below, Trinity Mirror would not fit my description of a high quality business. Its return on capital employed is very modest and has been for some time. However, 2016 saw a big improvement in ROCE. If this can be continued then Trinity Mirror might start looking a more attractive investment proposition.

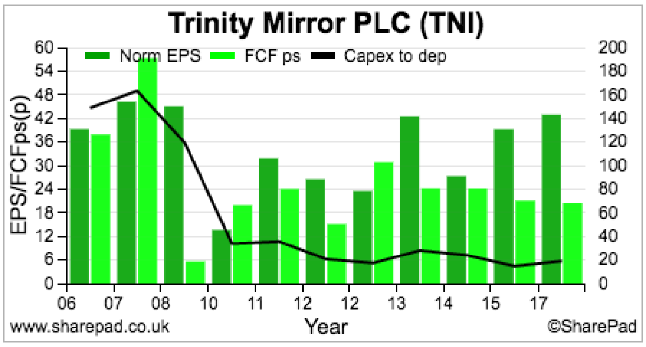


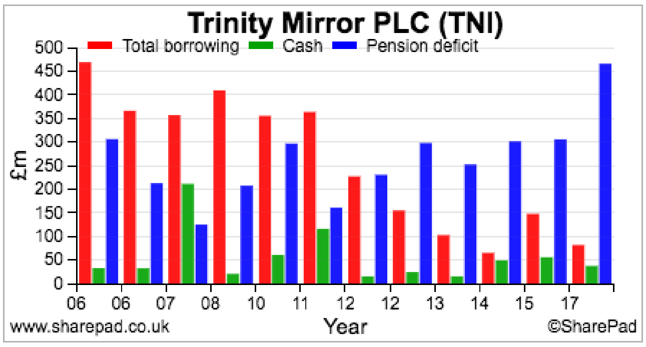


Looking at its ROCE performance more closely, we can see that the company has high profit margins (the darker bars) but a low capital turnover (sales per £1 of capital invested).

Companies with high profit margins usually make for safer investments. This is because it shows that a business is better placed to withstand a temporary decline in its profits. It is encouraging to see that Trinity Mirror's margins have been increasing for the last few years.

Unfortunately, the company is not very good at turning its profits into free cash flow. This is due to the cash the company needs to spend to plug its enormous pension fund deficit. The pension fund has been closed to future accruals (member benefits) since 2010 and so only a £2.2m adminstration charge was expensed in the income statement in 2016. This compares with the £40m that was paid into the fund which went through the cash flow statement.





The pension fund deficit ballooned in 2016 from £161m to £466m.

The company has agreed to pay £36m a year into the fund in order to plug the deficit over a ten year period. It also has to pay more if the dividend increases as well. Given the state of the deficit, I don't think it's unreasonable to assume payments of around £40m a year continuing for a while yet. This will mean that Trinity Mirror will also not turn all its profits into free cash flow for the foreseeable future.

The company is going to have to trade itself out of trouble. Only by growing its profits and free cash flow is it going to be able to get rid of this pension millstone. If it can do this, then the shares could be a very attractive to contrarian and brave investors.

Recent full year results were flattered by the inclusion of Local World, a regional newspaper business which Trinity Mirror bought in 2015. Pre-tax profits increased by 23.9% but this was primarily driven by £35m of cost cutting. The underlying revenue trends for the print newspaper business made for very grim reading indeed.

The circulation volumes of its core newspapers titles declined significantly and also lost market share.

Newspaper title	Change in 2016 circulation (%)
Daily Mirror	-10.8
Sunday Mirror	-14.7
Sunday People	-14.1
Daily Record	-11.5
Sunday Mail	-13.9
Regional dailies	-15.1
Regional weeklies	-17.1
Regional Sundays	-17.9

These figures are worrying. Print advertising revenues were also weak - particularly in recruitment - and this is only likely to get worse as more people switch to reading news and adverts on the internet or mobile devices.

Trinity Mirror is growing its digital revenues (internet and mobile) strongly. Average monthly page views grew by 15.4% in 2016 to 636.1 million, whilst digital transaction and advertising revenues grew by 24.7%.

This was a good result but digital is just over 11% of total revenues. The company is still heavily reliant on the fortunes of its print titles. The company's strategy is to grow digital revenues to offset the decline from print so that total revenues stabilise and possibly grow. This seems a way off at the moment.

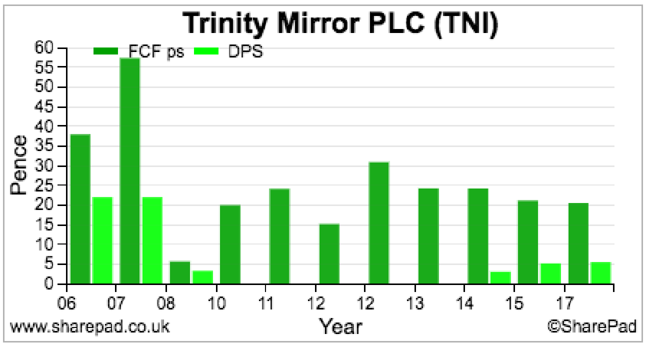
To turn itself around, it has to be able to compete with the likes of Facebook and other online media in local and national news. There have been some promising developments in this area with the launch of several local “LIVE” news websites which keep people up to date on what’s going on locally. Based on my experience of my local EssexLive website, I’d say that that these sites have potential to bring in advertising revenue.

But could all the challenges I have mentioned be more than reflected in Trinity Mirror’s current share price?

Maybe. Consensus EPS forecasts for 2017 are 34p rising to 35p in 2018. This makes the shares at 101p look very cheap at 3 times earnings. However, if you are going to value this share I think you should not use EPS but focus on free cash flow per share instead as EPS fails to account for the pension fund deficit as I explained above.

SharePad has calculated Trinity Mirror’s free cash flow per share for 2016 to be 26.7p. This is after the £40m of cash to fund the pension deficit has been deducted. This gives the shares a P/FCF multiple of 3.8 times or a free cash flow yield of 26.4%.

That is cheap if you believe that free cash flow can be maintained at current levels. Given the trends in the print business it may not be wise to bet on this. Low interest rates on bonds during the last few weeks could have increased the pension fund deficit further and additional cash to plug it could be needed.



However, my view is that a lot of bad news is priced in to the shares.

The other attraction is that the company is paying a growing dividend stream to shareholders. The 2016 dividend was increased by 5.8% to 5.45p and is comfortably covered nearly five times by free cash flow.

Management has said that it wishes to grow the dividend by 5% per year. Combine this with a starting yield of 5.4% and you can make a case for the shares attracting adventurous income seekers.

The quality of the print newspaper business would worry me from a buy and hold view point and this share is certainly not one for the nervous. But I think it could be of interest to bargain hunters.

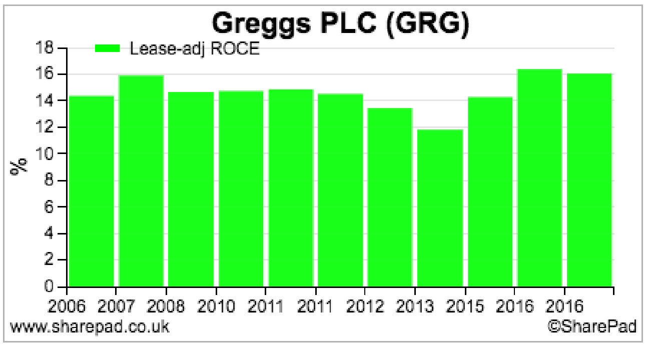
Share Discussion: Greggs (LSE:GRG)

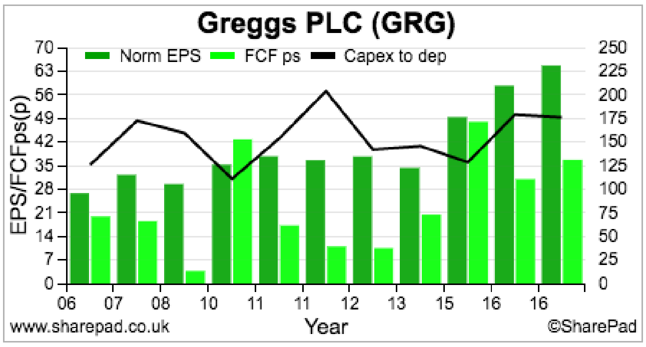
If you were looking to invest in a company that was easy to understand Greggs, the Newcastle based bakery retailer. is a pretty good example. Most people understand sandwich and coffee shops and what makes a good one.

Greggs has had its ups and downs in recent years with the shares having fallen quite sharply during the last twelve months. It has, however, been an outstanding long-term investment. With the 10:1 share split in 2009, anyone fortunate to have bought the shares for £1.35 at flotation has seen the equivalent value of each share rise to over £100. Taking the dividend per share of 31p for 2016 (equivalent to 310p adjusted for share splits), the yield on initial cost would be a very impressive 230%.

Greggs is a very good business in my opinion, operating in a fiercely competitive sector. ROCE when adjusted for the rents on its shops was 16% in 2016 and has averaged 14.7% for the last decade. This is considerably better than what any of the major UK supermarkets have achieved.

Greggs reckons it is achieving a site ROCE of 22.5% on its shops over a 7 year investment cycle. What happens after 7 years is unclear. My guess is that a shop is either relocated or refurbished to keep it attractive to customers.





Free cash flow performance is less impressive as the company consistently spends more than its depreciation charge on new assets (capex). Free cash conversion of profits over the last five years has averaged just under 60%. This can be explained by the company converting the format of its shops under its strategy of placing itself firmly in the ‘food to go’ market.

Cash conversion is unlikely to improve any time soon as Greggs is investing heavily in its bakeries and distribution as well as refurbishing its shops. All of this is funded from cash flow

2016 was a good year for Greggs with like-for-like sales up a very creditable 4.2% combined with higher profit margins. Trading profits (EBIT) increased by 8.6% with the dividend increasing by 8.4%.

I think that some investors may be concerned that Greggs has become a mature business, in a competitive sector and may have limited growth prospects. After all, there is no shortage of places to buy a coffee and a sandwich during the day.

One of the key weaknesses of Greggs in recent years has been its high exposure to the high street where fewer people are visiting. The company is addressing this by relocating its shops away from the high street to areas of higher footfall such as transport hubs (rail and bus stations, airports and service stations), leisure and workplace locations. During the last three years the proportion of its store estate in these locations has increased from 13% to 30% and this should continue to increase and improve sales and profits.

I see three other positive developments for Greggs:

Firstly, it is changing the mix of its sales to more profitable areas such as breakfasts, hot drinks and healthier foods. It tends to offer its products at value for money prices which undercut more upmarket sandwich and coffee shops.

Secondly, the company still has scope to open more shops. It currently has 1764 and and sees the potential for over 2000. It will open up another net 100 (openings less closures) in 2017.

Thirdly, the company is able to control the costs and quality of its food as it makes a large proportion of it iitself. This is a key source of competitive advantage compared with rival chains that buy food from outside suppliers. Greggs is also upgrading its bakeries and logistics which should make the business more efficient with a potential boost to profit margins over the coming years.

However,it does face cost pressures in the form of rising wage costs, commodity costs and business rates. Despite the current year starting well with 2.9% LFL sales growth during the first eight weeks, Greggs is flagging a slight fall in margins this year.

Analysts' consensus forecasts are for sales growth of 4.2% in 2017 and underlying EPS growth of 3.5% to 62.9p. At 1002p, this puts the shares on a forward PE of 15.9 times. That seems about right for a quality company with low short-term growth.

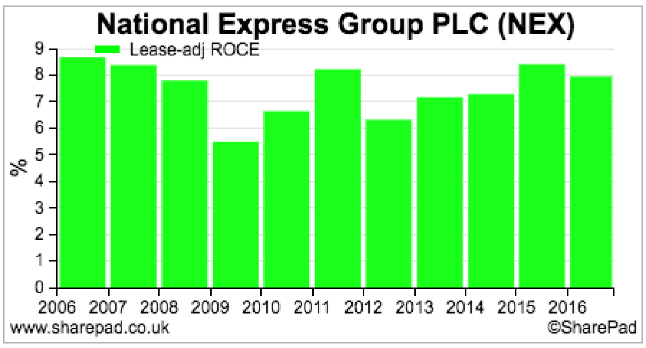
Share Discussion: National Express (LSE:NEG)

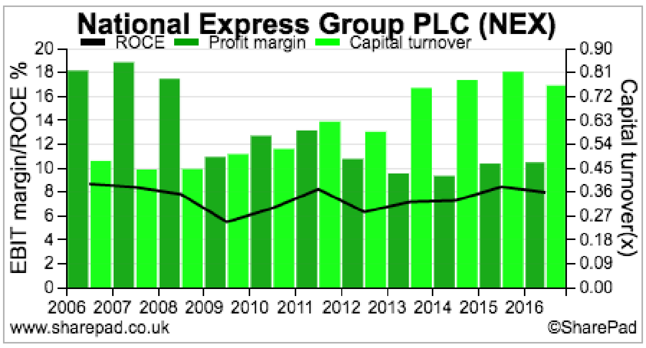
National Express has been quietly getting on with restoring its fortunes over the last few years. The company got itself into a terrible mess in 2009 by taking on the East Coast Trains rail franchise for a price it couldn't afford whilst at the same time buying a Spanish bus company with lots of debt.

It looks to be in good health now as evidenced by its recent 2016 results statement. Total trading profits grew by 14.2% - thanks to the devaluation of the pound boosting the profits of its overseas businesses - and by 4.8% on an underlying basis. Dividends increased by 8.4% to 12.28p per share.

Despite steady improvements in profits and cash flows in recent years I would not say that it was a great business.

Running fleets of buses and coaches is very asset-intensive whilst rail franchises have lots of hidden debts. As you can see from the chart below, ROCE is - and has been - very modest.

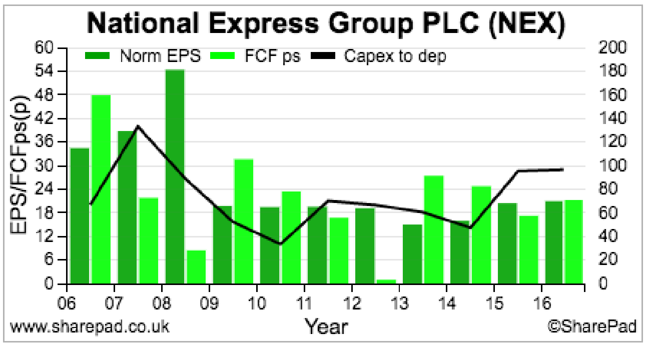


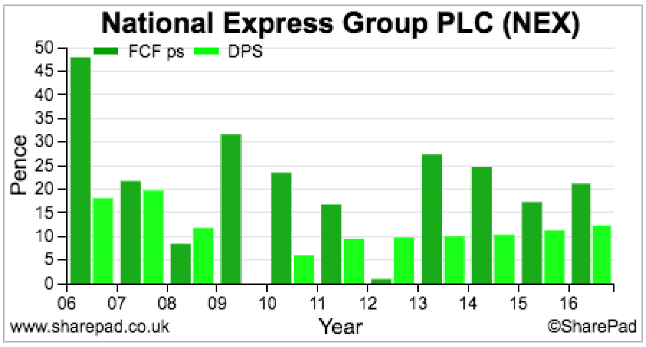


Improving profit margins is not easy as shown by the darker bars in the chart below. Not only are bus companies asset-intensive but they are labour-intensive as well. Driver wages have been going up and it has not been easy to recover cost increases by increasing fares or contract prices.

The other significant cost is fuel. Bus companies try to hedge their fuel costs but the oil price can introduce uncertainty and volatility into their profits. Sometimes falling fuel prices give a profits boost. This is what the company expects to happen on 2017.

National Express has been bearing down on costs and improving efficiency in recent years with a big focus on free cash flow generation. This has paid off as the company has proven to be good at turning its profits into free cash flow.





Free cash flow dividend cover is comfortable and this should allow the company to keep on growing its dividend for the next few years.

Future prospects

In my opinion, National Express should be able to continue to make steady rather than spectacular progress. This will come from its school bus business in America and its long-distance coach businesses in Spain and Morocco.

	Normalised operating profit 2016 GBPm	Intangible amortisation 2016 GBPm	Segment result 2016 GBPm	Normalised operating profit (restated) 2015 GBPm	Intangible amortisation 2015 GBPm	Segment result (restated) 2015 GBPm
UK Bus	35.5	–	35.5	37.5	–	37.5
UK Coach	33.3	(0.4)	32.9	32.3	(0.5)	31.8
German Rail	(1.5)	(0.8)	(2.3)	(0.1)	–	(0.1)
Spain and Morocco	84.7	(9.5)	75.2	71.5	(9.9)	61.6
North America	84.0	(23.0)	61.0	66.8	(15.2)	51.6
Central functions	(17.0)	(0.1)	(17.1)	(16.2)	(0.1)	(16.3)
Operating profit from continuing operations	219.0	(33.8)	185.2	191.8	(25.7)	166.1

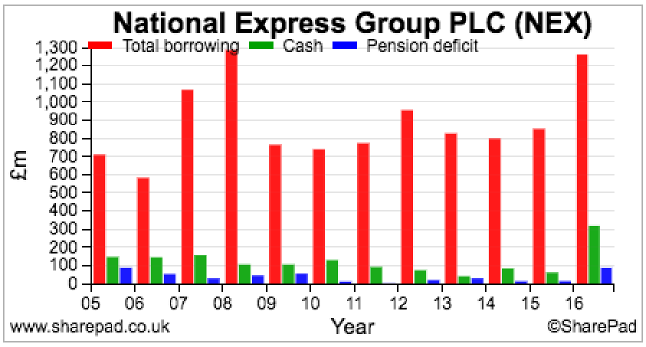
Its UK bus business is struggling. Profits fell in 2016 and bus travel continues to be plagued by rising levels of urban congestion which make it difficult to grow passenger numbers. The iconic National Express inter-city coach business made modest progress.

National Express is the biggest school bus operator in North America. This is a decent business that provides steady and reliable cash flows. The market is highly fragmented and I expect the company to get most of its growth in this business from buying smaller, rival companies.

Spain and Morocco should also be steady growers. There is increased competition from retendering of contracts in Spain and this might see margins fall slightly. This will be offset in 2017 and 2018 by a helpful fall in the fuel bill.

The company has exited the UK rail market by selling its C2C franchise which linked Essex to London. I think this is a very good move and makes National Express less risky. Inter-city and London commuter UK rail franchises have become more risky in recent years as the owners of them have had to promise to pay larger sums of money (premiums) to the government in order to run them. These premiums tend to rise every year of the franchise. Unless revenues keep growing, it is become harder to maintain or grow profits. In a recession, large losses are possible.

Getting out of UK rail will also remove some hidden debts from National Express and should lead to an improvement to its lease-adjusted ROCE. I do not see its current loss-making German rail operations as a big source of value for shareholders at the moment.



National Express still has a lot of debt. I'd like to see debt levels come down but don't see them as a big risk given the predictable cash flows that come from running buses.

Some debt refinancing in 2016 will see interest costs fall by £9m in 2017 which should help profits for shareholders to keep on growing.

I view National Express as an unregulated utility company. With a forecast yield of 3.6% and the prospect of some reasonable dividend growth it could be an attractive and relatively low risk share for income seekers. I don't see it as a share to get rich on.

National Express Group PLC (NEX)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	31/12/14	31/12/15	31/12/16	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	1,867.4	1,919.8	2,103.7	2,327.1	2,372.0	2,386.0
%chg	▼-1.3	▲2.8	▲9.6	▲10.6	▲1.9	▲0.6
EBITDA	269.6	295.2	343.1	374.6	400.4	417.1
EBIT	136.1	165.2	186.3	203.8	220.2	226.6
EBIT margin	7.3	8.6	8.9	8.8	9.3	9.5
EPS(p)	16.0	20.5	20.9	28.7	31.2	32.3
EPS % chg	▲6.8	▲27.7	▲2.4	▲37.0	▲8.7	▲3.5
DPS(p)	10.3	11.3	12.3	13.2	14.1	15.5
DPS % chg	▲3.0	▲10.0	▲8.4	▲7.5	▲6.8	▲9.9
Dividend cover	1.6	1.8	1.7	2.2	2.2	2.1

Filter of the week - Extremely profitable cash generators

I am a great believer that when it comes to investing that cash is king. If you are looking for companies that can grow in value over the years then one of the things I look for in a company is a high free cash flow margin.

The free cash flow margin tells you what proportion of a company's turnover (revenue) turns into free cash flow for shareholders. The higher the number, the more profitable the company. Anything over 10% is good. Below is a list of shares with consistent free cash flow margins of more than 20%. These may be exceptional companies to own - at the right price of course.

free cash flow margin Add criteria Exit

FCF margin Min: 20 Max: Edit

FCF margin 10y average Min: 20 Max: Edit

No.	TIDM	Name	Market Cap. (m)	FCF margin	FCF margin 10y avg
1	REL	RELX PLC	£31924.9	20.1	21.5
2	LGEN	Legal & General Group ...	£15005.7	35.0	44.9
3	LSE	London Stock Exchange...	£11010.1	27.8	29.4
4	SDR	Schroders PLC	£8154.9	25.0	35.5
5	IHG	InterContinental Hotels ...	£7630.1	30.9	21.8
6	HL.	Hargreaves Lansdown P...	£6327.4	40.7	39.1
7	INVP	Investec PLC	£5330.0	24.8	25.7
8	ADM	Admiral Group PLC	£5161.0	29.5	26.4
9	AUTO	Auto Trader Group PLC	£3897.5	52.7	37.0
10	ADN	Aberdeen Asset Manage...	£3746.8	20.8	22.3
11	RMV	Rightmove PLC	£3697.6	63.5	56.1
12	PTEC	Playtech PLC	£2865.6	29.9	45.3
13	ASHM	Ashmore Group PLC	£2584.4	47.1	56.3
14	INDV	Indivior PLC	£2522.7	35.2	47.5
15	IGG	IG Group Holdings PLC	£1965.2	34.7	40.9
16	JUP	Jupiter Fund Manageme...	£1923.3	35.9	28.2
17	MONY	Moneysupermarket.com ...	£1852.4	26.2	20.7
18	ZPG	ZPG PLC	£1711.6	26.6	27.7
19	ERM	Euromoney Institutional I...	£1209.8	20.0	21.5
20	RAT	Rathbone Brothers PLC	£1150.8	215.4	47.4
21	HVPE	Harbourvest Global Priv...	£976.7	85.7	98.1
22	ESUR	esure Group PLC	£901.5	81.9	85.2
23	UKW	Greencoat UK Wind PLC	£880.0	56.2	60.6
24	ITE	ITE Group PLC	£412.4	20.3	25.2
25	SWEF	Starwood European Rea...	£407.8	337.3	242.1
26	OTB	On The Beach Group PLC	£390.3	21.3	27.5
27	JLEN	John Laing Environment...	£365.1	237.8	159.2
28	VSL	VPC Specialty Lending I...	£294.6	111.0	111.0
29	CLIG	City of London Investme...	£102.0	22.4	23.8