Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

17th March 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 2/1/17	%chg 1y	1 y high	1 y low	Date 1 y high	Date 1 y low
FTSE 100	7415.57	▲1.38	▲1.89	▲3.82	▲20.1	7415.57	5923.53	16/3/17	14/6/16
FTSE 250	19011.5	▲0.635	▲1.63	▲5.17	▲13.5	19029.2	14967.9	13/3/17	27/6/16
FTSE SmallCap	5391.41	▲0.806	▲0.756	▲4.83	▲19.7	5391.41	4272.07	16/3/17	27/6/16
FTSE AIM 100	4516.83	▲2.13	▲3.98	▲11	▲34.7	4516.83	3188.77	16/3/17	27/6/16
S&P 500	2382.31	▲0.737	▲1.49	▲6.41	▲17.5	2395.96	2000.54	1/3/17	27/6/16
UK Treasury 10 Year Par Yield	1.21	▲2.54	▼-6.92	▼-4.72	▼-22.4	1.72	0.61	26/4/16	12/8/16
Brent Oil Spot $	$51.545	▼-1.6	▼-7.63	▼-9.18	▲28.3	$56.965	$37.59	29/12/16	4/4/16
Gold Spot $ per oz	$1229....	▲2.48	▼-0.71	▲6.89	▼-2.32	$1366.48	$1128...	6/7/16	15/12/16
GBP/USD - US $ per £	1.23655	▲1.72	▼-0.966	▲0.686	▼-13.2	1.47895	1.20401	22/6/16	16/1/17
GBP/EUR - Euros per £	1.15115	▲0.187	▼-1.62	▼-1.98	▼-9.39	1.3174	1.1066	25/5/16	13/10/16

I've not much to say this week except to highlight the continued outperformance of AIM and new highs being set across the main UK stock market indices. Gold has had a good week despite rising interest rates in America. The oil price continues to decline.

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	HOC	Hochschild Mining PLC	▲26
2	CIU	Cape PLC	▲22
3	LMI	Lonmin PLC	▲20.1
4	FXPO	Ferrexpo PLC	▲19.8
5	TTG	TT electronics PLC	▲19.4
6	KAZ	KAZ Minerals PLC	▲16.7
7	VED	Vedanta Resources PLC	▲15.2
8	SIA	SOCO International PLC	▲14.9
9	OXB	Oxford BioMedica PLC	▲13.5
10	CKN	Clarkson PLC	▲13

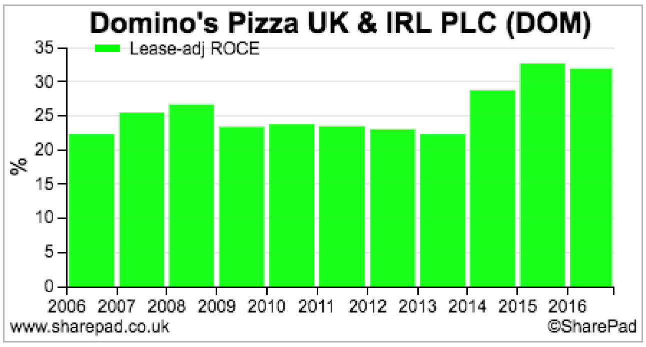
Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	GDWN	Goodwin PLC	▼-14.5
2	CWD	Countrywide PLC	▼-12.8
3	SGRO	Segro PLC	▼-8.32
4	IRV	Interserve PLC	▼-7.91
5	RTN	Restaurant Group (The) PLC	▼-6.88
6	ADN	Aberdeen Asset Management PLC	▼-6.74
7	HSV	Homeserve PLC	▼-6.46
8	ALD	Aldermore Group PLC	▼-6.02
9	MCB	McBride PLC	▼-5.97
10	SMP	St Modwen Properties PLC	▼-5.95

Share Discussion: Domino's Pizza (LSE:DOM)

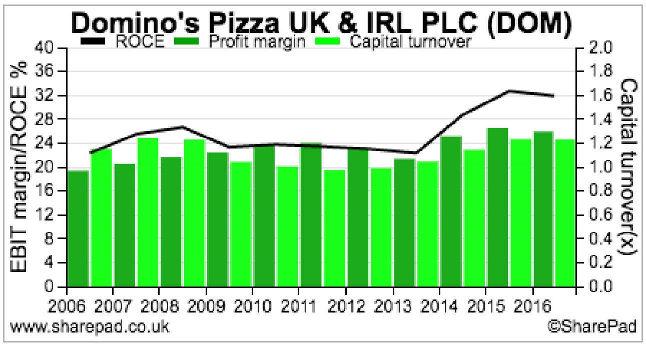
Domino's Pizza has proven to be a very satisfactory investment for long-term investors. In my opinion, it is a very high quality business and the kind of company I would be happy to invest in - at the right price.

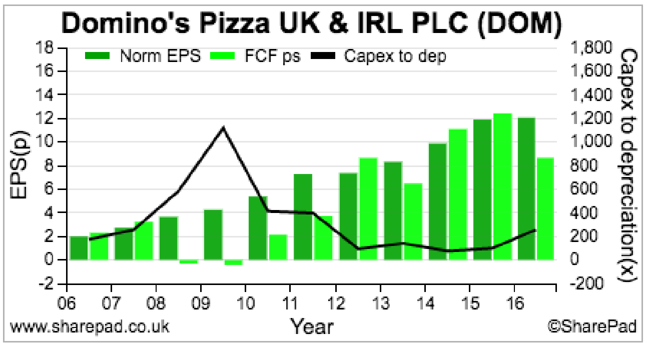
In terms of the benchmarks of quality - ROCE and free cash flow - the company scores highly.



Lease-adjusted ROCE was 31.9% in 2016 and has averaged 26.1% over the last decade. ROCE has been driven by very high profit margins and improving capital turnover ratio - selling more per £1 of capital invested.

Domino's has also been good at converting its rapidly growing sales and profits into free cash flow. Free cash conversion was not as good because investment in the business was significantly higher than a year ago and there was a significant increase in trade receivables.





The company owns the master franchise for Domino's Pizza in the UK and Ireland. It also owns stores in Switzerland and franchises in Liechtenstein, Luxembourg, Norway, Sweden and Iceland. The company owns a stake in the largest pizza delivery business in Germany.

Domino's has been well placed to exploit the growth in the take-away food market. The company is a franchisor and grants franchises to people wanting to run their own pizza company. Domino's supplies pizza ingredients, marketing, menus and stores in return for a franchise fee (a royalty) based on the stores' turnover.

This royalty income does not come with a burden of huge costs and lots of assets to look after. This means that Domino's can earn very high profit margins, high ROCE and produce lots of free cash flow. As well as the royalty income, Domino's makes very good profit margins on supplying food to its franchisees.

Analysis of UK & ROI operating profit

	52 weeks ended 25 December 2016 £m	52 weeks ended 27 December 2015 £m	% Change
Net royalties	27.6	24.2	14%
Supply chain centre margin	83.3	71.3	17%
Net overheads, realty and incentives	(20.0)	(17.2)	(16)%
UK joint ventures and associates	2.1	1.7	24%
Depreciation	(6.5)	(5.5)	(17)%
UK&I operating profit	**86.5**	**74.5**	**16%**

When these attractive characteristics are combined with a store roll out programme and strong underlying sales growth it is not surprising that Domino's shares have done well in recent years and have commanded a very high valuation. Up until last week's results statement, the shares were trading on a 2017 forward PE ratio of around 25 times.

2016 was another good year for Domino's with sales up 13.8%, driven by very strong like-for-like sales growth in the core UK and Irish business where profits increased by 14%. Earnings per share increased by 15.6% to 13.8p.

	25 December 2016	27 December 2015	Variance
System sales (GBPm)			
UK and ROI	GBP988.8m	GBP865.6m	14.2%
Switzerland	GBP15.4m	GBP11.7m	31.6%
Like-for-like sales growth			
UK	7.5%	11.7%	
ROI	10.3%	8.6%	
Switzerland	9.3%	5.4%	
Statutory revenue (GBPm)			
UK	GBP323.4m	GBP283.7m	14.0%
ROI	GBP21.6m	GBP21.4m	0.8%
Switzerland	GBP15.6m	GBP11.7m	32.9%
Underlying operating profit/(loss) (GBPm)			
UK and ROI	GBP86.5m	GBP74.5m	16.0%
Switzerland	GBP(1.3)m	GBP(1.3)m	0.0%
International Associates	GBP1.0m	-	n/a%
Underlying basic EPS (pence)	13.8p	11.9p	15.6%

Yet, the share price has lost nearly 19% of its value during the last week. What has spooked investors is the sharp slowdown in UK like-for-like (LFL) sales during the first 9 weeks of 2017.

It is not reasonable to expect Domino's to grow LFL sales at 11.7% as it did in 2015. The 7.5% growth that it achieved in 2016 was therefore a very good result. However, LFL sales growth has slowed to 1.5% in early 2017 and it is no surprise that investors are worried about this.

I think they are right to be worried. Domino's has been opening up lots of new stores in the UK in recent years. It opened 81 last year on top of the 61 in 2015. It will open a further 80 in 2017. New stores take time to mature and build up to their potential sales levels. Domino's should be getting a nice boost from maturing stores which have opened in the last year or so.

However, what I find concerning is the strategy of the new store openings. Of the 81 opened in 2016, 51 were classified as 'splits'. These splits are when a new store is added to an existing Domino's territory.

Domino's is opening stores with a lower number of address counts in order to get more sales per address. This is how it is probably going to achieve its aim of increasing its UK store base from 950 to 1600. Splits are clearly part of this strategy but they come with risks.

Opening a new store close to an existing one increases the risk of sales cannibalisation. This is when the new store takes sales from the existing one reducing its LFL sales. The new store also potentially hits trouble by not reaching the same potential level of sales as if it was on a standalone basis. Total sales in an area grow but underlying growth and profitability get weaker.

Is this going to happen at Domino's? I don't know but I think there's a risk that it might. We have seen with companies such as Restaurant Group which expanded its restaurant numbers by opening new ones next to existing ones what can happen when growth in numbers is pursued too aggressively.

This then presents a problem for the investment case for Domino's shares. At 324p, they still trade on a 2017 forecast PE of 21.5 times. This kind of valuation implies strong growth in future profits and free cash flows. Despite a significant share price fall during the last week there's still not a lot of room for disappointment priced in.

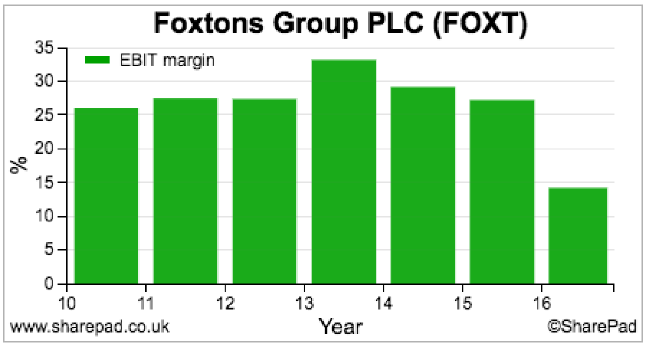
Capex will rise significantly to £50m-£60m as a new supply centre is built in Warrington. This will significantly reduce free cash flow in 2017 only but should see some nice efficiency gains accrue to the company from 2018 onwards.

The other area of caution is on ingredients costs. These are expected to increase during the first half of 2017 having been quite helpful to Domino's profits in recent years. Rising inflation from a depreciating pound is clearly a risk for imported ingredients. Will Domino's be able to pass these costs onto customers?

City analysts are forecasting EPS of 15.1p for 2017. This implies 15% underlying EPS growth. Given the pressure on sales and costs this could be too ambitious and forecast downgrades are possible. Given this backdrop, it would not surprise me to see the share price continue to drift lower.

Share Discussion: Foxtons (LSE:FOXT)

An estate agent in central London has probably been one of the best businesses to own over the last 5 years. When housing markets are buoyant, estate agency is literally a licence to print money. For an agent such as Foxtons, charging more than 2% commission on the sale of very expensive houses is extremely profitable.



Even with all the costs of staffing expensive offices, its profit margins have been very impressive.

The crazy prices for houses in London have pushed more and more people into rented accommodation which has provided an extremely stable and valuable source of income for Foxtons and other agents. The growth of this income source has made estate agents intrinsically more valuable than they were 10-15 years ago. Lettings accounted for just over half of Foxton's revenue in 2016.

But now it seems that the good days are over for London estate agents and perhaps estate agency in general. The London housing market is going through something of a slump with a big fall in the number of houses being sold. Foxtons blames the changes in stamp duty and the EU referendum for the slowdown. There's undoubtedly some truth here but could it just be that London property has become so expensive that some kind of slowdown was long overdue.

Estate agents have lots of fixed costs. This makes them very operationally geared and their profits very sensitive to changes in revenue. In 2016, revenue fell by £17m with pre-tax profits falling by £22m or more than half.

This had a big impact on profit margins as shown the table below.

Foxton's results announcement revealed that profit margins on house sales have collapsed as sales revenue fell by 23% on the back of a 28% fall in volumes. Lettings revenues fell by 1% but margins fell due to higher costs and the dilutive effect of less mature branches which do not yet have the volume of lettings and the same profitability.

Adjusted EBITDA	2016	2016	2015	2015
	GBPm	margin	GBPm	margin
Sales	7.0	12.7%	23.8	32.8%
Lettings	16.2	23.6%	20.9	30.2%
Mortgage broking	1.4	16.1%	1.3	16.0%
Group Adjusted EBITDA	24.6	18.5%	46.0	30.7%

Take note that two thirds of Foxton's EBITDA came from lettings in 2016. In my opinion, this is where the bulk of the value of its shares comes from, not from the more volatile estate agency side of the business. However, competition in lettings is increasing as all agents face the same problems and clamour for more secure lettings income. Will margins be able to be maintained, especially if lettings fees for things such as references are banned by the government?

There is arguably an even bigger threat to the estate agency business from online agents such as Purplebricks. Foxton's customer paid an average commission of over £13,783 on an average selling price of £568,000. Fees like this cannot last in my view and neither therefore can Foxton's profitability.

Trying to predict Foxton's future profits is very difficult. The London housing market is likely to remain tough for some time to come. City analysts are predicting another fall in EPS to 5.0p. At 94p, that puts the shares on a forward PE of 18.8 times which does not look particularly attractive.

TIDM	Name	PE	fc PE	Yield	fc Yield	Lease-adj EBIT yield (7x, 7%)	EPV ps (7%)	EPV implied (7%)
CWD	Countrywide PLC	11.3	8.7	3.2	4.0	5.3	47.5p	-70.1
FOXT	Foxtons Group PLC	17.7	18.8	2.1	5.0	7.4	85p	-9.5
LSL	LSL Property Services PLC	15.5	9.8	4.7	4.3	19.6	684.3p	213.2

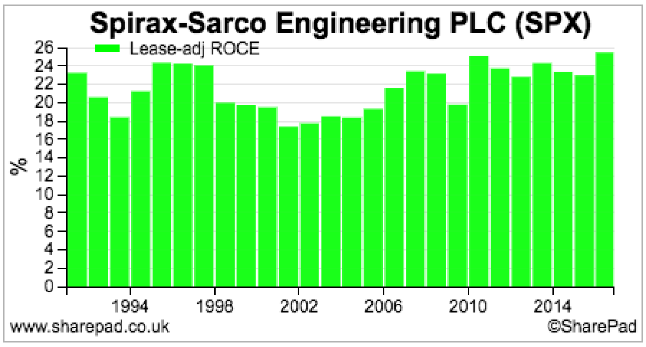
The company does have a strong balance sheet with no debts but the shares will not look attractive until the slump in profits has bottomed out. I don't think it has yet.

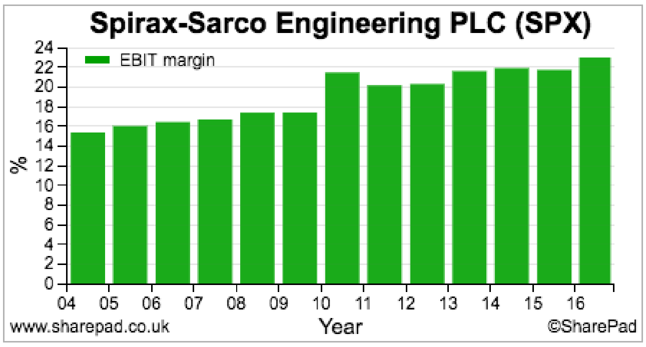
Share Discussion: Spirax-Sarco (LSE:SPX)

Despite the decline in heavy manufacturing, Britain remains the home to outstanding engineering companies. Spirax-Sarco, a leader in fluid and steam technology products, is one of the best in my opinion.

Its shares have been a fantastic long-term investment as the company has been consistently able to produce high returns on capital invested.

The chart below shows the company's ROCE going back to 1992. Just look at how high and consistent it has been. Even during the last recession in 2008/09 it was still able to produce ROCE of 20%. 2016 saw ROCE and profit margins at a record high.





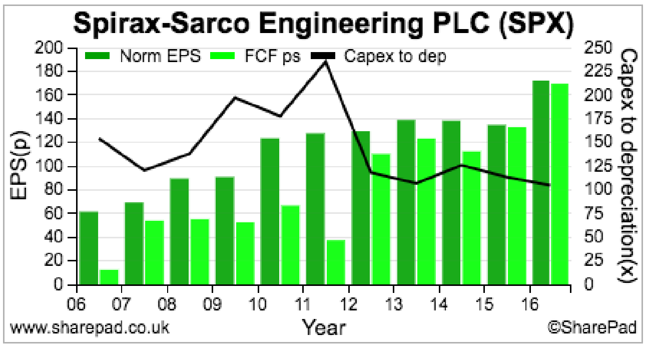
This is a business which is clearly doing something right and has been doing so for some considerable time. Around three quarters of its revenues come from its steam business. Steam has extensive industrial uses such as heating, cleaning, drying and cooking as well as a source of energy. This allows Spirax-Sarco to sell to a diverse range of industries and customers which helps to give it a very resilient income stream.

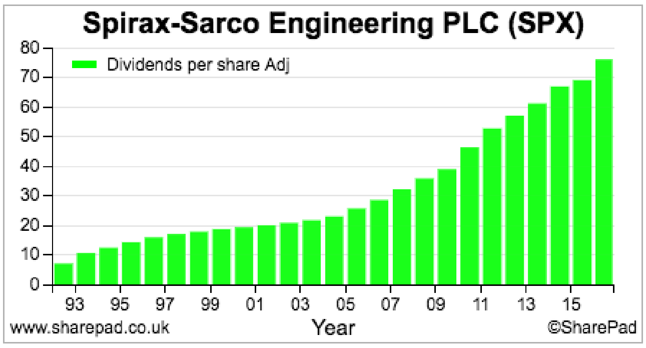
The remainder of the company's revenue comes from Watson-Marlow Fluid Technology. This business sells niche pumps and fluid handling products also to a broad range of industrial customers.

Spirax-Sarco has prospered by selling products that help its customers improve their performance in the following ways:

- Lower energy costs
- Low carbon dioxide emissions
- Water savings
- Higher productivity
- Better reliability

It employs a direct sales force to sell to customers rather than selling through distributors. Most of its products relate to a company's ongoing operating and maintenance costs rather than big capital projects. This explains why its sales and profits have been so resilient over the years. By forging customer relationships and designing innovative new products, Spirax-Sarco has been able to keep growing year after year.





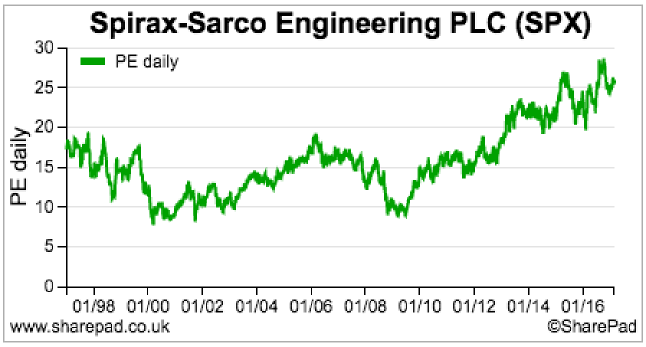
The company is a stickler for keeping levels of investment in its business high which does impact on its free cash flow conversion ratios. Generally speaking though, it is good at turning its profits into cash.

This fantastic and consistent investment performance has seen it increase its dividends for shareholders for the last 24 years, with little sign of this trend being broken going forward.

2016 was another good year for Spirax-Sarco despite lacklustre industrial production trends. Watson-Marlow saw good underlying growth but growth was more modest in the Steam business. Sales and profits received a significant boost from the devaluation of the pound which increased the value of overseas sales and profits when translated into Sterling. The company should get a further boost from a weaker pound in 2017.

The company is confident of making further progress and maintaining its high profit margins. Numis Securities is forecasting EPS of 193p in 2017, rising to 205.3p in 2018. At 4760p, this puts the shares on a 2017 PE of 24.7 times, falling to 23.2 times in 2018. That's a high valuation even given the high quality of company's businesses.

In SharePad, you can now look at the rolling PE of a company over time. As we can see from the chart below, Spirax-Sarco's valuation on this measure has never been as high.



This is a share that most long-term investors would be happy to have in their portfolio but perhaps not at current prices. A worthy addition to anyone's watchlist.

Filter of the week - Long-term growth companies that keep on growing

Filters are the start of an investment process, not the end. One of the great things I like about SharePad is how customisable its filtering is. I can get it to try and answer questions that would otherwise take me ages.

This one is looking for companies that have grown their turnover and EPS for at least 10 years and are expected to keep on growing them. I was surprised to find out how few had been able to achieve this. I'll leave you to work out whether this fact makes these companies good investments today.

Filtered LSE Shares sorted by forecast Yield (3 matches)

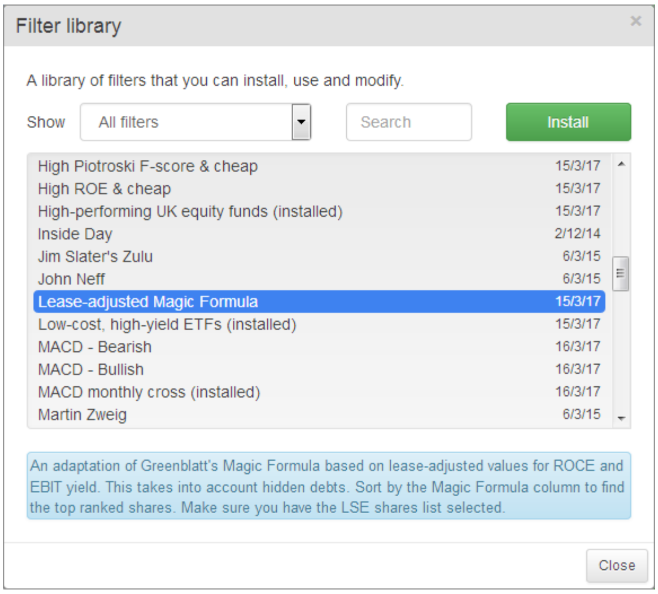
10 years turnover & EPS growth Add criteria | i | Exit

Criteria	Min	Max
forecast Turnover change %	5	
Turnover years of growth	10	
Normalised EPS years of growth	10	
forecast Normalised EPS change %	5	

No.	TIDM	Name	Price	Turnover 1y %chg	1y fc Turnover 1y %chg	Turnover yrs gr	Norm EPS yrs gr	fc Norm EPS %chg
1	DOM	Domino's Pizza UK & IRL PLC	323.55p	▲13.8	▲17.7	20	16	▲25.3
2	BNZL	Bunzl PLC	£23.125	▲14.5	▲9.2	12	12	▲24.5
3	ABC	Abcam PLC	875.25p	▲19.2	▲26.4	13	10	▲16.0

We have been busy behind the scenes upgrading our library of filters for SharePad. As well as the filters which copy the strategies of legendary investors we have added some new ones as well. We have provided the filters from my weekly articles and a wide range of valuation, growth, income and quality-based filters. There is also a range of technical and momentum filters. In all, there are now more than 50 different filters in the SharePad library – and we'll be adding more.

Some examples are shown in the screenshot to the right. We hope you will find them useful. I'll be writing an article about some of them shortly.



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