Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

14th July 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	7421.73	▲1.15	▼-1.05	▲3.9	▲11.3	7547.63	6634.4	2/6/17	3/8/16
FTSE 250	19302.2	▼-0.345	▼-2.81	▲6.78	▲15.2	20024.9	16727.3	26/5/17	15/7/16
FTSE SmallCap	5599.07	▲0.308	▼-0.559	▲8.86	▲21.9	5661.48	4595.04	26/5/17	13/7/16
FTSE AIM 100	4794.96	▲0.558	▼-1.43	▲17.8	▲38.3	4969.33	3452.44	2/6/17	14/7/16
S&P 500	2443.25	▲1.39	▲0.119	▲9.13	▲13.5	2453.46	2085.18	19/6/17	4/11/16
UK Treasury 10 Year Par Yield	1.28	▼-3.76	▲21.9	▲0.787	▲50.6	1.54	0.61	26/1/17	12/8/16
Brent Oil Spot $	$47.4645	▼-1.08	▼-1.62	▼-16.4	▲1.95	$56.965	$41.965	29/12/16	2/8/16
Gold Spot $ per oz	$1221.62	▼-0.101	▼-3.61	▲6.18	▼-9.22	$1363.18	$1128...	2/8/16	15/12/16
GBP/USD - US Dollar per Bri...	1.29297	▼-0.298	▲1.42	▲5.28	▼-1.44	1.34149	1.20401	6/9/16	16/1/17
GBP/EUR - Euros per British...	1.1337	▼-0.15	▼-0.334	▼-3.47	▼-4.12	1.2023	1.1066	14/7/16	13/10/16

If my own experience is anything to go by then it's getting harder to make money from shares at the moment. My own portfolio was ticking along nicely until around a month ago but has since been behaving a bit like a tyre with a slow puncture - slowly losing a little bit seemingly on most days.

I have to say that I am not really worried by this. This is what stock market investing is all about. My view is that the gains we have seen over the last couple of years have felt a little bit too easy and in many cases have been difficult to justify given the business performance of companies.

What we have seen is a kind of momentum mania where shares that have gone up in price keep on doing so. In many cases - companies such as boohoo.com and Fevertree spring to mind - valuations have been cast aside. A good business which tells investors that profits will be higher than previously expected has seen a voracious appetite for its shares.

Now it seems that this phase is coming to an end. Companies are finding it harder to keep on growing their sales and profits. This has clearly been seen with high quality companies in the mid-cap FTSE 250 index. JD Sports is a fine example. It recently said that it has had to cut prices - read lower margins - to maintain sales growth. In a couple of days its shares derated from a forward PE of just over 20 to 15. It seems that a similar derating exercise is going on at Domino's Pizza where the risk of a profits warning is increasing in my opinion.

These kinds of markets are to be welcomed by long-term patient investors as good businesses can be offered for sale at more reasonable prices. I must admit to picking up a few shares of JD Sports at 350p (note: this is not a recommendation, please do your own research) and have seen since it drift lower but I am not losing sleep over it.

One of the other things I am trying to do is tune out from all the noise in the markets. I am not looking at my portfolio valuation. Instead I have set up news alerts in SharePad which get emailed to my mobile phone to let me know if anything important is happening with my shares. This approach takes a lot of the stress out of investing and allows you to concentrate on more important things in life such as enjoying the lovely summer weather. I strongly recommend that you give this a try.

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	CIU	Cape PLC	▲44.6
2	PMO	Premier Oil PLC	▲23.3
3	FENR	Fenner PLC	▲18
4	GOCO	Gocompare.com Group PLC	▲12.5
5	GFRD	Galliford Try PLC	▲9.45
6	KAZ	KAZ Minerals PLC	▲8.13
7	PHI	Pacific Horizon Investment Trus...	▲7.12
8	RSW	Renishaw PLC	▲6.85
9	RWA	Robert Walters PLC	▲6.65
10	SYNC	Syncona Ltd	▲5.91

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	CLLN	Carillion PLC	▼-70.8
2	OPHR	Ophir Energy PLC	▼-16.3
3	IMG	Imagination Technologies Grou...	▼-14.5
4	GEMD	Gem Diamonds Ltd	▼-12.7
5	EXI	Exillon Energy PLC	▼-12.5
6	OXB	Oxford BioMedica PLC	▼-10.5
7	HSW	Hostelworld Group PLC	▼-9.31
8	NOG	Nostrum Oil & Gas PLC	▼-9.08
9	PSON	Pearson PLC	▼-8.97
10	DC.	Dixons Carphone PLC	▼-8.16

Share Discussion: Carillion (LSE:CLLN)

The share price of support services and construction company Carillion has been under a cloud for some time. On Monday this week that cloud burst as the company announced a terribly downbeat trading update.

It said that profits for 2017 would be lower than expected but what was worse was the huge provisions - totalling £845m - for construction contracts which have become loss making. The final kick in the teeth for shareholders was that the dividend was being scrapped.

I am not really surprised at this and, given that Carillion was one of the most shorted stocks on the London market, neither were many professional investors. Carillion had been too reliant on acquisitions - and the cost savings it could extract from them - in order to grow. When the cost savings ran out growth stalled. This was why it tried to buy Balfour Beatty a couple of year ago in my opinion.

Its burdensome pension fund deficit has been consuming lots of cash flow and the company had been reliant on selling stakes in PFI investments to pay its dividend. This is because it has generated insufficient free cash flow to do so as shown in the table on the right.

Year	Free cash flow	Cash dividends	Gap	Disposals	Gap after disposals
2010	144.1	61.4	82.7	45.8	128.5
2011	126.8	68	58.8	31.4	90.2
2012	-22.7	78.6	-101.3	0	-101.3
2013	-71.2	75.7	-146.9	143.7	-3.2
2014	112.2	76.7	35.5	36	71.5
2015	56.5	80	-23.5	54.1	30.6
2016	44	78.9	-34.9	47.1	12.2
Cumulative	**389.7**	**519.3**	**-129.6**	**358.1**	**228.5**

So where does Carillion go from here?

The company by its own admission has too much debt and will look to sell businesses which should bring in around £140m during the next year. The problem is that this will largely be offset by the cash outflow from the huge provision being made against construction contracts both in the UK and overseas.

Carillion is making a provision because the economic benefits from the construction contracts are less than the costs involved in fulfilling them. The company's new finance director is pursuing a welcome approach of being very open and transparent with investors and has helpfully explained how the £845m provision works and the cash flow effects from it. This is shown in the screenshot on the right.

£845m
TOTAL EXPECTED PROVISION

£m	Expected provision
UK	375
Canada	145
Middle East	325
	845

£m	Current position	Impairment provision	Revised position (net)
Receivables	927	(599)	328
Payables	(197)	(246)	(443)
Remaining cash flow	**730**	**(845)**	**(115)***

* Range of £100-£150m

Of the contracts concerned, Carillion now expects to receive £599m less from customers and pay £246m more. This is how the £845m provision is made up. When the contracts end there will be an expected cash outflow of £115m within a range of £100-£150m.

So how is Carillion going to reduce its debts?

Scrapping the £80m dividend helps as does reducing the size of the construction business where working capital movements create volatile cash flows. However, this does not address the problem of Carillion's weak free cash flow relative to the size of its average net debt balance which was £695m at the end of June.

It is not difficult to see why some analysts are suggesting that the company will have to raise a large amount - more than its current market capitalisation of £335m at the time of writing - to shore up its financial position.

Given this uncertain backdrop it begs the question as to how much Carillion shares are really worth?

Stockbroker Numis revised its forecasts on 11th July and is forecasting EPS of 27.2p for 2017 and 2018. At 66p per share this would put the shares on a forecast PE of just 2.4 times. However, the company is making pension top up payments of £47m which are not expensed in the income statement and has a non-cash interest expense - which is in the income statement. Combined these would reduce cash earnings by around £25m or 6p per share and give adjusted cash EPS of 21.2 and raising the PE to 3.1.

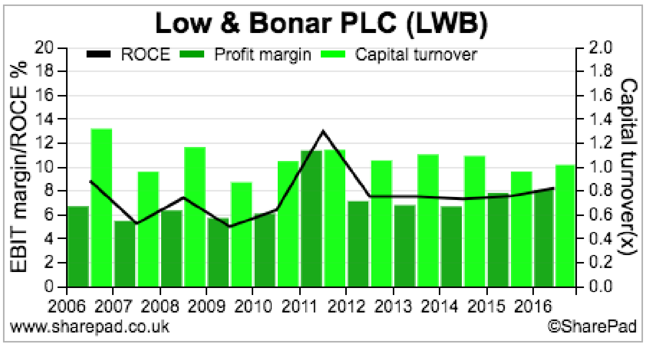
This may be largely irrelevant given that average borrowings of £695m and a pension fund deficit of £711m are over four times the current market capitalisation. My view is that the leverage caused by these huge liabilities are just too big and that a deeply discounted rights issue is a distinct possibility and this is why the share price has continued to fall.

Buying the shares of Carillion now looks to be very risky. However, a credible turnaround strategy combined with the announcement of a rights issue could create an interesting buying opportunity in the future.

Share Discussion: Low & Bonar (LSE:LWB)

Low & Bonar is in the specialist textiles business. It makes different types of textiles for niche markets and applications such as construction, road building, carpet tiles and car mats.

This is a relatively low profit margin and low ROCE business where profits are exposed to the ups and downs of the economic cycle. The company operates in very competitive markets and deals with big customers who have a tendency to exercise a lot of buying power. This means that most profit improvements are relatively hard won.



This week the company released a decent set of half year results with sales and profits up by just over 16%. Like many businesses with significant overseas earnings it has received a significant boost from the devaluation of the pound which has increased foreign earnings when they are translated back into sterling. However, unless the value of the pound has another sharp move downwards, this effect will not be repeated. Underlying sales growth was a more modest 4.6%.

The Building & industrial division saw strong sales growth with improved margins but elsewhere the performance was more mixed. Civil engineering made no profit and the largest profit centre of Interiors and Transportation saw profits fall due to higher costs. Coated textiles saw flat sales but improved profits.

Low & Bonar PLC (LWB)

← Prev Next →	2015	2016	2017	2017	2018	2019
Fiscal period ending	30/11/15	30/11/16	31/5/17	1/11/17	1/11/18	1/11/19
£ millions unless stated	Q4	Q4	TTM	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	362.1	400.0	429.7	430.2	442.4	469.7
EBIT	25.7	29.7	31.9	-	-	-
Norm Pre-tax	21.8	24.8	28.0	34.7	37.9	41.4
EBIT margin	7.1	7.4	7.4	-	-	-
EPS(p)	4.5	4.8	5.5	7.1	7.8	8.7
EPS % chg	▲3.9	▲6.9	▲21.1	▲47.3	▲9.9	▲11.5
DPS(p)	2.8	3.0	3.0	3.2	3.3	3.6
DPS % chg	▲3.0	▲7.9	▲8.9	▲6.7	▲3.1	▲9.1

The company is not expecting a pickup in demand from its key markets and is relying on self-help measures and getting out of underperforming businesses in order to improve its business performance. Analysts are currently expecting some quite respectable rates of earnings growth.

Name	Close	Market Cap. (m)	fc PE	fc Yield	EPV ps (8%)	EPV yield (8%)	fc PEG
Low & Bonar PLC	80p	£263.5	11.3	4.0	36.5p	64.1	1.1

Based on Low & Bonar's earnings power value (EPV) of 36.5p per share, current profits only account for 45% of the current share price (36.5/80). This implies that higher sustainable profits are already priced in.

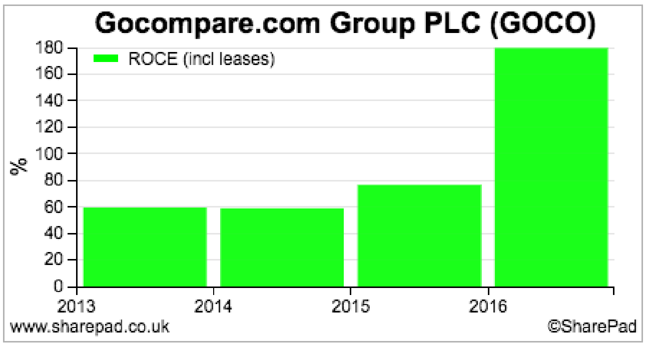
Share Discussion: Gocompare.com (LSE:GOCO)

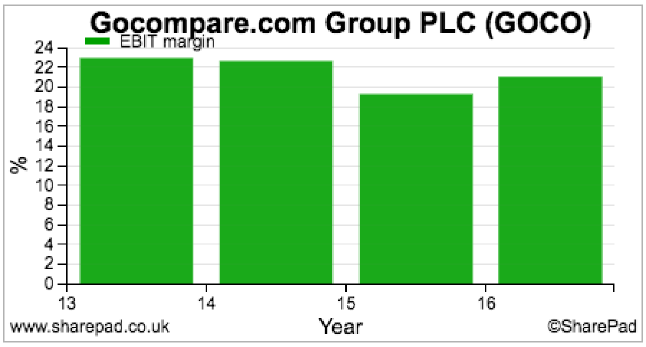
I must admit that I have never bought any product through a price comparison website. I've always felt happier dealing direct with insurers and energy companies directly as I believe I get a cheaper price that way. However, millions of people do choose to use price comparison websites as a way of buying products such as insurance, energy, broadband and mortgages.

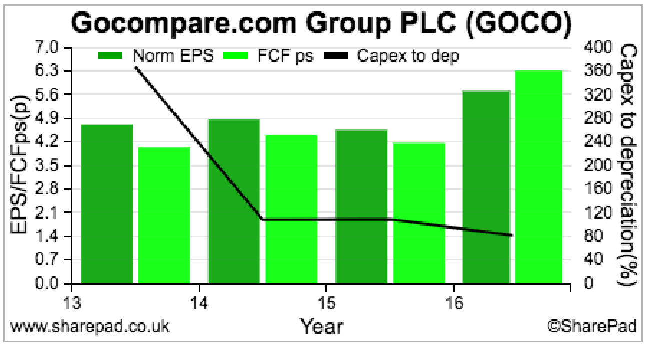
It seems that every other advert on TV these days is for a price comparison website with some quirky annoying thirty seconds of meaningless blurb. I find the one with the meerkats quite amusing but the GoCompare one drives me nuts and have to admit it would put me off buying anything through them.

But that's not the point. All these adverts are trying to do is get you to remember their names and brand. Gocompare has done this with bells on.

Without doubt, the main attraction to investors of owning a slice of a price comparison website is their outstanding profitability. Websites do not need much in the way of capital, whilst the commissions received from selling products make big profit margins after expensing marketing costs (largely adverts) and staff costs.







Gocompare.com has a ROCE of 180% in 2016 which is very impressive but actually not uncommon for website businesses (Rightmove being a case in point here). Given that capex requirements are low, it is also very good at turning its profits into free cash flow.

On the basis of key financial performance indicators I think there's a lot to like about this company. But high returns on capital, high profit margins and good cash conversion on their own are not enough to make a good investment in my view. Companies need to combine these desirable characteristics with profits growth.

This is where things could start to get tricky for Gocompare. My main issue with this company is that it makes virtually all its profits from selling car and home insurance. This is not surprising given that the company was spun off from esure last year.

However, car and home insurance are essentially commoditized products where competition is ferocious and where customers may not necessarily use a price comparison site in order to switch. This is because big insurers such as Aviva and Direct Line do not sell their products through them.

Gocompare knows it needs to broaden its product base into areas such as energy, credit cards, loans and mortgages and is taking steps to do this. This will take some time to have a meaningful impact on its results and takes the company into competition with other sites that have been doing this for years.

At the moment, the lack of product range does not seem to be holding the company back. This week's half year trading update revealed that revenues were up by 4% with operating profits up by 22% as the company continues to improve its marketing margins (commission income less marketing costs). The debt the company was saddled with when it was demerged from esure has also continued to come down which will provide a useful boost to earnings from lower interest costs.

Interestingly there were was little to encourage analysts to increase their forecasts as the company said that it expected full year results would be in line with expectations.

Gocompare.com Group PLC (GOCO)

← 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	113.1	118.9	142.1	154.0	172.2	181.9
EBIT	25.6	22.9	29.9	35.9	41.8	46.6
Norm Pre-tax	25.8	23.1	29.6	33.2	40.1	43.5
EBIT margin	22.6	19.3	21.0	23.3	24.3	25.6
EPS(p)	4.9	4.6	5.7	6.0	7.5	8.3
EPS % chg	▲3.2	▼-6.4	▲25.3	▲5.3	▲25.0	▲10.7
DPS(p)	-	-	-	2.1	2.5	3.0
DPS % chg	-	-	-	-	▲19.0	▲20.0

Having said that, forecasts seem to be quite bullish with a step up in growth rates expected in 2018. The expected growth in turnover seems to indicate that analysts are expecting a contribution from new product lines. Profit margins are also expected to keep on improving.

TIDM	Name	Close	Market Cap. (m)	fc PE	fc Yield	EPV ps (8%)	EPV yield (8%)	fc PEG
GOCO	Gocompare.com Group PLC	112.5p	£470.6	18.8	1.9	52.1p	52.0	0.8
MONY	Moneysupermarket.com Group PLC	356.2p	£1930.0	21.1	3.1	179.3p	49.8	2.1

A lot of this looks to be priced into the shares as the EPVps is well below the current share price. However, Gocompare is cheaper than Moneysupermarket on a forecast PE basis and relative to its expected growth rate as evidenced by a lower forecast PEG ratio.

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