Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

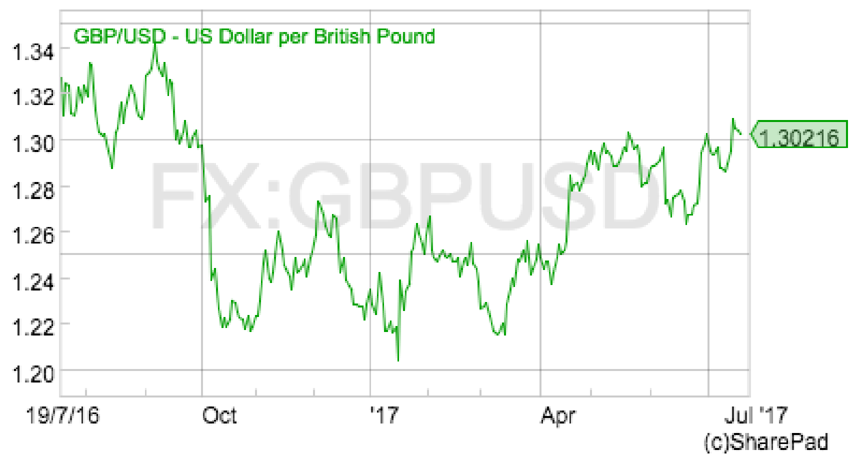
21st July 2017

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	7422.99	▲0.0817	▼-1.34	▲3.92	▲10.8	7547.63	6634.4	2/6/17	3/8/16
FTSE 250	19658.3	▲2.03	▼-1.08	▲8.75	▲16.3	20024.9	16906.3	26/5/17	19/7/16
FTSE SmallCap	5638.44	▲0.803	▲0.23	▲9.63	▲21.4	5661.48	4645.33	26/5/17	19/7/16
FTSE AIM 100	4823.08	▲0.449	▼-1.84	▲18.5	▲38.5	4969.33	3482.1	2/6/17	19/7/16
S&P 500	2466.26	▲0.942	▲0.522	▲10.2	▲14	2466.26	2085.18	19/7/17	4/11/16
UK Treasury 10 Year Par Yield	1.29	▲0.781	▲22.9	▲1.57	▲41.8	1.54	0.61	26/1/17	12/8/16
Brent Oil Spot $	$49.1455	▲3	▲4.94	▼-13.4	▲5.23	$56.965	$41.965	29/12/16	2/8/16
Gold Spot $ per oz	$1243.24	▲1.98	▼-0.0506	▲8.06	▼-6.73	$1363.18	$1128...	2/8/16	15/12/16
GBP/USD - US Dollar per Bri...	1.30362	▲1.12	▲2.4	▲6.15	▼-0.529	1.34149	1.20401	6/9/16	16/1/17
GBP/EUR - Euros per British...	1.13025	▲0.102	▼-1.06	▼-3.76	▼-5.02	1.2021	1.1066	20/7/16	13/10/16

I think there are two economic indicators which investors should be thinking about more and both of them are related to each other. I am talking about the value of the pound and the rate of inflation.

The fall in the value of the pound since the EU referendum has boosted the value of companies' overseas profits when they are translated back into pounds. This effect is beginning to wear off as the pound's value against the dollar is not much different from a year ago. The benefit to translated overseas profits going forward is not big unless we get a further devaluation.



The value of the pound has also pushed up the price of imported goods. Yet this week it was revealed that the rate of inflation was lower than expected mainly due to a lower oil price. The currency will also stop inflation rising if it doesn't fall in value which leads me to believe that inflation threats may be overplayed.

This is good news for investors as lower inflation is beneficial for the buying power of money and the value of future company profits and dividends.

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	LMI	Lonmin PLC	▲45.7
2	CLLN	Carillion PLC	▲16
3	IGG	IG Group Holdings PLC	▲15.4
4	NCC	NCC Group PLC	▲14.1
5	LSL	LSL Property Services PLC	▲11.6
6	KAZ	KAZ Minerals PLC	▲11.1
7	SPD	Sports Direct International PLC	▲11
8	PDL	Petra Diamonds Ltd	▲10.4
9	RPC	RPC Group PLC	▲10.3
10	MCRO	Micro Focus International PLC	▲10.2

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	QQ.	QinetiQ Group PLC	▼-7.47
2	PMO	Premier Oil PLC	▼-6.63
3	RWA	Robert Walters PLC	▼-5.67
4	EZJ	easyJet PLC	▼-5.36
5	STHR	SThree PLC	▼-4.92
6	IAG	International Consolidated Airlines ...	▼-4.49
7	TLW	Tullow Oil PLC	▼-3.98
8	DRX	Drax Group PLC	▼-3.94
9	ASIT	Aberforth Split Level Income Trust P...	▼-3.7
10	GYM	The Gym Group PLC	▼-3.6

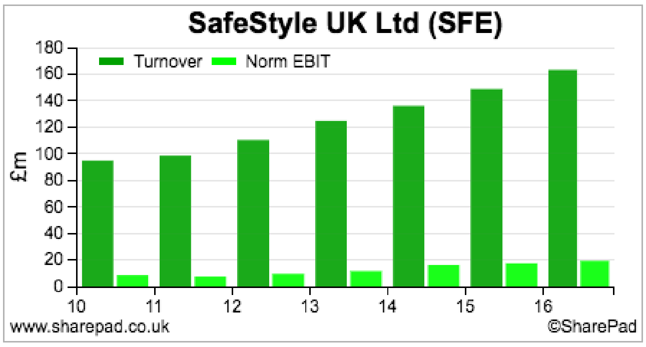
Share Discussion: Safestyle UK (LSE:SFE)

Selling replacement windows and doors is a cutthroat business where competition between suppliers is fierce. Safestyle is the UK market leader with just over 10% of the market which was accounted for by 288,640 window and door installations in 2016.

Historically this market has exhibited significant boom & bust characteristics. Back in 2007 at the top of the last housing market there were around 4.6 million new replacement windows and doors installed in the UK. Today that figure is less than 3 million which shows the toll taken on the industry from the last recession.

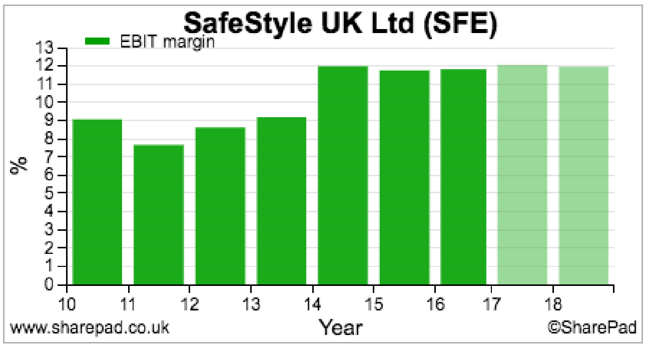
Despite this backdrop, Safestyle has been doing well and has more than doubled its share of the market during the last decade. It makes its own windows and doors from its manufacturing sites in Yorkshire. This gives it a competitive advantage which allows it to position itself as one of the lowest-cost providers in the market and follow a strategy of targeting lower and middle-income households.

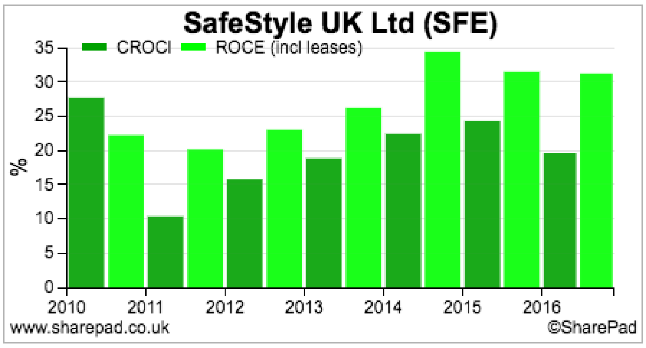
It has 36 sales branches and 13 installation depots across the UK. The company is looking to increase its market share further by targeting areas in the south of England.



A strategy of low-cost manufacturing and low selling prices combined with strong marketing and promotional finance deals (Safestyle offers two years interest free payment terms through third party providers and pays a fee for this) has seen the company prosper in recent years with strong sales and profits growth.

At the same time, it has been able to earn very respectable profit margins and returns on capital employed (ROCE).



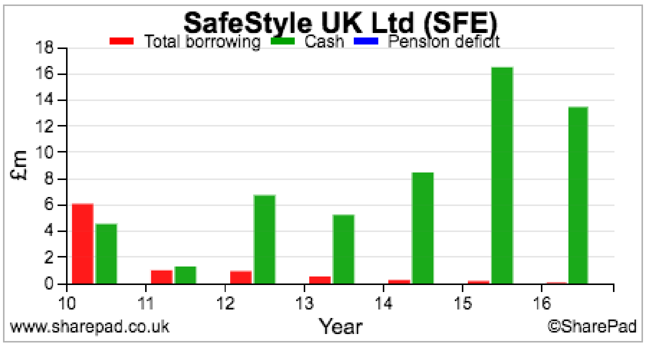


The darker bars in the chart above highlight that the company has been pretty good at generating free cash flow as evidenced by a very respectable CROCI performance.

This is a company that has measured up well on key metrics such as profit margins, free cash flow, cash conversions and returns on capital over the last five years as shown in the table below.

TIDM	EBIT margin	EBIT margin 5y avg	FCF margin 5y avg	TTM FCF margin	Op cash conversion	Op cash conversion 5y avg	Capex to Op. cash flow	Capex to Op. cash flow 5y avg	Lease-adj CROCI (7x, 7%)
SFE	11.8	10.7	7.0	7.0	109.8	109.3	28.0	20.0	19.6

This excellent performance combined with growth goes a long way to explaining why Safestyle's shares more than doubled since it floated on AIM at the back end of 2013.



The company also has a debt-free balance sheet. This is not only a good sign for shareholders as it makes the shares less risky but it is a key marketing tool with which to reassure customers. Smaller windows and doors companies do have a tendency to go bust on a regular basis which can leave customers in difficulties if there is a problem with their purchases.

However, it now seems that Safestyle has hit a sticky patch having announced a profits warning this week. This is not totally unexpected as the company's previous trading statements have highlighted a weakening order intake.

Back in March it said that order intake was up by 4% year on year. That fell to 2% in May and has stayed at that level. The trouble for Safestyle is that it seems that the market has fallen off a cliff. According to FENSA - the industry body – market volumes for the five months to May 2017 fell by more than 10%.

This weak consumer backdrop has led Safestyle to warn that sales growth will be minimal for both its half year and full year results. Profits will be lower for the half year to June and flat for the year to December. Unsurprisingly, Safestyle's shares tanked on this news.

But could there be worse to come?

This has to be a legitimate fear for shareholders. A weak market will see companies scrapping for business. Safestyle is also about to open up a new factory and will be anxious to keep it busy in order to cover the increased fixed costs that will come with it. This raises the possibilities that prices may have to be cut in order to defend market share and keep factory utilisation levels high.

It is also important to acknowledge that Safestyle is operating in a market where quite a few customers fund their purchases with borrowed money. Safestyle's average order size is just over £3,000 which is due to its focus on windows and doors. This leaves it less reliant on credit than companies selling large conservatories. However, weaker consumer confidence may mean that customers decide they can wait to have their windows and doors replaced until they feel more comfortable about their finances.

According to Safestyle around three quarters of the domestic repairs, maintenance and improvement market comes from the over 50s age group who can fund their purchases from pension pots or equity release. It believes that this section of the market will be more resilient.

SafeStyle UK Ltd (SFE)

← 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	136.0	148.9	163.1	165.8	172.2	179.0
EBIT	16.3	17.5	19.3	20.0	20.6	21.7
Norm Pre-tax	16.4	17.6	19.3	20.1	21.1	22.2
EBIT margin	12.0	11.7	11.8	12.1	12.0	12.1
EPS(p)	15.8	17.3	18.9	19.6	20.7	21.8
EPS % chg	▲53.1	▲9.1	▲9.4	▲3.6	▲5.6	▲5.3
DPS(p)	9.3	10.2	11.3	11.7	12.5	13.1
DPS % chg	▲69.1	▲9.7	▲10.3	▲4.0	▲6.8	▲4.8
Dividend cover	1.7	1.7	1.7	1.7	1.7	1.7

Revised analyst forecasts are now reflecting a subdued growth outlook but assume no deterioration in EBIT margins. Along with a continued downturn in trading, I see this as the key risk to forecasts.

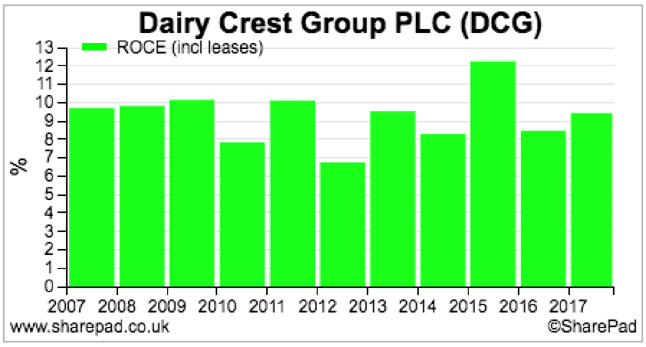
Name	Close	Market Cap. (m)	fc PE	fc Yield	EPV ps (8%)	EPV yield (8%)	fc PEG
SafeStyle UK Ltd	215.5p	£178.4	11.0	5.4	251.4p	117.3	2.0

The shares have lost over 30% of their value over the last week or so and have been savagely derated. They now trade below earning power value which implies that current profits - which are expected to be maintained in 2017 - are not sustainable.

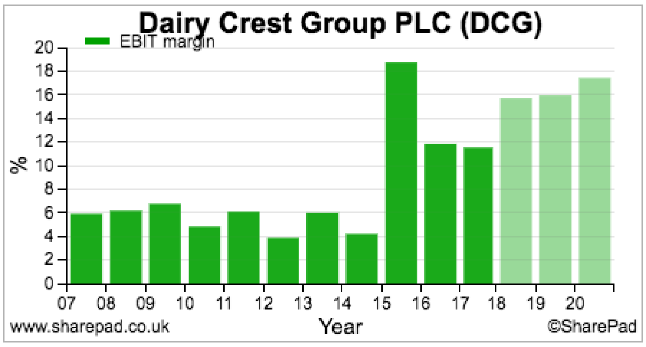
Share Discussion: Dairy Crest (LSE:DCG)

For years Dairy Crest struggled to make decent money from selling milk to supermarkets. This business was very capital-intensive and consequently the company struggled to make decent returns on capital employed (ROCE). In fact, ROCE is actually quite poor and nothing to shout about at all.

A look at the chart on the right shows that Dairy Crest has been a very modest business indeed in terms of its profitability and returns. But I think there are grounds for thinking that the future could be more promising than the past.



Dairy Crest is now out of the milk business and is pursuing a growth strategy focused on four key brands and its whey-based ingredients products. This is expected to feed through to higher profit margins in the years ahead.



The company has four very good food brands in the form of Cathedral City cheese, Clover spread, Country Life butter and Frylight - a one calorie cooking spray - and is putting most of its marketing efforts behind them. These brands regularly find themselves in shoppers' grocery baskets and have significant value.

However, a study of recent results suggests that these brands do not have the same degree of pricing power as some more powerful consumer brands might have. For example, in 2016 there was too much cheese on the UK market and prices fell. Dairy Crest refused to discount aggressively in order to preserve its premium pricing and lost out because of it.

The company is also a big buyer of milk - 500 million litres a year - and is subject to volatile swings in its price that take some time to adjust to. Cream prices have more than doubled over the last year and this is reducing the profit margins of its butter and spreads products.

2017 has started better for the cheese and spreads business with sales for the three months to the end of June up by 7% with Cathedral City sales up 15%. This bodes well for 2017 profits but I expect that profits in future years will continue to have a tendency to move up and down depending on what is happening with milk and cream prices.

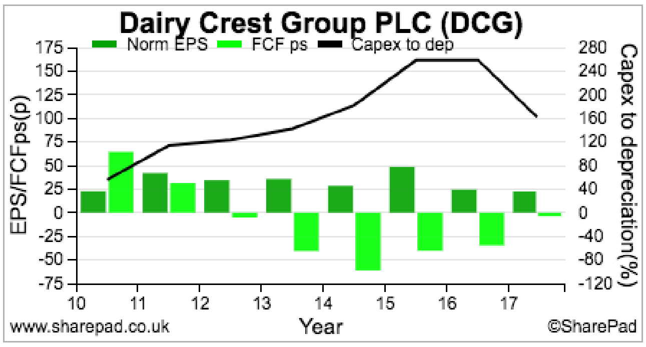
What interests me about Dairy Crest as a potential investment is what's going on in its ingredients business. The company has spent a lot of money developing facilities to produce high grade demineralised whey and galacto-oligosaccharide (GOS) which is used in infant formula products. GOS - a prebiotic which helps digestion and gut health - also has the potential to be used in animal feed and human food products. It is selling these high value products under contract to a New Zealand company called Fonterra, the world's biggest milk supplier.

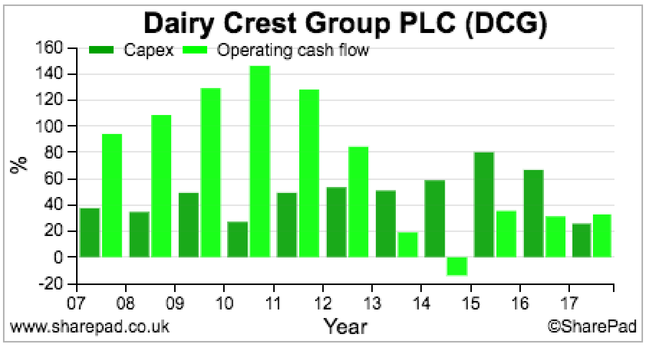
Dairy Crest has invested £75m at its plant in Davidstow, Cornwall to pursue this project which will take a few years to pay off. But if it does, I would expect it may well be able to contribute to an improvement in Dairy Crest's profit margins and ROCE.

One thing that Dairy Crest has to improve on is its awful cash flow performance in recent years. Its capex ratios have been very high whilst its operating cash flow conversion has been awful.

TIDM	EBIT margin	EBIT margin 5y avg	FCF margin 5y avg	TTM FCF margin	Op cash conversion	Op cash conversion 5y avg	Capex to Op. cash flow	Capex to Op. cash flow 5y avg	Lease-adj CROCI (7x, 7%)
DCG	11.5	10.5	-7.0	-1.2	68.2	34.7	78.0	71.8	1.7

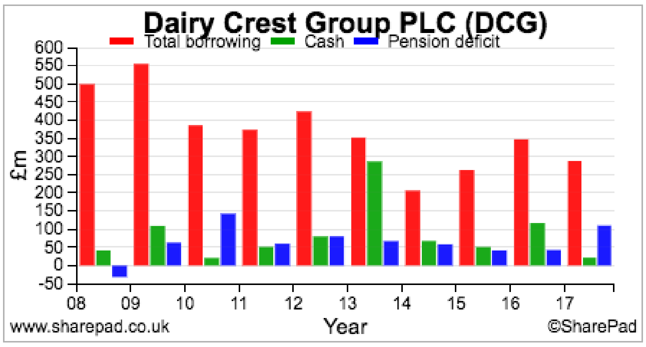
You can see from the chart below how bad Dairy Crest has been at turning its EPS into free cash flow per share.





However, the light at the end of tunnel may be in sight as capex has been coming down now that it is out of the milk business.

Operating cash flow has been pretty poor in recent years due to high one-off cash costs such as double running costs of having two ingredients facilities. This will end soon. So hopefully Dairy Crest shareholders should see higher operating cash flows and lower capex which means higher free cash flows. This can be used to pay higher dividends and reduce debt. Either way it should help to increase the value of Dairy Crest's equity.



Dairy Crest should be able to grow its earnings and dividends at a modestly decent rate going forward. At just over 15 times forecast earnings and a prospective dividend yield of over 4%, I don't think its shares are desperately expensive.

Dairy Crest Group PLC (DCG)

← Prev Next →		2015	2016	2017	2018	2019	2020
Fiscal period ending		31/3/15	31/3/16	31/3/17	1/3/18	1/3/19	1/3/20
£ millions unless stated		Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS							
Turnover		448.2	422.3	416.6	457.7	470.9	473.9
EBIT		84.1	50.0	48.1	71.9	75.2	82.5
Norm Pre-tax		74.2	41.1	39.6	66.0	70.5	72.3
EBIT margin		18.8	11.8	11.5	15.7	16.0	17.4
EPS(p)		48.6	24.5	22.6	37.7	39.8	43.9
EPS % chg		▲71.7	▼-49.7	▼-7.8	▲67.2	▲5.6	▲10.3
DPS(p)		21.7	22.1	22.5	23.4	24.3	25.8
DPS % chg		▲1.9	▲1.8	▲1.8	▲4.0	▲3.8	▲6.2
Dividend cover		2.2	1.1	1.0	1.6	1.6	1.7

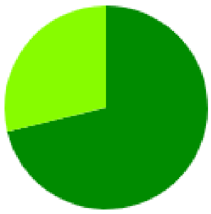
I also wouldn't discount the possibility that Dairy Crest could become a bid candidate perhaps for a food brand and baby food company like Nestle.

Share Discussion: Royal Mail Group (LSE:RMG)

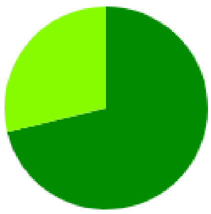
Royal Mail Group (RMG) has proven to be a very disappointing investment. Despite some views that the company was sold off too cheaply by the government and talk of substantial hidden property assets it is the tough economics of the markets that it operates in that have prevailed so far.

Royal Mail Group PLC (RMG)

ACTIVITY BREAKDOWN



Region	Pre-tax	%
UK	398.0m	71.2%
Non-UK countries	161.0m	28.8%



Product	Pre-tax	%
UK Parcel, Intl. and Letters	398.0m	71.2%
General Logistics	161.0m	28.8%

Turnover | Pre tax profit

RMG's letters business is in significant long-term decline. Fewer people and businesses send letters these days. Email, texting and social media are the main forms of communication whilst many bills are settled by direct debit with emailed statements and invoices.

In response to this trend, RMG is looking to take £600m of operating costs out of its business and grow revenues from its parcels division. The problem with cost-cutting is that you eventually run out of costs to cut.

Parcels is a growth market as more business is done over the internet and home shopping becomes the normal way to buy things. The problem is that lots of different companies are chasing a slice of this market.

This has led to lots of capacity in the form of trucks, vans and sheds coming onto to the market which has put downwards pressure on prices. Evidence of this is seen in RMG's trading statement this week where parcel volumes were up by 5% in the three months to the end of June but revenues only increased by 3%.

The ray of light in RMG's parcels business comes from its European network which continues to grow nicely. However, whether this business can be relied upon to drive profit growth for the company as a whole looks to be a case of wishful thinking.

There remains a significant risk of damaging industrial action facing RMG and its shareholders. Significant cost-cutting is never a good backdrop for labour relations but there could be a storm brewing in relation to RMG's final salary pension scheme.

This scheme is in surplus - the previous benefits earned by members was transferred to the government in 2012 - but the surplus is going to run out in 2018. RMG cannot afford the increase in costs that would follow and has therefore closed the scheme to further benefit accruals for its employees.

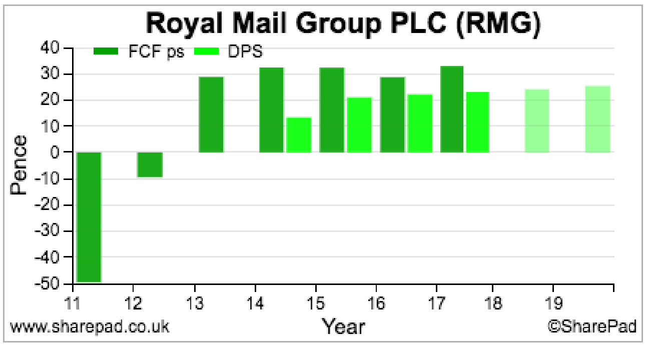
It is trying to soften the blow by offering a bigger lump sum to workers in retirement but the CWU trade union doesn't seem to be very happy about this proposal. There has been no mention of any strike by postal workers but the risk of one never seems to be far away as far as RMG is concerned

Royal Mail Group PLC (RMG)

← Prev Next →	2015	2016	2017	2018	2019	2020
Fiscal period ending	29/3/15	27/3/16	26/3/17	1/3/18	1/3/19	1/3/20
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	9,328.0	9,251.0	9,776.0	9,914.0	10,150.3	10,399.0
EBIT	463.0	320.0	373.0	311.1	548.3	564.0
Norm Pre-tax	515.0	427.0	478.0	299.6	599.9	618.0
EBIT margin	5.0	3.5	3.8	3.1	5.4	5.4
EPS(p)	44.2	36.7	40.8	41.2	43.0	44.5
EPS % chg	▼-70.2	▼-16.9	▲10.9	▲1.1	▲4.4	▲3.5
DPS(p)	21.0	22.1	23.0	24.2	25.4	26.3
DPS % chg	▲57.9	▲5.2	▲4.1	▲5.2	▲5.0	▲3.5
Dividend cover	2.1	1.7	1.8	1.7	1.7	1.7

RMG is running hard to stand still. Analysts don't expect much in the way of earnings growth but continue to expect further dividend growth by running down dividend cover levels.

RMG has been fairly good at maintaining its free cash flow per share in recent years which currently underpins its current dividend and 5.9% forecast yield. But how long can it last?



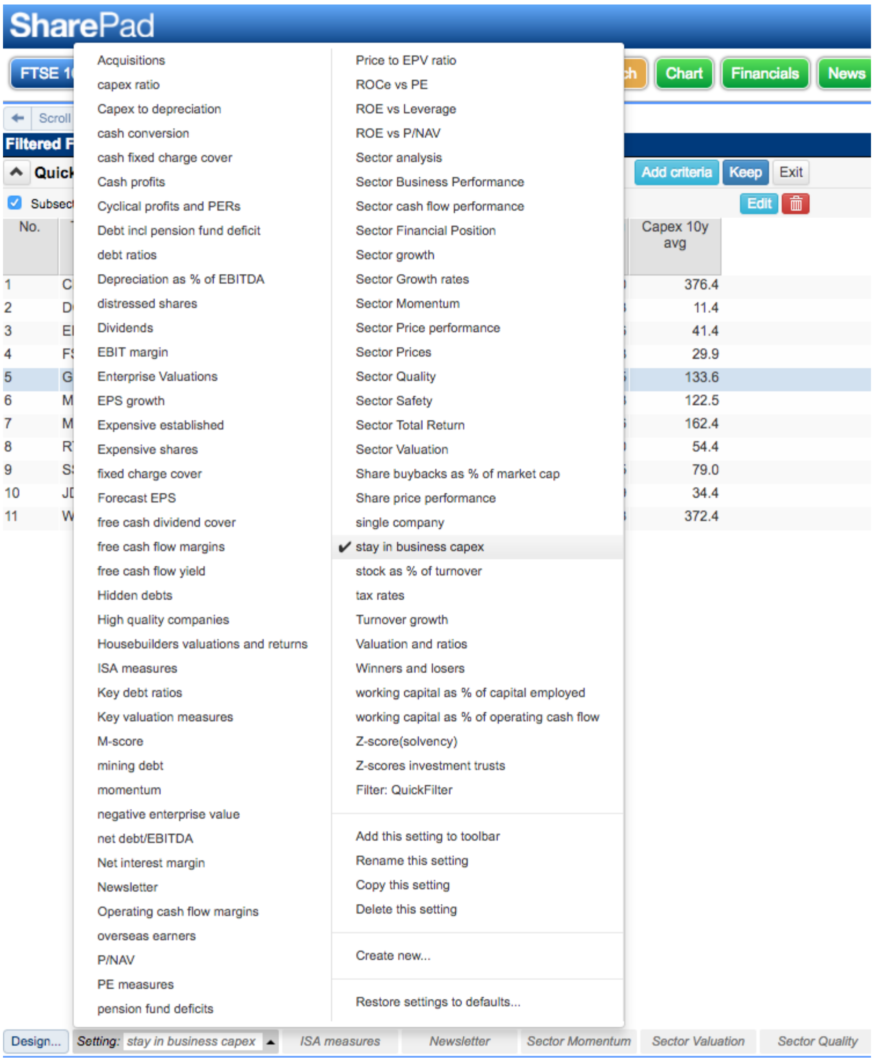
I think there's a chance that its shares could bounce in the short-term if a pension deal is done with the unions but in the long-term its high fixed costs and competitive position make it hard for me to feel positive about RMG. It could be a classic yield trap.

Using SharePad for bespoke financial analysis

Instead of discussing a filter this week, I thought I'd give you some insights into how I use SharePad to do some quite interesting and useful financial analysis.

One of the things I like about SharePad above everything else is how it allows the user to customise it for their own needs. One of the ways I utilise this benefit is by creating different List settings. These allow me to perform the kind of bespoke financial analysis which helps me form an opinion of a company - and save me loads of time in doing so.

Below is a screenshot from my SharePad account. What it is showing is all the customised List settings I have set up and which I can apply to any list, portfolio or individual share.



I spend a lot of time trying to work out an estimate of a company's cash profits. To do this I need to get an estimate of stay-in-business capex. In order to help me in my quest I find it useful to compare the current depreciation and amortisation expense in a company's income statement with cash spent on new assets (capex).

All you need to do this is create a new setting in the List view and add the data columns you want to look at. In the screenshot below, I am comparing capex with depreciation but also with five year and ten year average capex spending.

Filtered FTSE All-Share sorted by Name (11 matches)

QuickFilter — Add criteria | Keep | Exit

Subsector includes **Restaurants & Bars** — Edit

No.	TIDM	Name	Deprec. & amort.	Capex	Capex 5y avg	Capex 10y avg
1	CPG	Compass Group PLC	426.0	578.0	482.0	376.4
2	DOM	Domino's Pizza UK & IRL PLC	7.4	22.5	10.3	11.4
3	EIG	EI Group PLC	16.0	4.0	2.6	41.4
4	FSTA	Fuller Smith & Turner PLC	21.0	35.0	35.8	29.9
5	GNK	Greene King PLC	112.6	194.9	168.5	133.6
6	MARS	Marston's PLC	40.0	143.7	141.8	122.5
7	MAB	Mitchells & Butlers PLC	113.0	167.0	152.6	162.4
8	RTN	Restaurant Group (The) PLC	41.8	65.3	68.0	54.4
9	SSPG	SSP Group PLC	80.7	104.3	82.5	79.0
10	JDW	Wetherspoon (J D) PLC	72.2	33.5	45.9	34.4
11	WTB	Whitbread PLC	220.1	609.8	504.3	372.4

Sometimes, I don't find it very revealing. In the case of restaurants and bars I do. It is telling me that for some companies, capex has been consistently more than depreciation. My next step is to find out whether this is due to opening up lots of new pubs or if companies may be under depreciating and overstating their profits.