Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

11th August 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1 y high	1 y low	Date 1 y high	Date 1 y low
FTSE 100	7389.94	▼-1.13	▲0.27	▲7.62	7547.63	6665.63	2/6/17	13/9/16
FTSE 250	19699.4	▼-1.05	▲1.77	▲11.3	20024.9	17271.2	26/5/17	4/11/16
FTSE SmallCap	5687.89	▼-0.264	▲1.89	▲17	5742.98	4862.54	8/8/17	10/8/16
FTSE AIM 100	5094.84	▲1.95	▲6.07	▲36.8	5144.96	3721.62	8/8/17	17/8/16
S&P 500	2450.35	▼-0.882	▲0.944	▲12.6	2480.91	2085.18	7/8/17	4/11/16
UK Treasury 10 Year Par Yield	1.24		▼-3.13	▲96.8	1.54	0.61	26/1/17	12/8/16
Brent Oil Spot $	$52.6755	▲1.4	▲12.1	▲20.1	$56.965	$43.86	29/12/16	10/8/16
Gold Spot $ per oz	$1284.36	▲1.19	▲5.81	▼-4.7	$1352....	$1128.22	17/8/16	15/12/16
GBP/USD - US Dollar per British ...	1.29827	▼-1.23	▲0.793	▼-0.288	1.34149	1.20401	6/9/16	16/1/17
GBP/EUR - Euros per British Pound	1.10495	▼-0.104	▼-2.23	▼-5.07	1.1972	1.1047	18/4/17	7/8/17

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	STCK	Stock Spirits Group PLC	▲17.5
2	PETS	Pets at Home Group PLC	▲13.8
3	CCH	Coca-Cola HBC AG	▲12.5
4	GMS	Gulf Marine Services PLC	▲10.3
5	UPGS	UP Global Sourcing Holdings PLC	▲10.3
6	WPG	Worldpay Group PLC	▲10.1
7	EVR	Evraz PLC	▲10.1
8	TOWN	Town Centre Securities PLC	▲8.07
9	RPS	RPS Group PLC	▲8.07
10	FXPO	Ferrexpo PLC	▲7.85

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	AA.	AA Ltd	▼-13.6
2	SPT	Spirent Communications PLC	▼-12.6
3	IRV	Interserve PLC	▼-12.3
4	IWG	IWG PLC	▼-11.9
5	GFS	G4S PLC	▼-8.9
6	CSP	Countryside Properties PLC	▼-8.7
7	SRP	Serco Group PLC	▼-8.14
8	GHG	Georgia Healthcare Group PLC	▼-8.11
9	PPB	Paddy Power Betfair PLC	▼-7.65
10	HIK	Hikma Pharmaceuticals PLC	▼-7.47

Shares magazine awards

You are probably getting bored of being asked to vote for us but this time we're asking for your support in the Shares magazine awards. We didn't win this last year, so please vote for ShareScope/ SharePad in the **Best Investment Software Program** category.

We believe we offer the best products and customer service and hope that you agree.

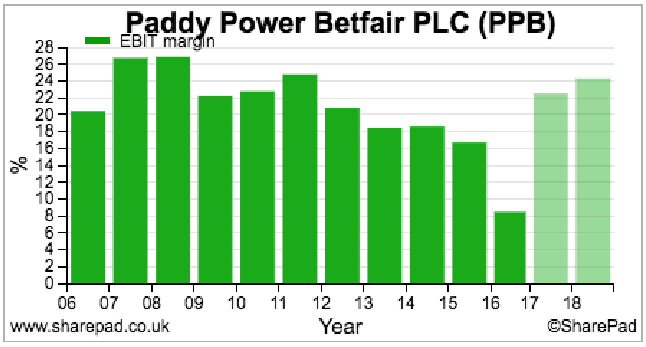
Click here to vote

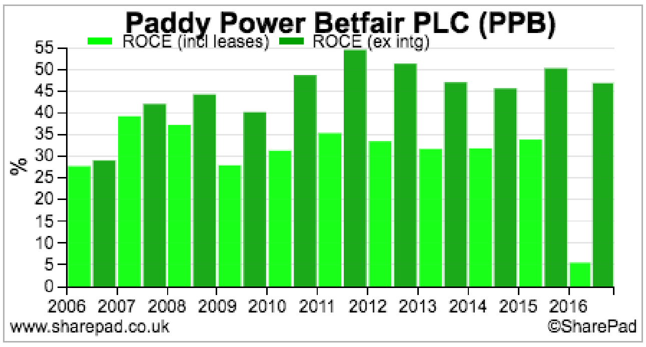
Share Discussion: Paddy Power Betfair (LSE:PPB)

Paddy Power shares have made long-term investors some reasonable money but they have been in a rough patch for the last 18 months or so. Gambling companies share many of the characteristics of other addictive businesses such as tobacco and alcohol in that they can be very profitable but operate with a cloud over them most of the time.

This cloud comes is represented by the constant threat of regulatory or political interference which might reduce their profits.

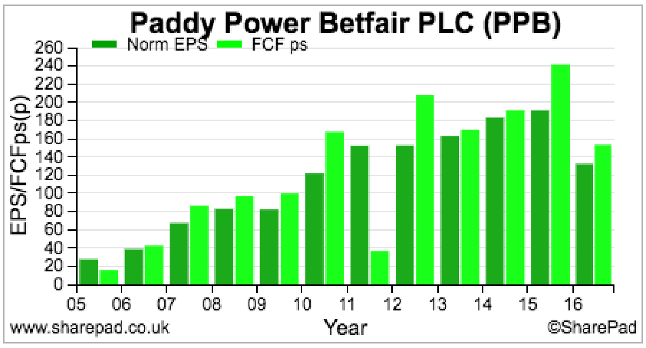
And there are plenty of profits for regulators to eat into. Paddy Power has very decent operating margins which show how profitable it is.

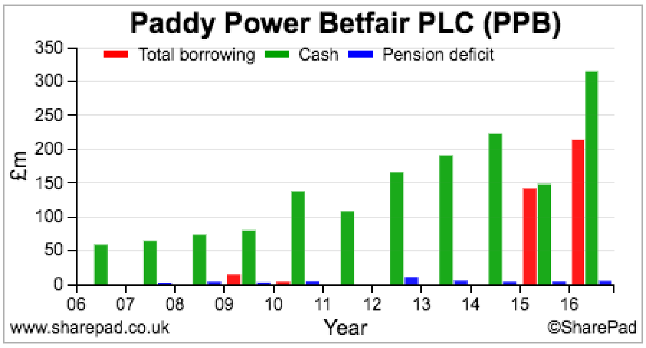




This has helped it to produce very high returns on capital employed. The big fall in ROCE seen in 2016 comes from the merger with rival betting company Betfair which placed a huge amount of goodwill onto the balance sheet. If this intangible asset is ignored, the returns on underlying tangible capital employed remain very impressive.

Cash generation is excellent with free cash flow per share regularly more than earnings per share (EPS) which is a sign of good profit quality.





There are no financial worries either as the balance sheet has a net cash position.

So with Paddy Power ticking a lot of boxes in terms of quality and financial strength why are its shares seemingly in a prolonged downwards trend?

This week has been an eventful one for the company. On Monday, it announced that its chief executive was leaving. He had been credited with much of the company's recent success and the market was caught a little bit off guard by the announcement. Departing CEOs have had a canny knack in recent years of getting out just before trading takes a dive and so there is always a suspicion - warranted or otherwise - that this was the reason behind his departure. Time will tell of course.

The following day Paddy Power announced its half year results for the period to June 30 2017. They didn't read too badly at first glance with decent growth in profits and a 25% hike in the interim dividend.

Look a little closer and you begin to understand why some investors might have cause to grumble a little bit.

Half year Trading profits (£m)	2017	2016
UK & Ireland Online	129	123
Retail Shops	28	23
Australia	46	26
USA	2.5	2.9

Betting is firmly an internet business these days and a very competitive one at that. You only have to watch a football match on TV to see how much competition there is in online sports betting. It seems as if this competition is beginning to hurt Paddy Power.

Sales were flat during the half year but what is more concerning is that the business had 9% fewer customers. The lack of a major football tournament has not helped but Paddy Power is fighting hard to retain customers with better odds and special offers for loyal customers. This costs money and looks like it will be a drag on profits for a while yet but at the moment are being offset from efficiencies from merging with Betfair.

That said, some analysts are also concerned that it is taking too long to integrate the Paddy Power and Betfair businesses and that this is holding the company back.

Australia is performing very well as it seems are the company's UK betting shops where sales and profits saw healthy growth.

The company has said that it expects full year underlying EBITDA to be in the range of £445m to £465m. Consensus forecasts from City analysts appear to be at the bottom of this range.

Paddy Power Betfair PLC (PPB)

← Prev Next →	2013	2014	2015	2016	2017	2018	2019
Fiscal period ending	31/12/13	31/12/14	31/12/15	31/12/16	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS							
Turnover	636.7	715.8	794.3	1,500.8	1,706.1	1,826.4	1,950.7
Norm EBITDA	151.2	172.0	171.1	369.1	445.4	527.0	584.6
EBIT	117.4	133.1	132.7	127.1	384.1	443.5	496.4
Norm Pre-tax	120.6	135.3	132.1	123.6	365.0	435.1	496.4
EBIT margin	18.4	18.6	16.7	8.5	22.5	24.3	25.4
EPS(p)	163.2	183.1	191.2	132.4	374.3	446.3	488.4
EPS % chg	▲6.9	▲12.2	▲4.4	▼-30.7	▲182.6	▲19.2	▲9.4
DPS(p)	135.0	151.9	180.0	153.0	187.1	223.1	244.2
DPS % chg	▲12.5	▲12.6	▲18.5	▼-15.0	▲22.3	▲19.2	▲9.5
Dividend cover	1.2	1.2	1.1	0.9	2.0	2.0	2.0

The company should be able to grow its profits from realising the cost savings from the Betfair merger but these will eventually wear off and growth will have to come from higher revenues or acquisitions. Of more concern is the fierce competition in internet betting in the UK as well as the growing regulatory threat in its key markets.

In Australia, taxes on betting companies are going up. From March 2018 there will also be a ban on TV advertising by betting companies from five minutes before a sporting event begins until five minutes after it finishes between 5am and 8.30pm. This is something that could find its way over to the UK in my view.

Later this year the government will announce the findings of its review into fixed odds betting terminals (FOBT) which are found in betting shops and are cited as major causes of gambling addiction. There is talk of reducing the maximum allowable stake on a FOBT from £100 to as low as £2. This would undoubtedly have a severe impact on the profitability of Paddy Power's 620 betting shops and could decimate companies such as Ladbrokes/Coral and William Hill.

TIDM	Name	Price	Market Cap (m)	fc PE	fc Yield	fc Dividend cover
PPB	Paddy Power Betfair PLC	£72.40	£6180.9	19.3	2.6	2.0
LCL	Ladbrokes Coral Group PLC	128.1p	£2298.5	11.0	3.0	3.1
GVC	GVC Holdings PLC	764p	£2225.3	14.7	3.8	1.8
WMH	William Hill PLC	256.1p	£2173.2	10.7	5.0	1.9
888	888 Holdings PLC	249p	£899.8	17.2	5.1	1.1

Despite the concerns about growth and regulation it could be that the main problem with Paddy Power shares is that they are just too expensive and don't reflect the possible downside risks.

The gambling sector is one that many private investors shun for understandable ethical reasons as well as the regulatory risks. However, I do think this sector is interesting and will see more takeovers in the future. Investors looking to play that theme may wish to spend some time looking at GVC Holdings - a prominent industry consolidator - and 888 Holdings - long seen as a takeover target.

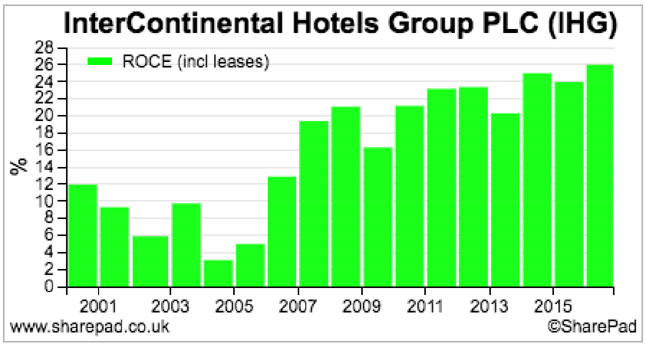
Share Discussion: InterContinental Hotels Group (LSE:IHG)

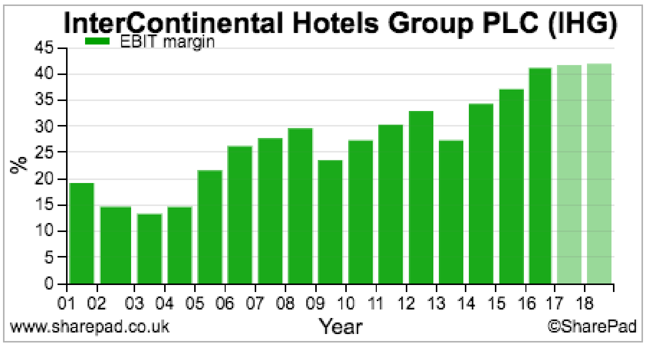
InterContinental Hotels Group (IHG) is one of the biggest hotel operators in the world. It is not one of the biggest owners as it has turned itself into a franchisor over the years by selling its hotel assets.

I am a big fan of franchise owners - provided the underlying product or service is good of course - and think they can make great long term investments. The reason for this is that they can be very profitable without having to invest lots of money to grow.

They collect royalty fees from franchisees (often a percentage of their turnover) and pass on most of the costs of running the business to the franchisees. Domino's Pizza is another very good example of a very profitable franchising business listed on the UK stock market.

Take a look at the trend in IHG's ROCE. Back in the early 2000s it was very modest as it was burdened with the large assets of big, plush hotels across the world. In 2005, it started selling these hotels and turning itself into a franchisor where it owned the InterContinental and Holiday Inn brands but not the actual hotels themselves. ROCE was transformed and has remained impressive ever since.

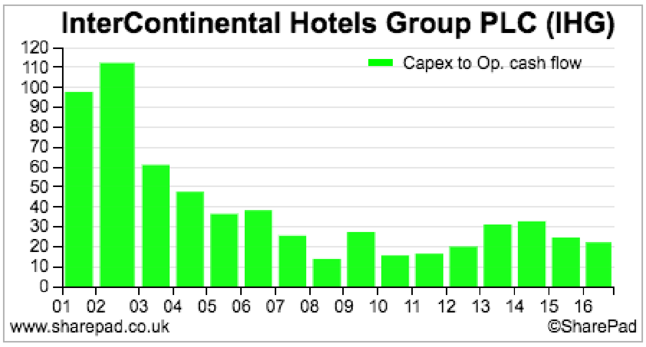


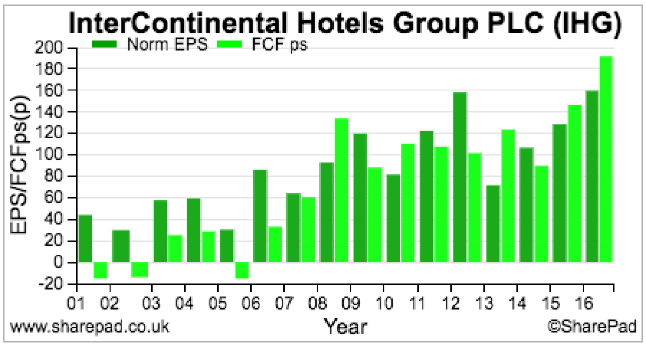


The same can be said for profit margins which are over 40%.

Without having to maintain and buy lots of hotel assets IHG's capex intensity plummeted. This meant it was able to keep hold of more of the cash generated by its business.

Free cash flow surged as a result which has helped to pay a growing dividend as well as several capital returns to shareholders.





IHG is a very good business in my opinion and one I would quite like to own a slice of. For me to buy this share I need to be comfortable with two key criteria:

1. Whether there is sufficient future profits growth potential.
2. Can I buy the shares at a reasonable price?

Let's look at the issue of profits growth first.

IHG is currently operating 777,675 hotel rooms across the world. It does manage a small amount of these rooms itself buy most are looked after by a network of 2,000 franchisees. The Americas is by far its most important market. This area along with China is where the company is targeting the bulk of its future growth.

As you can see, IHG has 229,526 rooms in its pipeline - including a new mid market brand for the US market - which would increase its overall size by nearly a third. Note that the company does remove rooms from its system in order to try and keep quality high and profits growing.

Appendix 3: Half Year System & Pipeline Summary (rooms)

	System					Pipeline	
	Openings	Removals	Net	Total	YoY%*	Signings	Total
Group	22,857	(12,317)	10,540	777,675	3.7%	31,773	229,526
Americas	10,618	(8,662)	1,956	489,949	1.6%	15,814	102,578
Europe	1,443	(1,150)	293	110,362	3.6%	3,128	23,974
AMEA	6,910	(1,029)	5,881	81,932	11.6%	3,003	34,807
G. China	3,886	(1,476)	2,410	95,432	9.3%	9,828	68,167

Growing the number of rooms is the first part of the growth strategy. That is all well and good but those rooms have to be very profitable. The key determinant of hotel profitability is the revenue per available room or RevPAR for short. RevPAR is calculated by taking the average room rate for a period and multiplying it by the occupancy rate. Ideally you want to see both these variables increasing.

Appendix 1: Comparable RevPAR Movement Summary

	Half Year 2017			Q2 2017		
	RevPAR	Rate	Occ.	RevPAR	Rate	Occ.
Group	2.1%	0.8%	0.9%pts	1.5%	0.9%	0.4%pts
Americas	1.1%	1.1%	0.0%pts	0.1%	0.9%	(0.6)%pts
Europe	6.2%	3.2%	2.0%pts	5.5%	3.3%	1.6%pts
AMEA	1.4%	(1.2)%	1.9%pts	2.7%	0.2%	1.7%pts
G. China	4.1%	(1.1)%	3.2%pts	4.4%	(0.8)%	3.4%pts

RevPAR growth was a very modest 2.1% in the first half of the year but what is more concerning is that it slowed during the second quarter. Occupancy fell in the Americas, whilst room rates fell in China. Europe looks to be strong whilst occupancy increased in China on the back of lower room rates.

Overall trading profits increased by 8% in dollar terms but a significant chunk of growth came from cost cutting and efficiency improvements. Without this, operating profits would have increased by 4.9%. That's alright but nothing stellar by any means.

InterContinental Hotels Group PLC (IHG)

← Prev Next →	2013	2014	2015	2016	2017	2018	2019
Fiscal period ending	31/12/13	31/12/14	31/12/15	31/12/16	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS							
Turnover	1,222.4	1,130.6	1,180.1	1,270.5	1,387.4	1,460.9	1,508.3
Norm EBITDA	388.0	445.4	500.7	592.6	660.6	682.6	722.2
EBIT	333.4	387.0	437.9	521.5	578.4	612.7	637.8
EBIT margin	27.3	34.2	37.1	41.0	41.7	41.9	42.3
EPS(p)	71.5	106.8	128.5	159.5	191.5	209.4	209.5
EPS % chg	▼-54.8	▲49.3	▲20.4	▲24.1	▲20.1	▲9.3	▲0.0

Growth in sterling profits should be reasonable this year as IHG benefits from a full year effect of a weaker pound but a weakening US market might unnerve some investors and make them think that 2018 forecasts might not be that safe.

TIDM	Name	Price	Market Cap (m)	fc PE	fc Yield	fc Dividend cover
MAR	Marriott International Inc Cl A	$103.95	$38848.7	26.2	1.1	3.4
IHG	InterContinental Hotels Group PLC	£41.64	£7911.2	21.7	2.1	2.2

I think the quality of a business such as IHG deserves to be highly valued by the stock market - and it is. The shares are also significantly cheaper on a PE basis than Marriott but that might be because Marriott is expensive.

But will IHG shares re-rate to a higher multiple having done so over the last couple of years? Without forecast upgrades this is unlikely in my view. Given the current valuation and outlook, my best guess is that the shares can continue to make modest gains in line with earnings growth.

I am sticking this share on my watchlist for now because I think it is a fabulous business. I'd be interested in buying some on a forecast PE of 18-19 times but at the moment I am not willing to pay more.

Share Discussion: Could Johnston Press (LSE:JPR) be a really cheap share or a very high risk value trap?

Despite this share trading on only 1 times it annual estimated EPS, I view the company as a classic and very dangerous value trap. I'm not sure that the equity is worth anything now intrinsically or will be worth anything in a couple of years' time.

The company has a market capitalisation of £12.3m. This is compared with net borrowings of £191m and a pension fund deficit of £53.1m at the end of June 2017.

Johnston Press is a local newspaper publisher with around 200 titles including The Scotsman and The Yorkshire Post. Last year it bought the i newspaper from The Independent.

Local newspaper businesses have been hammered by the internet and the growth of Google and social media. This has meant that very lucrative classifieds advertising revenue has moved away from the likes of Johnston Press.

This company is in deep trouble because of these trends and very large debts.

Most of its trading cash flows are being eaten up by plugging the pension fund deficit (around £5m per year) and paying the interest on £220m of bonds at a rate of 8.625% (£19m per year). Last year the company had negative free cash flow of £31m.

Even though the company's first half loss narrowed this year due to a decent performance from the i and growth in non classified digital advertising, the shareholders look all set to be wiped out when the £220m bond is due to be repaid on 1 June 2019.

Reconciliation of statutory net debt to net debt excluding mark-to-market

	1 July 2017 GBPm	2 July 2016 GBPm	31 December 2016 GBPm
Outstanding principal amount	220.0	220.0	220.0
Cash and cash equivalents	(28.8)	(10.6)	(16.1)
Net debt excluding mark-to-market	191.2	209.4	203.9
Mark-to-market on Bond(1)	(68.2)	(67.3)	(72.6)
Bond discount (net) at launch	(4.4)	(4.4)	(4.4)
Statutory net debt	118.6	137.7	126.9

The company has £28.6m of cash. Even if it somehow repurchased all the bonds in the market at a 31% discount from their par value (due to the very real risk of default) there is unlikely to be sufficient asset value in the business to leave anything left over for shareholders.

The carrying amounts of the publishing titles by cash generating unit (CGU) is as follows:

	31 December 2016 GBP'000	Impairment GBP'000	1 July 2017 GBP'000
Scotland	9,436	-	9,436
North	64,430	-	64,430
Northwest	9,734	-	9,734
Midlands	2,903	-	2,903
South	19,452	(4,513)	14,939
Northern Ireland	13,590	-	13,590
The i	24,000	-	24,000
Total carrying amount of publishing titles	143,545	(4,513)	139,032

On the current most rosy scenario the company has net debt and pension fund liabilities of £171.7m. It has been regularly writing down the value of its newspaper titles which now have a carrying value of £139m as shown in the table below.

This leaves a gap of £32.7m or £100.9m including the £220m par value of the bonds in 2019. Consequently, it is difficult to see any intrinsic equity value in Johnston Press. The company had this to say in it's recent half year results to the stock exchange:

> *"The repayment of the GBP220 million of high yield Bonds on 1 June 2019 falls within the three year period of this viability review.* ***The Directors anticipate that the Group will remain in a position to meet its obligations in respect of the Bonds, including with regard to the payment of interest, in the period to their maturity****. However, in light of the challenges faced by the industry as a whole, the current trading experience of the Group, and the likely financial position of the Group at the time the Bonds are due for repayment in June 2019* ***there is uncertainty surrounding the Group's ability to refinance the Bonds at par in the debt markets on commercially acceptable terms. Failure to repay,***

> ***refinance, satisfy or otherwise retire the bonds at their maturity would give rise to a default under the indenture governing the Bonds dated 16 May 2014 and could have a material impact on the Group's operations and its ability to continue as a going concern****. As a result, the Directors, along with the Group's advisors, are currently exploring the strategic options available to the Group in the event that a refinancing of the Bonds in the debt markets prior to June 2019 is not possible."*

It then went on to say:

> *"On 29 March 2017 when the Group presented the Viability Statement above it also announced a Strategic Review working with our advisers Rothschild and Ashurst LLP, to assess the financing options open to the Group in relation to the GBP220 million 8.625% senior secured notes which become due for repayment on 1 June 2019. As a key part of the strategic review process, the Board has engaged with its major stakeholders, including shareholders, holders of senior secured notes, Pension Trustees and the Pensions Regulator.*
>
> *After a period of initial consultations with the largest shareholders and bondholders* ***we are currently focused on discussions with the Pension Trustees****. The Board is pleased by the continued support of the major stakeholders during the review process."*

In the absence of some sort of miracle I don't think I am sticking my neck out much by suggesting that the current shareholders look doomed.

The company is clearly putting its pension fund first and foremost in its priorities. What I see happening is similar to what happened with Eurotunnel years ago when it could not trade itself to solvency. The bondholders will end up taking a significant haircut in returns for shares and the existing shareholders will be wiped out.