Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

1st September 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7430.62	▲0.318	▲0.795	▲9.57	7547.63	6665.63	2/6/17	13/9/16
FTSE 250	19803.6	▲0.473	▲0.114	▲11.7	20024.9	17271.2	26/5/17	4/11/16
FTSE SmallCap	5715.18	▲0.718	▲0.249	▲16.7	5742.98	4862.64	8/8/17	11/11/16
FTSE AIM 100	5162.65	▲0.878	▲3.86	▲37.8	5162.65	3742.47	31/8/17	1/9/16
FTSE All-Share	4072.98	▲0.358	▲0.662	▲10.2	4130.15	3641.91	26/5/17	4/11/16
S&P 500	2457.59	▲0.763	▼-0.515	▲13.2	2480.91	2085.18	7/8/17	4/11/16
UK Treasury 10 Year Par Yield	1.24		▲0.813	▲90.8	1.54	0.65	26/1/17	31/8/16
Brent Oil Spot $	$50.645	▼-2.91	▼-3.81	▲7.84	$56.965	$44.565	29/12/16	11/11/16
Gold Spot $ per oz	$1307.27	▲1.6	▲3.13	▼-0.195	$1349.15	$1128.22	6/9/16	15/12/16
GBP/USD - US Dollar per British Pound	1.28868	▲0.68	▼-2.35	▼-1.88	1.34149	1.20401	6/9/16	16/1/17
GBP/EUR - Euros per British Pound	1.0833	▼-0.157	▼-2.96	▼-7.98	1.1972	1.0795	18/4/17	29/8/17

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	FDL	Findel PLC	▲22.3
2	PFG	Provident Financial PLC	▲18
3	FOUR	4imprint Group PLC	▲16.8
4	POG	Petropavlovsk PLC	▲16.8
5	CCC	Computacenter PLC	▲16.1
6	EVR	Evraz PLC	▲15
7	OXB	Oxford BioMedica PLC	▲13.3
8	HSW	Hostelworld Group PLC	▲11.6
9	IMG	Imagination Technologies Gro...	▲10.8
10	CMS	Communisis PLC	▲9.41

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	HSS	HSS Hire Group PLC	▼-11.1
2	NANO	Nanoco Group PLC	▼-11.1
3	ENQ	EnQuest PLC	▼-10.6
4	CMBN	Cambian Group PLC	▼-8.01
5	POLY	Polymetal International PLC	▼-7.48
6	MRO	Melrose Industries PLC	▼-6.46
7	CLLN	Carillion PLC	▼-6.13
8	CNE	Cairn Energy PLC	▼-5.87
9	HTG	Hunting PLC	▼-5.85
10	AA.	AA Ltd	▼-5.49

Share Discussion: Avon Rubber (LSE:AVON)

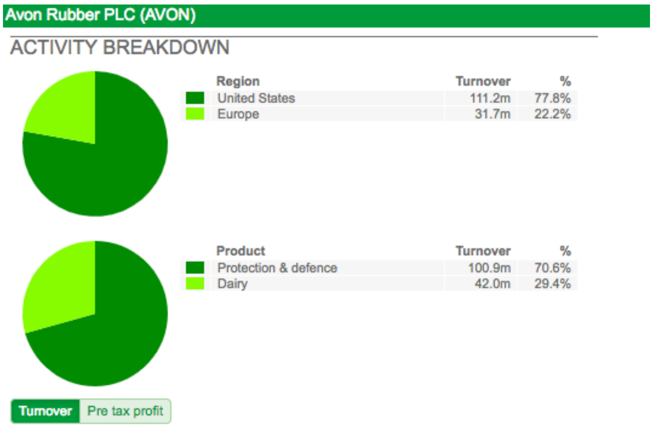
Avon Rubber is not a share that is likely to be on many investors' radar screens. The company has been in business since 1885 and has been involved in many different activities since then. Some of you will be familiar with the Avon Tyres brand but the company sold this business back in 1994.

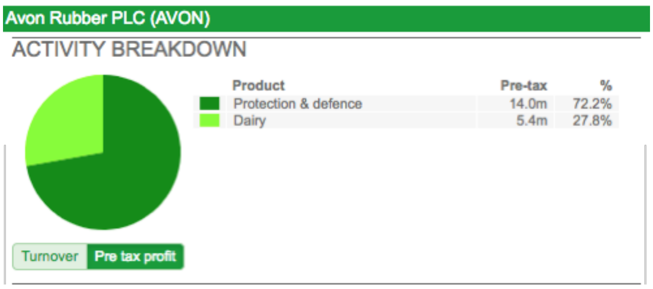
Today Avon Rubber concentrates on two main businesses:

- **Protection Systems** - Avon is a world leader in highly technical and specific protection masks used by the military, security and emergency services. The masks are also used in industrial businesses as well. In addition, it makes thermal imaging cameras and breathing apparatus for fire services.

- **Dairy** - The company makes liners and tubing - under the Milkrite brand - which are used in milking machines. These aim to make the milking process more efficient as well as improving the health of dairy cows. It also makes milking machine components such as pulsators, clusters and milk meters. There is a growing stream of income from replacement parts.

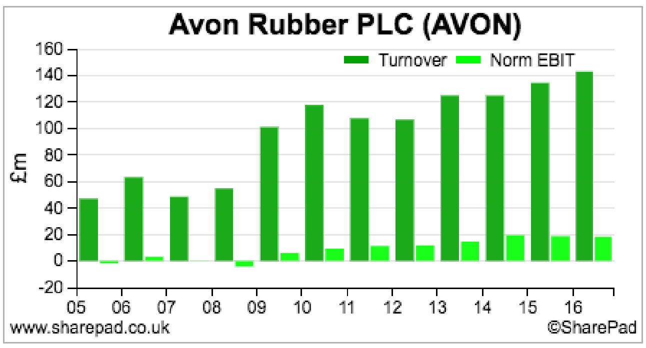
The Protection business dominates the company accounting for over 70% of sales with around half of that coming from the US Department of Defence (DOD). Nearly 80% of total group sales come from the United States as the Dairy business also has a large chunk of its customers over there.

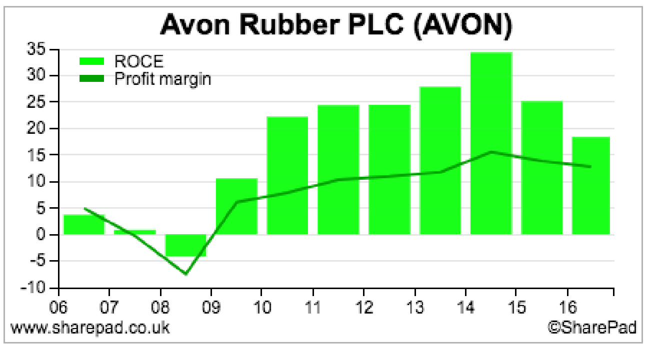




Nearly three quarters of group profits come from the Protection business.

Avon Rubber has been making steady progress in recent years in growing its sales and profits with a slight pause in 2016.

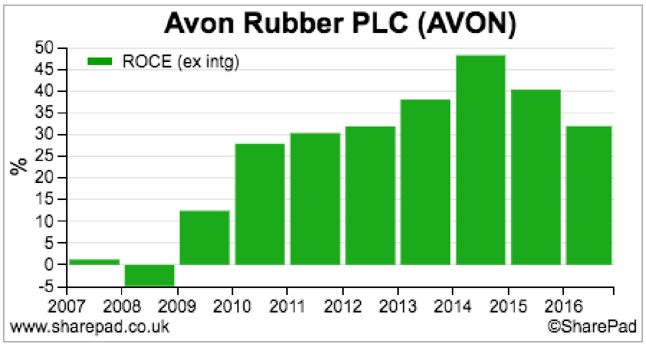




Despite this, I think Avon has many of the hallmarks of a very good quality business. Ten years ago this was definitely not the case but now the company is producing a pretty decent return on the money it has invested (ROCE).

ROCE has trended down following the acquisition of the InterPuls milk business in 2015 but underlying returns on assets remain very good at over 30%.

The company also has very decent profit margins with the Protection business currently making 14% and the Dairy business 16%.



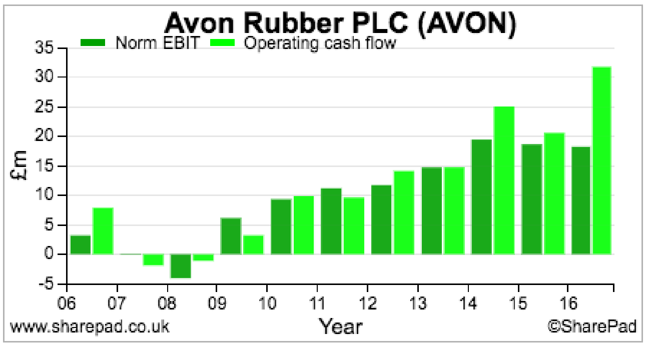
High levels of ROCE are often a sign that a business has some form of protection from competition which may allow it to keep on being very profitable in the future. When you come across a business with a high ROCE you need to try and get behind the numbers and find out why.

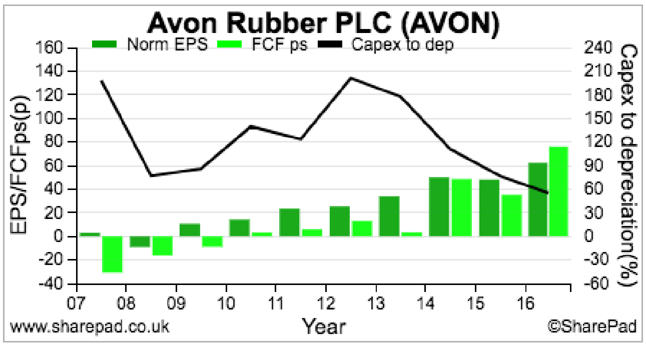
With Avon, a big factor is the nature of its Protection business. Most of its products are safety critical and sell into highly regulated markets with strict approval standards. Once a product has been approved it is not easy for a competitor to come along and replace it.

The products also have long life cycles, so once on the list and being used by the military or fire service there tends to be a very sustainable stream of income and profits. One of Avon's biggest earning products is its M50 mask with the DOD which is on an exclusive 10 year contract.

Relationships with customers also tend to be sticky as long as product quality is good. One of the benefits of a long-term relationship is that some customers will fund some of Avon's research and development (R&D) activities.

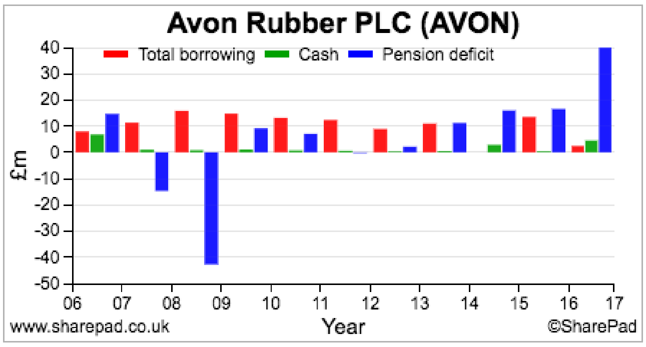
Avon seems to be reasonably good at backing up its ROCE performance with good cash generation. Operating cash flows have been strong in recent years and higher than operating profits which is also a good sign.





Its free cash performance has been improving as capex spending has been coming down.

The company also has a debt-free balance sheet with £12.6m of net cash at the end of March 2017, although it does have a rising - but manageable - pension fund deficit.



Current trading and future growth prospects.

Interim results to March 2016 showed that the company was doing well. With most of its profits being earned overseas it has benefitted from the weakness in the value of the pound. That said, underlying sales growth was up 6% at Protection and 7% at Dairy.

There was a blip in shipments of the key M50 mask but new orders coming through should see things improve next year. Overall, the company's order book across both businesses was up by 9% (in constant currency terms) and represented 111% of ongoing sales compared to 93% at the end of 2016 - a sign of improving demand.

Going forward, the growth prospects for Avon look to be reasonable. US military spending is increasing as the threats from terrorism and places such as North Korea is unlikely to disappear anytime soon. Avon has new products in development which can potentially increase its sales with the US military and earn higher profit margins at the same time.

The thermal imaging and breathing apparatus business with Fire departments is also doing well and looks to be able to keep on growing.

The prospects for the Dairy business also seem to be picking up after a difficult few years. Rising milk prices are making farmers more confident in spending money on new milking equipment. The company is looking to expand into new geographies such as South America and China to grow the business.

The Farm Services business - which provides replacement parts for milking machines - is growing and has the potential to provide a growing source of recurring revenues which will help to reduce the cyclicality of the Dairy business going forward.

I think there's quite a lot to like about Avon Rubber. One concern I do have is the potential for the tax charge to keep on rising. This was seen in the interim results where the underlying tax rate increased to 19% from 1% the year before. This resulted in EPS not growing despite growth in trading profits. This is expected to result in subdued EPS growth for 2017 as a whole.

The company benefitted from a tax credit last year and it is looking to see if "*further prudent tax provisions taken in previous years will ultimately be required*". This suggests that further tax credits - and a boost to EPS - in the future are possible.

That said, an underlying tax rate of 19%, whilst close to the statutory UK company tax rate is quite low for a company which makes a large chunk of its profits in the US where the corporation tax rate is 35%. This is something that requires a bit more thought and investigation. It may be nothing to worry about and hopefully something that is factored into analysts' profit forecasts.

As we can see, EPS growth is expected to be quite modest as the benefit from the weak pound is also expected to wear off. Dividends are expected to grow significantly as the company currently only pays out a small percentage of its profits and looks set to increase the amount.

Avon Rubber PLC (AVON)

Prev Next	2014	2015	2016	2017	2018	2019
Fiscal period ending	30/9/14	30/9/15	30/9/16	1/9/17	1/9/18	1/9/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	124.8	134.3	142.9	167.3	176.7	177.0
Norm EBITDA	25.5	26.7	30.6	34.9	36.8	37.5
EBIT	19.4	18.6	18.2	-	-	-
EBIT margin	15.5	13.9	12.7	-	-	-
Norm Pre-tax	18.9	17.6	17.4	24.8	26.9	28.0
EPS(p)	50.0	48.1	62.2	65.0	69.0	71.7
EPS % chg	▲46.9	▼-3.8	▲29.2	▲4.5	▲6.2	▲3.9
Dividend per share Adj	5.6	7.3	9.5	12.1	14.8	20.8
Dividend per share %chg Adj	▲25.2	▲29.9	▲30.0	▲27.6	▲22.3	▲40.5
Dividend cover	8.9	6.6	6.6	5.4	4.7	3.4

Avon's shares have had a bit of a rocky ride this year following the departure of both the chief executive and finance director. The CEO retired after 15 years whilst the finance director was headhunted by Chemring. These events understandably raise suspicion that managers are leaving as there is nothing more to achieve but this looks to be unfounded at the moment.

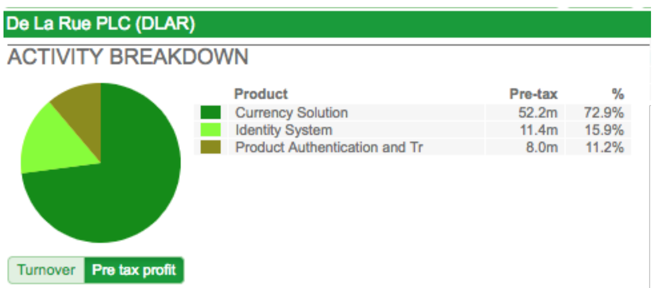
I see Avon as a modestly growing quality business. At 945p its shares trade on 14.5 times September 2017 EPS falling to 13.7 times 2018 forecast EPS. Strip out 40.6p per share of cash and those multiples fall to 13.9 times and 13.1 times respectively. That doesn't look too expensive. A share that is worthy of a closer look perhaps?

Share Discussion: De La Rue (LSE:DLAR)

De La Rue literally has a licence to print money. It is the world's biggest designer and printer of banknotes and passports. It also has a product authentication and track and trace business to make things difficult for tax evaders and counterfeiters.

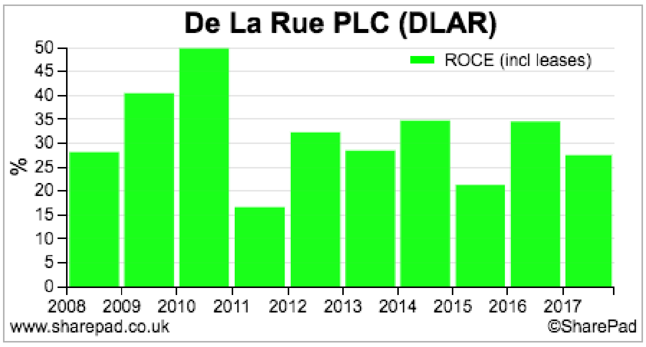
The company and its shareholders have endured tough times in recent times but with a five year turnaround plan put in place in 2015 the share price perked up a bit over the last year or so.

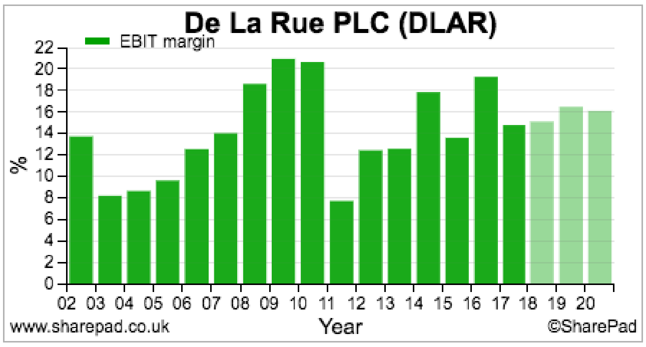
De La Rue's problem has been that its core currency business is operating in an industry which is plagued by overcapacity. There are too many currency printing businesses chasing too little business. This has meant that industry pricing has been under pressure as companies look to keep their paper mills busy.



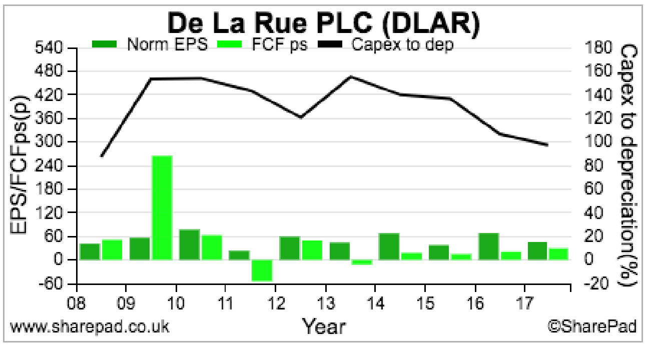
Despite this challenging backdrop, De La Rue is still making very decent returns on capital employed (ROCE).

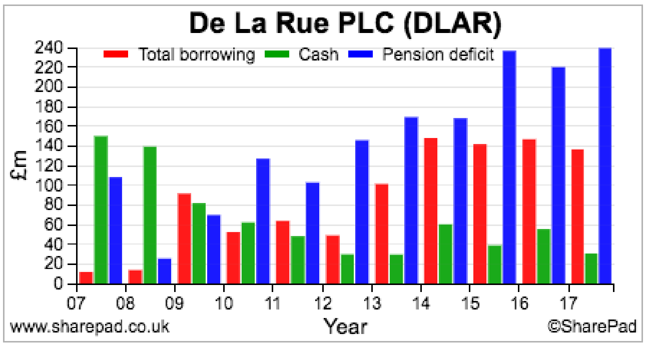
Its profit margins are still pretty respectable as well. Analysts expect them to go up a little over the next couple of years.





When it comes to free cash flow, the picture is not as pretty as the company has struggled to convert its profits into cash.

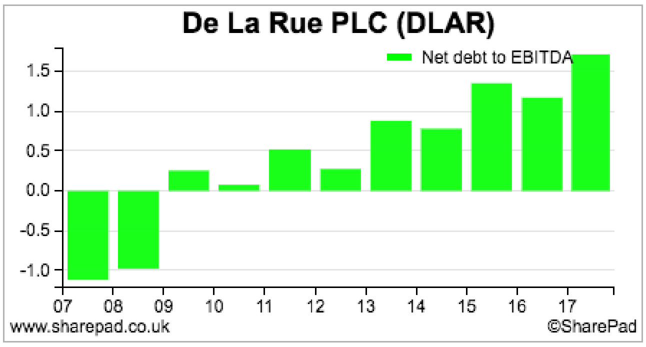




This can be explained by capex which has been higher than depreciation until quite recently, some working capital outflows - although this does not look too serious an issue - and cash top ups to the final salary pension scheme - which does look to be something of a concern.

The lack of free cash flow resulted in a hefty dividend cut back in 2015 but it is still not covered which explains why dividends have not grown for a couple of years and are unlikely to do so for some time to come.

Whilst its balance sheet is not the prettiest out there this company is in no danger of getting into financial difficulties at the moment. Fixed charge cover was nearly 11 times for the year to March 2017 whist net debt to EBITDA is comfortably below its lending covenant limit of 3 times.



So De la Rue's task is relatively straightforward. It needs to grow its profits and cashflows, pay off the pension fund deficit and start building value again.

This is easier said than done given that the overcapacity issue in the bank note market looks like it is not going to go away anytime soon. That said, there are grounds for optimism.

The order book is currently strong and there is good growth potential in polymer bank notes which should help profit margins. The company has also diversified into two very attractive businesses in the form of Identity Solutions and the Product Authentication.

I think the Product Authentication business has decent prospects as tax authorities around the world look to crack down on evasion. This business has high margins of over 25% and whilst quite small in respect of the overall company it should improve the quality of earnings. This will be helped by the recent acquisition of Dupont Authentication.

Whilst the trends towards a cashless society continues I think we are still a long way away from the end of cash. This means that De La Rue banknote business is still very relevant. By being innovative with polymer products and improved counterfeit features it can still carve out a profitable business in this area. New services such as DLR analytics which help central banks manage their cash cycle requirements are being rolled out in 26 countries and will boost growth.

The company is also taking out costs with £13m of annual cost savings due to be achieved in 2019 - although some of this will be reinvested back into the business.

Even so, it seems that analysts are expecting EPS growth to pick up in 2019.

De La Rue PLC (DLAR)

← Prev Next →	2015	2016	2017	2018	2019	2020
Fiscal period ending	28/3/15	26/3/16	25/3/17	1/3/18	1/3/19	1/3/20
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	422.8	454.5	461.7	489.2	499.0	517.1
Norm EBITDA	82.1	90.6	70.6	100.5	109.3	113.3
EBIT	57.4	87.6	68.1	73.9	82.2	83.3
EBIT margin	13.6	19.3	14.7	15.1	16.5	16.1
Norm Pre-tax	46.6	76.9	57.7	59.6	66.9	71.3
EPS(p)	37.2	67.6	46.1	47.1	52.7	56.9
EPS % chg	▼-44.7	▲82.1	▼-31.8	▲2.1	▲11.9	▲8.0
Dividend per share Adj	25.0	25.0	25.0	25.0	25.0	25.0
Dividend per share %chg Adj	▼-43.0	▼0.0	▼0.0	▼0.0	▼0.0	▼0.0
Dividend cover	1.5	2.7	1.8	1.9	2.1	2.3

Analysts' forecasts should always be taken with a pinch of salt as they are rarely any good at spotting turning points in a company's fortunes. The company's latest trading statement from July does give grounds for making people a little bit nervous:

> *"The Group's order book remains strong at the end of the first quarter, providing good visibility and confidence at this early stage of the financial year.*
>
> *Based on the current production and shipment schedules, the Group's performance is expected to be* ***weighted towards the second half of the financial year****, in line with previous years. While there was an* ***unfavourable mix of orders in the first quarter****, this is expected to normalise throughout the rest of the year."*

Talk of second half weighting of profits can often be seen as a veiled profits warning but the company has pointed out that this is quite normal. It is the reference to an unfavourable mix of orders which might highlight a potential issue going forward if this does not normalise as the company expects.

De La Rue is a business that might be easily dismissed by investors given the nature of what it does. I think that it is actually quite a good business. At 625p it trades on 13.3 times March 2018 EPS whilst offering a 4% yield which looks quite safe at the moment. This is an undemanding valuation - a bit like Avon Rubber discussed above - and one which might mean that the shares are worth closer inspection.

Share Discussion: Headlam Group (LSE:HEAD)

Headlam Group is Europe's largest distributor of floor coverings. The company has 60 wholly owned businesses in the UK which trade under local brand names and are supported by a head office and a nationwide distribution network. Headlam also has businesses in France, Switzerland and Holland but nearly 90% of sales come from the UK.

Around two thirds of sales come from residential customers with the remainder from commercial businesses.

Headlam's shares have performed well in 2017 but as you can see from its share price chart there has been plenty of volatility. Last week's half year results to the end of June showed that the company is doing alright in a difficult consumer spending environment.

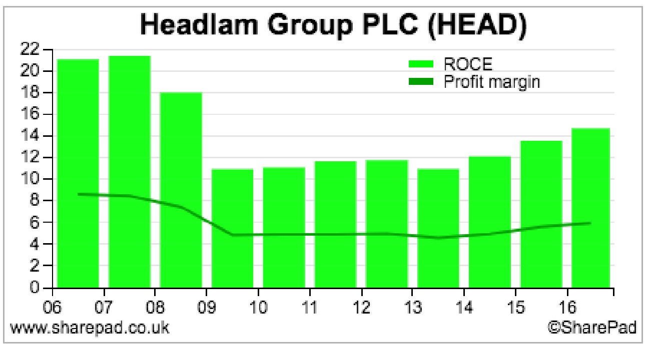
The company is growing across all its businesses with growth slightly better in Europe than the UK. UK residential like-for-like sales increased by 2.8% but the European residential business saw LFL growth of 6.7%. The Commercial businesses saw minimal underlying sales growth.

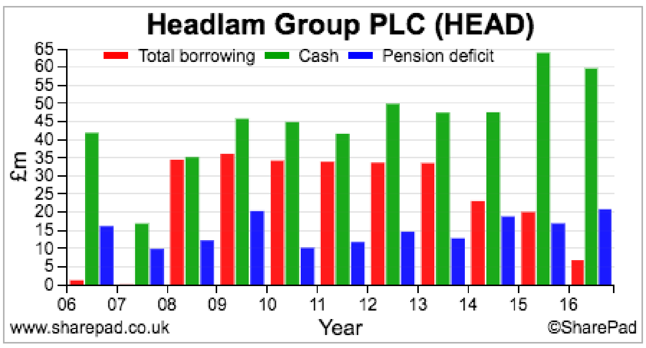
The company has been working hard on its costs. The devaluation of the pound has increased the cost of buying carpets, flooring and tiles which has seen the company increase its selling prices with another increase to come in September. This and some good work on efficiency improvements has seen Headlam's gross margins increase 1% to 31%, helped pre-tax profits increase by 11% and contributed to a healthy 12.7% growth in the half year dividend payout.

Headlam is a seasonal business with most of its profits earned in the second half of the year (due to things such as commercial refurbishments during school holidays). It is also a cyclical one which tends to suffer during recessions. During the last recession it slashed its dividend as the housing market took a dive and many consumers kept their hands in their pockets.

Headlam's ROCE is reasonable rather than outstanding but its profit margins are quite modest.

This point should not be overlooked and do make the company's profits vulnerable to a downturn in sales as was seen back in 2008/09.





However, arguably Headlam's main attraction to investors is its decent cash flow and virtually debt-free balance sheet.

The company had net cash balances of nearly £50m at the end of June. Having paid a special dividend in 2015 and 2016 I think there must be a good chance of another one in 2017.

However, the main issue for Headlam and its shareholders is growth. Given high levels of consumer borrowing, wages growing slower than prices and a rapidly slowing housing market it is difficult to take a bullish stance on the UK consumer and therefore Headlam's growth prospects.

City analysts seem to have a similar view based on their profit forecasts.

Headlam Group PLC (HEAD)

← 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	635.2	654.1	693.6	711.3	730.7	732.9
Norm EBITDA	36.3	41.8	46.3	48.5	50.2	50.8
EBIT	31.4	36.6	41.0	-	-	-
EBIT margin	4.9	5.6	5.9	-	-	-
Norm Pre-tax	30.3	35.6	40.1	42.7	44.1	44.4
EPS(p)	28.5	33.5	38.7	40.9	42.1	42.5
EPS % chg	▲19.1	▲17.7	▲15.6	▲5.6	▲2.9	▲1.0
Dividend per share Adj	17.5	20.7	22.6	25.4	25.5	26.4
Dividend per share %chg Adj	▲14.4	▲18.3	▲8.9	▲12.6	▲0.4	▲3.5
Dividend cover	1.6	1.6	1.7	1.6	1.7	1.6

I think Headlam is a pretty decent business and put it in a similar bracket to kitchen maker and distributor Howdens. For both these companies, quality and financial strength are not an issue but profits growth is. Given this backdrop I find it hard to see Headlam shares taking a sharp move upwards any time soon but the dividend attractions make it a worthwhile share to own.

Filter - Searching for very safe and growing dividends

Many forms of dividend investing are focused on looking for high dividend yields. This is fine if your main aim is income to live on. Yet, the rate of dividend growth can be a better way of making money from shares and pocketing some cash whilst doing so. I've asked SharePad to look for companies with very robust and growing dividends with the following criteria:

- A forecast dividend yield of at least 2%.
- Forecast dividend cover of 2.5 times - very well covered by profits.
- Dividend growth of at least 10%.
- No debt or pension fund deficit - as they divert cash flows away from shareholders.

Filtered LSE Shares sorted by Market Cap. (m) (10 matches)

very safe dividends — Add criteria | Exit

	Min	Max
forecast Yield	2	
forecast Dividend per share change % adjusted for splits & cons...	10	
forecast Dividend cover	2.5	
Net borrowing (inc. pen.def) % of Enterprise value		0

No.	TIDM	Name	Market Cap. (m)	fc Yield	fc Dividend per share %chg Adj	fc Dividend cover	Net debt (inc. pen.def) % of EV
1	BWY	Bellway PLC	£3904.9	3.8	▲11.1	3.0	-0.474%
2	CSP	Countryside Properties ...	£1561.5	2.3	▲138.2	3.3	-0.772%
3	ERM	Euromoney Institutional I...	£1165.2	2.5	▲12.4	2.8	-6.71%
4	MCS	McCarthy & Stone PLC	£884.4	3.1	▲13.3	2.8	-6.65%
5	RWA	Robert Walters PLC	£380.0	2.0	▲20.0	3.1	-6.3%
6	CHRT	Cohort PLC	£156.7	2.1	▲14.1	3.5	-5.56%
7	RM.	RM PLC	£134.3	4.1	▲10.0	2.9	-4.04%
8	CCT	Character Group (The) P...	£100.4	4.0	▲26.7	2.7	-7.39%
9	FEN	Frenkel Topping Group ...	£40.9	2.7	▲26.1	2.8	-2.93%
10	TON	Titon Holdings PLC	£15.8	2.8	▲14.3	3.4	-16.1%