Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

8th September 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7396.98	▼-0.453	▼-1.79	▲8.04	7547.63	6665.63	2/6/17	13/9/16
FTSE 250	19696.7	▼-0.54	▼-1.46	▲9.06	20024.9	17271.2	26/5/17	4/11/16
FTSE SmallCap	5713.92	▼-0.022	▼-0.197	▲15.6	5742.98	4862.64	8/8/17	11/11/16
FTSE AIM 100	5162.2	▼-0.00...	▲1.24	▲35.9	5188.4	3794.58	1/9/17	13/9/16
FTSE All-Share	4054.62	▼-0.451	▼-1.68	▲8.47	4130.15	3641.91	26/5/17	4/11/16
S&P 500	2461.99	▼-0.391	▼-0.763	▲12.6	2480.91	2085.18	7/8/17	4/11/16
Brent Oil Spot $	$54.3295	▲2.97	▲3.92	▲11.9	$56.965	$44.565	29/12/16	11/11/16
Gold Spot $ per oz	$1346.62	▲1.9	▲7.07	▲0.161	$1346.62	$1128.22	7/9/17	15/12/16
GBP/USD - US Dollar per British Pound	1.3066	▲0.978	▲0.236	▼-2.04	1.33384	1.20401	7/9/16	16/1/17
GBP/EUR - Euros per British Pound	1.0893	▲0.267	▼-1.39	▼-8.22	1.1972	1.0795	18/4/17	29/8/17

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	AVV	Aveva Group PLC	▲28.3
2	VCT	Victrex PLC	▲15
3	PMO	Premier Oil PLC	▲11.7
4	MCB	McBride PLC	▲11.3
5	AMFW	Amec Foster Wheeler PLC	▲10.8
6	WG.	Wood Group (John) PLC	▲10.7
7	BVS	Bovis Homes Group PLC	▲10.2
8	ENQ	EnQuest PLC	▲8.91
9	GAW	Games Workshop Group PLC	▲8.72
10	PFC	Petrofac Ltd	▲8.56

Top 10 FTSE All-Share losers

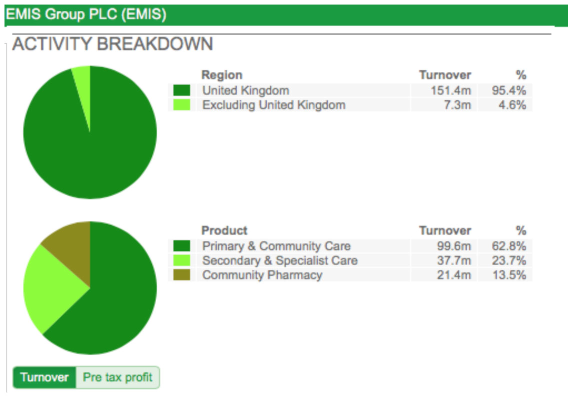
No.	TIDM	Name	%chg 1w
1	INDV	Indivior PLC	▼-27.3
2	EXI	Exillon Energy PLC	▼-22.6
3	VEC	Vectura Group PLC	▼-17.9
4	HSS	HSS Hire Group PLC	▼-15.6
5	ARW	Arrow Global Group PLC	▼-14.3
6	GOG	Go-Ahead Group (The) PLC	▼-13.9
7	CAR	Carclo PLC	▼-12.8
8	NANO	Nanoco Group PLC	▼-12.5
9	BEZ	Beazley PLC	▼-11.9
10	OXB	Oxford BioMedica PLC	▼-11.7

Share Discussion: EMIS Group (LSE:EMIS)

EMIS is a software and technology company which provides its services to healthcare organisations such as the NHS and pharmacies. Its business is split up into the following areas:

- **Primary Care** - Here software is used to connect different parts of a health service to each other such as when a doctor (GP) wants to see what has been written about one of their patients at a specialist clinic. The EMIS Health software is used in 56% of English GP practices providing access to over 40 million patient records. It is increasingly being used to link up with social, child and mental heath services in the NHS.

- **Secondary Care** - Software used to access patient records in hospitals and in hospital pharmacy services.
- **Community Pharmacy** - Emis' ProScript product provides a variety of services to independent and supermarket pharmacy businesses such as dispensing prescriptions and repeat prescriptions, updating patient records, ordering and stock control. The company has a 37% share of the UK independent pharmacy market.
- **Specialist Care Services** - Such as diabetic eye screening.
- **patient.info** - A web-based medical and wellbeing self help service for consumers.

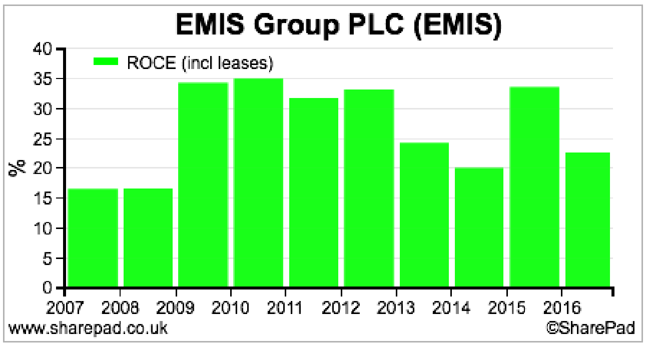


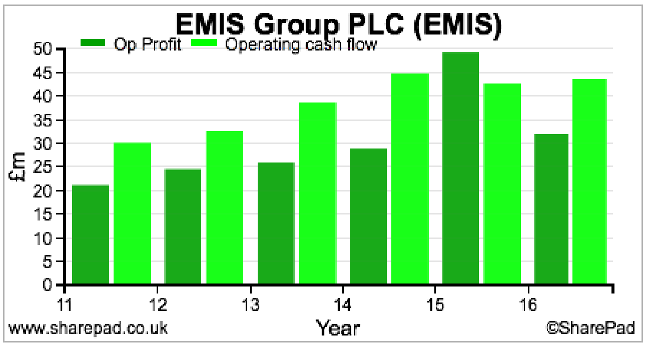
A key characteristic of EMIS' business is that most of its revenue comes from subscriptions to its software products. This gives a very good source of predictable and recurring revenue. In the six months to June 2017, 84% of its revenues were classified as recurring. This is a feature that most businesses would be very pleased to have.

A brief glance at some key financial performance indicators suggests that EMIS is a very good business.

It has very decent returns on capital employed (ROCE)

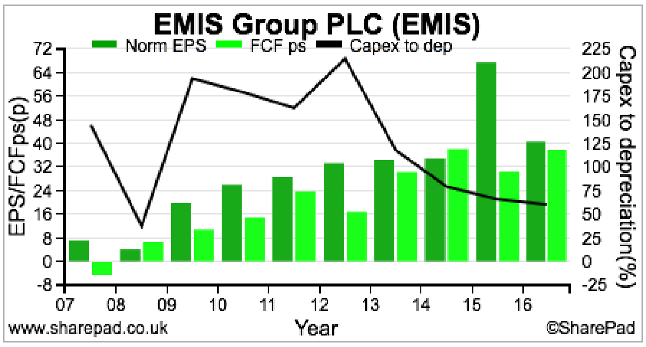
It turns most of its operating profits into operating cash flow.

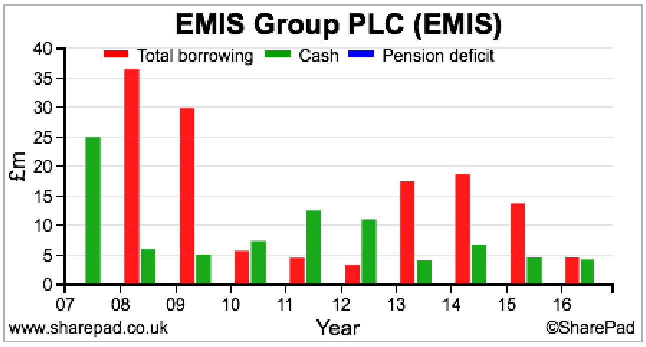




With good conversion into free cash flow as well.

It also has pretty clean finances as well. Net cash balances were £10.5m at the end of June 2017.





This is all well and good but to make a good long term investment a company needs an essential ingredient - profits growth. Even if you have fantastic ROCE and good cash generation, without the expectation of reasonable profits growth going forward a share price is unlikely to move upwards in my opinion - unless it is extremely undervalued.

Growth is where EMIS is falling short if its recent interim results are anything to go by. Sales are down by 1% and underlying operating profits fell by the same amount. The company tried to keep customers happy with a 10% hike in the interim dividend per share.

EMIS Group PLC (EMIS)

← Prev Next →	2016	2017	2017	2018	2019
Fiscal period ending	31/12/16	30/6/17	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	TTM	Forecast	Forecast	Forecast
KEY FORECASTS					
Turnover	158.7	159.2	165.8	176.2	184.0
Norm EBITDA	52.1	51.0	48.0	50.9	55.2
EBIT	32.1	30.5	-	-	-
EBIT margin	20.2	19.1	-	-	-
Norm Pre-tax	31.8	30.7	37.0	40.4	44.6
EPS(p)	40.6	39.5	45.6	49.6	55.3
EPS % chg	▼-39.9	▼-42.6	▲12.3	▲8.8	▲11.5
Dividend per share Adj	23.4	24.6	25.0	26.9	28.6
Dividend per share %chg Adj	▲10.4	▲10.3	▲6.8	▲7.6	▲6.3
Dividend cover	1.7	1.6	1.8	1.8	1.9

EMIS' main difficulty is that its main customer is the NHS. It's not exactly a secret that NHS funding is under severe pressure. This is making it difficult for EMIS to grow its profits in areas such as acute care. The good news is that its core business with GP surgeries in England is holding up well with growth potential from a rollout of its software in the rest of the UK and in areas such as child protection.

Pharmacies have also seen their funding levels cut. In this area of the market, EMIS is targeting market share gains in order to grow. The business is doing well with a 16% growth in profits during the first half of the year. EMIS is just about to launch a new prescription software which it hopes will help it increase its share of the pharmacy market from 37% to 50%.

Elsewhere the company is struggling to make additional profits. Its Specialist Care business saw good sales growth of 19% in the first half of the year but moved from a small profit a year ago to a small loss this year. There is also a risk that it may lose customers following its non-selection for Public Health England's screening platform.

patient.info has seen rapid sales growth of 42% but also moved from a small profit to a small loss. I like the idea behind this business and think it fits in well with initiatives to get people to try and look after themselves and take pressure off the NHS. But with just under £1.5m of sales from over 17 million monthly website visitors in the first half of the year I am struggling to see how it is going to make a meaningful contribution to EMIS' profits going forward.

Profits have been held back slightly by the costs of implementing new contracts in 2017 and these costs will not be repeated in 2018. There should also be some revenue growth from the Pharmacy business from new business but I do not see scope for profit upgrades from analysts with this company given the tough funding position in the NHS. If anything, forecasts could be a little bit optimistic based on current growth rates but given that I do not follow this company on a full-time basis this opinion may be misplaced.

At 919p, EMIS shares trade on just over 20 times 2017 forecast earnings. Despite its high quality profits that looks high enough to me given the muted and uncertain growth outlook.

Software companies and deferred income

One of the important parts of a software company's finances with subscription revenues is something known as deferred income or deferred revenue.

Deferred income refers to cash that has been received as a lump sum - such as an annual software subscription - but has not been earned. For example, if you take out an annual subscription to SharePad for £250 per year on January 1, the £250 goes onto our balance sheet as a deferred income liability. It is a liability because SharePad has an obligation to the subscriber to provide the service for a year. Every month, £20.83 is earned as revenue in our income statement. This continues until the initial £250 has been used up.

In the case of EMIS we can see deferred income show up in its balance sheet and cash flow statement.

	Notes	30 June 2017 Unaudited GBP'000	30 June 2016 Unaudited GBP'000	31 December 2016 Audited GBP'000
ASSETS				
Non-current assets				
Goodwill		50,336	54,388	50,336
Other intangible assets	13	55,937	63,539	60,617
Property, plant and equipment		21,159	21,198	22,187
Investment in joint venture and associate		502	402	152
		127,934	139,527	133,292
Current assets				
Inventories		2,489	1,742	1,815
Trade and other receivables		41,793	35,782	39,970
Cash and cash equivalents		10,484	4,568	4,303
		54,766	42,092	46,088
Total assets		182,700	181,619	179,380
LIABILITIES				
Current liabilities				
Trade and other payables		(20,646)	(22,336)	(21,089)
Current tax liabilities		(700)	(2,081)	(1,918)
Bank loans		-	(3,902)	(1,951)
Bank overdraft		-	-	(2,782)
Deferred income		(37,436)	(32,646)	(28,418)
		(58,782)	(60,965)	(56,158)

Cash and cash equivalents at end of period(1)	14	10,484	4,568	1,521
Cash generated from operations				
Operating profit		10,466	12,141	23,539
Adjustment for non-cash items:				
Amortisation of intangible assets		7,185	6,728	13,571
Depreciation of property, plant and equipment		2,965	3,509	6,459
Impairment of goodwill		-	-	4,616
Profit on disposal of property, plant and equipment		(141)	(140)	(229)
Share-based payments		383	310	473
Operating cash flow before changes in working capital		20,858	22,548	48,429
Changes in working capital:				
Increase in inventory		(674)	(536)	(609)
Increase in trade and other receivables		(2,048)	(2,665)	(6,369)
Increase in trade and other payables		963	4,583	1,915
Increase in deferred income		9,011	4,646	291
Cash generated from operations		28,110	28,576	43,657

We can see that EMIS' deferred revenue balance has increased by just over £9m since the end of December 2016.

This is picked up as an operating cash inflow in the cash flow statement.

But what do deferred income balances mean to you as an investor? How do you interpret them?

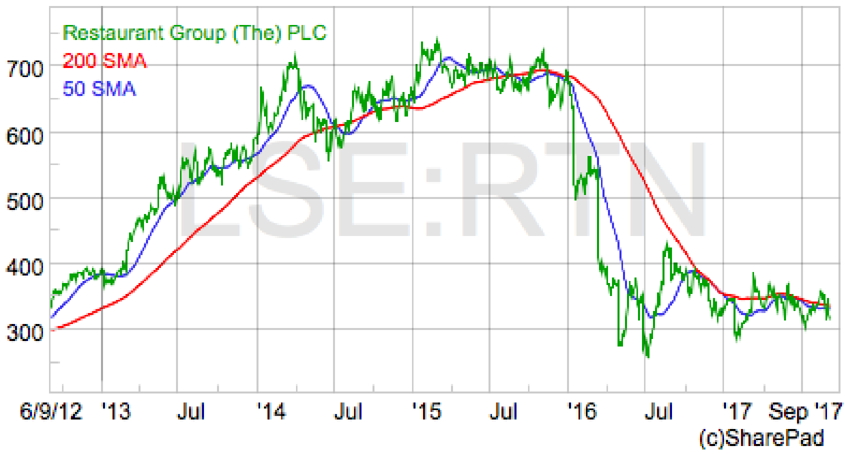
The truthful answer is that it is not easy. Deferred income can be a useful source of cash flow - very similar to a working capital inflow such as increasing trade creditors - especially for young businesses who need sources of finance.

However, a growing deferred income balance is not necessarily a sign of growing revenue in the future. It can be but it may also be due to the timing of subscriptions or the size of them - a renewal of a two year subscription will clearly have a bigger impact on deferred income than an annual one but will not increase revenues going forward.

You would prefer to see the balances increasing rather than shrinking. A shrinking deferred income balance may be a warning sign of lower growth or falling revenues ahead.

Share Discussion: Restaurant Group

As you can see from the chart, Restaurant Group has swiftly moved from stock market darling to stock market dog. The owner of the Frankie & Benny's and Chiquito restaurant chains represents a retail roll out that has been and gone as far as investors are concerned.



The best time to own a restaurant or retail company share is when the company behind it is opening up lots of new maturing outlets. This tends to lend itself to a combination of growing profits from the maturing outlets' like-for-like sales and growth in store numbers. Stock markets have a tendency to put high valuations on these growing profits which can make them good trading shares.

Eventually the roll out, like-for-like sales growth and profitability peaks and sometimes the process goes into reverse. Management is then given the task of trying to get the company back on track.

This is the situation that Restaurant Group finds itself in at the moment. If last week's half year results are anything to go by, the turnaround plan is not going well. The company has brought in a new chief executive to try and sort things out but perhaps one of Warren Buffett's many famous quotes is true in this respect.

> *"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." Warren Buffett*

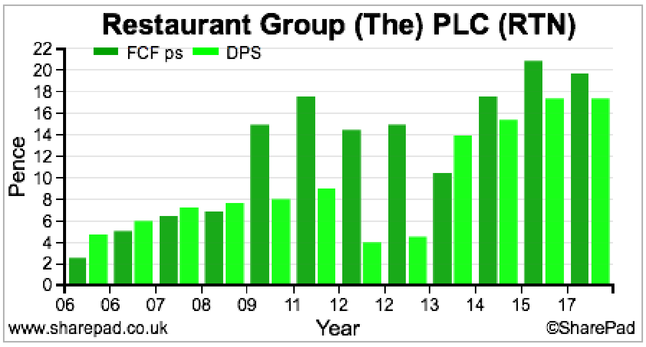
Sales were down but pre-tax profits were down by nearly a third to £25.5m. Underlying profit margins fell significantly from 10.5% to 7.9%. What is concerning is that the trend in like-for-like sales seems to be getting worse as the company has cut prices at its restaurants but also has to battle against a backdrop of fierce restaurant competition, rising cost pressures and increasingly cash-strapped consumers. On the bright side, its Pubs and Concessions business is doing well. However, it is the Restaurants that will drive profitability and the share price.

The first 20 weeks of 2017 saw LFL sales down by 1.8%. The 34-week rate of decline is 2.5% that implies that LFL sales have declined by 3.5% during the last 14 weeks. When costs are rising, a business needs increasing revenues to offset them and/or to get more efficient.

The company is improving its gross margins and cutting costs but there must be a risk that profit margins continue to come under pressure.

City analysts are expecting around 21.5p of EPS this year which puts the shares on a forward PE of 14.6 times. With no big recovery in profits on the cards this valuation looks quite punchy in the context of the quoted restaurants and bar sector. I think it is quite difficult to justify a big premium to a reasonably well run pub business such as Greene King even after the latter's debt levels are taken into account.

TIDM	Name	Close	Market Cap. (m)	fc PE	fc Yield
SSPG	SSP Group PLC	529.5p	£2516.3	28.5	1.2
CPG	Compass Group PLC	£16.25	£25697.3	22.4	2.1
DOM	Domino's Pizza UK & IRL PLC	271p	£1333.3	18.8	3.2
JDW	Wetherspoon (J D) PLC	£10.67	£1158.8	17.5	1.1
FSTA	Fuller Smith & Turner PLC	£10.165	£328.6	16.3	2.0
WTB	Whitbread PLC	£37.40	£6858.6	14.7	2.7
RTN	Restaurant Group (The) PLC	314.4p	£632.1	14.6	5.5
GNK	Greene King PLC	666p	£2064.4	9.5	5.0
MARS	Marston's PLC	112.8p	£744.9	8.0	6.7
EIG	EI Group PLC	135p	£650.6	7.4	
MAB	Mitchells & Butlers PLC	253.9p	£1072.8	7.3	3.0



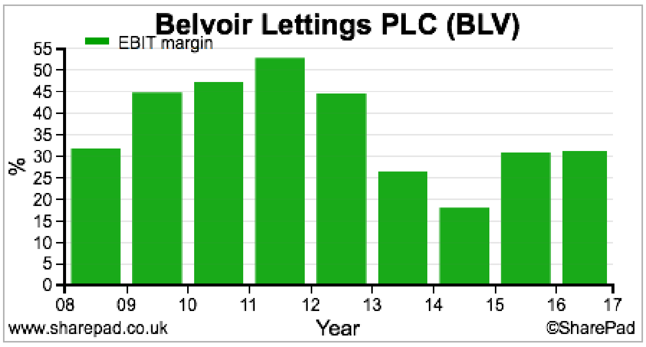
The dividend yield of 5.5% is not growing but does give some support to the shares for now. Free cash flow is holding up as capex has been cut back and this should mean free cash flow will be sufficient to cover the dividend this year. If profits fail to pick up then the dividend will be under threat.

Share Discussion: Belvoir Lettings

Lettings agencies are going through a tough time at the moment. Having profited on the back of the buy-to-let boom, where income-starved investors ploughed their savings into property, the tide has firmly turned against them.

Landlords have been hit by additional stamp duty costs and curbs on their ability to offset some mortgage interest costs against their rental income. This has taken a lot of the heat out of the buy-to-let market. Letting agents have also been in the firing line and have lost a lucrative source of income and profits from charging tenants high and unnecessary fees.

Belvoir Lettings is the UK's largest letting agency franchise. I am a big fan of franchises. Good ones tend to be very profitable as they get a steady stream of royalty income from franchisees without most of the costs and overheads of running a chain of businesses.



Belvoir is no exception to this and has very attractive profit margins.

The company has steadily grown its number of franchisees over the years and has bought up competitors.

This week's interim results saw a big jump in pre-tax profits from £1.07m to £1.73m driven mainly by the acquisition of Northwood in 2016. Underlying management service fees (MSF or franchise income) increased by 4% which is respectable given the difficult market backdrop. The company also sold more properties following its push into estate agency.

The lettings market is unlikely to collapse given poor levels of affordability for people wanting to buy homes. Belvoir has been busy supporting its franchisees by lending them money to buy out local rivals. This will help grow market share and MSF growth next year. The company now has 57,637 properties on its books compared with 54,000 a year ago.

As well as estate agency, the company is looking to sell mortgage advice and products having bought Brook Financial Services in July this year.

Current trading is in line with expectations and cash flow remains healthy enough to pay an unchanged interim dividend of 3.4p per share.

Belvoir Lettings PLC (BLV)

← Prev Next →		2016	2017	2017	2018	2019
Fiscal period ending		31/12/16	30/6/17	1/12/17	1/12/18	1/12/19
£ millions unless stated		Q4	TTM	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover		9.9	10.6	11.0	13.3	14.6
Norm EBITDA		3.7	4.6	4.6	5.7	6.5
EBIT		3.1	3.9	-	-	-
EBIT margin		31.2	36.9	-	-	-
Norm Pre-tax		3.2	3.7	4.0	5.0	5.7
EPS(p)		7.8	8.6	10.5	12.0	12.7
EPS % chg		▲8.5	▲9.5	▲35.3	▲14.3	▲5.8
Dividend per share Adj		6.8	6.8	6.9	7.0	7.1
Dividend per share %chg Adj		▼0.0	▼0.0	▲1.5	▲1.4	▲1.4
Dividend cover		1.1	1.3	1.5	1.7	1.8

I think Belvoir is a steady business that should be robust enough to weather the current tough conditions in the UK lettings market. The main attraction of the shares is its high dividend yield of 6.4%.

This is unlikely to grow much and is just about covered by free cash flow. The shares may be worth consideration as part of a well diversified income portfolio but you are unlikely to grow rich from owning them.

Filter: A simple screen for cheap quality shares with momentum

Momentum investing - buying shares which have gone up in price a lot - is all the rage at the moment with shares such as Fevertree Drinks and IQE delivering spectacular gains for shareholders. Buying expensive shares in the hope that they get even more expensive isn't everyone's cup of tea but you can't argue with some of the results.

Simple Quality Value and Momentum Add criteria i Exit

	Min	Max
ROCE (excluding intangibles)	15	
forecast PE		15
RSI(63)	60	70

No.	TIDM	Name	ROCE (ex intg)	fc PE	RSI(63)
1	RDW	Redrow PLC	21.3	8.0	61.0
2	WIZZ	Wizz Air Holding PLC	26.1	14.9	65.4
3	FXPO	Ferrexpo PLC	29.2	6.1	67.4
4	SQS	SQS Software Quality S…	26.3	14.7	64.4
5	CPS	CPL Resources PLC	20.9	12.8	64.5
6	REC	Record PLC	19.7	14.9	60.7
7	NWF	NWF Group PLC	17.5	11.8	63.3
8	LGT	Lighthouse Group PLC	29.5	12.7	61.1

For those of you who don't like doing this you can add some quality and valuation criteria to a simple momentum indicator such as a relative strength index (RSI). Here is a very simple filter you can build in SharePad and ShareScope in a couple of minutes. It uses the following criteria:

- Quality - ROCE of 15% or more. In SharePad, choose the option to exclude intangibles from the calculation of capital employed.
- Valuation - Forecast PE of no more than 15.
- 3 month RSI between 60-70 - a share price in an upwards trend but not considered to be overbought yet.

Play around with these criteria and see if you can come up with some interesting shares to trade.